Executive Board Minutes 20/122-1

December 17, 2020–10:00 a.m.

People's Republic of China—2020 Article IV Consultation

Documents: SM/20/170 and Cor.1 and Sup.1 and Sup.1, Cor.1; SM/20/172

Staff: Berger and Kang, APD; Panth, SPR

Length: 1 hour, 45 minutes

ISSUED: July 27, 2022
APPROVAL: August 3, 2022

CEDA OGADA
Secretary

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[1] Minutes are the official record of a formal Board meeting in which the Board may adopt decisions and reach understandings related to the business of the Fund. Staff background documents issued before the meeting are the principal basis for the meeting. Preliminary "gray" or "buff" statements by Executive Directors and staff's responses to Directors' technical questions are circulated prior to the meeting. Adopted decisions and/or summings up—the Chair's "sense of the meeting" or policy conclusions/recommendations—are issued after the meeting. The minutes include all these elements, as well as the discussion record (a verbatim transcript of the discussion lightly edited for clarity). Minutes are made public consistent with the IMF's Transparency Policy and Open Archives Policy.

THE ACTING CHAIR'S SUMMING UP

Executive Directors agreed with the thrust of the staff appraisal. They noted that the COVID-19 crisis has inflicted significant human and economic costs on China and commended the authorities for the effective containment measures and swift macroeconomic and financial policy support to mitigate the economic impact of the pandemic. Directors noted, however, that growth was still unbalanced and that fiscal, monetary, and structural policies should aim at strengthening private demand to allow for more balanced medium-term growth.

Directors called for a continuation of the moderately supportive fiscal and monetary policies until the recovery is on solid ground, while noting that, in the medium term, fiscal consolidation was necessary to ensure debt sustainability. To maximize the policy space, they saw benefits in further improving the macro-fiscal framework, including intergovernmental coordination and macroeconomic data, and called for a modernization of the monetary policy framework to strengthen the transmission of conventional interest rate policies and enhance financial intermediation. Some Directors encouraged the authorities to focus on broader concepts of the fiscal deficit. Directors also called for enhancements to the social safety net to reduce precautionary savings, which combined with greater progressivity in the tax system would help address income inequality.

Directors stressed the importance of addressing financial vulnerabilities proactively to safeguard financial stability. As the recovery takes hold, the temporary measures supporting the financial sector should be replaced with policies to address problem loans and strengthen regulatory and supervisory frameworks. Directors noted the need for a comprehensive bank restructuring framework in line with international best practices to allow for the orderly exit of weaker banks. While agreeing with the authorities on the potential benefits from digital currencies, Directors considered that more work was needed to assess risks. They also encouraged the authorities to continue improving their AML/CFT framework.

Directors welcomed continued progress on structural reforms, particularly in further opening up of the financial sector and improving labor mobility through *hukou* reforms. They stressed the need for further reforms of SOEs, including ensuring competitive neutrality between SOEs and private enterprises, and some Directors called for the need to remove remaining implicit guarantees. Structural reform will be key to boosting potential growth, reduce external imbalances, and build a more resilient, green, and inclusive economy.

Directors noted that while the current account surplus in 2020 should widen temporarily, it is expected to narrow over the medium term, reflecting an unwinding of the temporary impact of the pandemic and a rebalancing of economic growth. Directors also stressed that greater exchange rate flexibility would help the economy adjust to the changing external environment. Some Directors called for further improvement in the transparency of foreign exchange interventions and phasing out of capital flow management measures.

Directors welcomed the authorities' commitment to global cooperation, and noted that China, together with its partners, had an important role to play in supporting an open and rules-based international trade system. Directors also welcomed China's intention to play an important role in multilateral efforts to address pressing global challenges, including making any approved vaccine developed in China widely available to other countries and in mitigating climate change. They noted that China has a key role to play in the G-20 DSSI and Common Framework to provide debt relief to low-income countries, but noted that further improvements in data transparency were needed for the success of the global debt relief efforts. They welcomed China's ambitious plans for emissions abatement and increased green investment.

It is expected that the next Article IV consultation with the People's Republic of China will be held on the standard 12-month cycle.

EXECUTIVE BOARD ATTENDANCE[2]

G. Okamoto, Acting Chair

Executive Directors	**Alternate Executive Directors**
I. Mannathoko (AE)	
A. Andrianarivelo (AF)	
S. Chodos (AG)	
C. Huh (AP)	
A. Bevilaqua (BR)	
Z. Jin (CC)	
	A. Guerra (CE)
L. Levonian (CO)	
D. Palotai (EC)	
A. Buisse (FF)	
R. von Kleist (GR)	
S. Bhalla (IN)	
	M. Massourakis (IT)
T. Tanaka (JA)	
H. Hosseini (MD)	
M. Mahmoud (MI)	
	A. De Lannoy (NE)
M. Poso (NO)	
A. Mozhin (RU)	
M. Mouminah (SA)	
A. Mahasandana (ST)	
P. Trabinski (SZ)	
S. Riach (UK)	
M. Rosen (US)	

S. Bhatia, Acting Secretary
K. Hviding, Summing Up Officer
D. Jiang, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Asia and Pacific Department: A. Balestieri, S. Barnett, H. Berger, D. Cerdeiro, W. Chen, F. Han, S. Jahan, J. Kang, K. Kang, X. Li, J. Ostry, C. Ruane, C. Zhou. Communications Department: P. Liu, T. Yan. European Central Bank: D. Rakitzis, R. Rueffer. Fiscal Affairs

[2] For countries in each constituency, please see the Constituency Codes in the annex.

Department: J. Ralyea. Institute for Capacity Development: R. Nord. Legal Department: E. Emre, G. Jackson, N. Rendak. Monetary and Capital Markets Department: U. Das, N. Griffin, H. Hoyle, P. Jeasakul, M. Saiyid. Research Department: F. Zhang. Strategy, Policy, and Review Department: H. Lin, B. McDonald, S. Panth, M. Saito, N. Shenai, E. Van Heuvelen, Y. Yang. Statistics Department: X. Zhao. World Bank Group: D. Mishra, L. Wang. Executive Director: P. Moreno (CE), E. Shortino (US). Alternate Executive Director: H. Azal (EC), K. Chikada (JA), M. El Qorchi (MD), F. Fuentes (BR), S. Geadah (MI), A. Grant (AP), L. Herrera (AG), C. Just (EC), F. Mochtar (ST), W. Nakunyada (AE), R. N'Sonde (AF), F. O'Brolchain (CO), O. Odonye (AE), L. Palei (RU), D. Ronicle (UK), P. Rozan (FF), B. Saraiva (BR), J. Sigurgeirsson (NO), F. Sylla (AF), C. White (AP), Z. Zhang (CC). Senior Advisors to Executive Directors: W. Abdelati (MI), K. Badsi (MD), M. Choueiri (MI), J. Garang (AE), L. Johnson (AP), S. Keshava (SA), B. Lischinsky (AG), M. Maidi (AE), S. Naka (JA), C. Quaglierini (IT), N. Thiruvenkadam (IN), A. Tolstikov (RU), G. Vasishtha (CO), R. Velloso (BR), C. Wehrle (SZ), J.Weil (CO), B. Yoo (AP), M. Zhunusbekova (SZ). Advisors to Executive Directors: P. Al-Riffai (MI), A. Arevalo Arroyo (CE), E. Cartagena Guardado (CE), T. Cham (AE), T. Chrimes (UK), O. Diakite (AF), F. Dogan (EC), R. Edwards (CO), D. Fadhel (MI), K. Florestal (BR), J. Garang (AE), T. Iona (AP), A. Maciá (BR), G. Meizer (EC), M. Merhi (MI), P. Mooney (CO), R. Moral Betere (CE), T. Nagase (JA), B. Singh (IN), I. Skrivere (NO), D. Susiandri (ST), D. Tevdovski (NE), I. Valdes Fernandez (NO), C. Westphal (US), J. Yoo (AP), A. Zaborovskiy (EC), J. Al Saud (SA), M. Law (CC), D. Coelho (BR), D. de Waziers (FF).

DISCUSSION RECORD[3]

The Acting Chair (Mr. Okamoto):

It is a real pleasure to be here this morning and to Chair our meeting on the People's Republic of China's Article IV consultation. Just to note that we have World Bank staff in attendance and have the benefit of all of the gray statements. This was a virtual Article IV, and it concludes at a very critical juncture for both the global economy and China itself. The discussions with the authorities focus squarely on the importance of securing the ongoing domestic recovery and sustaining it beyond 2021 in a way that promotes internal and external balance. This is important because a successful implementation of the strategy is not only going to benefit China itself, but also the global economy. I had the pleasure of also joining a week's worth of meetings towards the end of the mission.

As all Directors indicated in their gray statements, for this to work it is going to be critical to make sure that we have the short-term macroeconomic policies to keep the momentum going until the handover to private demand is complete, one that is more consumption-driven, but it is just as important to continue strong reform to allow the economy to rebalance toward high-quality growth going forward.

I will note that staff has provided very careful answers in writing to the very helpful technical questions. Just to note, to kind of pull back the curtain a little bit on this process, these questions come in from all Directors, and our staff spends many hours in the 24 to 48 hours prior to a Board meeting to turn around responses. I believe in this iteration it was almost 50 pretty detailed questions that resulted in almost 20 pages worth of response to Executive Directors. In light of that, I will ask that Directors this morning for the sake of the efficiency of our meeting to try to focus on those questions that they did not get a written response to their question on, so that is where we can have our discussion. Let me also stress that some of the issues that have been raised are on future topics. In particular I will mention the e-CNY and climate mitigation. Let me assure Directors that these are very important and are very much on staff's radar and will deserve the full attention of our team once the pandemic is behind us.

I also understand that because of the in-depth response that staff provided, they are not going to make any opening remarks, so we can get

[3] Edited for clarity.

straight to oral remarks, but they will be here to answer any additional questions that Directors bring up in this morning's discussion.

Mr. Rosen:

The Chinese economy has made an impressive recovery from the COVID-19 crisis, thanks in large part to aggressive containment and testing measures combined with targeted fiscal and monetary easing. However, we found the Article IVs focus on short-term measures and the absence of a deeper discussion of China's medium-term structural challenges quite disappointing and inconsistent with the treatment of the United States in its Article IV. For example, we were concerned by the recommendations that the authorities should implement fiscal tightening starting in 2022. Doing this without dealing with structural issues related to local government spending and broadening the social safety net would exacerbate China's external surplus.

Secondly, on the external sector, we found staff's discussion of exchange rate issues to be rather light. By pointing only to depreciation during 2018 and 2019, amid US-China trade tensions, the report bypasses a more fulsome discussion of China's exchange rate regime and the tools used by the authorities to influence the exchange rate.

We believe the report's focus on goods purchases under the Phase 1 trade agreement is misleading and did not mention the inclusion of numerous structural reforms in the agreement. Further, the report focused excessively on tensions with the United States and gives little mention of the many challenges facing China, including tensions with other regional neighbors, human rights issues in Xinjiang Uygur Autonomous Region, and undermining democratic processes in Hong Kong Special Administrative Region. We did, however, welcome the reference in the report to the importance of publication of comprehensive FX intervention data on a regular basis.

Thirdly, we are concerned about the limited review of China's central bank digital currency (CBDC). As Mr. Buisse, Ms. Riach, Mr. Tanaka, Mr. von Kleist noted in their gray statements, the CBDC may pose unique or heightened risks to privacy and consumer protection, operational risks, and financial integrity concerns. Widespread adoption of China's CBDC could also have implications for macroeconomic stability in the international monetary system, and we look forward to more detailed analysis on this topic by staff, as promised in staff's responses to questions about the CBDC.

Finally, a comment on China's role in the multilateral system. It is unfortunate that the staff report chose to use language that indicates that China is currently playing a leadership role in addressing global challenges. We agree that China has a significant role to play in the international response to this crisis, in particular regarding its support to countries facing rising risks to debt sustainability. In our view, Chinese efforts have fallen short so far. To that end, as mentioned in several countries' gray statements, it is critical, in our view, that China fulfills its commitments on the implementation of the Common Framework and that it provides timely debt relief to countries that need to undertake debt restructurings. We urge staff to remain closely engaged with China on this front and to provide regular updates to the Board.

The Acting Chair (Mr. Okamoto):

On the issue of CBDCs, many chairs brought this up, and it is an important issue for us to have a look at. There is both crosscutting work on this issue that is ongoing in monetary and capital markets in conjunction with other bodies, and I think our China team's attention will pivot to this once they clear the Article IV.

Mr. Buisse:

We agree with the key messages and issued a gray statement, so let me just offer a few comments for emphasis.

First, we note that strict and targeted containment strategy coupled with sizeable fiscal, financial, and monetary support measures, have enabled a quicker recovery than has been possible in many other countries, leading to a positive Chinese growth rate in 2020. It is quite commendable. Nevertheless, we agree with staff that the stimulus measures put at risk progress made in terms of economic rebalancing, which were aiming at a more qualitative and sustainable long-term growth model. Financial leverage is increasing while private consumption is struggling to recover.

Second, we share the view that the crisis has reinforced financial risks, which should be monitored. The vulnerabilities of banks' balance sheets to the high level of corporate debt and the deterioration of credit quality call for vigilance. The regulatory framework and the banking resolution regime should be enhanced while gradually phasing out crisis financial support measures.

Third, we concur with the recommendation to keep the policy mix accommodative to support the recovery while setting up a comprehensive macro-fiscal framework to reduce fiscal risk and enhance fiscal management at the local government level, withdrawing potentially distortive lending measures, and modernizing the monetary policy framework to improve the transmission of conventional interest rate policies.

Fourth, we thank staff for their presentation of China's new central bank digital currency (CBDC). It is not an easy topic but an important one, as the Chair has mentioned, given the size of the country, and the potential effects that China's CBDC project may have on the international financial system. So like other colleagues and Mr. Rosen, we invite staff to further assess the potential risks and opportunities of such projects in future analysis and to accompany countries in designing mitigating measures.

Fifth, we agree with staff that key structural reforms will help rebalance and strengthen growth, and we very much welcome the authorities' commitment to implement policies fostering domestic, sustainable, and greener sources of growth. Reinforcing social safety nets to reduce precautionary savings, reforming state-owned enterprises (SOEs) to ensure a level playing field between companies and promoting green investment should be key to build a more resilient, green, and inclusive economy.

Regarding climate, we strongly welcome China's new commitments, and we encourage staff to further analyze critical climate change mitigation strategies given the magnitude of the challenges ahead.

Finally, the country has a key role to play to support multilateral efforts. We welcome China's participation to provide debt relief to low-income countries as agreed at the G20 level, but we hope to see China's full and timely implementation of the Debt Service Suspension Initiative (DSSI) and the Common Framework, and we look forward to further strengthening the constructive dialogue and cooperation in multilateral debt discussions.

Mr. Poso:

As Mr. Rosen and Mr. Buisse also noted, the Chinese economy rebounded swiftly from the health and economic crisis, thanks to a strict containment effort and strong policy support. However, growth remains unbalanced as the recovery has relied heavily on public support with private consumption lagging behind. In addition, the credit-driven and investment-heavy recovery could reverse recent progress on rebalancing and exacerbate financial risks and high leverage. We have issued a comprehensive gray statement; however, I would like to highlight four brief points for emphasis.

First, we fully share staff's policy advice on the structural reform agenda, including the need to further open up domestic markets, strengthen social safety nets, and importantly, advance SOE reforms. The Selected Issues Paper provides helpful analysis and demonstrates that SOE reform could provide a substantial boost to productivity and growth in the medium term.

Second, I believe that climate change mitigation would deserve more attention in future Article IV reports for China, and I welcome the Chair's comments that we will see more on climate change mitigation in the coming Article IV reports.

Third, we agree that China and its trading partners should work together to build a more open, stable, and transparent, rules-based international trade system. Like many other chairs have noted in their gray statements, the box on the negative effects of technological decoupling was very interesting. I would like to encourage staff to continue providing such analysis, clearly demonstrating the harmful effects on the global economy of escalating trade and technology tensions.

My last point is on data and transparency. We continue to support staff's use of the augmented general government fiscal data, as it gives a clearer picture of the actual fiscal situation. More generally, we support further efforts to improve data quality and coverage. In the annex on statistical issues, staff say that while data are broadly adequate for surveillance, they are only barely so. Against this background, I would like to ask staff if China National Statistical Bureau has any major projects underway to improve the data quality. I note that in the answers to the technical questions, the data on fiscal deficit and debt are very well covered, so my question here refers to other data.

Mr. Trabinski:

We commend the authorities for their strong and swift policy and containment measures that have allowed a V-shaped recovery, notwithstanding a difficult external environment. We also welcome the continued strong structural reform momentum throughout the crisis, especially with regard to opening up domestic markets and hukou reform. We, nonetheless, agree with staff on the areas in which further improvements would be useful in the medium term. This includes strengthening the expanding of social safety nets and reforming the SOEs.

We encourage the authorities to adopt a more prudent approach to debt. While we agree with the authorities' strong fiscal policy response at the beginning of the crisis, we caution against overly relying on the assumption that China can easily outgrow its debt. We especially see some room for tax broadening measures. Here like Mr. Tanaka in his gray statement, we also stress the need to monitor debt developments at all levels of government, including the local level.

We welcome the authorities' recent commitment to transition to a lower carbon future and achieve carbon neutrality by 2060, and we look forward to their detailed mitigation strategy to achieve this ambitious target. As the role of China in the world is rising, and the country is further transforming and rebalancing, as Mr. Poso, we stress the importance of providing reliable data, including sufficiently broad loan data and complete macroeconomic data.

Lastly, we welcome staff's assessment of the impact of technological decoupling on global growth and stress the importance of an open, stable, transparent, and rules-based international trade and investment system to the benefit of all. On CBDC, I also echo the voice of Mr. Rosen and Mr. Buisse on the need for more detailed analysis of this issue in the future reports.

Mr. Bevilaqua:

We issued a comprehensive gray statement, and I will only make a few brief points.

The Chinese economy has rebounded swiftly from the health and economic crisis and is set to be one of the few countries to register positive growth in 2020. As others, we commend the authorities for their strict containment measures and swift macroeconomic and financial policy support to temper the social and economic fallout and secure recovery.

The pandemic has significantly affected China's delicate multi-dimensioned rebalancing strategy as the strong and sizeable responses from the public sector were critical to mitigate the impact of the crisis.

It is important that going forward, the short-term support to the economy during this crisis does not compromise the medium to long-term economic transition. Therefore, as recovery takes hold, we encourage the authorities to carefully consider framing macroeconomic policies to resume the rebalancing efforts and the structural reform agenda to enhance resilience and sustain China's dynamism.

The global economic recovery critically depends on conquering the pandemic, and China can play a crucial role in supporting multilateral efforts to help the global economy emerge from this crisis. We are encouraged by the authorities' commitment to support the international efforts by expanding access and affordability of a vaccine and ensuring that any vaccine developed in China would be widely available to all countries.

Finally, we appreciate China's participation in the G20 Initiative to provide debt relief to low-income countries and underscore the importance of the participation of Chinese official creditors in the extension of the Debt Service Suspension Initiative (DSSI), as well as in the Common Framework for Debt Treatment beyond the DSSI. Given China's increased importance as a bilateral creditor, its further engagement in other constructive and proactive initiatives will also have very positive impacts on debtor countries.

The Acting Chair (Mr. Okamoto):

Several Directors have noted here and in their gray statements the importance of DSSI and the Common Framework which happened under the Saudi leadership of the G20. These are very impactful in terms of the Fund's membership and have in some cases material impacts on financing gaps and analyses that are happening in the context of countries in Fund programs, so it is absolutely critical that, as many Directors put it, all countries participate fully in both efforts.

Mr. Tanaka:

We issued a gray statement and would like to offer specific comments. While China was the first country to be affected by the COVID-19 outbreak, the spread of the virus has been well contained. We welcome the economy continues its fast recovery thanks to the authorities' swift and forceful containment measures and support through the macroeconomic and financial policies.

However, those measures could have intertemporal tradeoffs as expressed in the staff report and gray statements issued by other chairs. In order to realize a resilient recovery from the crisis, as well as balanced economic growth, and also to fully contribute to helping solve the global crisis, it is critical for China to steadily implement policy reforms, including the enhancement of transparency on various fronts.

China should also continue SOE reforms and expand the roles of markets to improve the productivity and increase potential growth.

On fiscal policy, we positively note the authorities' discretionary measures have boosted the Chinese economy. However, given the recent sharp increase of the public debt, fiscal consolidation efforts will be indispensable to the extent possible. To this end, we encourage the authorities to establish a comprehensive macro-fiscal framework and to enhance fiscal transparency at the same time.

It is also required to improve fiscal balance of local governments, as Mr. Trabinski said, and tackle the emerging challenges, including inequality and climate change, through strategic fiscal policies. As regards to the monetary and financial sector policy, the authorities should proactively address financial vulnerabilities and risks once the crisis abates, especially the authorities should pay due attention to the corporate debt outstanding and increase in nonperforming loans.

Regarding CBDC, we think it is important to carefully analyze and monitor the development of the PBC's CBDC. As Mr. Rosen and Mr. Buisse stated, we encourage staff to accelerate their work, taking transparency, the rule of law, and sound economic governance into full account, all of which are discussed in the October G7 meeting.

Concerning external sector, we think the authorities should continue the efforts to make the exchange rate more flexible and market-determined. We urge the authorities to disclose information on their foreign exchange intervention (FXI) in a timely manner. We also encourage the authorities to make further efforts to realize more transparent and rules-based international trade and investment system in an opener and stabler way.

Last but not least, on the debt issues, we believe China should make further efforts as the largest official creditor and urge the authorities to steadily implement the debt treatment in a transparent way following the G20 Common Framework.

We also expect China to fulfill their responsibility to ensure accuracy and improved transparency of the debt data and fully cooperate with the Fund and World Bank on the debt data reconciliation.

Mr. Chodos:

We issued a gray statement, and we touched most of the issues there, so I will be making some very minor points on the side. On the one hand, I think it is important that we recognize the role of China in embracing the DSSI initiative and that I think it is also important to understand that from the debtor countries' perspective. It is sometimes from another perspective very easy to look at it in terms of tranches or different sorts of arrangements, but from the treasury side of any debtor country, it is mostly one whole holistic problem. So I think China should deserve recognition for their advancement on the DSSI.

I just want to make a point on the SOEs. I think that recent history has shown us that there is nothing inherently wrong or inherently right with SOEs, so it is more of a case-by-case work. I trust the Chinese authorities are doing that with a thorough understanding of what makes sense or what does not make sense in a very specific case, but I think it is important that we warn off taking an ideological approach on whether they are a good thing per se or a bad thing per se. I think it is warranted that every case deserves its own study.

Ms. Levonian:

Our main takeaway from the Article IV consultation is that while both the health and economic response to the pandemic have been very effective, the effectiveness has come at the cost of further unbalancing China's growth model and could also exacerbate preexisting financial vulnerabilities. We agree with that assessment and in particular the importance of rebalancing by shifting spending towards supporting households and by leveling the playing field between private and public enterprise and reducing the state's footprint in the real economy.

Staff suggested shifting spending towards green infrastructure in particular, which we support, but at the same time, we did not have a clear sense of China's current domestic infrastructure priorities and how those might be inconsistent with a green and sustainable recovery, and we welcome staff's views there.

Like Mr. Poso, we were fascinated by staff's analysis of the global economic consequences of technological decoupling, and we would hope that staff will consider our suggestion to present this work more comprehensively in the upcoming WEO. Like Mr. Buisse, we encourage the authorities to improve the transparency and quality of economic data. In particular, estimates of general government debt should be refined and expanded to include subnational off-budget liabilities. As well as noting the Chair's comments, we support Mr. Buisse and others on China's full implementation, full and timely implementation of the DSSI and the Common Framework. I feel it is important just to show the support there.

Like Mr. Rosen, we were somewhat puzzled by staff's choice of words in reference to China's role in tackling global issues. Specifically, we think that the statement that China should continue to lead multilateral efforts to address global challenges might be overstating the extent to which China has played a leadership role in addressing issues such as debt relief or others. With that said, we absolutely agree that China has a significant role to play in multilateral efforts to respond to the crisis and tackle shared challenges.

Lastly, we encourage the authorities to engage constructively with the incoming U.S. administration towards improving economic relations. A more harmonious China-U.S. relationship would have positive spillovers for the entire membership and would promote global economic and financial stability.

Mr. Mouminah:

We welcome the rapid recovery of the Chinese economy as a result of the authorities' strong pandemic containment measures, as well as the timely fiscal and monetary support to mitigate the economic and social impact of the crisis. We take positive note of the targeted support to the most vulnerable households and firms, including SMEs and micro enterprises. We also commend the authorities for pursuing structural reforms despite the crisis.

The rebound of the Chinese economy is generating positive spillovers on the global economy and supporting global recovery, which we strongly welcome. As we underlined in our gray statement, China should continue to play a central role in further advancing global cooperation, including in expanding the vaccine access. In particular, we welcome the strong support provided by the Chinese authorities for the G20 DSSI, as well as the Common Framework for Debt Treatment beyond the DSSI during the Saudi G20 presidency. We know this was a very tough discussion, but their support has made us come to that agreement. We look forward to the full implementation of both the DSSI and the Common Framework, as mentioned by many other colleagues.

I have three specific topics I would like to deeply dive into. One on the dual circulation strategy, we thank staff for the response to our questions. We are encouraged that China's opening up will continue under the strategy, while domestic sources of growth will be promoted. This will further help strengthen consumption growth and accelerate economic rebalancing. We look forward to the details of the strategy when the next Five-Year Plan is rolled out in the spring.

Second is on the central bank digital currency. This holds a potential to enhance financial inclusion and improve payment efficiency, as noted in the report. Since the focus of this Article IV consultation was rightly on COVID-related issues and challenges, we are pleased that more detailed analysis of domestic and international implication of the CBDC will be provided in the future staff work.

Finally, we welcome the authorities' ambitious goal with regard to tackling climate change. Here we note that the authorities have started working on a detailed plan, including on the rollout of carbon capture and sequestration program. We commend them for that, especially as it may be recalled that the G20 Leaders Summit recently endorsed the circular carbon economy platform with its four-pillar framework, namely reduce, reuse, recycle, and remove. We strongly urge staff to build the knowledge regarding this platform, which focuses on the elimination of waste and sustainable use of resources. Indeed, the reliable and affordable sustainable energy system are key for delivering economic prosperity while helping tackle climate change.

Mr. von Kleist:

We, like others, commend the authorities on their strong and timely containment measures, as well as the fiscal and monetary support, which have mitigated the impact of the crisis and facilitated a swift recovery. However, the recovery is still subject to continued high uncertainty, underscoring the need to increase the economy's resilience towards adverse shocks in general.

We agree with staff that fiscal policy should remain moderately expansionary in 2021 before returning to rebuilding fiscal buffers as the recovery gains momentum. To make fiscal support more effective and to facilitate economic rebalancing, we support staff's recommendation that funds should be shifted from infrastructure spending towards strengthening social safety nets and promoting green investment. In this context, we welcome the authorities' intention to strengthen domestic sources of growth and promote green and inclusive growth.

We also agree that monetary policy should remain accommodative until there are clear signs of strengthening private demand and inflation, but then again talking about inflation, there were recent reports that inflation, both CPI and MPI, reached double digit numbers, so I wonder if staff could comment on that.

We take positive note that the exchange rate is becoming more market driven and encourage the authorities to pursue further financial market liberalization, which will make things much more efficient. At the same time, the authorities should consider additional measures to contain financial stability risks. On the structural side, we echo staff's call to let market forces operate more freely—other speakers have commented on this point—to open up domestic markets more and to reform SOEs.

Looking at climate change mitigation, given China's role in the world economy, strong policy measures are needed to reduce CO2 emissions to the welcome goal of achieving carbon neutrality by 2060, which is of great significance for both China and the world at large.

Lastly, and as several other Directors have expressed in their gray statements, we welcome China's participation in multilateral efforts, including in the G20, to address global challenges. We look forward to further strengthening the constructive dialogue and cooperation in the different international fora in order to jointly promote a strong, sustainable, and inclusive global recovery from the crisis. Very important in this active and constructive participation in multilateral debt discussions underpinned by transparency is crucial. We therefore welcome China's participation in the G20 DSSI, and we hope to see China's full and timely implementation of the agreed Common Framework.

Ms. Mahasandana:

I will limit my comments on three points.

First, we applaud the Chinese authorities for their rapid, decisive, and comprehensive containment measures, as well as the policy response, which successfully steered health and the economy away from a deeper crisis. Their stringent health measures have effectively contained the spread of the pandemic while their economic activities have rebounded very quickly generating positive spillover to the global economy.

However, the recovery remains subject to uncertainty and downside risks both in the short term and the long term. The short-term outlook is still uncertain and hinges on the successful vaccine distribution and public health response in defeating the pandemic, while unbalanced growth and structural impediments create challenges on the macroeconomic and sustainability of the recovery in the long term.

This brings me to my second point. Given the importance of China in the global economy and their integration to many economies, including the countries in our constituency, we encourage the authorities to carefully calibrate their policies to further enhance economic rebalancing and deepen structural reform to foster sustainable and inclusive growth, which will contribute positively to global growth and stability.

The authorities should stand ready to adjust the policy to pace the recovery, as Mr. De Lannoy and Ms. Riach has rightly pointed in their gray statements. In doing so, we encourage the authorities to complement with their clear policy communication and transparency so as to avoid market volatility and uncertainty.

Finally, we encourage the authorities to actively continue in supporting multilateral cooperation to tackle multifaceted global challenges to foster a robust global recovery. Here, we want to emphasize on the global trade. We have been observing that the trade and technological tensions have taken a toll on global economy with no benefit for the respective countries. Like many other Directors, we continue to urge both China and its trading partners to seek a more constructive collaboration to resolve trade and technology tensions and address the underlying problem in a sustainable manner. We view that these efforts become more pertinent in the current juncture where the country should work cooperatively to facilitate recovery amidst the COVID-19 crisis.

Ms. Mannathoko:

We issued a gray statement commending the authorities for containing the virus and successfully cushioning the economic impact. As the Chair noted in the opening remarks, China's recovery and its strategy also matters at a global level, so we are happy that there is some progress being made. I just wanted to make a few points.

First, like Ms. Riach and Ms. Levonian and various other Directors, we also wanted to welcome China's commitment to support global efforts, including in vaccine provision, but we also welcome China's ongoing participation in the G20 DSSI and its joining of the Common Framework, and we just wanted to say that we hope that staff can perhaps facilitate implementation of this as providing guidance but having specific guidance pertinent to the context in China, perhaps guidance to Chinese SOEs and agencies which are engaged in the process, as well as to private creditors. Beyond this, we do encourage ongoing measures on the climate agenda and also appreciate the country's efforts really at the global level but encourage ongoing collaboration in negotiations and efforts to support a rules-based multilateral trading item and one with positive global spillovers.

Second, I just wanted to say we look forward to gaining more insights around PBC central bank digital currency. Some news reporting recently indicates that the recent trial they had of the digital currency. The central bank is not a private operator, and there is a sense that this could give some firms significant competition. So maybe there is scope also for central bank digital currencies to play a role in limiting corporate power. It is interesting to see how this will evolve, but we also note that it would promote financial inclusion and enhance payment efficiency on a broader scale.

However, as noted also by various Directors, we think lessons derived on cross-border and financial stability implications will also be of particular interest, and as noted by Mr. Buisse, staff guidance on how to mitigate negative spillovers. As the country emerges from COVID, we wanted to encourage the authorities to upgrade the AML/CFT framework in line with FATF recommendations, also while developing a comprehensive strategy to strengthen the banking sector and to minimize fintech risk.

Finally, we just wanted to also indicate our appreciation for the Selected Issues Paper (SIP), especially on productivity gaps between SOEs and private enterprises and just say that as the state shifts towards a greater private sector role, we do welcome the authorities' measures looking towards supporting reallocation of credit from highly leveraged SOEs to private enterprises as we agree that this would help to support going forward aggregate investment and productivity.

Mr. Huh:

China is one of the most successful stories to contain the pandemic as well as to preserve growth potential during the ongoing economic crisis. However, as a developing country, it faces multipronged challenges, not only managing crisis but also breaking through the kind of the middle-income structure. This report well reflects the difficult challenges of China. Even though we issued a gray statement, I would like to mention several points additionally.

First on the balanced growth, the response to the pandemic crisis is still focused on the support on investment mainly through the SOEs. The share of total investment to GDP has been still around 43 percent since the pickup at a time of the global financial crisis. While this year's share of private consumption to GDP will be reduced to 36.3 percent from 38.2 percent last year, the imbalance between the consumption and investment become more serious through government intervention during the pandemic. To make the economy more sustainable in the balance while mitigating capacity, China should make more efforts to boost consumption and strengthen its social safety net.

Second, on the labor market reform, as this report emphasized, the reform of the hukou system is very important for the flexibility and existence of the labor market. The hukou system by segregating the labor market for very low-income workers only deteriorates the inequality of society as well as the productivity of the economy. The high entry barrier of certain markets should be addressed.

Third, on the need of a well-coordinated exit plan, the recovery of the Chinese economy is very important not only for China itself, but also for its neighbors considering its size and spillovers. As the Chinese economy is ahead of the recovery phase compared to other economies, its early tightening of spending might cause some unexpected ripple effects on many economies.

Fourth, while highly appreciating the successful Regional Comprehensive Economic Partnership (RCEP) agreement recently, China should closely work with trading, partners to build a more open, fair, and transparent rules-based trade system, with a further liberalization and opening of a service market. Like Mr. Rosen, we are somewhat disappointed that trade was lightly covered and mostly devoted to the U.S.-Chinese case.

We welcome Chinese active participation in the G20 DSSI and the Common Framework for Debt Treatment and look forward to more progress in the near future. Also, we reiterate a closer look into the effects and progress of technology decoupling and the CBDCs.

Last but not least, the main interest of China might be how to successfully overcome so-called middle-income trap, which every developing country confronts when their per capita income touches close to $10,000. Looking back on Korea's economic development, once per capita income was just $94 in 1961, now surpassed at $30,000 in half a century. Its most radical challenge was the Asian crisis in 1997. However, through successfully overcoming the crisis in a few years, Korea succeeded in fundamentally reshaping its economy from state-led to market-lead one. Through comprehensive reform of financial and labor market, in addition by successfully innovating its industries mainly integrating advanced IT technologies, Korea also succeeded in upgrading its industrial structure towards more comprehensiveness, competitiveness, and high value addition.

Mr. Palotai:

We issued a gray statement; therefore, I will be very brief just on a few points.

The Chinese authorities responded very decisively with sound policies to the pandemic, and thanks to this, the economic recovery has gained momentum, and we can almost certainly say China can be one of the few countries in the world to show positive growth rates in this year. In this environment, as Mr. Poso also emphasized, the authorities' focus should be on balanced growth rather than high headline growth rates. This will entail addressing the longstanding structural challenges and taking the steps towards green and inclusive growth, which will strengthen the resilience of the Chinese economy.

In our view, fintech will continue to play a significant role for China's growth in the medium- and longer-term, and the rapid development of fintech requires an agile adaptation in regulations, mainly in the financial sector. For its importance, the report is rather slim on China's development of CBDC. We would be interested to learn from staff and the authorities more about the experience with the e-CNY tested in the four cities as well as future plans. And like other Directors stressed, we wonder about the implications of the technological decoupling. We also join other Directors' calls that addressing macroeconomic data gaps will help improve the accuracy of analysis and policymaking.

Lastly, we would like to reiterate China's role in providing debt relief to low-income countries as agreed at the G20 level and welcome the authorities' commitment towards a green recovery, as outlined in the buff statement.

Mr. Mozhin:

We have issued a written statement, and I will only add one or two points in my oral intervention.

My first and main comment is on the concept of augmented deficit and debt. It is my understanding that this concept is related or even based on the concept of implicit guarantees provided to public sector entities. In this connection, my question is how many Western banks, supposedly private, have been bailed out over the past decade? How many Western nonbank companies, also supposedly private, have been bailed out in the recent periods? In the case of the United States, for example, the whole industries have been bailed out, from the automobile industry to airlines and everything else. I wonder how many supposedly private companies have sheltered themselves under Chapter 11 bankruptcy protection and how these companies restructured or cut their losses. I think the first thing all these companies did was that they simply reneged on their pension obligations and sent their pension plans to the government as a Christmas gift, so in that respect I even wonder whether what we call private companies, what is the meaning of this. Yes, they privatize profits, but they also tend to socialize their losses.

So the whole idea that public sector companies have this implicit guarantee from the government while private sector companies do not have such an implicit guarantee makes no sense to me. I think this is true for the national level as well as to subnational levels. At subnational levels, they also have local champions, too-big-to-fail companies, and local budgets may have to cover the cost of bailing them out from time to time. This is my first point, and I think I have been clear that I just disagree with the whole concept of the augmented deficit and debt.

My second and last point is that I would encourage the Chinese authorities to publish the report regardless of their disagreements with certain parts of it. I would suggest Mr. Jin to remind his authorities that their agreement to publish the report does not mean that they agree with each and every point in the report. That is what I have been doing for the last 20 years. Since 2000, Russia has published everything produced by the Fund as a matter of our Transparency Policy, not meant to indicate that we agree with everything that is written. The report is high-quality, including the rich analysis of the genuine risks facing the Chinese economy. So once again, I think everybody will benefit from publication of this report.

The Acting Chair (Mr. Okamoto):

I think there is going to be a lot for us to assess from the current economic experience about what supports what. And I think it is a shifting landscape, but the point is noted.

Ms. Riach:

We find staff's paper to be well balanced, nicely splitting its focus between the current crisis and economic conjuncture and the medium-term challenges facing the Chinese economy that must not be ignored. What happens in China's economy inevitably matters for the rest of the world, so we are pleased to see the containment of the virus and the impressive start to the recovery.

We also welcome gradual efforts to move towards more market-based approaches, including to help address issues in the financial sector. While there may be short-term challenges for individual vulnerable firms, this is crucial to avoid perceptions of implicit guarantees and in the long run will lead to a more competitive and sustainable system. A growing Chinese economy that is balanced, sustainable, open, and transparent will be positive for the global economy.

We are pleased to hear the authorities express their commitment to multilateralism and to the rules-based international system. The world is facing unprecedented challenges. Multilateralism and addressing shared challenges together is a crucial part of the solution, and for it to work effectively, a forward-leaning collaborative China is essential. In particular, China's participation in the Common Framework is an important step towards a coordinated approach to debt treatment. Full and timely implementation of its principles will be crucial.

I join Mr. von Kleist in recognizing the significance of China's recent commitments on climate change. Climate change cannot be addressed globally without ambitious mitigation actions by the world's largest economies. China's commitment to net zero emissions by 2060 and the 2030 objectives for renewable technologies and carbon intensity have historic significance. We look forward to continuing to work with the Chinese authorities through the IMF and through other institutions to promote a fair and sustainable recovery from this crisis across the membership and to build a better future.

Mr. Hosseini:

We have issued a comprehensive gray statement but would like to make a few brief comments for added effect.

First, thanks to significant preparation of policy response, China successfully managed to limit the spread of the pandemic and contain its economic and social fallout. China's economy bounced back quickly and is generating positive global spillovers at a time when other major economies are lagging. As the recovery takes hold, the authorities are encouraged to revert to rebalancing their long-term and public-private growth model, leveraging the exceptionally private savings.

Second, fiscal policy supported the recovery and helped protect the vulnerable population. As recovery gains momentum, fiscal consolidation is important to put the debt ratio on a firm downward track. Monetary policy should continue to be geared to price stability while opting for exchange rate flexibility.

Third, we welcome the authorities' intention to strengthen the social safety nets and encourage them to expand the coverage unemployment insurance, particularly for migrant workers and workers in rural areas.

Fourth, the Chinese authorities should be commended for maintaining the pace of structural reforms despite the crisis. Further SOE reform and increasing labor market flexibility are critical.

Fifth, we welcome China's participation in the G20 Initiative to bring debt relief to low-income countries.

Sixth, we commend China's intention to make an effective COVID-19 vaccine available to all countries, particularly to low-income countries with limited financial resources.

Finally, we welcome China's commitment to global cooperation and trade, investment in technology, climate, and health areas. I close here and wish the authorities all the success.

Mr. Massourakis:

We issued a gray statement, and I would just want to emphasize three points today.

Regarding monetary policy, we support the staff recommendations endorsed by most other Directors to explore options to further modernize the monetary framework towards more market-based interest rates to strengthen monetary transmission and improve credit intermediation while phasing out potentially distortive noninterest rate mechanisms that have been quite effectively used in the anti-crisis monetary policy response to ensure credit to the economy.

Second point, we commend the authorities for their determination in promoting a more inclusive society, taking care of the most vulnerable groups in the population, especially during the difficult times of the global pandemic, which has led to rising inequality. In this regard, the target set by the authorities to eradicate extreme poverty by the end of this year is laudable, and the outcomes mentioned in the buff report are extremely valuable.

Finally, given the size and high degree of interconnection of the Chinese economy with the global economy, we encourage the authorities to make further progress to address the statistical data gaps indicated in the staff's informational annex that seems to mainly affect national accounts data and government finance statistics. Those efforts would also be consistent with the authorities' commitment to implement the G20 Data Gaps Initiative.

Mr. Guerra:

I will react to staff answers and Directors' comments on only two points.

First, we join Mr. Poso and Ms. Levonian in commending staff for the analysis on the effects of technology and decoupling. This adds to the IMF work on the effects of trade restrictions. We have a two-fold request regarding the analysis in this important issue. First, the IMF should continue and broaden the analysis in order to include not only systemic economies but also the effects on other emerging and developing economies. Second, the analysis takes a long-term perspective of the costs and benefits. It is usual in these kinds of analyses that there are positive effects to some economies in the short term if their technological decoupling takes place. Nevertheless, without doubt, it must be that in the long term, all member countries will reach a lower level of economic development in a fragmented world.

In a nutshell, in the post-COVID world, the IMF has an important role to be a strong advocate so that all major economies follow a cooperative path to trade and technological and productive capacities. IMF policy analysis and economic research in this regard will be instrumental.

My second and final point relates to the assessment of the implication and risk from China's central bank digital currencies. As Mr. Mouminah, we welcome that staff will include more detailed analysis of its domestic and international implications in future Article IVs, and we also very much welcome that the Chinese authorities have clarified that international and bilateral and multilateral coordination is essential before any potential cross-border usage of the central bank digital currencies.

Mr. Andrianarivelo:

We have issued a gray statement, so I will limit my intervention to three points for emphasis.

First, we commend the Chinese authorities for the quick economic rebound, which is largely due to the prudent and calibrated reopening of the economy and the effective macroeconomic and financial policy response to the pandemic.

Second, as stated by Ms. Mannathoko, we believe that a strong recovery of demand in China will have positive spillovers for the global economy, notably for many low-income countries that are commodity exporters. We therefore encourage the authorities in their effort to implement sound macroeconomic policies and structural reforms to rebalance the economy and foster strong and inclusive growth, as mentioned in their Five-Year Plan.

Second, to tackle COVID-19 pandemic crisis, could staff elaborate on further contribution of China in their Five-Year Plan could consider and support the global economy?

Third, as said by many Directors, we welcome China's commitment to play a leading role in the resolution of global health, climate, and economic issues. In this period of pandemic, the authorities' decision to contribute to the distribution of affordable vaccine, notably in poor countries, is well appreciated.

We also look forward to China's setting the pace by providing a good model and leadership for the resolution of debt issues in the context of the G20 DSSI, notably considering the participation of private creditors to the Common Framework for Debt Treatment.

Mr. Mohieldin:

Based on the gray statement that we issued, I would like just to mention three matters.

First, I wish to recognize the rapid deployment of bold health and economic measures by the Chinese authorities. These measures definitely supported the recovery from a sharp and unprecedented recession in the second quarter. I agree with the staff that the macroeconomic policy should remain moderately expansionary in 2021 and be adjusted to the pace of recovery going forward with the policy mix oriented toward supporting more balanced growth.

Second, there is a very important accomplishment achieved in 2020. That is China's eradication of treatment poverty, which is Sustainable Development Goal No. 1. I was pleased back in November 2019 in a meeting led by the First Vice Premiere of China organized by the Development Research Center, that this announcement was made as an expectation for 2020 to happen, and it is happening, which is a great achievement to end extreme poverty ten years ahead of the 2030 target date.

We commend the Chinese authorities for the bold growth strategy and major reforms across sectors that help to reach this milestone. Talking about the SDGs, it is always a good reminder that climate change is SDG 13. It is not a goal in its own. For a developing economy it is always good to put it in this context, and we welcome the authorities' reaffirmation of President Xi's announcement of climate goals and plans to put in place concrete measures for green investment and climate change mitigation in line with the international objectives and include international cooperation.

Before I get into the last point, I followed with great interest the discussion about the global role and multilateralism. My point here is not just about China, but for the major economies at large, especially for the G20 members including, of course, China. From a non-G20 perspective, one could really always judge the leadership role with critical, significant or important based on the contribution to global public goods within the multilateral system and international cooperation. Definitely one of the areas of work is related to the Debt Relief Initiatives that were mentioned. The DSSI is an example of the debt relief approaches by the G20 beyond the DSSI that we see as necessary.

There are other aspects of great importance related to sustainability of the planet and the climate agenda and, indeed, matters related to the vaccine, and this gets me into the final point. The general issue here is the worrying news that we got globally about the availability of the vaccine for the poor countries, where 75 percent of the available production for 2021 by the pharmaceutical industry is being reserved already for the rich nations. There is really trouble getting access to the poor countries. The low-income countries with vulnerabilities as well would be in trouble getting the vaccine, and there is not sufficient funding for the COVAX initiative. And we expect from the leading economies to contribute to the availability of the vaccine.

Having said that, of relevance to the discussion today on China, like many colleagues, we recognize China's readiness to continue to play a role in developing a global solution in this particular area on the vaccine availability, and the support for the low-income countries to get access is very welcome. In addition to that, of course, the participation and the debt relief based on the DSSI, and the Common Framework for Debt Treatment beyond DSSI is also commendable in order to make matters better for the developing economies to deal with the challenges making the vaccine available, dealing with the implications of the COVID crisis.

The Acting Chair (Mr. Okamoto):

Mr. Mohieldin makes a very good point as it relates to global public goods and vaccine. Several Directors raised that here, and certainly this institution is quite committed to working with all of our partners to make sure that there is accelerated access, as fast as possible by all members to the vaccine, so that we can put this pandemic in the history books so to speak, learn our lessons and move on toward where Mr. Guerra went in his intervention, about policies that give us growth and prosperity.

Mr. Jin:

I can make a response to the discussion up to now. First, please allow me to go directly to the easiest. 2020 is a year with a rare challenge to both China and the world. Thanks to our authorities' decisive response and the support of the general public, the COVID-19 outbreak has been brought under control timely, and the economy has been recovering since the third quarter. The economy has continued to make progress in important areas such as poverty reduction, environmental protection, intellectual property right protection, financial market opening up, and many others. We share most of staff's analysis and insights and have listened carefully to Directors' comments and critiques.

I want to respond to some of the focal issues briefly. The policy response to COVID-19 will inevitably incur a sizable cost to the economy. Both public and corporate debt levels have increased significantly. The NPL ratio in banking sector is also likely to rise. The authorities are aware of these risks and are prepared to deal with them. The measures include, among others, increasing provisioning requirements, strengthening non-performing loan (NPL) treatment, raising capital for small local banks, and establishing a bank resolution mechanism, et cetera.

While we largely share the staff's assessment, there are both underestimation and overestimation on a few issues. The positive impact on the externality of many government-led projects, such as infrastructure investment, has been underestimated. Unlike the development banks, the Fund usually calculates financial returns, not economic returns. So in this way, it has ignored the increased capacity and treated as a pure burden of further growth. On the other hand, when staff say China can lead on global solutions to overcome global crises, we feel it is an overestimation and a reflection of lack of inclusive leadership and a call for more multilateral cooperation.

We will, no doubt, to make initiatives when necessary and make our contribution to the joint effort of the international community to overcome global crises. The dual circulation development strategy is an answer to the changing internal and external environment and uncertainty. China is one of the few largest single country markets in the world. This market has big potential, a much deeper division of labor, and the improvement in supply chains and is the basis and bottom line of our growth. The technology decoupling adverse impacted by some people is a policy against a whole large country with a population accounting for one-fifth of global population. If truly implemented, it will be an unprecedented racial discrimination and a new form of Apartheid policy. I think the Fund should take a high moral ground to deal with this issue.

China will continue to expand global economic linkage and cooperation to enhance economic efficiency and resilience. The signing of the RCEP Free Trade Agreement, the negotiation of bilateral investment agreement with EU, the continued effort to reform WTO, and the negotiation and the implementation of trade deals with the United States are all part of this effort.

On the external sector, the RMB exchange rate has been quite flexible and appreciated by more than 10 percent since the beginning of this year. Responding to the moderate widening surplus in the balance of payments, China has fulfilled the requirement on data disclosure under its agreement with the Fund regarding the inclusion of RMB into SDR basket. We will continue to improve the quality of our data reporting based on the rules of the Fund.

On digital currency, the PBC is carefully designing and testing the e-CNY and advanced work in a very cautious manner, paying special attention to protection of privacy and avoiding major negative effects. We will actively participate in international communications and the discussions to work on best practices.

China has attached great importance to the implementation of the DSSI. China's total suspended collection of debt service payments has amounted to US$2.5 billion, and this is the largest contributor among G20 members. We will make more efforts in this regard. The challenge is that the total bilateral official credit only accounts for one-third of total debt in low-income countries.

Regarding climate change, China has established one of the most developed green bond markets in the world, and the central bank has recently issued a comprehensive policy guidance to further implement the green financing agenda in both banking system and the capital market. I would refrain from responding to some Directors' accusation on China's policy to safeguard sovereignty and social stability in Hong Kong SAR and the Xinjiang Uygur Autonomous Region. They are basically a legacy issue of colonialism or issues related to anti-extremism and anti-terrorism. My authorities have expressed its consent to publish this Article IV staff report at an appropriate time soon.

The Deputy Director of the Asia and Pacific Department (Mr. Kang):

I will touch on issues regarding the e-CNY and climate change and then turn over to Mr. Berger to answer the remaining questions there.

First, many Directors called for further work on the e-CNY and the climate change issue, and as the FDMD noted, the focus of this year's consultation was very much on the pandemic. But we did feel the issue of the e-CNY was important to include a box on recent developments in that area. We have been working very closely with MCM, our colleagues there, and will continue to do so to follow this rapidly changing issue, including on the domestic and international implications of the e-CNY.

As to the question raised by Ms. Mannathoko and Mr. Palotai on the recent update on the e-CNY, I can report that there was another case where the e-CNY was tested using consumption vouchers to about 100,000 users in Suzhou City near Shanghai. It was the first test of an online merchant scenario, as well as its offline function.

On the issue of cross-border e-CNY, the PBC and the Hong Kong Monetary Authority have been working closely in discussing the possible use of the e-CNY in Hong Kong's payment system through what they call payment versus payment function, which could improve the transparency as well as the efficiency of cross-border transactions between these two areas. Of course, in terms of the e-CNY, they do plan to test it during the 2022 Winter Olympics in Beijing, as it is currently difficult for tourists sometimes to use international credit cards, and it would be easy to use the e-CNY for payments and exchanges during that time.

Finally, on climate change, we agree on the importance of this issue. We very much look forward to seeing details of China's mitigation strategy, which will be announced in the 14th Five-Year Plan expected in the spring. And I think there will be, as Mr. Jin mentioned, a large focus on green finance, and that is something that we will turn much attention to.

The staff representative from the Asia and Pacific Department (Mr. Berger):

I would add to the forthcoming work, since a number of Directors have mentioned it, that we plan on publishing a working paper laying out details of our decoupling work that you have seen a glimpse of in the staff report. This should help one to understand the approach we are taking and also some further results at the individual country level. Country-level results differ by the layer of analysis, as the paper will explain.

As to questions raised at the table, let me start with the question about improving economic data. We are, indeed, aware of ongoing work at the NBS about improving national account data around GDP and also evaluating the national capital stock. We do not have a timeframe in which these projects are completed. Many Directors pointed to financial data. Also being of interest, I point to Appendix V in our staff report that discusses some very important financial data initiatives that are worthwhile taking into account when thinking about data.

A second question asked how China's climate goals factor in the current infrastructure efforts that are part of China's fending off the crisis at the macroeconomic level. We find it helpful here to compare the current effort in supporting the economy, including through higher public investment with the effort that China put forward after the GFC. In terms of public investment growth during the GFC, we have seen public investment growing by about 26.6 percent in 2009. This contrasts with an increase of only 10.8 percent in 2020, based on our current estimate. About two-thirds of the discretionary spending effort is on budget public investment and about two-thirds of climate-related measures are "green" based on the estimate of the October 2020 Fiscal Monitor.

I would see a difference in the use of public investment that is helpful as we think about how China is going to implement these climate-mitigation goals. Implementation, of course, is difficult, and we have had discussions with the authorities during the Article IV. We know that the authorities are diligently thinking through the ways in which these commitments can be implemented going forward, including, for example, by changing the structure of power supply, by ways of expanding current regional trading systems for CO2 emissions to the national level. We will continue, as Ken mentioned, to work on this issue together with colleagues in FAD and Research Department, so you can look forward to further work as we exit, hopefully, the COVID phase of our bilateral surveillance.

There was a question on inflation, and it is, indeed, the case that many leading indicators of inflation and its subcomponents have shown negative values recently, but it is important to look a little bit in closer detail at what is driving this. As far as CPI is concerned, this is mostly, if not exclusively, driven by the pork crisis that China suffered last year which drove up prices that are now coming down. If one pulls this out of the CPI number, it looks quite different. Indeed, core inflation has been rather constant, if at low levels, since a couple of months. We expect inflation to increase going forward as the output gap closes, and core inflation will strengthen, and these one-off factors that are affecting CPI will wane.

There was a brief return to the question about what the Five-Year Plan will imply for China's trading partners and more generally the external economy. It is a little bit early to answer this question. As we have said in the technical replies, the Five-Year Plan will be finalized only in the Spring, but our current assessment based on the available information is that the Five-Year Plan will include important continuations of reforms both in the external sphere—that means a continuation of opening up and domestically reinforcement of longstanding commitments to SOE reform—and other reforms that ultimately will, and we hope that is indeed the case to foster the market economy within China.

The Acting Chair (Mr. Okamoto) noted that the People's Republic of China is an Article VIII member, and no decision is proposed.

The Acting Chair (Mr. Okamoto) adjourned the discussion.

ANNEX

- Gray Statements
- Staff's Responses to Executive Director's Technical Questions
- Constituency Codes

BUFF/ED/20/167

December 14, 2020

Statement by Mr. Jin, Mr. Zhang, and Ms. Liu on People's Republic of China
Executive Board Meeting 20/122
December 17, 2020

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.

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GRAY/20/3737

December 15, 2020

Statement by Ms. Mannathoko and Mr. Garang on People's Republic of China (Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for the comprehensive set of reports and Mr. Jin, Mr. Zhang, and Ms. Liu for their informative Buff statement. We associate ourselves with the gist of staff's appraisal and policy recommendations and offer the following points.

The policy response of the Chinese authorities to the COVID-19 pandemic is noteworthy. Robust containment measures and sizable fiscal, monetary and financial policy support moderated the impact of the pandemic and fostered a quick recovery. Despite the very sharp decline in production during the first quarter of the year, growth for 2020 remained positive and is projected to rebound to 7.9 percent in 2021. However, we believe the current boost to production is driven in part by the export response to global demand for pandemic and work-from-home related products, and is likely to be a one-off effect, tapering off in 2021.

Fiscal policy: We agree that a moderately expansionary stance in 2020 remains appropriate. Careful consideration should be given to the adjustment path to ensure that adequate domestic demand is generated to help compensate for a decline in COVID-related exports after 2021. In this regard, we support the shift in policy toward domestic demand support and note the nascent recovery in consumption, reflected in a rebound is service sector activity in October. We also encourage the authorities to advance the green investment agenda, which could help counter a slowdown, post-COVID. We encourage more attention to improving PFM reforms and intergovernmental coordination, to enhance efficiency. *Could staff elaborate on the assumptions underlying the large boost in domestic demand projected for 2021? Furthermore, what measures are envisaged to stimulate greater private consumption and alleviate the uncertainty that motivates excessive precautionary savings?*

Further strengthening social safety nets could also boost domestic consumption of essential goods, while helping to address concerns over high inequality and inadequate social support. We urge leveraging digital technologies to deliver support to vulnerable households. Making the tax system more progressive would also help to reduce inequality. Attention to spending efficiency in social assistance and expanding unemployment insurance would likewise support this goal, as would expanding coverage to migrant workers. Further, as noted by staff, a recovery in domestic demand will have positive spillovers, including for those African LIDCs that are commodity exporters dependent on Chinese demand.

Debt: We welcome the plan to switch to fiscal consolidation once the recovery is secured. While high national savings do help to ameliorate potential risks from the very high augmented debt ratio, and the authorities continue to benefit from a very advantageous growth-interest rate differential, we nevertheless urge the authorities to ensure they have in place a robust debt management strategy for the post-COVID era, as debt is expected to rise further over the medium term.

Monetary and financial policies: An accommodative monetary policy stance amidst low inflation is justified. Nevertheless, rapid credit expansion seen in the wake of PBC deploying a wide range of measures in response to COVID-19 led to a significant increase in lending to the private sector, warranting careful monitoring. Improving monetary policy efficiency is also important and we encourage ongoing efforts to modernize the monetary policy framework with an eye to strengthening the transmission of policy and advancing financial intermediation to broaden access to finance, especially for MSMEs. We welcome the PBC's central bank digital currency, e-CNY and look forward to following its impact in promoting financial inclusion and payment efficiency. In the financial sector, vulnerabilities have increased from very high corporate debt and reduced debt service capacity in both corporate and household sectors. Addressing these risks as soon as the recovery takes hold is essential, even as various temporary support measures are phased out. Efforts will also be needed to address legacy loans as regulatory and supervisory frameworks are strengthened. We encourage a comprehensive bank restructuring framework to help in lowering systemic risks and reducing NPLs.

Structural reforms are necessary to support growth potential. We encourage a concerted effort to reform SOEs and ensure their competitive neutrality with private firms. Upgrading property rights (including for intellectual property), strengthening innovation, reducing shadow-banking risks, greening investment and improving resource allocation will help to build a more resilient and inclusive economy. Addressing macroeconomic data gaps will also enhance the accuracy of analysis and policy making. On labor market mobility, we agree that a more holistic reform approach that further improves the hukou system and accommodates migrant worker rights, while improving the efficiency of rural land markets, would facilitate labor market adjustment and support growth. We note the progress on hukou liberalization so far. *Could staff elaborate on implementation progress for hukou reforms cited in the 2019 Article IV report?*

Global solutions: We commend the Chinese authorities for stepping up efforts to address global challenges. Given that the global economic recovery hinges on defeating the pandemic, China's role in supporting multilateral efforts to expand access to a vaccine remains key. We agree with the authorities that the pandemic could still undermine global recovery and reiterate the importance of global cooperation to ensure universal affordable access to an effective vaccine, including for poorer regions, to ensure the global economy emerges from this crisis in 2021. China's participation in the G20 Debt Service Suspension Initiative (DSSI) and the Common Framework for debt treatment also remains essential, and we look forward to measures that ensure effective operationalization by its creditors. China's engagement on sustainable financing for global infrastructure investment, and tackling climate change is also appreciated, and we hope for successful outcomes from ongoing efforts to work with trading partners and WTO to remove uncertainty in global markets and build a more open, stable, and transparent, rules-based international trade and investment system for the good of the global economy.

With these remarks, we wish the Chinese authorities success in ongoing reforms.

GRAY/20/3738

December 15, 2020

Statement by Mr. Fanizza, Mr. Massourakis, and Ms. Quaglierini on People's Republic of China
(Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for insightful reports and Mr. Jin, Mr. Zhang and Ms. Liu for their informative Buff statement. We concur with the thrust of staff's appraisal and welcome China's swift policy response to the pandemic crisis. Looking ahead, it is important to foster a more inclusive and sustainable growth model, paying attention to reforming state-owned enterprises (SOE) while broadening the social safety net and addressing financial vulnerabilities deriving from high corporate debt levels. Green investments and climate change mitigation policies remain key in view of China's ambitious climate targets. Finally, we would welcome a stronger presence of China in multilateral global efforts.

- **Continue structural reforms for the rebalancing of the Chinese economy** away from public investment- and credit-led, towards a more consumption- and services-driven growth, in line with the "dual circulation strategy". We underscore the relevance of further enlarging the social safety net and address the rising income inequality. In this respect, we fully support staff's focus on the need for additional progress on the *Hukou* reforms and for bolstering support to migrant workers.

- **Fiscal policy strategy and fiscal transparency**. We concur with staff about the importance of elaborating a medium-term, structural, fiscal policy strategy to address rising public debt vulnerabilities. We support staff's suggestions to improve fiscal transparency and examine options to enhance the inter-governmental framework for fiscal transfers to local governments when shocks hit. This would help ensure more effective stabilization while enhancing risk-sharing.

- **Financial sector**. The high level of private sector debt poses potential risks for financial stability. We thus concur with the staff's view that phasing out the measures introduced to sustain the economy is crucial. Renewed emphasis should be placed on completing the regulatory and supervisory frameworks, enhancing the banking resolution regime, and improving regulation for online lending.

- **Central Bank Digital Currency (CBDC)**. We appreciate staff's elaborations on the advantages from the development of the People Bank of China's digital currency (e-CNY), including enhancing payment efficiency and promoting financial inclusion. At the same time, we would encourage further study on possible risks, including from potential cross-border usage, considering the impact on exchange rate policy and capital account framework.

- **Pursue SOEs' reforms**. We urge the authorities to ensure a level playing field among firms and, more generally, further opening China's domestic market, improve SOEs' governance, addressing non-viable businesses and ensuring adequate intellectual property protection. This would help foster productivity and investment, reduce possible credit misallocation and, ultimately, bolster economic performance.

- **Continue enacting policies on climate change mitigation, considering China's ambitious green targets.** Such measures would provide clear environmental, health and economic benefits. Reforms along these lines would help anchor productivity growth, support consumption and build a more resilient, green, and inclusive economy.

- **Global role of China in the G20**. A deeper and sustained engagement of China in the international stage is key to address the global common challenges, including multilateral efforts to respond to the crisis and address debt vulnerabilities, as well as climate change mitigation issues. We encourage further involvement on such critical topics, as is the need to provide debt relief to low-income countries as agreed at the G20 level, to tackle climate change and to contribute to a more open, stable and transparent rules-based international trade and investment system. As regards trade relations, we appreciate the recent agreement among Asian countries on the Regional Comprehensive Economic Partnership (RCEP) and encourage further opening of China's domestic market, including in the services sector.

GRAY/20/3739

December 15, 2020

Statement by Mr. Pösö and Ms. Skrivere on People's Republic of China
(Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for the comprehensive set of reports and Mr. Jin, Mr. Zhang, and Ms. Liu for their informative Buff statement. We agree with the thrust of the report and would like to add the following comments for emphasis.

Economic outlook and risks

We broadly agree with staff's assessment of the economic outlook and associated risks. The Chinese economy rebounded swiftly from the health and economic crisis due to a strict containment effort and macroeconomic and financial policy support. China is the only major economy forecast to have positive growth in 2020 (about 1.9 percent). Still, growth remains unbalanced, as the recovery has relied heavily on public support, in particular for infrastructure investment with diminishing returns, while private consumption has been lagging behind due to social distancing and a spike in precautionary savings. Overall, rising financial vulnerabilities, a reversal of previous deleveraging efforts, and a still-challenging external environment pose risks to the outlook.

While swift policy actions have helped to mitigate the economic impact of the crisis and supported the recovery in 2020 in 2021, the credit-driven and investment-heavy recovery could reverse recent progress on rebalancing and exacerbate financial risks and high leverage. Credit growth has accelerated, the already very high corporate debt is expected to increase further, and the fiscal deficit (IMF definition) is projected to almost double to 11.9 percent of GDP in 2020. Therefore, we see scope for a more prudent balancing act between the competing objectives of supporting growth and containing leverage and preventing even deeper macroeconomic imbalances.

Fiscal policy

Shifting from infrastructure investment towards household support, strengthening social safety nets, and focusing more on green investment will facilitate economic rebalancing, and sustainable and inclusive growth. In addition, further fiscal reforms are necessary to increase fiscal transparency, improve the medium-term sustainability of public finances, limit the large fiscal imbalances at the local-government level, strengthen social safety nets, and make the tax mix greener. We also concur with the assessment that lowering the minimum social security contribution would reduce the very high effective tax rates for low-wage earners. At the same time, a reduction of the tax-free threshold in order to broaden the tax base could potentially offset the previous measures to increase private consumption. In addition, other taxes such as environmental taxation and taxes on property could be used to boost tax revenues.

Monetary policy

Given the low inflation, monetary policy should remain accommodative, while phasing out potentially distortionary measures as the recovery takes hold and avoiding an abrupt tightening of financial conditions. We agree with staff's assessment that the use of non-interest rate instruments, such as the large expansion of re-lending facilities and increased targets for bank lending to certain sectors, has provided credit to vulnerable sectors when the normal functioning of financial markets was under threat. We also share staff's view that further modernisation of the monetary policy framework toward more market-based interest rates would strengthen the transmission of conventional interest rate policies and help improve credit intermediation. In this respect, we welcome the PBC's loan prime rate framework reforms.

Exchange rate flexibility continues to be important in facilitating adjustment to the changing external environment. We agree with staff that further liberalisation of portfolio inflows and outflows would reinforce the role of markets in exchange rate determination. Capital flow management measures (CFMs) should be gradually phased out in a sequence consistent with greater exchange rate flexibility, and FX intervention should be limited to counter disorderly market conditions.

Financial sector

The high level of debt in the private sector poses potential risks for financial stability. We would welcome greater emphasis on containing financial sector risks by the authorities. We also support staff's view that phasing out the measures introduced to support the economy is crucial to keep financial risks in check. In this process, renewed emphasis should be placed on completing and enhancing the regulatory and supervisory frameworks.

The extension of forbearance measures through 2021 should proceed in parallel with actions aimed at reforming the banking sector. As supporting measures are gradually withdrawn, non-performing loans could increase, further weakening the balance sheets of troubled banks. Enhancing the banking resolution regime, bringing it in line with international standards, and improving regulation for online lending, would be welcome.

A house price correction could pose risks for financial stability. The high leverage of developers is a cause for concern, together with banks' exposure to the sector. Thus, a downturn in the property sector might catalyse other sources of financial stress.

Structural reforms

While some structural reforms have advanced well despite the crisis, significant progress is needed in other areas, particularly on the SOE reform. We welcome the progress on reforms to open up the financial sector through streamlining the negative list for foreign investment and lifting foreign ownership restrictions in selected areas. There has also been progress streamlining business administration, relaxing labour market restrictions, strengthening intellectual property protection, and fostering innovation. At the same time, we fully agree that significant progress is needed on the SOE reform, with particular emphasis on SOEs with non-viable business models and low productivity, in order to ensure a level playing field between companies. In general, strengthening the role of markets is of the essence, including by relaxing restrictions for private companies' entry into China's service sector. Green investment and climate change mitigation strategies would also provide environmental, health, and economic benefits. Greater progress is also needed to strengthen the social safety net, particularly after accounting for the deleterious effect of the pandemic on inequality. Reforms along these lines would help anchor productivity growth, support consumption, and build a more resilient, green, and inclusive economy with higher welfare levels for Chinese citizens.

Helping solve global crises

We strongly support staff's view on China's role on the global stage. This includes the need to provide debt relief to low-income countries as agreed at the G20 level, as well as tackling climate change, and contributing to a more open, stable, and transparent rules-based international trade and investment system. We found staff's analysis in Box 6 on the effects of technological decoupling particularly interesting, as it highlights the harmful effects to the global economy and underscores the importance of free and fair cross-border trade.

We thank staff for very insightful Selected Issues papers on the challenges of monetary policy, SOEs, and local government financing. We believe the report could have further benefitted from a more detailed analysis of critical climate change mitigation strategies, given the magnitude of the challenge ahead as well as the recent announcement by China on their ambitious goals in this area.

Data gaps and transparency

Addressing data gaps will help improve policy making and credibility. We welcome the substantial steps in improving monetary policy and financial stability communication. However, we believe there is still room for enhancing transparency and statistics. We fully agree with staff that estimates of the general government deficit and debt should be improved and should include off-budget liabilities, including local government financing vehicles, government-guided funds, and special construction funds. Additionally, further efforts to improve national accounts data and labor market statistics is warranted.

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

GRAY/20/3740

December 15, 2020

Statement by Mr. Andrianarivelo, Mr. Sylla, and Mr. Diakite on People's Republic of China
(Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for the comprehensive reports and Mr. Jin, Mr. Zhang, and Ms. Liu for their helpful Buff statement.

We commend the Chinese authorities for the rapid and effective macroeconomic and financial policy response to the pandemic, which has enabled the ongoing fast recovery from the crisis. The authorities' prudent and calibrated reopening of the economy across regions has helped to effectively control the outbreak. While the economy shrunk markedly in 2020, it is poised to grow by 7.9 percent in 2021, up from an estimated 1.9 percent. This strong recovery is underpinned by public support and the good performance of exports, including of medical supplies. However, strengthening the recovery will entail robust private investment and sustained domestic consumption. In addition, it will be important to pursue the implementation of structural reforms to mitigate external shocks and foster higher and inclusive growth. We broadly agree with staff's policy recommendations in this regard and provide the following comments for emphasis.

Fiscal policy should aim to support the strengthening of private demand, and focus on consolidation once the recovery from the crisis is on solid grounds. Private demand has been severely weakened by the pandemic, and its revitalization is warranted to achieve a more balanced growth. The authorities' fiscal policy response has helped to mitigate the economic fallout of the pandemic, notably on manufacturers of medical supplies and on small and medium enterprises. Public investment in infrastructure has also been instrumental in supporting the economy. As fiscal space is available, we agree that fiscal stimulus should continue in 2021 with the view to stimulating household consumption and strengthening social safety nets. *We note the high household savings rate induced by the crisis and would like to know to what extent more structural factors such as demographic changes and ageing population are at play, and how China compares to regional peers in this regard.* In the medium term, it will be important once the crisis abates and the recovery takes hold to also focus on fiscal consolidation to reduce the fiscal deficit and bring down public debt.

With inflation subdued, we see merit in pursuing an accommodative monetary policy, but based on more conventional interest rate instruments. An accommodative monetary policy is justified insofar as inflation is below target, and there is the need for close coordination with fiscal policy in strengthening the recovery. We take note of the non-conventional measures implemented by the authorities during the crisis, which have helped to support financial markets and facilitate credit, notably targeted lending to support strategic sectors and employment. Nonetheless, we agree that it will be important to promote the use of interest rate instruments to guide monetary policy once private demand has strengthened to avoid creating durable distortions in the allocation of credit to the economy. In this respect, we welcome the authorities' intentions to use conventional instruments and phase out gradually some non-interest rate policies. Regarding the exchange rate, we take positive note of the authorities' commitment to increasing flexibility and stopping regular FX interventions, which should help to facilitate economic adjustment.

We encourage the authorities to pursue their efforts aimed at strengthening financial sector stability. The measures adopted to increase liquidity and credit, notably the expanded national credit guarantee fund and the SME loan securitization have been effective in supporting SMEs and employment during the crisis. However, it will be important to closely monitor the risks to financial stability, and phase out these measures gradually as the recovery completes. In this regard, we welcome the authorities' intention to continue supporting the recovery while being mindful of financial stability risks. We also encourage them to continue improving their AML/CFT framework, and develop a comprehensive strategy to strengthen the banking sector. On this last point, addressing weak banks based on market principles and the rule of law is appropriate.

The implementation of key structural reforms should be accelerated to foster a balanced, inclusive and environmentally- friendly growth. In complement to the reforms needed to build stronger social safety nets, continuing to improve SOE governance will be necessary. The Selected Issues Paper (SIP) provides interesting insights on how a more efficient SOE sector could boost total factor productivity growth, and we appreciate the authorities' commitment to pursue further reforms in this area. It will also be important to continue implementing structural reforms aimed at facilitating the transition to a greener economy.

We welcome the authorities' commitment to international cooperation in addressing global challenges. China has a leading role to play in the global stage in tackling climate issues, enhancing international rules-based trade and investment, facilitating the distribution of vaccines, including to the poorest countries to fight the pandemic, and contributing to addressing debt issues in LICs.

With these comments, we wish the Chinese authorities success in their endeavors.

GRAY/20/3741

December 15, 2020

Statement by Mr. Huh, Ms. Johnson, and Mr. Yoo on People's Republic of China (Preliminary)
Executive Board Meeting 20/122
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.*

GRAY/20/3742

December 15, 2020

Statement by Mr. Bhalla and Mr. Singh on People's Republic of China
(Preliminary)
Executive Board Meeting 20/122
December 17, 2020

1. We thank the staff for their analytical report and insightful selected issues papers on the monetary policy transmission, credit allocation, and local government financing and Mr. Jin, Mr. Zhang, and Ms. Liu for their informative Buff statement. We broadly concur with the thrust of the staffs' appraisal and wish to make the following remarks for emphasis.

2. It is encouraging to note that the Chinese economy continues its speedy V-shaped recovery from the pandemic as reflected in many high frequency indicators, buttressed by an effective containment strategy and swift policy actions to mitigate the impact of the crisis, including a discretionary fiscal stimulus of 4.7 percent of GDP in 2020. While investment demand and exports are emerging as key drivers, private consumption demand continues to remain weak and recovering slowly mostly due to the gradual removal of containment measures. *We would like to understand from the Staff if the government support programmes to households have led to precautionary savings rather than solely boosting consumption due to inadequate social safety nets? Second, whether the rise in savings rate during the pandemic, despite a fall in incomes, mirrors a strong cutback in the discretionary consumption demand by households?* Furthermore, real estate investment quickly rebounded with housing starts outpacing sales. In the midst of *weakening household incomes and elevated uncertainties, what may have been the drivers of real estate demand?* We appreciate the authorities' efforts for continuing reforms to further open up the economy and encourage then to allow a greater role for market forces in their economic rebalancing efforts towards consumption-led growth.

3. An important concern flagged in the staff report is that alongside impressive growth performance over the decades, income inequality has increased sharply, leaving China more unequal than other countries in the region. The staff report also suggests that even with a lower level of potential GDP, a significant negative output gap of around -3.5 percent of potential GDP is expected in 2020 before closing

gradually over the medium term, mostly reflecting the slow recovery of domestic private demand. *Does the staff have an estimate of the relative contribution of slack in domestic demand versus the external demand in contributing to the wide output gap in the economy?* Further, *why do the authorities expect the output gap to close in 2021, against the staff expectation of an output gap of -1.8 percent?*

4. Trade tensions have had a significant impact on the Chinese economy. We acknowledge the continued policy measures implemented to open up the economy, including a reduction of the effective tariff rate, as well as the prohibition of forced technology transfer, revision of the negative list for foreign investment to liberalize investment regime, and protection of intellectual property rights. In this context, greater exchange rate flexibility may also be desirable.

5. The corporate debt is expected to rise by about 10 percentage points to 127 percent of GDP in 2020. Rising defaults among some financially weaker state-owned enterprises (SOEs) could also add to pressure on bank balance sheets. Concerns seem to be especially pronounced for lending to small businesses, especially once the financial support measures are withdrawn. We also note the staff concern that financial pressures at some local governments are also spilling over to the corporate and banking sector. However, the Buff statement argues that the debt burden of LGFVs issued after 2014 is borne by issuers themselves and are not legally recognized by the Chinese government and hence should be considered as corporate debt rather than public debt. *We would appreciate more insight and clarity from the Staff on this sharp divergence in views.*

6. Though we understand that the authorities are committed to further pursuing mixed-ownership reforms and improving SOE governance through corporate boards, SOEs governance and competitive neutrality continue to remain important challenges for sustained growth.

7. We agree with the staff that exceptional financial support measures during the COVID-19 can be phased out as the recovery takes hold as they run the risk of undoing recent progress in strengthening bank transparency and governance. We also endorse the staff suggestion of reforming interest rate guidance policies to strengthen market-based credit allocation to riskier firms, increasing the effectiveness of the interest-rate based monetary policy.

8. As suggested by the staff, establishing a personal insolvency regime would help address the over-indebtedness of small entrepreneurs and households, supporting adjustment in the aftermath of the pandemic. Equally important will be a market-based corporate restructuring framework to facilitate the deleveraging and exit of non-viable firms. Improving the legal insolvency and debt enforcement framework in tandem would help address problems of creditor coordination, incomplete contracts, and asymmetric information, and thus, help reduce excessive indebtedness in an orderly fashion.

9. We welcome China's participation in the G20 efforts to bring relief to low-income countries, including the participation of Chinese official creditors in the extension of Debt Service Suspension Initiative (DSSI) as well as the common framework for debt treatments beyond DSSI. At the same time, we agree with the staff suggestion on strengthening the external lending frameworks by enhancing debt sustainability monitoring and transparency.

10. We also encourage the authorities to strengthen the AML/CFT framework and to introduce a comprehensive legal framework to implement UN-based targeted financial sanctions requirements. With these remarks, we wish the Chinese authorities all the very best in their future endeavors.

GRAY/20/3743

December 15, 2020

Statement by Ms. Levonian, Mr. O'Brolchain, and Mr. Weil on People's Republic of China
(Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for their reports which recognize China's rapid economic recovery from the COVID-19 crisis while emphasizing the unbalanced nature of the recovery to-date. We also thank Mr. Jin, Mr. Zhang, and Ms. Liu for their helpful Buff statement in which they underscore that China remains committed to pursuing prudent policies that will foster sustainable and high-quality growth going forward.

We support the staff appraisal and recommendations to support a rebalancing of the economy away from investment- and export-led growth, toward greater reliance on domestic consumption. This is needed both in support of the on-going recovery and as part of longer-term structural efforts to shift to a higher growth path. To-date, the recovery from the COVID-19 crisis has relied heavily on public spending and investment and has benefitted from temporarily strong exports of medical and protective equipment and work-from-home-related electronics, while private consumption has lagged. However, China's medium-term growth prospects are facing headwinds from technology tensions, demographics, and falling productivity that will necessitate deep reforms in the real economy that can stimulate domestic demand and generate more balanced and sustainable growth. While the authorities may be mostly concerned with external risks, there are important downside risks to the outlook, including a resurgence of the pandemic prolonging weak consumer and business confidence or interconnected financial vulnerabilities being exacerbated by the recovery efforts themselves.

Fiscal policy should shift from focusing on infrastructure investment toward supporting households by strengthening the social safety net and reforming the tax system. Income inequality remains high, and the COVID-19 crisis has only highlighted the need to improve the size and coverage of the social safety net which staff have characterized as "woefully inadequate". In parallel, investment could be more narrowly focused on green infrastructure that can support the transition to a lower-carbon economy. Further reforms are also necessary to increase fiscal transparency, improve medium-term sustainability of public finances, and limit the large fiscal imbalances at local-government level. Regardless of one's view regarding the ‘augmented debt’ concept—i.e. whether certain forms of debt are counted as part of General Government Sector or as part of the other domestic sectors—the increase in overall debt poses risks to fiscal sustainability that should be addressed. While past experience may inform authorities’ view that economic growth is “the key to mitigating risks from debt”, given the longer-term slowing trajectory of China’s economic growth, and the already high levels of indebtedness, this may no longer be the case.

The crisis response has exacerbated pre-existing financial stability risks. Gradually phasing-out crisis financial support measures, such as relaxed NPL recognition standards and repayment moratoria, will be important for managing financial stability risks. As support is withdrawn, non-performing loans could increase, highlighting the importance of improving supervisory capacity across the system and developing a credible bank resolution framework. The authorities have intervened to rescue several small lending institutions in recent years, but these interventions have increased moral hazard that should be addressed through the development of a credible bank resolution framework. The crisis response has increased already high levels of corporate debt, and it will be important for the authorities to take steps to contain leverage and prevent deeper macroeconomic imbalances. Recently announced measures to contain vulnerabilities in the real estate market are a welcome step. While China’s new central bank digital currency holds the promise of promoting financial inclusion and improving payment efficiency, it would be desirable for staff to elaborate further on associated risks considering the potentially significant and wide-ranging implications of CBDC. *Staff comments are welcome*. We encourage the authorities to continue their efforts to address weaknesses in the AML/CFT framework.

The authorities should continue to modernize the monetary policy framework. Exchange rate flexibility continues to be important in facilitating adjustment to the changing external environment, and further liberalization of portfolio inflows and outflows would reinforce the role of markets in exchange rate determination. In that regard, we welcome the phasing-out of the reserve requirement on FX forward and the counter-cyclical adjustment factor in the daily trading band and encourage the authorities to continue phasing-out CFMs consistent with greater exchange rate flexibility. We share staff’s view that further modernization of the monetary policy framework toward more market-based interest rates would strengthen the transmission of conventional interest rate policies and help improve credit intermediation.

Structural reforms are needed to enhance the role of the private sector and generate more balanced growth. China’s progress on key structural reforms to open-up and rebalance the economy has been rather mixed. While significant progress has been made to lower barriers to foreign investment, we remain very concerned about the role of SOEs in the economy, and lagging progress on SOE reform and competitive neutrality. We hope that staff’s excellent selected issue paper on the economic drag caused by the state’s large footprint in the real economy provides an impetus for redoubled efforts to level the playing field. There seems to be a gap between the level of formal guarantees provided by the state (as intended in the 2014 Budget Law) and the informal expectations from market actors about potential state intervention to rescue distressed assets, especially those of quasi-state entities. The extent of these expected implicit state guarantees is difficult to quantify, possibly explaining the authorities' disagreement with the staff regarding the 'augmented' debt concept. *Staff comments are welcome.*

China and its trading partners should pursue open, stable, and transparent rules-based international trade and investment. Staff have correctly flagged trade tensions as a major risk to the outlook. In the context of a Chinese push for technological self-reliance, we welcome staff's assessment of the economic impacts of technological decoupling which, through misallocation and lower knowledge diffusion, could have significant negative impacts on global growth. We encourage staff to present this analysis in the Spring 2021 WEO as part of the Fund's ongoing efforts to demonstrate the economic consequences of escalating trade and technology tensions and a general retreat from the rules-based trading system.

We welcome the authorities' recent climate commitments and call on China to engage multilaterally to help tackle the global threat from climate change. Decisive mitigation and adaptation measures will be required to reach the climate targets, including a gradual increase in carbon pricing. The Fund is uniquely placed to assess the evolving risks to the economy, including the financial sector, of China's transition to a less carbon intensive economy, and we would welcome further coverage of this issue in future Article AIV consultations.

China has a significant role to play in multilateral efforts to respond to the crisis and support the global economy. We welcome China's participation in the G20's DSSI and Common Framework for debt relief. However, we believe that China should invest efforts in improving their debt transparency and coordination amongst their official lending institutions like the China Development Bank. We look forward to further strengthening the constructive dialogue and cooperation with China in the different international fora in order to jointly promote a strong, sustainable, and inclusive recovery from the crisis.

GRAY/20/3744

December 15, 2020

Statement by Mr. Guerra and Ms. Arevalo Arroyo on People's Republic of China (Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for its comprehensive report and set of issues papers. We also thank Mr. Jin, Mr. Zhang, and Ms. Liu for their insightful buff statement. The authorities responded swiftly to confront the health and economic crisis, with decisive containment measures and a comprehensive policy agenda to support the economic recovery. Going forward, it will be instrumental to place the economic recovery on a more balanced path, with further solid private consumption while containing leverage and preventing macroeconomic imbalances. The Chinese economy will face continued uncertainty coming from possible outbreaks of the pandemic and high external volatility given weak global demand and the possibility of heightened trade and geopolitical tensions.

We broadly agree with staff's assessment and policy recommendations. Specifically, we highlight that China and other systemic economies can play an instrumental role in securing a more sustainable and green economic recovery based on an open and rules-based international trade and investment system.

- We welcome staff's analysis on the effects of technological decoupling. The IMF should continue to analyze the negative global effects that arise from the current trend of technological decoupling by major economies, including the US and China. *Has staff analyzed how technological decoupling could impact growth in emerging markets?* The examination of foreign value added in gross exports could also bring light to the important implications of technological decoupling for emerging markets, including the potential effects on the electronics and auto sectors.
- Another front where China's cooperation will be instrumental is in the mitigation of climate change. We welcome the authorities' commitment, as expressed in the Buff statement, that China will actively support a green recovery through green finance, innovative green financial products, further investment into green industries in line with market principles, and a low-carbon green growth model. We concur with the Chinese authorities that climate change mitigation requires comprehensive and global action and welcome the recent announcements that China aims to have CO_2 emissions peak before 2030 and achieve carbon neutrality before 2060.
- On trade, it will be instrumental for China and the US to continue to work to reduce trade restrictions that have a negative impact at a global level. We welcome China's efforts to continue working on multilateral trade agreements, including the recent signing of the RCEP. Going forward, it will be of

the essence that China continues to strengthen intellectual property protection to safeguard the legal rights and interests of foreign investors.

- Finally, we agree that the continued engagement of the Chinese economy in many global initiatives is crucial to their success, including securing expanded access to a vaccine and debt relief for low-income countries.

We agree with staff that macro policy should remain moderately expansionary in the short-term with the policy mix reoriented to support more balanced growth going forward. It will be instrumental for fiscal policy to shift from infrastructure investment towards household support, strengthening social safety nets and focusing more narrowly on green investment. Given that public debt has been rising, the macro fiscal framework and intergovernmental coordination should continue to improve. *We notice that the authorities do not agree with staff's assessment regarding the use of the concept of augmented deficit and debt. Could staff comment on how this debt measure compares to definitions used in other countries, particularly on the concept used under the new DSA methodology framework?*

We commend the PBC for its comprehensive and timely set of policies undertaken to support economic recovery and limit the pandemic negative effects. We consider that China continues to benefit from the policy space to maintain a flexible, fine-tuned, and targeted monetary policy that aims to balance growth and manage risks. We share staff's view that further modernization of the monetary policy framework could reinforce the transmission of conventional interest rate policies and help improve credit intermediation. The recent PBC's loan prime rate framework reforms are important advances in this regard. Going forward, given the changing external environment, to facilitate an effective adjustment the authorities should continue with the process of portfolio flows liberalization to increase the role of a more flexible exchange rate.

We welcome the authorities' greater emphasis on containing financial sector risks and support an approach to phasing out the measures introduced to support the economy in order to keep financial risks in check. As stated in the Buff, 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. *Could staff comment on the recently issued draft to amend the Law of the People's Bank of China? Which are the main objectives of the proposal and its role in strengthening the PBC's operational authority and oversight of the financial sector? Has staff made any analysis on the possible cross-border implications of the Chinese digital currency and possible domestic financial stability challenges?*

Finally, we agree with staff on the need to address macroeconomic data gaps. We encourage the IMF to support the authorities in this important endeavor.

GRAY/20/3745

December 15, 2020

Statement by Mr. Mouminah, Mr. Alkhareif, and Mr. Keshava on People's Republic of China
(Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for the well-written set of reports and Mr. Jin, Mr. Zhang, and Ms. Liu for their informative Buff statement. We broadly share staff's analysis and policy recommendations and would limit our remarks to the following issues.

We welcome the rapid recovery of the Chinese economy from the COVID-19 shock. Indeed, the authorities deserve to be commended for their strong containment measures as well as comprehensive policy actions to mitigate the economic and social impact of the crisis and support the recovery. In particular, we take positive note of the targeted support to the most vulnerable households and firms, including SMEs and micro-enterprises. It is also encouraging that important reforms have progressed despite the crisis, including further opening of the financial sector. The rebound of the Chinese economy is generating positive spillovers for the global economy and supporting global recovery. In this context, we welcome the staff's assessment that the authorities' policy efforts are expected to boost global GDP by about 0.6 percentage points cumulatively in 2020 and 2021.

Looking ahead, we welcome the focus under the 14th 5-year Plan (2021-25) on achieving high-quality growth. In particular, the emphasis placed on further strengthening domestic economy, supporting technological innovation, strengthening employment by improving support for key groups, modernizing agriculture and rural areas, and strengthening the social security system bodes well for meeting the authorities' high-quality growth objective. In this context, we take note of the adoption of a **"dual circulation"** strategy, which aims at relying more on domestic demand as the main driver of growth while promoting international trade and broadening access to Chinese markets. This seems to be in line with the staff's recommendations on strengthening consumption growth and accelerating economic rebalancing as well as on implementing a comprehensive reform package to boost productivity and potential growth. *Staff's elaboration on the "dual circulation" strategy especially the expected spillovers to the global economy will be appreciated.*

Fiscal policy should remain supportive to secure the recovery. In this context, we welcome staff's assessment that China has some fiscal space and therefore a moderate stimulus in 2021 would be appropriate to provide insurance against downside risks. To facilitate economic rebalancing, the authorities should build on the progress in providing unemployment insurance coverage, including for migrant workers, increasing transfers to low-income households, and further strengthening the public healthcare system. In this context, we take positive note of the greater use of digital technologies to deliver government support and look forward to continued efforts to leverage technologies to provide support to vulnerable households and firms. We also welcome the authorities' intention, as underlined in the Buff statement, to continue their efforts to prevent and mitigate potential risks associated with local government debt.

Monetary policy should remain accommodative given low inflation. The authorities should also continue their efforts to modernize the monetary policy framework to strengthen the effectiveness of interest-rate transmission. Box 8 of the report provides a good outline of the ongoing work on a central bank digital currency named e-CNY, which holds the potential to enhance financial inclusion and improve payment efficiency. The launch of the e-CNY will provide important lessons for other countries, and we look forward to continued coverage of this important area in staff work.

Containing financial stability risks should remain a key priority. In this connection, we positively note the progress in implementing the 2017 FSAP recommendations, including the regular conduct of stress testing by the PBC to study banks' ability to withstand risks under stress scenarios such as macroeconomic downturns, deterioration of risk conditions in key areas, increases in liquidity stress, among others. Here, we are reassured to note in the Buff statement that the recent stress test shows that the banking sector is resilient to severe shocks. We also note that the authorities have recently asked commercial banks to make full use of options to increase provisions and strengthen the resolution of non-performing loans. Once the recovery takes hold, we see merit in staff's recommendation on resuming financial regulatory strengthening to help contain corporate leverage and reduce shadow-banking risks. On AML/CFT, we welcome the progress on the issues identified in the FATF report and look forward to continued progress in addressing any remaining weaknesses in the framework.

Finally, we recognize the authorities' varied contributions to advance global cooperation. In particular, we welcome participation in the G20 DSSI as well as the common framework for debt treatments beyond the DSSI. We also highly appreciate the authorities' commitment to make any approved vaccine developed in China widely available to all countries. On the trade and investment fronts, we concur with the staff's recommendation that China and its trading partners should work together to build a more open, stable, and transparent, rules-based international trade and investment system.

With these remarks, we wish the authorities continued success.

GRAY/20/3746

December 15, 2020

Statement by Mr. Bevilaqua, Mr. Saraiva, and Ms. Mohammed on People's Republic of China
(Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for the informative and comprehensive set of papers and Mr. Jin, Mr. Zhang and Ms. Liu for their useful statement. China has demonstrated that a sound economic recovery is possible when the virus is brought firmly under control. This quick recovery brings China back on track to contributing significantly with global growth. We commend the robust containment efforts, coupled with sizable macroeconomic and financial support, which helped mitigate the impact of the crisis. We broadly agree with the staff's appraisal and note that recovery is currently still unbalanced and greatly dependent on public support. Going forward, resuming a well-managed strategy of structural rebalancing of the economy, focusing on the quality of growth and reducing financial vulnerabilities will shape a positive path both for China and the global economy.

The Chinese economy should continue to pursue its delicate, multi-dimensional transition to enhance its resilience and sustain its dynamism. Over the years, China has achieved significant gains in rebalancing the economy – from external to domestic demand, from investment to consumption, from industry to services, while developing a more ambitious environmental agenda and, more recently, striving with mixed results to improve income distribution. The pandemic has greatly affected this rebalancing strategy, calling for strong and sizable responses from the public sector to mitigate the impact of the crisis and resume growth. As recovery takes hold, the authorities should carefully consider framing macroeconomic policies to resume their rebalancing efforts and enhance the resilience of the economy.

Fiscal policy should remain adaptable to the current delicate environment and with due regard to the elevated debt dynamics. We agree with staff that continued near-term fiscal policy support is needed to secure the recovery, by re-directing spending towards social safety nets, healthcare and household to bolster the authorities' efforts to rebalance growth, while promoting a smooth but determined handoff to private demand. Nevertheless, as conditions allow, gradual consolidation should be pursued as debt remains high. We note that the augmented debt is expected to reach 113 percent of GDP by 2025 under the baseline, where debt does not fully stabilize within the next five years, and financing needs remain large. In this regard, we encourage the authorities to continue to explore the options of establishing a macro-fiscal framework to improve fiscal policy transmission and making the tax system more progressive in a way that will help stabilize debt over the medium to long term. Meanwhile, in case there is a resurgence of the virus outbreaks, we agree that fiscal expansion should be on-budget, centrally financed, and focused on low-income households, public health, and social safety nets. We take note of the authorities' disagreement, as expressed by Mr. Jin and colleagues in their statement, with the concept of augmented debt and deficit used by staff, arguing that debt issued by local government financing vehicles (LGFV) since 2014 is "not legally recognized by the Chinese government". *Could staff elaborate on how the concept compares internationally and on the potential sources of error for the "staff's best estimate of general government data"?*

Monetary policy should remain accommodative to support the recovery. We recognize that there has been substantial use of non-interest rate instruments to provide credit to vulnerable sectors as financial markets were under pressure. However, given the potentially distortionary nature of these measures, they should be phased out and more conventional interest-based measures should be utilized, as recovery takes hold and financial markets stabilize. Further modernization of the monetary policy framework to strengthen the effectiveness of interest rate transmission would be beneficial to improve credit intermediation. Meanwhile, we welcome the recent easing and increased transparency of capital flow management measures and encourage the authorities to continue on this track. Macroeconomic adjustments and greater exchange rate flexibility should be used to protect against the build-up of systemic risk stemming from capital flows.

Financial risks should be actively and quickly addressed to safeguard the system's stability. We commend the authorities for ensuring adequate liquidity in the financial system. However, with the recovery on track, the exceptional financial support measures such as modified NPL recognition and standards and repayment moratoria should be phased out gradually. Enhancing macroprudential tools to contain vulnerabilities from rising household debt and strengthening regulatory reforms to reduce shadow-banking risks would also contribute to the resilience of the financial sector. At the same time, supervisory oversight of fintech firms should be further strengthened and the deficiencies in the AML/CFT framework addressed in line with FATF recommendations. A comprehensive bank restructuring approach should be introduced to support the recovery and lower systemic risks and continue de-risking. However, we remain to be convinced on the appropriateness of staff's proposal to establish "a temporary and fiscally backed centralized resolution fund" as it could lead to moral hazard and hinder market-based incentives. *Could staff situate this proposal within the international experience and elaborate on why it would be important in the Chinese context?*

Reforming state-owned enterprises (SOEs) remains paramount to foster competition, increase productivity and enhance resilience of the economy. We note that the pandemic has reversed the progress of SOE deleveraging and reforms, as they were instrumental in ensuring economic stabilization. Consequently, the role of the state in SOE governance was amplified by the COVID-19 crisis. In view of this, we welcome the SIP on SOEs' resource allocation and production. We note that reallocation of credit from highly leveraged SOEs to privately-owned enterprises (POEs) could increase aggregate investment and productivity. We concur with staff on the need to ensure equal access to credit and capital by POEs and allow SOEs to deleverage. To that end, it would be important to develop a medium-term plan to remove the implicit guarantees benefited by SOEs, improve access to credit financing to private firm, and strengthen the overall credit culture. SOE reforms will be key to reducing fiscal risk and drive potential output growth as China recovers from the crisis.

In the current juncture, China can play a leading role in advancing multilateral efforts to address global challenges. We commend the authorities' support to the international efforts to expand access to a Covid-19 vaccine and their commitment to make any approved vaccine developed in China widely available to all countries. Moreover, China's participation in the G20 initiative to provide debt relief to low-income countries, including the extension of the debt service suspension initiative (DSSI) and the common framework for debt treatment beyond the DSSI is most welcome. We agree with staff's view that China and the global economy would benefit from a more open, stable, and transparent, rules-based international trade and investment system. We underscore that it is important that the issues underlying trade and technology tensions be addressed in a sustainable and timely manner. We also welcome the authorities' commitment to effectively develop strategies to address climate change issues and boost green investments.

GRAY/20/3747

December 15, 2020

Statement by Mr. Trabinski and Ms. Wehrle on People's Republic of China (Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We agree with staff's assessment of the current and projected state of the Chinese economy. The swift containment measures undertaken by the authorities have helped bring the pandemic quickly under control, while substantial policy support has helped the economy to rebound. Nevertheless, growth has largely been unbalanced and dependent on public investment, with private consumption remaining relatively weak despite some recent signs of recovery. As a result, the economic outlook remains uncertain with risks tilted to the downside. In particular, the anticipated transition from public to private demand as the key driver of the recovery could be derailed by a sudden tightening of financial conditions or a potential COVID-19 resurgence. Further, the external environment and geopolitical developments remain key sources of uncertainty.

The expansionary fiscal policy has been effective in supporting the recovery but increasing debt levels require vigilance. Transfers and tax cuts were important to mitigate the financial losses to companies and households. In order to secure the recovery in the currently still fragile environment, an expansionary fiscal stance remains warranted. We also second staff's call to shift from public investment to targeted household support and to continue efforts to strengthen the social safety nets in a more permanent manner, including by expanding the coverage of unemployment insurance. Meanwhile, the rapid build-up of public debt over the course of the crisis requires vigilance. We thus highlight the importance of sustainable consolidation measures once economic growth is back.

China's accommodative monetary policy stance is appropriate for the time being. Given that inflation pressures remain subdued and considering staff's expectation of a negative output gap in the medium term, the currently still accommodative policy stance remains adequate. The emergency policy measures taken by the People's Bank of China (PBC) have helped provide ample liquidity and boost lending when the normal functioning of financial markets was under threat. As the recovery proceeds, the PBC should continue to shift its focus back to containing financial stability risks. We also note that efforts to reform the monetary policy framework have advanced well in recent years. China has increased interest rate liberalization and capital account opening. We also welcome the authorities' renewed commitment to increasing exchange rate flexibility going forward.

We encourage the authorities to build on the pre-pandemic progress in reducing financial vulnerabilities. Measures such as loosening NPL recognition standards and introducing repayment moratoria were key to reduce the impact of the epidemic on enterprises. However, they have also led to a rise in financial stability risks, as evidenced by the significant increase in private sector and corporate debt. In this context, we notice the heightened market concerns about credit quality deterioration. Also, a series of recent defaults of state-owned enterprises (SOEs) has triggered investors' concerns. Although we welcome the removal of implicit guarantees for SOEs to improve competitive neutrality vis-à-vis private firms, larger-scale SOE defaults bear the risk of market disruptions. *How does staff assess the risk of future SOE defaults and their economic impact in China – in the current environment and in a scenario of rising rates and tighter credit conditions?*

The opening up of the financial sector and liberalization of the capital account have advanced but major barriers remain. We welcome China's measures to further allow foreign financial institutions to participate in the Chinese financial market. Further opening up measures to create a level-playing field for foreign financial institutions in China would be welcome. The liberalization of the capital account has also led to a steep increase of foreign investors' participation in Chinese bond and stock markets. We encourage the authorities to further explore schemes, programs, and stock exchange collaborations to integrate China's capital market into the global capital market. Closer international collaboration could also help improve transparency and audit oversight that are important to foreign investors. While we appreciate these inbound relaxations, we encourage the authorities to facilitate outbound portfolio investments to enhance the diversification of Chinas' private and institutional savings.

We welcome the authorities' commitment to global cooperation. A joint effort by the global community is particularly important amid the current global challenges due to the pandemic. In this respect, we appreciate China's participation in the efforts by the G20 in multilateral debt management. We also welcome the authorities' commitment to an open, stable, transparent, and rules-based international trade and investment environment, as well as to preventing technological decoupling. Lastly, as the role of China in the world is rising and the country is further transforming and rebalancing, we stress the importance of providing reliable, consistent, and complete macroeconomic data, that is comparable to similarly large economies in the world such as the US or the Eurozone.

GRAY/20/3748

December 15, 2020

Statement by Mr. Hosseini and Mr. Badsi on People's Republic of China
(Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for a well-written set of papers and agree with the thrust of the staff appraisal and policy recommendations. We also thank Mr. Jin, Mr. Zhang and Ms. Liu for their insightful Buff statement.

China successfully managed to limit the spread of the pandemic and temper its economic and social fallouts, thanks to swift and proportional policy response through higher public investment, financial sector measures and increased income transfers and unemployment benefits for support the more vulnerable population. The Chinese authorities are particularly to be commended for their forceful measures to halt the spread of the virus at an early stage and limit its contagion across borders. The speedy economic recovery of China from the crisis has had positive spillovers globally—particularly for commodity exporters and African countries—at a time when the other major economies continued to weaken. The economic recovery, and domestic consumption in particular, has begun to gain steam in more recent months, as indicated in the Buff statement. We agree with staff that as the recovery takes hold the unbalanced public-private growth model would need to be adjusted over the medium-to-longer term by leveraging China’s exceptionally high private savings and opening up the scope for private investment, including foreign investment, that would also make growth more resilient. On distributional issues, we take positive of the statement of Mr. Jin, Mr. Zhang and Ms. Liu on progress made in eliminating absolute poverty and narrowing of the rural-urban income gaps. Challenges however remain.

Risks to the outlook on balance are skewed to the downside, mostly reflecting external factors—including intensification of barriers on trade and technology transfer—many of which could be alleviated through stronger international cooperation. There is appreciable uncertainty regarding the outlook and we welcome staff’s analysis of the need to adjust macroeconomic policies to the pace of the recovery. We would like to stress, however, that structural reforms—including measures to strengthen the role of markets and foster competition and openness—would be equally relevant regardless of whether recovery exceeds or falls short of the baseline scenario.

The large fiscal imbalance and the small increase in the external current account surplus in 2020 largely reflect the effects of the pandemic-related spending domestically, and the surge in pandemic-related exports, as well as a sharp decline in outward remittances and a favorable terms of trade movement, despite the overall difficult external environment. To ensure a durable post-pandemic recovery we agree with staff that in 2021 a mildly expansionary fiscal stance in support of domestic demand would be advisable. We are pleased that the authorities intend to improve the public healthcare system and to strengthen social safety nets that would also help to discourage excessive precautionary private savings and stimulate private consumption. As the crisis abates and economic activity become stronger, fiscal consolidation should be resumed forcefully to bring the public debt ratio on a sustainable downward track, while continuing to strengthen social safety nets and tackle income inequality through targeted income transfers to low-income households, leveraging digital technology. The coverage of unemployment insurance should also be expanded—particularly to migrant workers and workers in rural areas—and the progressivity of the tax system be improved. We support the authorities' plans to reinforce the medium-term macro-fiscal framework to guide fiscal policy, enhance fiscal transparency and strengthen intergovernmental policy coordination on transfers and debt.

The supportive monetary policy stance has been prudent during the crisis and will be crucial to the recovery, but should remain well calibrated in line with inflation objectives. The PBC should focus on interest rate-based instruments and, as the recovery takes hold, to gradually withdraw other support measures that helped ease credit constraints during the crisis. We welcome the reform of the LPR framework and encourage the authorities to fast track the envisaged structural improvements in the policy framework to enhance monetary policy transmission and policy effectiveness. The crisis has exacerbated existing financial fragilities in nonfinancial corporate, banking and housing sectors. We encourage the authorities to address, in a timely manner, the identified risks threatening financial stability, including the high private sector debt, banks' deteriorated credit quality, intensified pressures on small banks, housing market valuations, and the fallout from the local government debt on the corporate and banking sectors.

We welcome the greater exchange rate flexibility that should continue to facilitate adjustment to a changing external environment post-crisis, as well as the recent measures to improve the functioning of the forex market. In our view, the use of CFMs in response to the crisis was appropriate and CFMs could be phased out gradually as external conditions permit.

The Chinese authorities should be commended for continuing their structural reform programs despite the crisis, including the adoption of a new foreign investment law, lifting foreign ownership restrictions in selected areas, and implementing multiple rounds of tariff cuts. *The report suggests that in spite of these measures, FDI is projected to remain stable in the medium term, and in some years below the pre-crisis levels. We would welcome staff's elaboration.* Looking forward, more substantive efforts are needed to strengthen the growth model, increase overall productivity and to tackle sectoral as well as public-private productivity gaps. We are pleased that the authorities are planning further SOE and market reforms that would boost productivity and are making advances in *hukou* reform. Addressing the structural shortcomings in the labor market and promoting labor market flexibility and mobility are also critical.

We welcome the authorities' focus on climate change issues and their plans to put in place concrete plans on green investment and climate change mitigation in line with international objectives and in close international cooperation. We are encouraged that, against the backdrop of elevated geopolitical tensions and trade, investment and technology frictions, the Chinese authorities stress the importance of a more open, transparent, and rules-based international trade and investment environment for the benefit of all. Technological decoupling and restrictions on high-tech products will be costly for all parties and are likely to have large negative spillover effects beyond the main parties. We welcome China's participation in the G-20 initiative to bring relief to low-income countries. Finally, we commend China's commitment to make an effective COVID-19 vaccine available to all countries, particularly to low-income countries many with limited financial resources.

We wish the authorities all the success.

GRAY/20/3749

December 15, 2020

Statement by Mr. De Lannoy and Mr. Tevdovski on People's Republic of China (Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for the excellent set of papers and Mr. Jin, Mr. Zhang, and Ms. Liu for the insightful Buff statement. We agree with the thrust of the report and would like to add the following comments for emphasis.

Economic outlook and risks

We agree with the staff assessment of the economic outlook and associated risks. China is the only major economy with a positive growth forecast in 2020 (about 1.9%). Still, growth remains unbalanced, as the recovery has relied heavily on public support, and in particular infrastructure investment, while private consumption has been lagging due to a spike in precautionary saving and restrained social interactions. The credit-driven and investment-heavy recovery could reverse recent progress in rebalancing, and exacerbate financial risks and high leverage levels. Credit growth has accelerated, the already very high corporate debt is expected to increase further, and the fiscal deficit is projected to almost double to 11.9% of GDP in 2020. Therefore, we see scope for a more prudent balancing of the competing objectives to support growth and contain leverage and prevent even deeper macroeconomic imbalances.

While the balance of risk to the growth outlook still lies on the downside, we find that some positive risks are underexposed. The most important one being the recent news regarding positive developments surrounding the vaccine. *Can staff elaborate if they expect effects on the growth outlook in a scenario of a sooner and wider available vaccine than assumed in the baseline projection?*

Fiscal policy

We welcome staff's extensive list of policy recommendations and broadly agree with the suggested policy mix to secure recovery and return to balanced growth. A balance should be found between consolidation and supporting economic growth. For now, the authorities continue to have some policy maneuverability. However, following staff's estimates, public debt will increase to 113 percent of GDP in 2025. As a result, consolidation in the medium-term, supported by transparent macro-fiscal frameworks, is necessary to prevent debt sustainability risks. Ideally, this should be done in tandem with enhancements to social safety and greater tax progressivity in the tax system to address high precautionary savings and income inequality.

Although we concur with staff's recommendation to shift policy support towards household demand, this should be conditional on the developments of the pandemic. Given that China's economic recovery has been driven by extensive public investments, staff rightly suggests a necessary shift towards supporting household demand to obtain a more balanced recovery. However, the extent and timing of stimulus, especially with regards to private consumption, should depend on developments concerning the virus and vaccines which determine the pace of the recovery of private demand.

Monetary policy

We agree with staff that in the short run a continued accommodative stance is warranted, while in the medium run the focus needs to be on further modernizing the monetary policy framework towards more market-based interest rates. This would strengthen the transmission of conventional interest rate policies and help improve credit intermediation. In addition, the use of non-interest rate instruments, such as the large expansion of re-lending facilities and increased targets for bank lending to certain sectors, has provided credit to vulnerable sectors when the normal functioning of financial markets was under threat. However, staff rightly recommends that phasing out of potentially distortionary measures is needed as the recovery takes hold and avoid an abrupt tightening of financial conditions.

Exchange rate flexibility continues to be important in facilitating adjustments to the changing external environment. We agree with staff that further liberalization of portfolio inflows and outflows would reinforce the role of markets in exchange rate determination.

We agree with staff that financial risks from central bank digital currency (CBDS) should be carefully monitored and assessed. A large-scale issuance may pose operational risks, from disruptions and cyberattacks, as well as challenges to privacy protection from the centralized collection and storage of user data. Also, CBDS expansion to include cross-border usage may have a destabilizing impact on exchange rate policy and the capital account framework, with implications on the international monetary system. Therefore, future staff assessment of the potential implications of CBDS is welcomed. We also support a more active role of the Fund in the design of a balanced international regulatory framework for digital currencies, which will help to properly manage the risks without negatively affecting the level playing field (i.e. by following the principle of 'same services, same risks, same rules'). The fragmented country-specific approach is not sufficient enough to deal with the risks.

Financial sector

We share staff's view that the pandemic has added to the many interconnected financial vulnerabilities. The crisis has increased both public sector and corporate indebtedness, while at the same time, many low productivity enterprises were supported. We agree with staff that the extension of forbearance measures through 2021 should proceed in parallel with actions aimed at reforming the banking sector. As supporting measures are gradually withdrawn, non-performing loans could increase, further weakening the balance sheets of troubled banks. Therefore, renewed emphasis should be placed on completing and enhancing the regulatory and supervisory frameworks. A comprehensive bank restructuring approach is welcomed, including an enhanced banking resolution scheme in line with international standards.

More attention should be given to the shadow banking sector. While in recent years, great efforts have been made in contracting shadow banking, the pandemic and economic slowdown may prompt regulators to rebalance the priority between curbing credit expansion and stimulating the economy. In addition, there could be an unintended consequence of skewing credit allocation towards inefficient SOEs. Tighter regulation and supervision of this sector are therefore required to level the playing field with private firms while preventing regulatory arbitrage.

Structural reforms

We agree with staff that the authorities need to accelerate reforms to strengthen the role of markets, increase competition, and foster openness. SOE reform, with particular emphasis on SOEs with non-viable business models and low productivity, should be a priority to ensure a level playing field between companies. In this regard, we would urge the authorities to strengthen their cooperation with the OECD's Governance Committee and the Working Party on Privatization Practices and State-Ownership. In general, the role of the market should be further strengthened by opening up, particularly services to private and foreign companies.

Technology decoupling, if it were to occur, poses a major challenge to China's productivity growth. While the authorities are taking this risk seriously and planning for more self-reliance by enhancing domestic innovation capabilities in sensitive sectors, these initiatives are often state-led with a risk that resources be misallocated, weighing down on productivity growth.

Green investment and climate change mitigation strategies would provide environmental, health, and economic benefits. We very much welcome China's recent commitment to achieving climate neutrality by 2060, thereby committing itself to an ambitious target to achieve the commonly shared goal of curbing global warming in line with the Paris Climate Agreement. For the short-term, stepping up green investments and adopting carbon pricing policies for sectors not yet covered would aid in fostering a green economic recovery. We believe that the staff report could have further benefitted from a more detailed analysis of critical climate change mitigation strategies, given the magnitude of the challenge ahead.

Helping solve global crises

We strongly support staff's view on the need to provide debt relief to low-income countries as agreed by the G20 and the Paris Club, as well as tackling climate change and contributing to a more open, stable, and transparent rules-based international trade and investment system. China's contribution to the improvement of global trading and investment system on multiple fronts should also include improvements in intellectual property rights and protections.

GRAY/20/3750

December 15, 2020

Statement by Mr. Chodos, Mr. Herrera, Mr. Lischinsky, and Mr. Morales on People's Republic of China
(Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for the clear set of reports and Mr. Jin, Mr. Zhang, and Ms. Liu for their informative Buff statement. After China was first hit by the Covid-19 virus, the authorities were successful in controlling local outbreaks through timely detection, targeted tracing, a strict lockdown of the Hubei province, and travel restrictions, measures that were critical to set the foundations for the ongoing economic recovery, supported by decisive macroeconomic policy measures. In this regard, we welcome the authorities' commitment to pursue prudent policies to foster sustainable and high-quality growth, as highlighted by Mr. Jin, Mr. Zhang, and Ms. Liu, which will generate positive spillovers for the global economy.

China's swift policy action continues to support steady economic recovery. The pickup in economic activity has relied on strong government support through a combination of financial relief and fiscal support to Chinese firms, including micro- small- and medium-sized enterprises (MSMEs). Lately, signs of rising private consumption have emerged, including rising retail sales and domestic travel during the October national holidays. However, the recovery has been somewhat uneven as person-to-person service activities remain weak because of social distancing policies, and precautionary savings increase in the face of long-standing social safety net limitations. The authorities have responded through expanding and accelerating unemployment insurance disbursements to help support households' livelihoods.

China's fiscal policy remains appropriately expansionary as the growth momentum consolidates. Fiscal support is still needed to help prevent a resurgence of the virus and support the recovery, and a positive growth-interest rate differential coupled with a high national savings rate ensures fiscal sustainability down the road. *In this regard, we wonder if staff could identify the reasons for the discrepancy between staff and the authorities on the extent of discretionary fiscal support.* Regarding public investment, caution is warranted given China's high public stock compared to peer countries, as further investment may yield diminishing returns. Moreover, local governments' funding gaps need to be addressed as they conspire against more effective fiscal interventions at the local level. Looking ahead, fiscal consolidation could be supported by a reduction in off-budget local government investment and tax reform within a comprehensive medium-term fiscal framework, as suggested by staff.

Accommodative monetary policy appears appropriate given below-target headline inflation and negative producer price inflation rates. Monetary policy has employed multiple tools to ensure sufficient liquidity and support balanced growth, including lower PBC rates, expanded lending facilities, lower reserve requirements, and lending and subsidy schemes, which had a sizable impact on bank lending. In addition, supportive financial policies have included regulatory forbearance for loan classification and repayment moratoriums for most MSMEs until 2021. We encourage the authorities to timely phase out these exceptional measures as the economy recovers and promptly return to the path of financial regulatory upgrading, especially as rising corporate and household debt entail latent risks. More broadly, monetary policy support should increasingly focus on a well-designed interest rate-based framework.

External demand for Chinese exports has continued to increase despite a difficult external environment. The pickup in external demand for Chinese medical and protective equipment combined with lower commodity prices explains a temporary widening of China's current account surplus. However, trade disputes and restrictions vis-à-vis the United States still affect the global environment and have hampered the reliability of global supply chains. Despite weak global demand and heightened geopolitical tensions, improved global risk sentiment has encouraged portfolio inflows, leading to RMB appreciation with limited PBC intervention in forex markets.

We welcome progress in structural reforms in several areas despite a complicated policy landscape. In particular, we welcome the Foreign investment Law, aiming at improving the business environment, the removal of caps and quotas for foreign investors, and measures to gradually open labor markets. Also, ongoing upgrades of the PBC Law and the Commercial Bank law aim at strengthening supervision and macroprudential management and enhancing governance, which should be complemented by improvements in the framework for bank and corporate restructuring.

We thank staff for the analysis of SOEs in the Selected Issues paper. SOEs' reform should resume, keeping in mind that SOEs and POEs have different objectives, with some SOEs providing social and non-economic services or goods, reaching a population or regions that is difficult to reach for POEs. *In this regard, the authorities suggest that the assumption of implicit government guarantees of SOEs' liabilities should no longer be appropriate given the recent treatment of SOEs' defaults, with corresponding risks being priced in bond markets. Staff's comments are welcome.* To better understand the relation between SOEs and POEs *could staff explain the relation of POEs' total assets to GDP in 2018 and how it has evolved since 2000?*

Social safety nets should be upgraded in line with staff's recommendations to build on progress on poverty eradication in 832 counties, as highlighted by Mr. Jin, Mr. Zhang, and Ms. Liu in their Buff statement. Finally, we welcome the authorities 'commitment to a green recovery through innovative financial products and the promotion of green investment.

With these comments, we wish the authorities and people of China the best in their endeavors in this challenging time.

GRAY/20/3751

December 15, 2020

Statement by Mr. von Kleist and Mr. Buetzer on People's Republic of China
(Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for its comprehensive and informative set of reports. We also thank Mr. Jin, Mr. Zhang, and Ms. Liu for their helpful Buff statement. With the outbreak of COVID-19 and the accompanying containment measures, the economy had to cope with a combined supply and demand shock. As a result, China experienced its first quarterly decline in output since records began in 1993 although the economy has by now returned to its pre-crisis growth path.

While we broadly concur with staff's appraisal and recommendations, we would like to highlight the following:

As outlined in the report and Buff statement, the swift recovery was a result of strong and timely containment measures as well as the fiscal and monetary support, which mitigated the impact of the crisis. There are, however, a number of significant downside risks to the short-term outlook, including a COVID-19 resurgence, a sudden tightening of (domestic) financial conditions, increasing default rates, and a further escalation of trade conflicts. Accelerated domestic debt accumulation and a potential downturn in the property market are further risks weighing on the outlook. Beyond the short-term recovery, the growth path appears subject to continued high uncertainty amid a more challenging external environment, underscoring the need to increase the economy's resilience towards adverse shocks to external demand.

We welcome the authorities' intention to strengthen domestic sources of growth and promote resilient, green, and inclusive growth. We note that the concept of *dual circulation* is aiming at a more balanced, high-quality growth model, concentrating on the large domestic market while simultaneously reducing reliance on exports of manufactured goods. At the same time, it will be challenging to strengthen domestic private consumption in the short term against the backdrop of a significant drop in the growth rate of average household income amid still weak labor market conditions and higher precautionary savings due to the crisis. *Could staff provide further comments on the concept of dual circulation, in* *particular whether it is intended to lead to a greater decoupling from external markets and thereby call into question the credibility of the strategy of market opening?*

We agree with staff that fiscal policy should remain moderately expansionary in 2021. As the recovery is gaining more momentum, we nevertheless consider it warranted to closely monitor fiscal developments in order to ensure a timely return to rebuilding fiscal space. Fiscal adjustment, led by reductions in off-budget local government investment and tax reforms to broaden the tax base, would be key to stabilize public debt over the long term.

In order to make fiscal support more effective and to facilitate economic rebalancing, we support staff's recommendation that funds should be shifted from infrastructure spending towards strengthening social safety nets and promoting green investment. A more comprehensive and effective social safety system would also act as an automatic stabilizer in future crises.

We agree that monetary policy should remain accommodative until there are clear signs that private demand has strengthened and inflation has risen to its target in a sustained manner. At the same time, and with the recovery being underway and financial markets stabilizing, we encourage the authorities to phase-out potentially distortionary measures. In particular, non-interest rate policies such as lending targets and window guidance may increasingly lead to credit misallocation and mispricing problems when in place for a prolonged period of time.

We take positive note that daily fixing of the exchange rate is now more market driven. Like staff, we welcome the removal of the reserve requirement on FX forwards and the phasing out of the counter-cyclical adjustment factor in the daily trading band's central parity formation. Moreover, a further opening-up of financial markets would strengthen the role of markets in determining the exchange rate. We agree with staff that publishing information on FX intervention would improve the transparency, credibility, and communication of the policy framework.

We agree with staff that the authorities should consider further measures to contain financial stability risks, including in the shadow banking system. As the recovery is gaining momentum, exceptional financial support measures such as relaxed NPL recognition standards and repayment moratoria should be phased out as they run the risk of undoing recent progress in strengthening bank transparency and governance. More transparent accounting of credit risks and classification of non-performing loans would allow to better assess adequate capitalization of banks. Moreover, a comprehensive bank restructuring and resolution approach is needed to strengthen the banking system. Additionally, regulatory and supervisory frameworks should be strengthened in line with FSAP recommendations.

We note that digital technologies can help to further improve the transmission of policy support to vulnerable households and firms. In this context, we agree with staff that the PBC's central bank digital currency (CBDC) could potentially promote financial inclusion and payment efficiency. At the same time, other consequences of the implementation of CBDC should be carefully considered. CBDC will increase competition in the payment market and put pressure on the business models of the dominating tech companies in the market. A crowding-out seems possible as costs associated with the use of CBDC are likely to be lower. Moreover, this could result in a deterioration in payment efficiency as technological innovation by market participants might diminish. Operational risks from potential disruptions and cyberattacks are further aspects that should be considered carefully.

On the structural side, we echo staff's call to implement key structural reforms, in particular to **let market forces operate more freely, further opening up of domestic markets, and reforming SOEs to ensure competitive neutrality**. However, the liberalization of the financial market should be well balanced in order to guarantee free market access for all competitors and to promote a level-playing field.

Looking at climate change mitigation and the status quo characterized by very high emissions and a strong reliance on coal, strong policy measures are needed to achieve China's ambitious goal to reduce CO2 emissions in a manner to reach carbon neutrality by 2060. We welcome the authorities' commitment to actively support the transition to a greener economy as described in the Buff statement. This process should be supported by a significant transformation of the current financial system to address the advent and needs of climate finance, including through the creation of financial instruments and structures. While we thank staff for a very insightful Selected Issues paper on monetary policy, SOEs, and local government financing, looking ahead we would like to encourage staff to also look into critical climate change mitigation strategies in greater detail, given the magnitude of the challenge ahead.

We welcome China's participation in multilateral efforts, including in the G20, to address global challenges. We look forward to further strengthening the constructive dialogue and cooperation in the different international fora in order to jointly promote a strong, sustainable, and inclusive recovery from the crisis. We welcome China's participation in the G20 DSSI, and we hope to see China's full and timely implementation of the agreed Common Framework. Active and constructive participation in multilateral debt discussions, underpinned by transparency, is crucial. We strongly support staff's comments on China's important role in providing debt relief to low-income countries as agreed at the G20 level, as well as in tackling climate change and contributing to a more open, stable, and transparent rules-based international trade and investment system.

Lastly, we encourage the authorities to consent to the publication of the staff report.

GRAY/20/3752

December 15, 2020

Statement by Ms. Mahasandana and Ms. Susiandri on People's Republic of China (Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for the comprehensive set of reports and Mr. Jin, Mr. Zhang and Ms. Liu for their informative Buff statement.

We commend the Chinese authorities for their swift and bold containment measures as well as macroeconomic and financial policy support, which successfully mitigated the adverse impact of the crisis and navigate the economic recovery. After experiencing a health crisis and a deep economic downturn due to the COVID-19 shock, the Chinese economy has rebounded very quickly which has also contributed significantly to the global recovery. That said, we cautiously note that its recovery remains unbalanced with heavy reliance on public stimulus and increased risk of financial instability and inequality. We welcome the authorities' strategy to adopt a "dual (internal and external) circulation" development pattern to support growth, as explained in the Buff. Going forward, policy mix should continue to be carefully calibrated to support a more balanced growth and promote financial stability. Given the large size of Chinese economy and its integration with many other countries, policy responses would affect not only the domestic economy but also its trading partners and global economy.

China could also play a vital role in multilateral cooperation to overcome many global challenges in this current juncture. We are encouraged by the authorities' strong commitment to ensure that any vaccine developed in China would be widely available to all countries. Amidst high uncertainty of the COVID-19 crisis, availability and affordability of vaccine is deemed to be "a game changer" in the global landscape to support economic recovery. We also appreciate China's contribution in the G20 DSSI and efforts to help LICs coping with their elevated debt due to the global pandemic crisis. At the same time, we continue to encourage China and its trading partners to keep working constructively on longstanding issues to resolve trade and technology tensions. We underscore our support for the open, rules-based multilateral trade system as this would bring benefit to the global economy.

On the domestic front, continued fiscal policy support is warranted in the near term to buttress economic recovery, before shifting to consolidation to preserve fiscal sustainability. Given strong fiscal support in 2020 to mitigate economic fallout due to the crisis, we underscore the need to maintain moderately accommodative fiscal stance in 2021 to facilitate the recovery. In this regard, we share staff's view that fiscal policy should be more targeted to stimulate private demand, while reducing reliance on public sector stimulus and enhance the efforts to rebalance the economy. This includes various measures to strengthen household supports, particularly to low-income segment. It will be aligned with the authorities' concerted efforts to alleviate poverty and reduce inequality. We take positive note of the authorities' emphasis on sustainable fiscal policies and the need to balance between containing the fiscal risks arising from higher public debt and continuing to support economic growth. We take comfort in knowing the authorities' commitment to putting more effort to prevent and mitigate potential risks associated with local government debt as stated in the Buff. In this respect, we view that fiscal data that are classified to accurately reflect fiscal operations and debt obligations would be essential for the calibration of effective fiscal policy responses and communication with the markets. We note the difference of views between staff and the authorities over the concept of general budgetary and debt, while recognizing the authorities' view on how financial obligations from SOEs or LGFVs are treated under the 2014 Budget Law. *Could staff provide further comment on the policy implication of this different view and the plan to resolve this?* Looking ahead, we see merit on staff recommendations to further improve macro-fiscal frameworks, reduce misalignment in central-local fiscal responsibilities and leverage digital technologies. Staff's recommendation to establish a comprehensive medium-term macro-fiscal framework, including setting fiscal policy target consistent with fiscal sustainability and macroeconomic stability is commendable. Moreover, to strengthen intergovernmental (central-local) framework, we value staff's analysis on Selected Issues Paper (SIP).

We welcome the progress in reforming the monetary policy framework and see some room for continued improvement of the framework going forward. We positively note the PBC's steps to gradually reform its interest rate regime to enhance monetary policy transmission. Nonetheless, we see merit in the continued efforts to strengthen the framework, including further reform on the interest rate framework, so as to improve market efficiency and strengthen the effectiveness of monetary policy. However, we underscore that it should be phased in accordance with economic development with clear communication with market participants to avoid any potential disorderly adjustment, which could be counterproductive to the economy. We welcome the PBC's commitment to enhancing exchange rate flexibility to facilitate external adjustment. On the publication of FXI data, we reiterate our view that it should be done cautiously, taking into account the country-specific circumstances to avoid any unintended consequences from publishing such data that could dampen the effectiveness of the operations. Overall, we support the authorities' moves to further open up the economy and to move towards a market-based mechanism.

Financial stability risks merit greater attention as vulnerabilities elevate in corporate, housing and banking sectors. We appreciate the authorities' works to address troubled banks and strengthen market discipline, which in turn improve banking sector resiliency as reflected in the recent stress test. We note staff's advice on the need to set up a comprehensive bank restructuring framework to address vulnerabilities in the banking sector, including by establishing a temporary resolution fund backed by fiscal budget. In the meantime, the authorities raise their concerns on the resolution fund, citing that it may amplify moral hazard. *We would like to invite staff to further comment on the appropriate safeguards to minimize its associated risk, drawing lessons from other countries' experiences.*

We appreciate the substantial reform agenda that has been implemented in China, while more remains to be done. Reform progresses in many areas, such as financial sector and labor markets are encouraging, but there is scope to step up effort to further promote a balanced growth and secure recovery, including continue SOE and market reforms to advance the role of private sector and to boost productivity. We understand that the COVID-19 shocks has been limiting the progress on structural reforms. Going forward, the authorities' intensive efforts to reform SOEs should be continued, while noting that SOE reform process might be quite complicated as they often provide many social and non-economic functions. *We invite staff's further explanation on their advice to remove "implicit guarantees" in the context of SOE reforms*, *considering the recent cases of default of bonds issued by SOEs.* Finally, in regard to promoting green economy, we commend the authorities' ongoing work on the detailed plan to effectively reduce CO2 emissions. We concur with Chinese authorities that a close multilateral cooperation is needed in order to achieve the commonly shared goal of reducing global warming.

GRAY/20/3753

December 15, 2020

Statement by Mr. Tanaka, Mr. Chikada, and Mr. Nagase on People's Republic of China (Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for the informative report and Mr. Jin, Mr. Zhang, and Ms. Liu for the insightful buff statement.

China was the first country to be affected by the COVID-19 outbreak in the world, and, in the first quarter, the COVID-19 crisis caused severe negative impacts on the Chinese society and economy. However, according to the public announcements of the authorities, the spread of the coronavirus in China has been well contained, and the economy continues its fast recovery. In this regard, we welcome the authorities' swift and forceful containment measures and supports through the macroeconomic and financial policies. On this point, we welcome the staff's analysis on the China's Exit Strategy from the crisis in BOX 1. *We note staff cautions that the baseline is built on "the strong assumption" that risks remain contained. On this point, we think this assumption seems reasonable, and would like staff to elaborate the background why they consider the assumption as "strong," particularly considering the authorities' successful containment of the virus so far and recent developments of the vaccine.*

In order to realize a resilient recovery from the crisis as well as sustainable and balanced economic growth, and also to fully contribute to "Helping Solve the Global Crisis", it is imperative for China to continue to steadily implement various policy reforms. Especially, it is essential for the authorities to enhance transparency on various fronts, particularly on fiscal, monetary, structural and trade issues.

Fiscal Policy

The authorities' sizable discretionary fiscal measures to address the crisis have boosted the Chinese economy. We agree with the staff's view that the authorities should maintain a moderately expansionary fiscal stance in 2021 to support the economy. However, given the recent sharp increase of the public debt and the staff's projection that it will continue to rise over the medium term, great fiscal consolidation efforts would be indispensable for China. To this end, we encourage the authorities to establish a comprehensive macro-fiscal framework, including the fiscal policy targets and medium-term macroeconomic and fiscal forecasting. In addition, we urge authorities to enhance transparency in fiscal policies to bolster market confidence, improve public investment efficiency, and support anti-corruption efforts.

Utilizing fiscal policies is also important to tackle the emerging challenges which are discussed as Key Priorities in the Fund, including inequality and climate change issues. As staff points out, we encourage the authorities to implement policy reforms such as strengthening social safety-nets, increasing the progressivity and efficiency of the tax system, improving carbon pricing policies, and expansion of green investment.

Improving fiscal situations of the local governments, which was also discussed in the China 2019 Article IV Consultation, remains as one of the critical challenges of China. Due to the current crisis, circumstances surrounding the local governments have worsened, and the risks have been elevating. We note the staff's analysis that this problem has caused negative spillovers on the corporate and banking sectors. We strongly encourage the authorities to conduct reforms on both expenditure and revenue policies such as decreasing off-budget investments and broadening the tax base, as well as reducing the long-standing misalignment of central-local fiscal responsibilities.

Structural Reform

In order to improve the productivity and increase potential growth in the medium-term, China should continue SOE reforms and expand the role of the market. From this perspective, we support the staff's policy recommendations that the authorities should remove the implicit guarantee for SOEs and make efforts to improve governance, including enhancement of transparency.

We understand the "dual circulation", which is discussed in BOX 9, is a model which is led by domestic demand and domestic and international markets reinforce each other. In this regard, staff points out that opening the domestic market, enhancing social security system, and SOE reforms would be the anchor of long-term economic growth. However, *we recognize aging, which will reduce the domestic savings in the future, and accumulation of corporate debt and non-performing loan could be constrain investment in China, and we would like to hear staff's views that whether the expansion of domestic demand envisaged in the dual circulation would be sustainable in the long-term.*

Monetary and Financial Sector Policy

Once the crisis abates and the economic recovery get back on track, China should proactively address financial vulnerabilities and risks. The accumulation of corporate debt and increase in non-performing loan have been structural issues even before the current crisis in China. We have a concern that financial positions of banks could be deteriorating and becoming more vulnerable due to the exceptional crisis response measures such as relaxation of non-performing loan recognition criteria and debt repayment deferment for SMEs. In this regard, *we would like to ask staff's comments on prospects of the financial sectors as follows*:

1) Increased lending to unproductive companies and relaxation of non-performing loan recognition criteria could exacerbate corporate debt and non-performing loan problems. On this point, how do staff see the authorities' risk recognition and management? We would like to hear staff's views on possible timeline and sequencing regarding termination of the exceptional measures, disposal of non-performing loans, and bank restructuring.

2) We note the number of SOEs defaults is increasing and the scale of bond defaults is the highest ever this year and wonder whether the authorities' stance towards SOEs has changed markedly, and we welcome staff's views. In addition, we would like to ask whether such increase of defaults can lead to future difficulty in raising funds in the bond market by sound borrowers and possibly systemic risk? If the risks materialize, to what extent do the central and local governments bear the fiscal burden?

3) How do staff see the developments in real estate prices and its ramifications to the financial system given the potential long-lasting impact on demand for office and retail spaces in the context of the "pandemic normal" economy?

Analysis and careful monitoring on the development of the PBC's central bank digital currency, e-CNY, are warranted. China is one of the first major countries to start exploring an introduction of CBDC, and in this regard we welcome BOX 8 which analyzed its development. However, as mentioned in the G7 statement issued in October, the stability of domestic payment systems and international monetary systems is underpinned by the public sector's credible and long-standing commitment to transparency, the rule of law and sound economic governance. We strongly encourage staff to work on CBDC issues taking into account of these points.

As to the AML/CFT, although we positively note that the Financial Action Task Force (FATF) recognizes the progress of the reforms in China, the authorities should continue their efforts to enhance the framework to improve risk management of the financial sector.

External Sector

The authorities should continue their efforts to make the exchange rate more flexible and market determined. We also urge the authorities to disclose information on their exchange intervention in more timely manner. We note staff proposed to consider tightening existing CFMs in line with the Fund's Institutional View if market conditions get disorderly, however, we would like to emphasize this should be conducted in transparent and temporary manner as staff points out, and it should be gradually phased out in the medium-term.

Opening of the financial sector has advanced, but further efforts are needed. We positively note that the authorities have made progress to open the markets to foreign investors, including the shortening the negative lists for foreign investment and removing foreign ownership caps on securities, fund management, futures and life insurance companies. On the other hand, we recognize there are still some problems such as non-transparency of regulations on capital transaction, law enforcement and tax system. We encourage the authorities to implement further reforms to build up a desirable investment environment as well as international standard based laws and regulations. Also, while investments by foreign investors to China are increasing, we recognize those investments are concentrated in bonds issued by the government and public financial institutions, and the liquidity of the corporate bond market is still low. Furthermore, improving credibility of the Chinese rating companies and enhancement of transparency of the Chinese corporations' information would be essential. *We have* *a concern that inadequate transparency and distortion of the markets can be a risk of the financial market. Staff's comments are welcome.*

Helping Solve the Global Crisis

On this point, we note the authorities' efforts so far. At the same time, we underscore that the international community as a whole needs to further strengthen policy responses and global cooperation to tackle global challenges, particularly at this critical juncture. From this point of view, we would like to point out that whether it is appropriate for the Fund to send a message like "China 'should continue to lead' multilateral efforts to address global challenges" in the report.

On the debt issues, China should make further efforts as the largest official creditor. The common framework for debt treatments beyond the DSSI, which was agreed by G20 countries, aims to facilitate timely and comprehensive debt resolution and it is an indispensable international collaboration to realize the recovery of the debt sustainability of developing countries. We urge the Chinese authorities, including the CDB, to steadily and transparently implement the debt treatments following the common framework. We also note that the authorities recognize the importance of debt data transparency, and thus expect that they fulfill their responsibilities to ensure accuracy and improve transparency of the debt data. To this end, it is essential for the authorities to fully cooperate with the debt data reconciliation of the Fund and the World Bank.

Last but not least, **we support the staff's view that more open, stable, transparent, and rules-based international trade and investment system will bring benefit for China and the global economy**, and we encourage the authorities to make further efforts on this front.

GRAY/20/3754

December 15, 2020

Statement by Ms. Riach and Mr. Chrimes on People's Republic of China (Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for a thought-provoking report. We agree with the key messages in their appraisal. We also thank Mr. Jin, Mr. Zhang and Ms. Liu for their helpful buff statement.

Since mid-March, China has been successful in containing the virus domestically and the economy has recovered rapidly. COVID-19 has caused havoc around the world since its detection in Wuhan. But after a difficult first few months, the Chinese authorities appear to have contained cases and kept them low. The authorities' containment strategy has been tough and targeted, supported by policies that helped the public health response; this in turn has enabled a quicker and more sustained reopening than has been possible in many other countries. As staff note, fiscal and financial sector measures have also played an important role in supporting the economy. Taken together, that is why China is set to be one of the few countries to register positive growth in 2020.

Nevertheless, there is some uncertainty about the sustainability of the recovery, and about China's medium-to-long-term growth prospects. While policies seem to have succeeded in reversing the initial economic shock and stronger growth is likely next year, some of the indicators and imbalances which were being addressed before COVID-19 have deteriorated further. We agree with staff that key structural issues merit significant attention: tackling them successfully is a daunting task which will take time but should not be deferred. SOE reform, continuing to erode "implicit guarantee" perceptions, and competitive neutrality are all key to boosting total factor productivity growth. That in turn is essential to sustain GDP growth as the working-age population declines and falling returns on investment weigh on capital stock growth. A more effective and comprehensive social safety net to offer better protection and reduce high private savings should also be a long-run objective.

The underlying health of the financial sector remains a concern; containing risks while maintaining the supply of credit to support efficient private sector investment will be key. Debt-to-GDP rose further this year due to extensive credit easing. There are signs that this has supported the real economy – including small and medium sized enterprises – but credit quality may have deteriorated in some areas. This could lead long-standing financial sector risks to crystallize. Several high-profile state-owned enterprise defaults have led to tightening credit conditions. The People's Bank of China (PBC) stress tests suggest that a large share of Chinese banks would struggle even under moderate stress scenarios, although the capital requirement threshold for passing the tests is more stringent than many advanced economy stress tests. Stress tests also highlight that small banks are vulnerable to a sharp increase in NPLs and are generally more risky than large banks, with lower capital buffers and provisioning.

We welcome the authorities' gradual move towards a more market-oriented framework to deal with troubled banks. This was emphasized in the PBC's 2020 Financial Stability Report, and the recent approach of taking over and restructuring banks rather than bailing them out is consistent with this. Regulators have also called for increased bank capitalization, provisioning, and asset disposal to mitigate risks from NPLs and corporate defaults. Navigating these challenges should continue to be a priority for economic and financial policymakers.

We agree with staff that monetary and exchange rate policies should be more market-based. A larger role for market forces could strengthen the monetary transmission mechanism and improve credit allocation. Further exchange rate liberalization is also required for China to open up its capital account and promote RMB internationalization. China has made progress in opening up the financial sector, through abolishing investment quotas and allowing more fully foreign-owned firms to operate, but there is further to go in terms of liberalizing its capital account. Recent reforms have focused on liberalizing inflows, but opening up in both directions will likely be needed to materially enhance China's integration into the global financial system.

In the near term, the policy stance needs to be carefully calibrated to play a supportive role for the economy and avoid inflaming risks. While monetary and credit policies may need to turn towards containing risks, premature monetary tightening could inadvertently inflame financial stability risks. The report sets out extensive steps to improve financial stability without restricting credit supply across the economy. One risk not covered in the staff report is deflation. Consumer price inflation dipped negative in November, for the first time since 2009. A deflationary spiral could lead households to defer consumption (further hampering private demand), as well as reversing the steady erosion of debt by inflation (complicating the financial stability challenge). On the fiscal stance, the authorities should stand ready to continue expansion if – as is the case now – sovereign bond yields remain low and tight financial conditions for the private sector persist. We continue to see value in staff's augmented debt and deficit analysis, noting that this is "staff's best estimate". The concepts provide a helpful perspective in understanding the timing and pace of quasi-fiscal stimulus, and of government debt sustainability, though we note the authorities' argument that local governments have not borne legal responsibility for market entities such as SOEs since 2014.

We agree with staff that initiatives like the PBC's central bank digital currency could potentially promote financial inclusion and payment efficiency, though there are risks

too. Careful coordination – domestically and internationally – is needed to manage risks. While the box offers some insights on the PBC's efforts, it is difficult to do justice to a complex issue in a single side; an explicit reference to staff's recent policy paper, which offers a more detailed set of considerations, would have been helpful.

We welcome China's participation in multilateral efforts, including in the G20, to address global challenges. We look forward to further strengthening constructive dialogue and cooperation across different international fora, including to jointly promote a strong, sustainable, and inclusive recovery from the crisis. We welcome China's participation in the G20 DSSI, and we hope to see its full and timely implementation of the agreed Common Framework. Active and constructive participation in multilateral debt discussions, underpinned by transparency, is crucial, given the current and growing pressures facing developing countries and the scale of Chinese investment. On climate change, President Xi's 2060 net zero commitment is globally significant; we look forward to concrete near-term actions – both within China and in its overseas activities – to reduce greenhouse gas emissions.

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GRAY/20/3755

December 15, 2020

Statement by Mr. Rosen, Ms. Shortino, and Mr. Westphal on People's Republic of China (Preliminary)
Executive Board Meeting 20/122
December 17, 2020

Overview

We would like to thank staff for this Article IV; and Mr. Jin, Mr. Zhang, and Ms. Liu for their informative buff, and we appreciate the renewed commitments to opening up the Chinese economy to foreign investment and to strengthening intellectual property rights. China's aggressive containment and testing measures following the outbreak of COVID-19, combined with targeted fiscal and monetary easing, facilitated an impressive production-led recovery in economic activity in the second and third quarters of 2020. On the whole, however, the Article IV's focus on these on short-term measures and lack of a deeper discussion of China's medium-term structural challenges is disappointing – and inconsistent with the treatment of the United States in its Article IV, for example. This resulted in an overly sanguine assessment of China's economic issues as well as its role in the global economy. In particular, we would have appreciated more analysis about reforms in FX intervention transparency, monetary policy, state-owned enterprises (SOEs), and the financial sector that are necessary to sustain China's economy over the medium term.

Macroeconomic Outlook

Regarding the analysis of this year's economic recovery, the report could have done more to highlight that China's recovery has been imbalanced, with domestic supply outpacing domestic demand, resulting in a wider external surplus this year. Further stimulus should be geared towards strengthening social safety nets and supporting household income growth, which will be key to any durable recovery in private consumption. Staff forecast a sizeable drop in gross national savings in 2021 from 45 percent to 42.7 percent of GDP. This is a large year-on-year move and seems unrealistic given evidence of higher household precautionary savings amid falling household incomes and the IMF's projection that fiscal policy will remain broadly neutral in 2021. More discussion of the projected decline in household savings and its relation to the significant rise in projected consumption would have been useful.

Fiscal

We support staff's recommendation for additional fiscal stimulus in 2021, but we were troubled by the recommendation that fiscal policy should turn to consolidation in 2022. Doing so without implementing fiscal structural reforms to replace off-budget spending by local governments with broadening the social safety net, for example, would result in an overall widening of China's external surplus. *Can staff provide estimates on the portion of the 4.7 percent of GDP in discretionary fiscal measures adopted this year that went toward boosting household consumption?*

We appreciate the focus on local government finances, particularly the IMF's continued focus on estimating the augmented fiscal deficit, in the Article IV sections on fiscal policy, the Debt Sustainability Analysis, and the Selected Issues Paper chapter on fiscal risk-sharing. Current practices conceal that China's public finances are now much weaker than they appear. Additional fiscal spending by local governments should be on-budget, and additional implicit debt issuance should be discouraged. In this regard, we are concerned by anecdotal reports that much of the new debt issued by local governments in 2020 has been used primarily to roll over existing debt. We would have appreciated more discussion about the need for a local government insolvency mechanism.

Monetary

We appreciate staff's discussion of monetary policy and concur with recommendation to strengthen the effectiveness of interest rate transmission, including with rapid implementation of deposit and lending rate reform. *What specific monetary policy mechanisms would staff recommend that the authorities pursue to avoid worsening existing bubbles, particularly in the property sector?*

Currency/Exchange Rate

Staff's discussion of exchange rate issues was particularly light. By pointing only to depreciation during 2018-19 amid U.S.-China trade tensions, the report bypasses a more substantive discussion of the objectives of China's exchange rate regime and its tools, such as the relationship between the Central Bank and Chinese state-owned banks. The report also failed to analyze China's limited official reserve accumulation this year amid a growing current account surplus and portfolio inflows in the second and third quarters. We strongly agree that publishing information on FX intervention would improve the transparency, credibility, and communication of the policy framework. China should fully disclose its FX intervention figures on a regular, public, and comprehensive basis. *Do staff consider China to meet the high data transparency standards that are a feature of currencies in the SDR basket?* While we appreciate staff's discussion about the removal of several capital flow measures, staff could have considered that these policy actions also provide market signaling to manage exchange rate flexibility around the capital flow cycle.

Balance of Payments/Trade

The widening of China's current account surplus reflects pandemic-related trends that have increased China's goods exports and reduced goods imports due to lower commodity prices. Significantly, China's trade deficit in services has narrowed due to the sharp drop in outbound tourism. In this context, China should undertake much more aggressive fiscal stimulus, including social safety net reforms, to help reduce precautionary savings and place China on a trajectory towards a more durable external balance.

While we agree that the external environment is difficult, we would welcome more discussion on the global challenges beyond tensions with the United States. References to U.S. national security concerns seem misleading, particularly without further explanation of the underlying issues that drove those U.S. measures such as human rights violations (Xinjiang) and the undermining of democratic processes (Hong Kong). The discussion of restrictions on financial flows through Chinese financial institutions operating in Hong Kong is speculative and disregards recent Chinese actions that may have diminished Hong Kong's attractiveness as an investment center. The IMF's focus on goods purchases under the Phase One Trade Agreement is misleading given the breadth of the agreement and its inclusion of structural reforms in agriculture, forced technology transfer, intellectual property rights enforcement, and financial services. Staff's analysis also leaves out trade disputes initiated by China, such as ongoing import restrictions that China imposed on a wide range of Australian goods exports. We look forward to a more balanced discussion in the next Article IV report.

Structural Reforms and the Real Economy

We agree that more progress is necessary in real sector reform, especially with respect to SOEs. We echo staff's assessment that there has been little tangible progress in SOE reform and that SOE deleveraging has reversed this year. We also concur that a larger role for markets and reducing barriers in the service sectors would improve productivity growth. *What do staff believe is the appropriate sequence to advance SOE reforms while balancing financial stability risks?*

We welcome staff's emphasis on social safety net reform given the need for households to reduce precautionary savings and boost consumption. The discussion of gaps in China's unemployment insurance framework, while brief, was helpful. We continue to believe that China's reported unemployment figures do not capture large numbers of migrant workers. We would have appreciated more discussion of land market reforms that would incentivize greater numbers of migrant workers to register as urban *hukou* holders.

Financial Sector

We agree that the authorities' measures following the pandemic have deepened indebtedness and exacerbated existing structural problems in the financial sector, ultimately increasing financial stability risks. The 10-percentage point increase in corporate debt levels this year seems to have undone some of the progress achieved during the deleveraging campaign. We also agree that regulatory forbearance including the easing of NPL recognition standards may be masking challenges in the banking sector.

China should establish and implement a nationwide bank resolution regime in line with international standards. A temporary and fiscally backed resolution fund to support the orderly exit of non-viable banks may be challenging to utilize effectively, and success would depend significantly on data transparency and NPL recognition. Insufficient safeguards may allow non-viable banks to continue operations or draw out resolution processes while draining public resources, and the use of funds for public recapitalization should be a last resort. *What safeguards do staff consider most important to mitigate moral hazard in a new Chinese bank resolution regime?* We also note that any well-functioning distressed debt market will require greater transparency from Chinese financial institutions.

We concur that ending moral hazard within China's financial system will be important. *How would staff recommend that China safeguard against financial sector volatility that would follow a repricing of bonds and bank loans to better reflect credit and counterparty risk?* Deposit rate liberalization will also be important for the medium-term health of China's financial sector.

Though we agree that important progress has been made in financial sector opening, we would have welcomed more discussion of the significant barriers that remain. While China has removed formal ownership caps across many financial services areas, a lack of regulatory transparency, burdensome licensing procedures, and data restrictive policies continue to limit foreign firms' ability to fully benefit from the removal of equity caps.

Central Bank Digital Currency

We are also concerned about the cursory review of China's Central Bank digital currency (CBDC), as the CBDC may pose unique or heightened risks to privacy and consumer protection, operational risks, and financial integrity. Widespread adoption of China's CBDC 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 authorities expand the CBDC to include cross-border usage. The IMF has a responsibility to its membership, particularly given the RMB is in the SDR basket, to provide a full analysis of the potential domestic and international implications of this project.

China's Role in the Global Economy

We agree with staff that China has a significant role to play in multilateral efforts to respond to the crisis and support the global economy. However, in the last nine months Chinese efforts have fallen short, in part as a result of its decentralized and nontransparent approach to official lending. For example, Chinese participation in the DSSI has been uneven, Chinese disclosure of debt data has been inconsistent, and delays in restructuring or reprofiling Chinese debt have prevented several IMF programs from moving forward in a timely manner. To that end, we were surprised by the staff report's language that "China should continue to lead multilateral efforts to address global challenges." Further, it is unclear why staff felt the need to call out China's role in multilateral efforts so directly when many countries play key roles in multilateral coordination.

GRAY/20/3756

December 15, 2020

Statement by Mr. Mozhin and Mr. Tolstikov on People's Republic of China (Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for the set of informative papers and Mr. Jin, Mr. Zhang and Ms. Liu for their helpful Buff statement. China was the first country, which successfully contained the COVID19 pandemic. The authorities' policy response helped mitigate economic impact of the shock and support the recovery. The implementation of structural reforms continued in an orderly way, including the opening up of the Chinese economy to foreign investors and strengthening of the financial system. The robust recovery of the Chinese economy provides the needed support to the ailing world economy. That said, the developments in China are not without potential risks, and the authorities should remain vigilant and proceed with their reform agenda. We broadly agree with the staff assessment and will make a few comments for emphasis.

Strong recovery of economic activity since the second quarter was driven mostly by investments. Recovery in private consumption was trailing behind, constrained by pandemic containment measures and by precautionary savings increase. However, recent data show that private consumption is also gaining pace, which will rebalance growth going forward. Exports and imports held strongly, to the benefit of China's trade partners. It is also encouraging that growth becomes "greener" and China remains a world leader in renewable power and electric vehicle deployment.

Despite broadly positive outcomes, numerous risks, mostly exogenous, can still affect the Chinese economy. First, there is still a possibility of the second wave of the pandemic affecting China, although the development of vaccines is diminishing this risk over time. Second, financial sector risks have increased in 2020, as private and public debt have risen substantially, while regulatory forbearance masked the deterioration of debt quality. Third, the US may broaden its campaign to contain China, widening sanctions and attempting to engage its allies into these efforts. In this regard, the authorities should continue their prudent macroeconomic policies, while remaining committed to further structural transformation and international cooperation. In the near future, continued policy support is needed, with policies aimed at strengthening private demand and addressing financial vulnerabilities.

Monetary policy response played an important role in countering the crisis. The specificity of the China's response was that a substantial increase in lending to the economy was driven by non-interest rate instruments. It was warranted, as interest rates reforms in China remain incomplete, and the authorities used the available policy tools. Advantages of purely interest rate-based approach could be discussed further. Going forward, the monetary policy stance should remain accommodative, until there are clear signs that private demand has strengthened. We welcome continued liberalization of the exchange rate regime and phasing out some CFMs. The PBC should continue to maintain the flexibility of the exchange rate, keeping it at the equilibrium level.

Managing risks to financial sector stability is becoming more urgent, as public and private debt is growing. We note the authorities' assessment that China's financial system remains broadly stable and resilient. Risks are facing mostly small- and medium-sized banks, and the overall loss absorption capacity of the banking sector remains strong. In this regard, exceptional financial support measures, including relaxed NPL recognition and repayment moratoria, could be phased out as economic recovery becomes entrenched. The authorities are encouraged to continue their regulatory and supervisory reforms, while strengthening bank resolution and restructuring framework.

China is moving forward in the area of central bank digital currencies (CBDC). The PBC's digital currency, named e-CNY, is currently being tested across several regions and electronic payment platforms. The authorities emphasized the domestic purpose of the e-CNY, but the significance of this step could not be underestimated. China is the first country among the G20, which entered such an advanced stage in the CBDC deployment, and this may have a significant impact on global developments in this area. *We would encourage staff to pay further attention to the Chinese experience and provide more information in the next Article IV report.*

Continuation of fiscal support should be balanced with the considerations of debt sustainability. The discretionary fiscal measures amounted to about 4.7 percent of GDP. On top of that, the pandemic caused a decline in revenues and additional automatic expenditures, resulting in augmented deficit of about 18 percent of GDP, in accordance to staff estimates. Augmented public debt is set to increase to 92 percent of GDP by end-2020. While deficit is high, debt sustainability benefits from a favorable growth-interest-rate differential, so that the debt ratio is not rising as fast as it could otherwise. Nevertheless, we agree that as soon as the recovery is entrenched, fiscal policy should turn to consolidation.

We note a continued use of the concept of “augmented public debt” and “augmented fiscal deficit” despite constant objections of the authorities. Taking into account the huge difference between the “standard” and “augmented” data, as well as the need to provide internationally comparable data, we urge staff to provide full explanation of their approach and objections to the authorities’ arguments. *We encourage staff to produce a selected issue paper or the staff working paper on this matter. Staff comments would be welcome.*

Even during the COVID19 pandemic, the authorities have been moving forward with their structural reform agenda. We welcome the continued opening up of the economy to foreign investment, especially in the financial sector. Labor and product markets reforms are continuing, including the relaxation of *hukoi* restrictions and developing capital markets. However, there is still room for reforms in the SOE sector and financial sector. Mutually reinforcing structural reforms, including strengthening the social security system and opening up the service sector, could boost potential growth and increase the efficiency of the economy. We also welcome the authorities’ strategy to support lower-carbon growth and green investment.

With these remarks, we wish the authorities further success in their endeavors.

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GRAY/20/3757

December 15, 2020

Statement by Mr. Mohieldin, Ms. Abdelati, and Ms. Choueiri on People's Republic of China
(Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for a comprehensive report and Mr. Jin, Mr. Zhang, and Ms. Liu for an informative Buff Statement.

The Chinese economy bounced back quickly from a sharp and unprecedented recession in the second quarter, aided by bold health and economic measures that were rapidly deployed. We note staff's emphasis on the need to switch from the public to the private sector as the main driver of the economic recovery and future growth, and to address preexisting and now rising financial sector vulnerabilities. We appreciate the graphic overview in Table 7 and discussion of progress on rebalancing, which was partly interrupted this year, especially with respect to environmental rebalancing.

We agree with staff's recommendation that the **macroeconomic policy should remain moderately expansionary in 2021 and be adjusted to the pace of the recovery**, with the policy mix reoriented toward supporting more balanced growth. In this regard, we agree that shifting from infrastructure spending towards strengthening social protection and promoting green investments will help secure a recovery more balanced toward private consumption and achieving environmental goals. We also agree on the merit of phasing out potentially distortionary lending targets and lending rate guidance as the recovery takes hold. Further modernization of the monetary policy framework to strengthen transmission of interest rate policies will help improve intermediation. Over the medium-term, a fiscal policy that focuses on high-multiplier spending and making the tax system more progressive would help to moderate debt, including off-budgetary government liabilities.

A major achievement that we want to highlight is China's eradication of extreme poverty in 2020, SDG #1, ten years ahead of its target date. This accomplishment is the outcome of its bold growth strategy and major reforms across sectors. We note that the pandemic has heightened concerns over inequality and the need to further strengthen the social safety net, which would help reduce the high private savings. Improved intergovernmental coordination would be important, including to further strengthen the automatic and non-regressive features of the fiscal transfer mechanism. We welcome the use of online service platforms to provide unemployment benefits and employment subsidies in a timely manner during the pandemic. We would encourage further use of digital technologies to help improve the transmission of social policy objectives. In this regard, we note that the central bank's digital currency, the e-CNY has the potential to promote financial inclusion and payment efficiency, but would need to be carefully monitored as it could also bring new risks of disruption or cyberattacks, and cut support to vulnerable firms and households.

The pandemic has also heightened **financial risks**. It will be important to resume financial regulatory strengthening to help contain corporate leverage and reduce shadow banking risks. In the near term, as the recovery takes hold, it will be important to reverse the easing of NPL recognition standards and the repayment moratoria and to replace them with efforts to address problem loans.

We commend the advancement of **structural reforms** despite the pandemic. We welcome the progress in of hukou reforms [residency permit system], opening of the financial sector to foreign investment, and amendment of the patent law to better protect property rights. We take note of staff's background Selected Issues paper on the SOE sector which identifies the productivity gap between the public and private enterprises that reflect significant resource misallocation through higher capital intensity. We are encouraged that the authorities have already reduced SOE leverage and are working on removing the legacy of social responsibilities and noneconomic functions. The Buff also indicates that "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." We look forward to improvements in governance through corporate boards and to pursuing mixed ownership reforms. We also encourage steps to improve market competition and to ensure equal access to credit. We fully recognize from other country experience, that such reforms take a lot of time.

We welcome the authorities' reaffirmation of President Xi's announcement of **climate goals** and agree with their emphasis on the need for more global cooperation in this area. We look forward to the authorities' completion of the detailed plans to effectively reduce CO2 emissions while recognizing the immense challenge of achieving carbon neutrality before 2060.

We commend China for its readiness to **take a leading role in global solutions to overcome the global health and economic crisis.** Its participation in global efforts to bring relief to low-income countries through the DSSI and the Common Framework for debt treatments beyond DSSI is commendable. We, therefore, welcome the authorities' agreement that data transparency is important for debt sustainability assessments and their intention to further upgrade environmental criteria for overseas lending projects. China can also facilitate a durable solution to the economic issues underlying the trade and technology tensions to reduce uncertainty and boost global trade. Its stance on removing trade restrictions on high-tech products to help promote trade and reduce external imbalances. We welcome China's financial support to the WHO this year which has helped the global effort to deal with the pandemic. We commend its readiness for international cooperation by ensuring rapid production and equitable distribution of the vaccine, which would be of great service.

GRAY/20/3758

December 15, 2020

Statement by Mr. Buissé, Mr. Rozan, and Ms. de Waziers on People's Republic of China (Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for their rich and insightful analysis and the relevance of the selected issues. As the first country affected by the pandemic, China has been at the forefront of the economic response and is now leading the way in terms of support to the recovery, with a strong rebound in growth.

We broadly agree with staff's assessment of the economic outlook and associated risks. China's recovery is indeed robust, though it is unbalanced and the sizable public support measures are further delaying rebalancing. Thanks to strict health controls once the importance of the epidemic was recognized, coupled with a fiscal stimulus plan and large-scale monetary and macro-financial easing, the economy quickly absorbed the shock and returned to growth. However, the stimulus measures put at risk the progress made in terms of economic rebalancing in favor of qualitative and sustainable development, with a focus on public investment and a boom in credit, while private consumption is struggling to recover. On the 2021 outlook, we find the probability of a strong rebound in domestic consumption relatively fragile, as the policy-mix still prioritizes supply rather than direct support to households. Given the increasing level of household debt, job losses, and ineffective social safety nets, the trend towards precautionary savings could continue.

We agree that reinforcing social safety nets is a prerequisite to a stronger rebound and to a long-term rebalancing of the economy towards stronger domestic consumption, but the reduced fiscal space makes this very complicated in the short term. Social protection remains incomplete despite recent notable progress. In this regard, we welcome the authorities' commitment to reform the unemployment insurance system. We agree with staff that tax reforms broadening the tax base and increasing tax progressivity are desirable, though designing tax reforms in the immediate aftermath of the crisis will require careful planning and communication, as they could potentially offset the previous measures to increase private consumption. In addition, while we agree with staff that a reform of Hukou is necessary, we are more reserved on the assessment of actual progress made so far. While the will to reform has been clearly signaled through the 14th Five-Year Plan, implementation measures have not been specified at this stage.

We share the view that the crisis has reinforced financial risks and reversed previous deleveraging efforts, and we underline the multiplicity of financial risks, especially in the banking and real estate sectors, and bond market. We note in particular that the very high corporate debt is expected to increase further, along with non-performing loans as supporting measures are gradually withdrawn, and that a sizable share of small banks face too low levels of CET1 capital. We think further analysis on the capacity of domestic Asset Management Companies to manage and dispose of non-performing loans would be useful. In addition, the repercussions of the recent bond defaults of Chinese SOEs call for vigilance as they can deteriorate banks' balance sheets. We agree with staff that the extension of forbearance measures through 2021 should proceed in parallel with actions aimed at reforming the banking sector, enhance banking resolution, and improve online lending regulation. Finally, in the real estate sector, we agree with staff that a house price correction could pose risks for financial stability. *More details on the recent events related to over-indebtedness and bankruptcy of real estate agencies would be appreciated.*

We support the recommendation to set up a macro-fiscal framework including all public administrations to make policy support more effective and reduce fiscal risks. In a context of high and rising public debt, a comprehensive macro-fiscal framework and an improved intergovernmental coordination will help ensure the effectiveness of fiscal policy and anchor confidence in the sustainability of public finances over the medium term. There is also scope to make fiscal management by local governments more efficient. In addition, we would suggest adding a sensitivity analysis to the price of real estate in the debt sustainability analysis, especially for local governments' fiscal capacity.

Given low inflation, we support the recommendation on maintaining an expansionary monetary policy while gradually withdrawing directed credit instruments. Nevertheless, we would underline the fact that the PBoC has remained relatively conservative, with no increase in its balance sheet. This stance has helped attract capital flows and supported upward pressures on the RMB. We share staff's view that further modernization of the monetary policy framework toward more market-based interest rates would strengthen the transmission of conventional interest rate policies and help improve credit intermediation. In addition, the narrow investor base weighs on liquidity levels on the bond market and hence on the smooth transmission of monetary policy. We think a mention of this issue could complement the analysis on the monetary policy effectiveness. In addition, the analysis in the selected issues could have further explored the reasons for the divergence in impact between sovereign bond rates and corporate rates (composition of investors, level of turnover or liquidity, etc.), as these assets are traded on the same interbank market. Finally, in addition to the comments in the third selected issue, we encourage a more thorough analysis of the effects of the limited operational independence of the PBoC on monetary policy and on policy tradeoffs.

Exchange rate flexibility continues to be important to facilitate adjustment to the changing external environment, and further liberalization of portfolio inflows and outflows would reinforce the role of markets in exchange rate determination.

We thank staff for their presentation of the authorities' CBDC project and note the potential effects that it may have on the international financial system. There are risks that should be taken into account. In line with the mandate given by the G20 to the IMF, it will be important to further assess these potential risks in future analyses, and to accompany countries in designing mitigating measures. In the case of China, we would welcome a prospective analysis of the implications of such a CBDC on the country's capital account openness and exchange rate regime, especially if the perimeter of this CBDC were to extend beyond China's borders. We invite the IMF to further follow forthcoming tests of the use of digital yuan for cross-border payments.

We welcome the fact that some structural reforms did advance well despite the crisis, in particular in opening up of the financial sector. This being said, significant progress is needed on the reform of SOEs. The opening of the financial sector goes in the right direction, while these progresses are still subject to many risks linked to the structure of domestic financial markets for foreign investors. Beyond, we note that the SOE reform is struggling to move forward. Market distortions in terms of competition and credit allocation weigh on total factor productivity. Reducing the productivity gap between private and public companies in all sectors and ensuring a level playing field between companies is particularly important.

We agree with staff that green investment and climate change mitigation strategies would provide environmental, health and economic benefits and help anchor productivity growth, support consumption and build a more resilient, green, and inclusive economy with higher welfare levels for Chinese citizens. A more detailed analysis of critical climate change mitigation strategies, given the magnitude of the challenge ahead as well as the recent announcement by China of ambitious goals in this area, would have been appreciated in this regard.

We encourage the authorities to further improve the transparency and quality of economic data. We take note of the remaining gaps in China's statistics underlined in the annex document, with gaps on fiscal, monetary, employment and financial data that hamper surveillance. Regarding debt, *staff's views on the classification of local government financing vehicles, whose debt is sometimes recorded as public debt (in the calculation of augmented debt) and sometimes belonging to corporate debt (p.61) are welcome*.

Finally, China has a significant role to play in multilateral efforts to respond to the crisis and support the global economy, and we welcome China's participation to these efforts. We encourage China to continue to actively participate in providing debt relief to low-income countries as agreed at the G20 level, as well as tackling climate change and contributing to a more open, stable and transparent rules-based international trade and investment system. Recent new climate commitments were particularly welcome. China should in particular ensure that all Chinese credit institutions implement DSSI for all eligible countries that request it and participate to the debt relief efforts that would be required under the Common framework.

GRAY/20/3759

December 16, 2020

Statement by Mr. Palotai, Mr. Azal, Mr. Just, and Mr. Dogan on People's Republic of China
(Preliminary)
Executive Board Meeting 20/122
December 17, 2020

We thank staff for their comprehensive set of papers and Mr. Jin, Mr. Zhang and Ms. Liu for their informative Buff statement. The Chinese authorities responded decisively with sound policies to contain the impact of the COVID-19 pandemic and the economic recovery has gained relatively rapid momentum. After more and more indicators point to a steady recovery, China can be one of the few countries in the world to show positive growth this year. In reviving the economy, the authorities have rightly emphasized the protection of workers and businesses and have cautiously tried to avoid relying primarily on massive credit expansion to stimulate the economy. As the economy has entered the recovery phase, it is now time to gradually shift to continue restructuring the economy, address financial vulnerabilities and prevent a decline in productivity and efficiency in resource allocation that could hurt China's growth prospects going forward. The future of the China-US trade relationship has also a decisive impact on outlook. We agree with the overall thrust of staff's policy recommendations that are focused on increasing the resilience of the economy.

We positively note that strong fiscal support was put in place targeting the most vulnerable households and firms. We agree with staff that fiscal policy should remain moderately expansionary in 2021 while public support measures such as various loans and tax reliefs should be gradually phased out also to reimpose fiscal discipline. Fiscal policy should be rebalanced towards enhancing the social safety net. Further fiscal reforms, in particular strengthening intergovernmental fiscal coordination as well as enhancing fiscal transparency could also improve the effectiveness of fiscal policy.

We take a positive view of the monetary policy measures taken by the authorities during the crisis. The interest-rate transmission efforts are key to further strengthen the monetary policy framework and enhance the effectiveness of monetary policy. The authorities' efforts to reform the loan prime rate is a significant step towards a market-based policy rate. Gradually removing the interest rate guidance and phasing-out pandemic-related measures including lending targets will help to simplify monetary policy implementation.

Developing the central bank digital currency is highly significant in terms of the conduct of monetary policy, financial inclusion as well as financial stability but we would have appreciated a less cursory discussion in the report given that the widespread adoption of an e-yuan could have significant implications for macroeconomic stability as well as for the international financial stability in view of the welcome increasing integration of China into the internal monetary system. We encourage staff to further analyze the domestic and global implications of China’s CBDC ambitions. Exchange rate flexibility continues to facilitate external adjustments and shocks. In that regard, FX intervention should be limited to counter disorderly market conditions. We welcome recent measures to reduce certain capital flow measures. Continuing with the liberalization of portfolio inflows and outflows and using hedging instruments in FX market would reinforce the role of markets in exchange rate determination.

Firming economic growth should give the authorities room to further strengthen the financial regulatory and supervisory framework. The pandemic has increased risks leverage and likely has contributed to the underreporting of non-performing loans especially in small banks. We welcome recent policy actions by the authorities to stabilize the macro leverage ratio, continue with strengthening the macroprudential framework and also point to removing implicit guarantees. Going forward debt restructuring will need to play an important role. Equally, we encourage the authorities to evaluate SOEs on their economic viability and to be vigilant to a possible correction in house prices.

Incentives to competition in the domestic market, encouraging private sector participation and limiting the role of the state in the economy will achieve higher productivity. The implementation of new “dual circulation” strategy could strengthen China`s medium-term growth prospects, while the acceleration of home-grown technology innovations could become one of the main pillars of productivity.

Despite the challenging environment, structural reforms advanced. We positively note the new foreign investment law, streamlining the list for foreign investment and lifting of foreign ownership restrictions in selected areas. Progress in streamlining business administration, relaxation in labor market restrictions and strengthening intellectual property protection is well noted. However, there is scope for strengthening the role of markets including increasing small and medium-sized enterprises participation. Progress on reforming SOEs as well as quantifying subsidies to SOEs continues to lag. We would like to also emphasize China’s important role in boosting green investment and mitigating climate change as well as providing debt relief to low income countries agreed at the G20 level. We strongly welcome the authorities` commitment to support a green recovery through green finance and innovative investments. China`s dedication will be critical to meet climate change targets globally.

People’s Republic of China

EBM/20/122, December 17, 2020

Staff’s responses to technical and factual questions are below.

Outlook and Risks

1. ***Could staff elaborate on the assumptions underlying the large boost in domestic demand projected for 2021? Furthermore, what measures are envisaged to stimulate greater private consumption and alleviate the uncertainty that motivates excessive precautionary savings?***

   - The high projected annual growth rate for 2021 of 7.9 percent reflects, to a large degree, the base effect of the pandemic in 2020. Sequential quarterly growth rates are lower, reflecting the leveling off of the rebound from the crisis. Sequential growth of private consumption is expected to increase gradually toward the end of 2021 as a broader recovery across consumption categories, including contact-intensive services, bolsters household incomes.
   - To support private consumption, staff recommends that the authorities shift fiscal expenditures toward household support and strengthening of social safety nets, which will lift consumption and reduce the need for precautionary savings. Specific recommendations include the expansion of unemployment insurance coverage, improving the coverage of the minimum guarantee income program (Dibao) and scaling up the capacity of the public healthcare system.

2. ***We note the high household savings rate induced by the crisis and would like to know to what extent more structural factors such as demographic changes and ageing population are at play, and how China compares to regional peers in this regard.***

   - The increase in aggregate household savings in 2020 was primarily driven by the dramatic decline in consumption relative to income due to the crisis. Similar to what occurred in other countries, government support helped reduce the impact of the crisis on incomes while lockdowns and social distancing led to dramatic reductions in consumption of services (travel, restaurants, cinemas). Household savings are expected to fall back down in 2021 to a lower level than in 2019 and revert back to the previous trend going forward.
   - As rightly mentioned in the question, other structural factors are important in driving the long-run downward trend in household savings. The most important of these are population aging, which alone is expected to lead to a significant decline in the aggregate household savings rate. In addition, younger Chinese

cohorts have lower savings rates than older cohorts at the same age, suggesting that there are behavioral shifts happening across generations which will likely contribute to lower savings rates going forward. Finally, gradual improvements in social safety nets are expected to reduce precautionary savings.

- As noted in previous staff analyses (e.g. APD's April 2017 REO), China may be further ahead in the demographic transition compared to its relative level of development. Along with Japan, Korea and Thailand, China is currently in a post-demographic dividend phase, where its working-age population is shrinking in terms of its share in the total population as well as in absolute numbers

3. ***We would like to understand from the Staff if the government support programmes to households have led to precautionary savings rather than solely boosting consumption due to inadequate social safety nets?***

   - Support for the most vulnerable will not generally increase the aggregate savings rate. The government support programs to households extended during the pandemic largely targeted households with limited capacity to save, including the measures to extend greater financial security to migrant workers through the extension of unemployment benefits, and the improved coverage of the Dibao program.
   - While we currently do not have data on savings rates by income groups to investigate this directly, evidence from other countries (including the U.S.) suggests that the large increase in aggregate savings was instead mostly driven by middle- and higher-income individuals which increased savings either out of precautionary motives or because of a lack of opportunity or willingness to consume related to the pandemic.

4. ***We would like to understand from the Staff whether the rise in savings rate during the pandemic, despite a fall in incomes, mirrors a strong cutback in the discretionary consumption demand by households?***

   - Household consumption growth rate decelerated markedly due to the crisis. In 2020Q1 this deceleration was twice as fast as that of household income (see Figure 1, bottom-left chart).
   - The consumption categories that suffered the most and that have been recovering more slowly are those related to contact-intensive activities. Domestically, this relates to education, culture and entertainment activities and, to a lesser extent, transport activities. Tourism imports also fell significantly and remain depressed.

5. ***In the midst of weakening household incomes and elevated uncertainties, what may have been the drivers of real estate demand?***

   - After the trough of the first quarter of 2020, the rebound in housing sales was helped by the resumption of economic activity and improving incomes, lower interest rates, and policy measures including the relaxation of hukou restrictions by some cities, and local policies aimed to attract high-skilled individuals.

6. ***Does the staff have an estimate of the relative contribution of slack in domestic demand versus the external demand in contributing to the wide output gap in the economy?***

   - Staff do not have a breakdown of slack into domestic and external demand. However, we note that the projected growth in domestic demand is slightly below headline GDP growth in 2020 (1.4 percent vs. 1.9 percent) and slightly above headline GDP growth in 2021 (9.1 percent vs. 7.9 percent).

7. ***Why do the authorities expect the output gap to close in 2021, against the staff expectation of an output gap of -1.8 percent?***

   - While the output gap is projected to fully close only in the medium term as noted in the text figure in page 15, staff's projected gap of -1.8 percent relative to potential output in 2021 is an annual average that partially masks the improvement taking place in the course of the year. In addition, staff understands that there are differences in the assumed level and path of potential output.

8. ***Has staff analyzed how technological decoupling could impact growth in emerging markets?***

   - The full analysis will be made available in a forthcoming working paper which will document the overall impact for some emerging markets. For the effects of decoupling on sectoral misallocation, the analysis will show results for an even wider set of countries. Staff is happy to provide further detail bilaterally.

9. ***Can staff elaborate if they expect effects on the growth outlook in a scenario of a sooner and wider available vaccine than assumed in the baseline projection?***

   - As indicated in Appendix II, an unexpected positive shift in the pandemic (including due to the wider availability of a vaccine) constitutes an upside risk to the outlook. Compared to other countries, the upside is relatively small given that authorities have managed to bring the virus under control with non-medical interventions. As noted in paragraph 44, however, a materialization of this upside should help to scale back policy support faster than expected.

10. ***We note staff cautions that the baseline is built on "the strong assumption" that risks remain contained. On this point, we think this assumption seems reasonable, and would like staff to elaborate the background why they consider the assumption as "strong," particularly considering the authorities' successful containment of the virus so far and recent developments of the vaccine.***

- Downside risks to the outlook remain significant. While the authorities have successfully contained the virus domestically, the pandemic continues globally, with any number of potential downside scenarios potentially affecting the Chinese economy. Other downside risks stem from rising domestic debt levels and banking weaknesses, for example.

11. ***How do staff see the developments in real estate prices and its ramifications to the financial system given the potential long-lasting impact on demand for office and retail spaces in the context of the "pandemic normal" economy?***

- After peaking in August, average property price growth started to decelerate, reaching 5.8 percent year-on-year in November. During this period, and as shown in Figure 1 of the staff report, real estate investment growth recovered relatively quickly and has also moderated recently. Under the baseline, staff expects a gradual slowdown in real estate investment as regulatory measures to strengthen developers' balance sheets take hold. At the same time, signs of lingering weakness in non-residential real estate investment and vacancy rates are consistent with the advance of online retail and could point a longer-lasting shift in demand patterns.
- The financial system is highly exposed to commercial property via developer lending and through collateral, and material declines in commercial real estate prices would likely generate significant losses. Nevertheless, even with changes in commercial real estate demand, such declines are unlikely given authorities' current proactive approach to limiting systemic risk and their past practice of closely managing real estate cycles through macroprudential and other housing policies.

12. ***In the real estate sector, we agree with staff that a house price correction could pose risks for financial stability. More details on the recent events related to over-indebtedness and bankruptcy of real estate agencies would be appreciated.***

- Developers are large and fund themselves with debt and pre-sales. The top 100 firms hold nearly RMB 25 trillion in assets and have in recent years run a high-leverage, high-turnover business model. Funding for developers primarily comes from bank loans, shadow bank borrowing, and bond issuance, but recently housing pre-sales have become about 50 percent of funding, following regulatory tightening on developer credit in past years.
- Liquidity challenges have been rising in parts of the sector as a new round of policy tightening is driving deleveraging at riskier developers. Market analyst reports suggest leverage at the largest property developers rose to historical highs of 170 percent (debt-to-equity ratio) as of mid-2019, from an average of closer to 150 percent in recent years. The short-term liquidity profile of these firms was also weak, with short-term debt 90 percent of available cash. This year's new regulations impose limits on developer debt growth based on balance sheet risk metrics, which is forcing some of the riskier developers to reduce debt.
- The most notable example of liquidity strains has been at one of China's largest and most indebted developers, Evergrande Group, which had nearly $118 bn in debt as of mid-2020. In November, it reportedly received a capital injection from local SOEs in its home province after it struggled to raise funds through a spinoff listing of a subsidiary, following earlier reports that liquidity concerns prompted high-level policy discussions about official support.

Fiscal Policy

13. ***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?***
    - Staff recommend fiscal policy to be moderately expansionary in 2021 to smooth the transition from exceptional support this year. This would call for an increase of ¾ percentage points of potential GDP in the cyclically adjusted augmented primary deficit (CAAPD) in 2021 compared to a roughly unchanged CAAPD currently forecasted. Greater support for households, as elaborated in the response to question 1, could serve to reduce households' economic insecurity and incentivize greater private consumption through lowering of precautionary savings.

14. ***The Buff statement argues that the debt burden of LGFVs issued after 2014 is borne by issuers themselves and are not legally recognized by the Chinese government and hence should be considered as corporate debt rather than***

public debt. We would appreciate more insight and clarity from the Staff on this sharp divergence in views.

- This is a longstanding discussion—covered in past Staff Reports—about the definition of the general government perimeter.
- The main reference for public definitions and compilation across member countries is the Government Finance Statistics Manual (GFSM), which sets international standards. The GFSM definition of general government is based on economic considerations. It includes all extra-budgetary units controlled by the government that operate on a non-market basis as is the case for many local government financing vehicles (LGFVs) and other government funds (see Rui and Stokoe WP 17/272 "Reassessing the Perimeter of Government Accounts in China"). Staff introduced the economic concept of an "augmented" balance/debt in the 2013 Staff Report and continues to use it in an effort to apply the GFSM standard to China's fiscal data. Augmented data remain staff's best estimate of general government activity.
- The authorities instead stress that LGFVs are legally not part of government, hence their debt is not government debt unless the government explicitly recognizes or guarantees it. In an effort to control LGFV borrowing, the central government has issued a number of regulations and taken action against some "non-compliant" borrowing since 2016. In staff's view, given that many LGFVs operate under state control, there remains a significant probability that their debt can become an explicit liability.
- Data limitations mean some nongovernment activity is likely included in augmented figures, and some LGFV and funds may have substantial revenues and assets. At the same time, LGFV debt has been increasing. This suggests that there is uncertainty around the precise amount of "augmented" debt.
- Data gaps are the main difficulties for staff to conduct more detailed analysis toward resolving differences between official general government deficit and debt and staff estimates. Staff remain committed to trying to resolve these differences and bridging data gaps by engaging and working with the authorities, with a view to increasing transparency and strengthening policymaking.

15. ***We notice that the authorities do not agree with staff's assessment regarding the use of the concept of augmented deficit and debt. Could staff comment on how this debt measure compares to definitions used in other countries, particularly on the concept used under the new DSA methodology framework?***

- Please see responses to Q14 above. The augmented deficit and debt, which are based on GFSM 2014 standards are consistent with the old and the proposed DSA frameworks. As noted in SM/20/169, general government (GG) debt, defined per GFSM 2014, will be the default institutional coverage for the new MAC DSA.

16. ***We note the difference of views between staff and the authorities over the concept of general budgetary and debt, while recognizing the authorities' view on how financial obligations from SOEs or LGFVs are treated under the 2014 Budget Law. Could staff provide further comment on the policy implication of this different view and the plan to resolve this?***

  - Please see responses to Q14 above. Also, the augmented deficits and debt are materially higher than the corresponding official general government debt figures. Based on augmented data, staff recommend the authorities embark on fiscal consolidation over the medium term.

17. ***We are interested to hear staff's response to the authorities' explanation on the treatment of debt issued by local government financing vehicles (LGFVs).***

  - Please see responses to Q14 above.

18. ***Could staff elaborate on how the concept compares internationally and on the potential sources of error for the "staff's best estimate of general government data"?***

  - Please see responses to Q14 above.

19. ***Taking into account the huge difference between the "standard" and "augmented" data, as well as the need to provide internationally comparable data, we urge staff to provide full explanation of their approach and objections to the authorities' arguments. Staff comments would be welcome.***

  - Please see responses to Q14 above.

20. ***Regarding debt, staff's views on the classification of local government financing vehicles, whose debt is sometimes recorded as public debt (in the calculation of augmented debt) and sometimes belonging to corporate debt (p.61) are welcome.***

  - Staff's augmented debt includes the debt of local government financing vehicles (LGFVs) based on economic considerations (see response in question 15).
  - In Table 6 (p. 61) of the staff report, staff's default definition of corporate debt excludes the LGFV debt, as the latter is part of staff's augmented debt. The

broader definition of corporate debt shown in the memorandum section includes LGFV debt and is equal to the sum of the default definition of corporate debt and the LGFV debt.

21. We wonder if staff could identify the reasons for the discrepancy between staff and the authorities on the extent of discretionary fiscal support.

- Staff's calculations follow standard Fund definitions based on fiscal policy announcements by the authorities. This means, staff does not consider total spending associated with a given policy. For example, the government issued a total of RMB 3.75 trillion of special local government bonds to finance public investment in 2020, staff's estimate of discretionary support only includes the increase in the issuance/expenditure relative to 2019 of RMB 1.6 trillion. In addition, discretionary fiscal measures do not include the effects of automatic stabilizers.

22. Can staff provide estimates on the portion of the 4.7 percent of GDP in discretionary fiscal measures adopted this year that went toward boosting household consumption?

- Based on announced policies, staff estimates that 0.5 - 1 percent of GDP in discretionary spending went toward households, not counting the indirect benefits households may have realized from support to firms. Household support included expansion of unemployment benefit coverage and the minimum guarantee income program as well as subsidies for basic health services and medical insurance for rural and non-working residents.

Monetary and Exchange Rate policy

23. Could staff provide the view on the deflationary pressures and the potential implications for the authorities' monetary policy normalization?

- Headline inflation dynamics mostly reflect the evolution of the output gap and food prices.
- The sharp increase in the output gap due to the crisis – estimated at -3.6 percent of potential on average in 2020, and as high as 6-7 percent in 2020Q1 – has put downward pressure on prices. The resulting deceleration in inflation has been relatively broad-based. Core CPI inflation fell to 0.5 percent in July, remaining at that level through November. PPI inflation, which had turned negative in 2019 (driven partly by oil price declines), bottomed at -3.7 percent yoy in May and has gradually bounced to -1.5 percent in November.

- Food prices have been a key driver of headline CPI inflation since early 2019. As China's pork supply fell by nearly 40 percent due to the swine flu, food price inflation picked up in early 2019. Pork supply started to increase in recent months (NBS reported that pork supply increased by 15.1 percent yoy in 2020Q3), and pork prices have stabilized since late 2019. As pork prices stabilize, the effect of food prices on headline CPI is expected to turn neutral going forward.
- Inflation is projected to gradually pick up as the output gap closes. In light of the outlook for output gap, the team currently projects core inflation reaching 1½ percent by end 2021—below the pre-crisis target of about 3 percent, and slowly converging to around 2 percent by end 2022.
- Staff's projections of headline and core inflation suggest that monetary policy should remain accommodative during 2021. Staff's estimates suggest that the current policy rate level is close to the Taylor-rule-implied rates, and hence should be maintained to keep a supportive monetary policy in the near term. To that end, the key short-term interbank rates should be kept near the current policy rate levels to avoid premature normalization of monetary policy which may lead to an abrupt tightening of financial conditions.

24. 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.

- The Fund is carefully monitoring the development of China's CDBC as well as other CDBCs both in the bilateral and multilateral context. This includes, for example, both standard and specialized surveillance, workshops and related outreach activity, and the publication of relevant analytical and policy work. While not the main focus of the COVID-guided 2020 China Article IV, the staff report featured a box on the e-CYN development and will certainly feature more in future Article IV work, including more detailed analysis of its domestic and international implications.

25. While China's new central bank digital currency holds the promise of promoting financial inclusion and improving payment efficiency, it would be desirable for staff to elaborate further on associated risks considering the potentially significant and wide-ranging implications of CBDC. Staff comments are welcome.

- As discussed in Box 8 of the Staff Report, there could be significant operational risks from the e-CNY, including cybersecurity risks and challenges from data security, particularly in the case of large-scale issuances including cybersecurity risks and challenges to data security and privacy protection from centralized data collection and storage, particularly in the case of large-scale issuances. Some disintermediation risk and run risk during periods of stress may be envisaged, particularly for smaller banks, but could be mitigated by the non-interest-bearing feature of the e-CNY and imposition of frictions on the switch from bank deposits to e-CNY. The e-CNY could also potentially affect the business models of private payment service providers such as Alipay and Tencentpay and reduce their available funding.

- While, the e-CNY is intended for domestic retail use, its possible use for cross-border transactions would have external implications. For example, depending on the design, it could potentially challenge the implementation of existing exchange restrictions and capital account policies, not only domestically but also for counterparty countries. These risks have been discussed in the recent Staff Report on the macro-financial implications of cross-border digital currencies, and the Chinese authorities have clarified that international bilateral/multilateral coordination is essential before any potential cross-border usage of the e-CNY.

26. Has staff made any analysis on the possible cross-border implications of the Chinese digital currency and possible domestic financial stability challenges?

- See responses to questions 24 and 25.

27. Could staff comment on the recently issued draft to amend the Law of the People's Bank of China? Which are the main objectives of the proposal and its role in strengthening the PBC's operational authority and oversight of the financial sector?

- The recently issued draft amendment to the Law of the People's Bank of China is a welcome development. As noted in the staff report, it aims to strengthen the macroprudential policy framework and coordinate supervision of systemically important financial institutions, as well as financial holding companies. It also provided the legal tender status for the e-CNY.
- In many areas, the Law seeks to formalize practices and responsibilities already taken on by the PBC. For instance, it codifies the PBC's recently granted power to draft major financial laws and regulations, as well as its leading role in systemic financial risk prevention and emergency resolution measures, and macroprudential policy. It fills in institutional gaps in the macroprudential framework, including clarifying the objectives and tools of this policy (e.g., the countercyclical capital buffer and stress testing), as well as the PBC's role as the macroprudential authority.
- One notable proposed change in the area of operational authority is to strengthen the role of the PBC in the area of financial institution supervision. Our

understanding is that this includes greater powers to conduct on-site supervision, require corrective action, and levy penalties, and gives the PBC a leading role in oversight of systemically important institutions and financial holding companies.

28. ***What specific monetary policy mechanisms would staff recommend that the authorities pursue to avoid worsening existing bubbles, particularly in the property sector?***

- Monetary policy in China needs to remain accommodative until there are clear signs that private demand has strengthened and CPI inflation has risen to its target on a sustainable basis. Against this backdrop, house price risks are best addressed through strengthened macroprudential policies. The recently issued draft amendment to the PBC law codified in law the PBC's leading role in systemic risk prevention and macroprudential policy.
- The recently announced prudential measures by the PBC targeting excessive growth in developers' interest-bearing liabilities can help contain macro-financial risks from the property sector. Further macroprudential policies for the housing market and household sector could be introduced or strengthened to contain the build-up of house price bubbles, including, for example, concentration limit and risk weights for property sector lending and limit on debt-service-to-income ratio for households (see staff's working paper Han *et al*. (2019) for recommendations on macroprudential policies for household sector).

29. ***Do staff consider China to meet the high data transparency standards that are a feature of currencies in the SDR basket?***

- During 2015 when the Board decided to the include the RMB in the SDR basket as a freely usable currency (effective October 1, 2016), the Chinese authorities subscribed to the IMF's Special Data Dissemination Standard and subsequently took further steps to strengthen transparency as documented in Appendix IV of the 2017 Article IV Staff Report, Appendix III of the 2018 Article IV Staff Report, Appendix V of the 2019 Article IV Staff Report, and Appendix IV of this year's staff report. The reference in the staff report is specifically in relation to surveillance and in that context, China lags behind many other countries across the globe in publishing FXI information.

Financial Sector Policy

30. ***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?***

- Staff assesses that the banking sector continues to have elevated vulnerabilities, particularly in the small- and medium-sized bank segment. Credit quality deterioration has been partially masked by exceptional financial support policies and risky linkages to the asset management sector have not yet been fully addressed. Profitability has been further compressed by lower lending rates and Common Equity Tier 1 (CET1) capital ratios remain low in international context, particularly at smaller institutions.
- Furthermore, risks to the banking sector remain considerable due to the many interconnected financial vulnerabilities outside the banking sector. Already high corporate debt has increased rapidly during the pandemic period. Financial pressures at some local governments are elevated, which is affecting financial conditions for local borrowers. A housing market correction or funding pressure in the highly leveraged real estate developer sector could also pose stability risks.

31. ***How does staff assess the risk of future SOE defaults and their economic impact in China – in the current environment and in a scenario of rising rates and tighter credit conditions?***

    - Defaults by selected SOEs may continue but are expected to remain limited despite their generally weak debt-servicing capacity. Local governments have been under pressure to reduce support to zombie firms, and many local governments face rising debt loads and weakened revenues amid the pandemic, which in some cases could constrain their capacity to support weak firms. Nonetheless, local governments are likely to continue to avoid outright SOE defaults when possible, in part to avoid contagion that might weaken credit market access for other local borrowers. As a result, market pricing suggests investors do not see a material increase in the risk of default even among many weak SOEs after the recent SOE defaults.
    - SOE defaults could potentially increase in a scenario of rising interest rates and significantly tighter credit conditions, in particular in regions where local governments are most indebted, creating incrementally more meaningful impact on economic activity. However, the authorities have highlighted that prevention of systemic instability is a key goal of financial policy, suggesting that steps would be taken to prevent a disorderly increase in SOE defaults.

32. ***The authorities suggest that the assumption of implicit government guarantees of SOEs' liabilities should no longer be appropriate given the recent treatment of SOEs' defaults, with corresponding risks being priced in bond markets. Staff's comments are welcome.***

- Staff believes that implicit government guarantees of SOE liabilities remain largely in force despite recent selected SOE bond market defaults. As in the past, these latest SOE defaults reflect idiosyncratic cases of stress rather than a system-wide policy change. Local governments are likely to continue to avoid outright defaults when possible, in part to avoid reputational damage that might weaken credit market access for other local borrowers. Some local governments have also re-affirmed their implicit guarantee policies in recent months.
- As of now, Chinese bond markets have not priced a meaningfully higher risk of default. Credit spreads for lower-rated corporate borrowers (primarily weaker SOEs) are only marginally higher than their year-to-date averages and remain comfortably below their five-year averages. The recent rise in financing costs primarily reflects higher risk-free interest rates.

33. We invite staff's further explanation on their advice to remove "implicit guarantees" in the context of SOE reforms, considering the recent cases of default of bonds issued by SOEs.

- The exit of non-viable SOEs is a necessary part of meaningful SOE reform—however, any such process would need to be handled with care. Exit can entail allowing non-viable SOEs to default on financial obligations, which can ultimately strengthen the pricing of credit and the efficiency of resource allocation. Unwinding wide-scale implicit guarantees in practice may however generate widespread financial risk and uncertainty, as it could imply a significant tightening in financial conditions for China's large contingent of heavily indebted SOEs, including many not in immediate financial peril. Authorities should ensure that weak but viable SOEs are guided towards restructuring or downsizing in a coordinated manner and that implicit guarantees are phased out in a structured, gradual, and well-communicated process.
- A strong set of policies are needed to support the transition away from implicit guarantees. Stronger restructuring frameworks for both firms and banks will be critical to minimizing the financial stability impact of defaults and ensuring efficient re-allocation from nonviable firms to viable firms. Banks should be encouraged to strengthen capital and liquidity buffers. A strong social safety net is likewise important to mitigate the economic drag from job losses that may result from closing inefficient and insolvent firms. More broadly, a stronger fiscal coordination framework could help ease negative feedback loops between rising government debt and tightening financial conditions in some weaker provinces. This would support economic adjustment in these provinces and lessen the possibility of disorderly market pressures.

34. ***We note the number of SOEs defaults is increasing and the scale of bond defaults is the highest ever this year and wonder whether the authorities' stance towards SOEs has changed markedly, and we welcome staff's views. In addition, we would like to ask whether such increase of defaults can lead to future difficulty in raising funds in the bond market by sound borrowers and possibly systemic risk? If the risks materialize, to what extent do the central and local governments bear the fiscal burden?***

- Following recent defaults, some firms from the defaulted borrowers' provinces or provinces with higher government debt loads have faced greater difficulty in issuance in recent weeks, but credit spreads remain broadly stable.
- As noted, the authorities have stated that preventing systemic financial risks is a key priority and so a disorderly rise in SOE defaults is not seen as likely. In the event of materializing risks, the central government has indicated that local governments should take primary responsibility for addressing localized debt problems. The central government, however, is seen as backstopping local governments' direct borrowing, reflected in the relatively small differences in credit spreads across provincial governments.
- Please also see responses to Q31 to Q33 above on SOE defaults and implicit guarantees.

35. ***How would staff recommend that China safeguard against financial sector volatility that would follow a repricing of bonds and bank loans to better reflect credit and counterparty risk?***

- Please see responses to Q31 to Q33 above on SOE defaults and implicit guarantees.

36. ***We remain to be convinced on the appropriateness of staff's proposal to establish "a temporary and fiscally backed centralized resolution fund" as it could lead to moral hazard and hinder market-based incentives. Could staff situate this proposal within the international experience and elaborate on why it would be important in the Chinese context?***

- The resolution fund is recommended as part of a comprehensive policy package that would include a functioning resolution framework where failing banks are closed and losses are imposed on shareholders and creditors in a timely manner. In staff's view, this kind of comprehensive approach is critical to addressing weaknesses in China's banking system and addressing many structural problems like credit misallocation and excessive debt.

- The fund would not be used for recapitalizing banks but rather supporting the orderly resolution of non-viable banks, for instance contributing resources to asset and liability transfers (i.e., selling parts of the failing bank to other banks) and injecting capital into bridge institutions.
- This proposal in many respects would resemble the permanent resolution funds (or mechanisms) that currently exist in many advanced economies. It would be functionally distinct from deposit insurance schemes which are guided by a narrow least-cost mandate, as it would have broader latitude to resolve systemic institutions and take actions to support financial stability. In the case of China, this flexibility would be particularly important for the possible phasing-out of implicit guarantees for bank creditors which may lead to risks in bank funding markets.
- As is common in many resolution mechanism and deposit insurance schemes in advanced economies, it would have a mechanism to recover any losses from the industry over time.
- This proposal would also resemble other bank clean-up efforts where existing deposit insurance schemes were inadequate relative to the scale of the problem. China's deposit insurance scheme is gradually increasing its funding, but current resources might not support an accelerated clean-up of many smaller institutions. A temporary vehicle expressly tasked with boosting resources to support this process may be appropriate.

37. The authorities raise their concerns on the resolution fund, citing that it may amplify moral hazard. We would like to invite staff to further comment on the appropriate safeguards to minimize its associated risk, drawing lessons from other countries' experiences.

- Staff's advice is a policy package. Establishing a nationwide bank resolution regime in line with international standards is central for providing the appropriate safeguards to a temporary resolution fund.
- In line with international standards, staff advocates that the closure of failing banks and the timely imposition of losses on shareholders and creditors as part of a resolution regime should be a precondition for continued reliance on the use of public funds. Furthermore, the use of public funds for recapitalization purposes should be a last resort, only used if financial stability is severely threatened, and subject to strict conditions and restructuring requirements that reinforce market discipline and protect taxpayers.
- Staff's recommendation on establishing a temporary resolution fund is to help maintain macro-financial stability. One particular concern is that many small banks have weak balance sheets and local governments may not be in a strong

position to provide support. Linkages between local governments, firms and banks could pose significant macro-financial stability risks. A centralized resolution fund can help overcome such challenges.

38. What safeguards do staff consider most important to mitigate moral hazard in a new Chinese bank resolution regime?

- Among other things, the bank resolution regime should emphasize the closure of failing banks and the appropriate imposition of losses on shareholders and creditors to ensure that they have the right incentives to monitor and manage banks' risks.
- Please also see responses to Q36 and Q37 above on moral hazard in the context of establishing a centralized resolution fund.

39. Increased lending to unproductive companies and relaxation of non-performing loan recognition criteria could exacerbate corporate debt and non-performing loan problems. On this point, how do staff see the authorities' risk recognition and management? We would like to hear staff's views on possible timeline and sequencing regarding termination of the exceptional measures, disposal of non-performing loans, and bank restructuring.

- Staff sees risks in prolonged use of relaxed NPL recognition and repayment moratoria policies, especially given the recent progress in strengthening NPL recognition policies.
- On NPLs, the authorities have highlighted that they are urging banks to proactively dispose of NPLs—and staff welcomes this accelerated clean-up of NPLs.
- On exceptional financial support policies, staff's understanding is that these measures are set to expire at the end of the first quarter of 2021. Staff recommends that these policies be gradually phased out as the recovery takes hold. If further support is needed after these policies are phased out, further financing support to SMEs could be provided in a more market-friendly manner.
- On repayment moratoria, supervisors should ensure that banks properly recognize both legacy and emerging problem loans after the expiration of these measures and hold adequate capital and liquidity buffers; those that cannot do so should be required to submit credible recovery plans. Restructuring may be required for banks that face difficulty in rebuilding buffers in a timely manner.

40. Improving credibility of the Chinese rating companies and enhancement of transparency of the Chinese corporations' information would be essential. We

have a concern that inadequate transparency and distortion of the markets can be a risk of the financial market. Staff's comments are welcome.

- A credible credit rating system and detailed, consistent, and timely corporate disclosures are important to the soundness and efficiency of financial markets. Staff agree that improving credit ratings and corporate disclosures are important for China's financial sector development and note the authorities have recently emphasized the importance of a well-functioning rating system while taking action against credit-rating agencies accused of misconduct.

Structural Reforms

41. Could staff elaborate on implementation progress for hukou reforms cited in the 2019 Article IV report?

- The cited reform goals in 2019 Article IV report were to remove hukou restrictions in cities with populations under 3 million (including Type II large cities with urban permanent population of 1 million to 3 million), relax restrictions in Type I large cities (with urban permanent population of 3 million to 5 million), and simplify them for larger cities with populations of over 5 million.
- Reform efforts continued in 2020 despite the pandemic, with the outcome differing by city size. To a large extent, hukou reform in smaller and medium-sized cities has been achieved. For example, small and medium-sized cities in the eastern part of the country have already removed restrictions. Major reforms are also still underway in larger Tier I cities, with many of them introducing "points-based systems" and otherwise reducing barriers to permanent status. However, mega-cities still have high barriers and more reforms are needed to improve the points-based settlement policies and otherwise relax restrictions.

42. The extent of these expected implicit state guarantees is difficult to quantify, possibly explaining the authorities' disagreement with the staff regarding the 'augmented' debt concept. Staff comments are welcome.

- The existence of implicit state guarantees is well-established and has been quantified using a variety of methodologies. Many analyses use listed firm data to control for size and leverage and find substantially lower interest costs for SOEs; others use bond market credit spreads which show large and widening credit spread differentials in favor of SOEs. Another approach found that roughly RMB 36 tn in debt was owed by local SOEs and local government financing vehicles (LGFVs) with negative or insufficient earnings, pointing to the existence of state support (See Box 1.3 in the Oct. 2020 GFSR).

- LGFV debt is not legally recognized as an obligation of the Chinese government, but many local governments still actively provide financial support to their LGFVs and SOEs. They have strong incentives to do so given that the perceived default of one local entity may weaken perceptions of state support for other local entities, undermining their market access to credit and potentially affecting the local economy.

43. ***Staff's elaboration on the "dual circulation" strategy especially the expected spillovers to the global economy will be appreciated.***

- Details of the strategy will become clearer as the next 5-year plan is rolled out in the spring. However, staff is encouraged by statements that dual circulation does not mean a retreat from reform but rather a commitment to continue China's opening up while fostering domestic sources of growth. In this context, staff would welcome a renewed focus on structural reforms that strengthen the role of markets and private firms. As noted in the staff report, these longer term reforms will anchor domestic growth and help build a more resilient, green, and inclusive economy, which would ultimately also support external rebalancing.

44. ***Could staff provide further comments on the concept of dual circulation, in particular whether it is intended to lead to a greater decoupling from external markets and thereby call into question the credibility of the strategy of market opening?***

- Please see responses to Q43 above.

45. ***The report suggests that in spite of these measures, FDI is projected to remain stable in the medium term, and in some years below the pre-crisis levels. We would welcome staff's elaboration.***

- Staff projects an increase in the FDI level by 6 percent in 2021, following a small decline this year. Over the medium term, annual growth of FDI is projected to be around 3 percent. Since nominal GDP grows faster, FDI relative to GDP is projected to decline slightly from 1.1 percent in 2019 to 0.8 percent in 2025, as shown in Table 2 of the Staff Report.

46. ***To better understand the relation between SOEs and POEs could staff explain the relation of POEs' total assets to GDP in 2018 and how it has evolved since 2000?***

- Given data limitations, it is difficult to split the SOE and POE share of economic activity for a broad coverage of industries. The best available data for consistent over time comparisons is the POE share of total assets among large industrial firms This share has increased dramatically since the early 2000s, from below 5 percent in 2001, to 14 percent in 2006 and up to 23 percent by 2018. There was a corresponding decline in the SOE share of assets during the 2000s, but this has stabilized in the last 5 years, standing at 27 percent in 2019.

47. We recognize aging, which will reduce the domestic savings in the future, and accumulation of corporate debt and non-performing loan could constrain investment in China, and we would like to hear staff's views that whether the expansion of domestic demand envisaged in the dual circulation would be sustainable in the long-term.

- As noted in the staff report, simultaneous implementation of key reforms can support a job-rich and balanced recovery now while fostering high-quality, balanced growth going forward. This includes reforms such as further opening up of domestic markets, SOE reform, and ensuring competitive neutrality while promoting green investment and strengthening social safety nets.
- As rightly pointed out in the GRAY, aging is also expected to lead to a reduction in household savings and an increase domestic consumption, as younger cohorts tend to save less than older cohorts of the same age.

48. What do staff believe is the appropriate sequence to advance SOE reforms while balancing financial stability risks?

- As a general point, the exit of non-viable SOEs is a necessary part of meaningful SOE reform. Any such process, however, would need to be handled with care to avoid a generalized financial tightening of financial conditions, with weak but viable firms guided towards restructuring or downsizing in a coordinated manner.
- A strong set of policies are needed to support the transition away from implicit guarantees, including improvements to restructuring frameworks, financial sector buffers, and social safety nets.
- Simultaneous implementation of reforms could enable a job-rich and balanced recovery for the medium term. One critical area is enabling competitive neutrality in both input (credit access in particular) and output markets (removing entry barriers and enabling market access). Product market reforms, such as deregulating protected industries, tend to be particularly effective during the recovery from crises as the entry of new private firms can be a net job creator. An important step is to also enable exit and restructuring of non-viable SOEs, however it is important these also get implemented with complementary reforms to social security so that workers are not the ones who lose out.

Climate Change

49. 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?

- Once implemented, China's carbon neutrality pledge could bring about the biggest reduction in projected global warming to date. A key to attracting investment, both domestic and foreign, in support of this goal is aligning China's green financing standards closer to international green standards. Among the areas deserving attention are, for example, (i) the elimination of coal-related projects (suggested in the latest draft of China's 2020 Green Bond Catalogue) and other non-coal fossil fuel projects such as oil and gas extraction; (ii) creating consistency across green finance taxonomies such as extending green standards to credit, and (iii) improving environmental disclosure requirements in stock markets. The PBC has also called for more environmental disclosure of bank's lending to carbon emitters as well as more spending on climate-related R&D.

Constituency Codes

OEDAE
Angola, Botswana, Burundi, Eritrea, Eswatini, Ethiopia, The Gambia, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Nigeria, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Tanzania, Uganda, Zambia, and Zimbabwe

OEDAF
Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Equatorial Guinea, Gabon, Guinea, Guinea Bissau, Madagascar, Mali, Mauritania, Mauritius, Niger, Rwanda, São Tomé & Príncipe, Senegal, Togo

OEDAG
Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay

OEDAP
Australia, Kiribati, Korea, Marshall Islands, Federated States of Micronesia, Mongolia, Nauru, New Zealand, Palau, Papua New Guinea, Samoa, Seychelles, Solomon Islands, Tuvalu, and Vanuatu

OEDBR
Brazil, Cabo Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Timor-Leste, and Trinidad and Tobago

OEDCC
China

OEDCE
Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, and Spain

OEDCO
Antigua and Barbuda, The Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines

OEDEC
Austria, Belarus, Czech Republic, Hungary, Kosovo, Slovak Republic, Slovenia, and Turkey

OEDFF
France

OEDGR
Germany

OEDIN
Bangladesh, Bhutan, India, and Sri Lanka

OEDIT
Albania, Greece, Italy, Malta, Portugal, and San Marino

OEDJA
Japan

OEDMD
Afghanistan, Algeria, Ghana, Islamic Republic of Iran, Libya, Morocco, Pakistan, and Tunisia

OEDMI
Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Maldives, Oman, Qatar, United Arab Emirates, and Yemen

OEDNE
Andorra, Armenia, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Luxembourg, Moldova, Montenegro, Netherlands, Republic of North Macedonia, Romania, and Ukraine

OEDNO
Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden

OEDRU
Russian Federation and Syrian Arab Republic

OEDSA
Saudi Arabia

OEDST
Brunei Darussalam, Cambodia, Fiji, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Nepal, Philippines, Singapore, Thailand, Tonga, and Vietnam

OEDSZ
Azerbaijan, Kazakhstan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, and Uzbekistan

OEDUK
United Kingdom

OEDUS
United States