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December 15, 2020

Statement by Mr. Huh, Ms. Johnson, and Mr. Yoo on People's Republic of China (Preliminary)
Executive Board Meeting
December 17, 2020

We thank staff for their comprehensive report and frank appraisal of the Chinese economy and Mr. Jin, Mr. Zhang and Ms. Liu for their informative Buff statement. We commend the Chinese authorities for faring well in containing the spread of the Covid-19 and managing economic growth though it was the first country hit by the pandemic. However, we acknowledge that China's economic growth has been unbalanced and uneven, relying heavily on public support, and fiscal and financial vulnerabilities have been elevated during the crisis. External conditions including trade tensions remain the biggest risk for the short-term economic outlook and are increasing the complexity of the longer-term transitions.

We urge the Chinese authorities to continue to work constructively together with trading partners to resolve trade disputes and to restore the reliability of global supply chains. We reiterate our strong support for the open, fair and transparent, rules-based multilateral international trade and investment system. China's economic performance is critical for global recovery as it will generate positive spillovers. However, trade tensions and disputes limit the extent of these positive spillovers. Given the importance of trade, a more extensive discussion of trade tensions would have been useful. **We also encourage more active role of China in international efforts to overcome the health and economic crisis including by helping poor countries' access to vaccine and medical supplies and providing debt relief to low-income borrower countries in a more consistent and transparent manner.**

We agree with staff's near-term outlook and macroeconomic policy advice for the Chinese economy. We note that the authorities broadly agree on the outlook – with their concerns focused on the external risks – but were more confident than staff in managing the domestic risks. We agree with staff's view that fiscal and monetary policies should remain supportive next year to secure durable recovery while shifting the focus of fiscal policy from infrastructure investment to household support and green investment and focusing monetary policy on conventional interest rate-based measures. We also concur that macroeconomic policy should be adjusted to the pace of the recovery given the heightened uncertainty. *Could staff provide further detail on the analysis underlying the recommendation of 'somewhat more fiscal support' to provide insurance against downside risks and secure the handover from public to private demand?* China's CPI declined 0.5 percent (y/y) in November for the first time since 2009 while PPI remained in deflationary territory. *Could staff provide the view on the deflationary pressures and the potential implications for the authorities' monetary policy normalization?*

We share the staff's view that fiscal policy should turn to consolidation once the recovery is on a solid foundation. Though China has fiscal space, it has narrowed with high augmented general government debt rising. We agree that reducing off-budget local government investment and broadening the tax base could form the basis for the fiscal adjustment. A comprehensive medium-term macro-fiscal framework and strengthened intergovernmental coordination framework could also be effective in enhancing fiscal sustainability. We note the difference of views between staff and authorities over the concept of augmented debt and deficit but continue to find this definition useful and encourage further work. *We are interested to hear staff's response to the authorities' explanation on the treatment of debt issued by local government financing vehicles (LGFVs).*

We agree with staff's assessment that simultaneous implementation of key structural reforms – such as further opening up markets, improving the social safety net, facilitating SOE reforms and promoting green investment – can support a balanced recovery with more employment in the near term and help build a more resilient and inclusive and greener economy in the longer term. We welcome staff's recognition of progress made by the authorities, despite the crisis, towards further liberalization of the economy. Nonetheless, we note that there is significant scope to enhance resilience and the role of the private sector. We support the staff's recommendation for stepping up efforts to make progress on SOE reforms and competitive neutrality to enhance productivity. In this regard, we welcome the emphasis on improving competition in the market and SOE governance by the staff and authorities' views. We are also encouraged by the Chinese authorities' announcement of achieving CO2 emissions peak before 2030 and carbon neutrality by 2060. A significant transformation and strengthening of existing green policies will be required to this end. While noting that the authorities have started working on detailed plans, *could staff illustrate some measures to be considered in financial policies and regulation to support this climate goal?*

We call for the authorities' continued efforts to address financial vulnerabilities accumulated by the pandemic and unprecedented policy responses. While taking a positive note of a wide range of measures taken by the authorities to manage financial sector risks, we encourage the authorities to continue to strengthen the financial regulatory and supervisory frameworks – particularly for online lending and asset management companies –

and to phase out exceptional financial support measures as the recovery takes hold. We note that the pandemic has added further pressures on small banks and encourage the authorities to consider staff's proposals to address vulnerabilities in the banking sector building on the achievements in dealing with weak financial institutions. *Could staff elaborate on the difference of the assessment on the banking sector soundness in the Buff statement from staff's assessment in the paper?*

We recommend staff should take a more cautious approach to China's central bank digital currency (CBDC). While e-CNY can promote financial inclusion and payment efficiency, it may pose unique or heightened risks to privacy and consumer protection, operational risks, and financial integrity. Widespread adoption of digital currency could also have implications for macroeconomic stability and, in an extreme scenario, the international monetary system. We also note the potentially destabilizing impacts on exchange rate policy and the capital account framework if the use of digital currency is expanded to include cross-border transaction. The Fund should take the responsibility to carefully monitor the development of China's CBDC and provide a full analysis of the potential domestic and international implications of this project. *Staff comment is welcome.*