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Statement by Mr. Jin, Mr. Zhang, and Ms. Liu on People's Republic of China
Executive Board Meeting
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Our authorities would like to thank staff and management for the constructive policy dialogue during this year's Article IV consultation. We greatly value staff's timely and well-focused analysis, especially during these challenging times. We also appreciate staff's professionalism and hard work under the exceptional pandemic circumstances. The authorities broadly share staff's assessment. As the Chinese economy continues to steadily recover from the COVID-19 shock, the authorities remain committed to pursuing prudent policies that will foster sustainable and high-quality growth going forward.

I. Crisis Response

COVID-19 has posed an unprecedented shock to the Chinese economy. The authorities have responded rapidly and decisively with comprehensive, stringent, and transparent containment measures, which focused on timely detection, targeted control, thorough tracing, and effective treatment. A set of measures were also implemented to mitigate the economic and social fallout. Specifically:

- Strong and exceptional fiscal support was put in place to offset the negative impact of COVID-19. China's budgetary deficit is projected to increase by RMB 1 trillion this year, reaching over 3.6 percent of GDP. Taxes and fees relief amounting around RMB 2.5 trillion is expected to reduce operational costs of the corporate sector and support manufacturing and small businesses in particular. The authorities issued RMB 1 trillion special central government bonds. The local authorities also increased the issuance of their own special purpose bonds of RMB 3.75 trillion for infrastructure investment and containment measures. Public health expenditures directly related to COVID-19 prevention and control increased by 66.1 percent in the first three quarters.

- Fiscal support has targeted the most vulnerable households and firms. This was achieved by increasing transfers and unemployment benefits, as well as strengthening the social security system. In the first three quarters, expenditure on social security and employment subsidies has increased by 8.2 percent. The authorities have introduced an unemployment allowance scheme, raised unemployment insurance benefits, prioritized budget arrangements for people's livelihood, and intensified supervision of the use of funds.

- The People's Bank of China (PBC) has taken timely action to respond to COVID-19 while supporting high-quality economic development. The PBC's supportive measures have amounted to around 9 percent of GDP. Since the beginning of this year, RMB 1.75 trillion of liquidity has been released into the banking system by lowering the RRR three times, and RMB 1.8 trillion of liquidity has been provided through central bank lending and discount window. The weighted average interest rate of newly issued corporate loans declined to 4.64 percent at the end of June 2020, 48 basis points lower than that of the end of 2019. The main interest rates in the money and bond markets are also significantly lower compared to the previous year. At the same time, a range of financial support measures have been taken to support the real economy, targeting the severely affected SMEs and micro enterprises.

II. Recent Economic Developments

As a result of the authorities' forceful response, the outbreak was brought under effective control. That in turn has allowed for the resumption of people's work and production, and paved the way for a steady recovery. In the first three quarters of this year, the Chinese economy recorded a positive 0.7 percent growth. Recent data indicate that the pickup in growth momentum has been broad-based, including the industrial and service sectors. The growth of retail sales of consumer goods in October accelerated to 4.3 percent year-on-year, while domestic traveling has rebounded notably. The manufacturing PMI has been staying above 50 for nine consecutive months. Other indicators have also pointed to a steady recovery – consumer prices and employment rates have remained basically stable, while FDI has continued to grow. The total value of import and export of goods in the first ten months increased by 1.1 percent year-on-year, of which exports increased by 2.4 percent and imports declined by 0.5 percent. China's steady recovery has also contributed substantially to the global recovery.

The Chinese economy is facing increasing external uncertainties and risks, including resurgences of infections, weak global demand, and heightened geopolitical tensions. However, we are confident that China's substantial growth potential and resilience remain quite solid. Given the fast-evolving external environment and huge domestic consumption growth potential, the authorities have adopted a "dual (internal and external)–circulation" development pattern, relying more on domestic demand as the main driver for growth while broadening access to Chinese markets and expanding international economic cooperation. Supported by concerted efforts in COVID-19 control and a quick and steady economic recovery, the Chinese economy is expected to register a positive growth of about 2 percent in 2020 and contribute to the global recovery. As we move into 2021, the first year of China's 14th Five-Year Plan, we are confident that growth is expected to pick up further from a relatively low base this year.

III. Broader Policy Issues

Fiscal Policy

As a result of the economic slowdown and the government's response to COVID-19, China's fiscal revenue declined 5.5 percent year-on-year in the first 10 months of this year. However, tax revenue increased by 11.2 percent in October, the highest single-month growth so far this year. With the economy recovering steadily, we expect fiscal revenue to continue to improve next year. Going forward, the authorities are committed to continue a proactive fiscal policy, with an emphasis on improving its effectiveness, while making more efforts to prevent and mitigate potential risks associated with local government debt.

We want to reiterate our disagreement with staff's concept of augmented deficit and debt, which cannot accurately reflect China's public debt and deficit in some important aspects. A major reason for our disagreement arises from the treatment of those debts issued by local government financing vehicles (LGFVs) after 2014. It is important to note that the debt burden of LGFVs issued after 2014 is borne by issuers themselves, and are not legally recognized by the Chinese government. Thus, these parts of LGFV debt should be considered as corporate debt rather than public debt.

Monetary Policy

China continues to have policy space to pursue prudent monetary policy in a flexible, fine-tuned, and targeted manner with an aim to balance growth and manage risks. The PBC will use a variety of policy tools to ensure appropriate and sufficient liquidity while avoiding "flooding" the financial system. Efforts will be made to enhance structured monetary policy tools to ensure precise liquidity injection and enable the policies to provide more direct support for the real economy. Policy measures – especially those assisting small, micro, and private companies, stabilizing employment, and promoting green development – will be continued to support the "dual-circulation" development pattern.

The RMB's purchasing power has remained basically stable, and its exchange rate moved in both directions based on market supply and demand with increased flexibility. The PBC has had little FX interventions in recent years. Going forward, the PBC will continue to maintain the flexibility of the RMB exchange rate and rationalize market expectations, so as to keep the RMB exchange rate at an adaptive equilibrium level.

Managing Financial Sector Risks

China's financial system remains broadly stable and resilient. Prior to COVID-19, excessive growth in the macro leverage ratio has been effectively brought under control. As a result of counter-cyclical adjustments in response to COVID-19, the macro leverage ratio has increased. With the steady recovery of the economy, we expect the macro leverage ratio to stabilize and decline gradually. The authorities have taken differentiated and tailored policies for troubled banks. Major risks have been resolved in an orderly manner and market discipline has been strengthened. The recent stress test shows that the banking sector is resilient to severe shocks, with risks facing most small- and medium-sized banks well under control, and the overall loss absorption capacity of the banking sector remaining strong. As of the end of 2020 Q3, the capital adequacy ratio and the non-performing loan (NPL) ratio of the banking sector were 14.41 percent and 1.96 percent respectively. The PBC and China Banking and Insurance Regulatory Commission (CBIRC) have recently asked commercial banks to make full use of options to increase provisions and strengthen non-performing loan resolution.

The authorities have also further strengthened the institutional and legal underpinning of its financial regulatory and supervisory framework. The PBC has recently issued a draft of the amended *Law of the People's Bank of China*, strengthening the PBC's operational authority and its role in overseeing the financial sector, and also providing legal basis for issuing digital RMB. The proposed amendments will strengthen macro-prudential management, and coordinate supervision of systemically important financial institutions and financial holding companies.

The draft version of the amended *Commercial Bank Law* was also issued in October 2020. The proposed amendments will focus on further improving governance, enhancing the core role of the board of directors and independent directors, strengthening macro-prudential and risk management requirements, and raising penalties for violations in the commercial banking sector. Meanwhile, the authorities also strengthened the orderly bank resolution mechanism through risk rating and alerting, early correction, restructurings, takeovers, and bankruptcies to address weak banks. New requirements regarding the protection of the rights of financial consumers have also been introduced.

The financial regulators have recently further refined the fintech regulatory framework and strengthened the coordination between China's regulatory authorities. The State Administration for Market Regulation (SAMR) recently issued a consultation draft of the *Anti-Monopoly Guidelines on the Sector of Platform Economies* aiming at preventing monopolistic behavior by internet platforms to ensure fair competition and strengthen anti-monopoly law enforcement. Under the new regulatory framework, all companies engaged in financial business must be subject to financial supervision. Measures to contain risks related to internet financing and illegal fund-raising have also been strengthened.

Establishing a temporary and fiscally backed centralized resolution fund, as suggested by some experts, may not facilitate formulating a market-based incentive and risk constraining resolution mechanism. Practices of some other countries have suggested that such funds have not achieved satisfactory results.

Stated-Owned Enterprise (SOE) Reform

SOE reform has made steady progress amid fighting against COVID-19, while the modern corporate governance system has been strengthened based on the principle of competitive neutrality. A market-oriented operation system has been facilitated with the formation of a career manager system and improvement in the incentive system. So far, 95 percent of zombie firms on the national level has been disposed of, and non-viable firms have been or will be liquidated. Meanwhile, viable SOEs are making greater effort in improving efficiency and profitability to offset downward pressure. SOEs have played a pivotal role in combating COVID-19, reopening the economy, and stabilizing the job market.

Staff pointed out in Box 5 that more fundamental reform would include removing implicit guarantees. Caution should be exercised when using the perception-based "implicit guarantee" concept. The recent cases of default of bonds issued by some SOEs have once again questioned assumptions and perceptions on implicit guarantee, and investors in the market have already repriced risks. The average coupon rate for newly issued SOE bonds has reached 5.7 percent in October concerning risks of default, which is one percentage point higher than that of the first three quarters. The financing cost of Chinese companies, including SOEs, is higher than most comparable companies in developed countries, where very low or negative interest rates were set by central banks there.

Regarding progress on structural reforms in Box 5, staff pointed out limited progress in SOEs and the financial sector due to the COVID-19 crisis. Structural reforms around the world always focus on policy objectives in the medium and long term. In the near term, policy objectives should continue to focus on responses to the COVID-19 crisis while keeping the structural objectives in mind. Many countries have also adopted supportive credit measures and adjusted regulatory policies in a flexible way. Such measures are time bound. China's progress on structural reforms should be assessed more objectively.

Inequality

Staff pointed out that the pandemic has brought China's inequality challenges to the forefront, which is a point that deserves a cautious discussion. Since the outbreak of COVID-19, China has stepped up efforts to protect the livelihood of vulnerable groups through introducing a series of measures to stabilize employment, increase household income, and help people out of poverty. The authorities have endeavored to ensure no single poor area or individual would be left behind and have committed to ending absolute poverty by 2020. All severely impoverished 832 counties in China have successfully eliminated absolute poverty by this November. In the first three quarters of this year, the income gap between urban and rural households has further narrowed, with the real rural per capita income growing 1.9 percentage points faster than that of urban per capita income, and the ratio of urban to rural per capita income narrowing to 2.67 from 2.75 a year earlier. Based on a consistent national standard, the number of people who live in poverty has been reduced from 98.99 million at the end of 2012 to 5.51 million at the end of 2019. The low income and fragile people in China have benefited the most from China's successful containment of COVID-19, through reduced or avoided unemployment and free treatment of COVID-19 cases by the country's medical system.

Trade

The COVID-19 and unfair export control measures taken by the U.S. have undoubtedly had an impact on Chinese purchases of U.S. goods and services this year. The two sides should work together and step up cooperation to get out of this difficult time. Restrictive and discriminatory action against Chinese firms should be stopped to create conditions for the implementation of the Phase 1 trade deal. It is imperative that countries enhance mutual trust, share information, refrain from trade restrictions, and take strong measures to maintain the normal functioning of the global supply chains. In this regard, the recent signing of the Regional Comprehensive Economic Partnership (RCEP) agreement represents a new milestone for international economic integration. The COVID-19 crisis has also further highlighted the importance of maintaining a multilateral trade system and strengthening international cooperation, while making joint efforts to reform the WTO in a good faith and win-win approach. That said, we concur with staff that China and its trading partners should work together to promote an open, stable, and transparent multilateral trading system.

We share staff's observation that China's current account surplus is expected to temporarily widen this year, mainly reflecting the surge in pandemic-related exports, declines in outbound tourism and commodity prices.

Opening Up

The authorities remain committed to opening up and jointly fostering development opportunities with other countries. Earlier this year, the *Foreign Investment Law,* aiming at providing a more reliable and friendly business environment, came into effect. Despite COVID-19, the pace of opening up in China has continued to step up this year. China is working towards full implementation of the "Pre-establishment National Treatment Plus Negative List" management system for foreign investment. The items on the national negative list for foreign investment have been shortened from 40 to 33. In the wake of COVID-19, China has adopted a range of pro-business policies that apply equally to all companies, including foreign firms, that have been registered in China. China has been resolutely pushing forward the opening up of the financial industry to create a market-oriented, law-based international business environment. From January to September this year, foreign investors have increased their holdings of interbank-market bonds by RMB

719.1 billion. Going forward, China will continue to strengthen intellectual property protection to safeguard the legal rights and interests of foreign investors.

Climate Change
The authorities are committed to building a low-carbon, safe, and efficient energy system. President Xi recently announced that China aims to have CO2 emissions peak before 2030 and achieve carbon neutrality before 2060. The authorities will actively improve the policy framework to boost the green recovery and implement the new development approach. At the end of 2019, China's carbon intensity declined by 48.1 percent from the 2005 level, while the share of clean energy in China's total energy consumption further increased to 23.4 percent, compared to 22.1 percent one year ago. Carbon emissions per unit of GDP in China has fallen by more than 50 percent from 2005 to 2019. China has also established the carbon trading market, covering high-carbon emitting industries. As of August 2020, cumulative transactions reached RMB 9.3 billion.

Going forward, China will actively support a green recovery through green finance, innovative green financial products, more investments into green industries in line with market principles, and a low-carbon green growth model. Meanwhile, Climate change mitigation requires comprehensive and global action. China will continue to promote the establishment of a fair, reasonable, and win-win global climate governance system, and strives to fulfill its global responsibilities commensurate with China's development level, and make contributions to build a beautiful and clean world.