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PEOPLE'S REPUBLIC OF CHINA

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE PEOPLE'S REPUBLIC OF CHINA

July 2014

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2014 Article IV consultation with the People's Republic of China, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 25, 2014, following discussions that ended on June 5, 2014, with the officials of the People's Republic of China on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 8, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Staff Statement** of July 25, 2014 updating information on recent developments.
- A **Press Release** summarizing the views of the Executive Board as expressed during its July 25, 2014 consideration of the staff report that concluded the Article IV consultation with the People's Republic of China.
- A **Statement by the Executive Director** for the People's Republic of China.

The publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

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STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

July 8, 2014

KEY ISSUES

Context. After three decades of remarkable growth, the economy has been slowing. Much of the slowdown has been structural, reflecting the natural convergence process and waning dividends from past reforms; weak global growth has also contributed. Moreover, since the global financial crisis, growth has relied too much on investment and credit, which is not sustainable and has created rising vulnerabilities. Growth was 7.7 percent in 2013, and is expected to slow to around 7½ percent this year and decline further over the medium term.

Focus. The pattern of growth since the global financial crisis is not sustainable and has resulted in rising vulnerabilities. The discussions focused on assessing the risks posed by the continued build-up of vulnerabilities; reforms to unleash new, sustainable engines of growth and reduce vulnerabilities; and how to best manage aggregate demand in this context, as growth is slowing yet risks are still rising. A key takeaway is that to secure a safer development path, accommodative policies need to be carefully unwound, accompanied by decisive implementation of the announced reform agenda to promote rebalancing. The result will be somewhat slower but safer growth in the near term, with the significant long-run benefit of securing more inclusive, environment-friendly, and sustainable growth.

Risks. Credit and 'shadow banking,' local government finances, and the corporate sector—particularly real estate—are the key, and interlinked, areas of rising vulnerability. In the near term, the risk of a hard landing is still considered low as the government has the capacity to combat potential shocks. However, without a change in the pattern of growth, the hard-landing risk continues to rise and is assessed to be medium-likely over the medium term.

Reform agenda. The authorities have announced a comprehensive and ambitious blueprint of reforms. Successful implementation should achieve the desired transformation of the economy, but will also be challenging.

Demand management. Reining in credit growth, local government borrowing, and investment will address the risks, but also slow growth. Macro support should be calibrated to allow needed adjustments to take place, while preventing growth from slowing too much.

Scenarios and spillovers. With faster adjustment and reform implementation, growth will be somewhat lower in the near term, with moderate spillovers for trading partners. However, in the medium term, income and consumption will both be higher—a result that is good for China and good for the global economy.

Approved By
Markus Rodlauer and Kalpana Kochhar

Discussions took place in Beijing, Shanghai, and Shenyang during May 22–June 5, 2014. The staff team comprised Markus Rodlauer (head), Steven Barnett, Mali Chivakul, Waikei Lam, Wei Liao, Wojciech Maliszewski (all APD), Philippe Wingender (FAD), Xiaoyong Wu (MCM), and Alfred Schipke, Murtaza Syed, and Shaun Roache (MCM) (Resident Representatives). Mr. Lipton (First Deputy Managing Director) joined the concluding meetings.

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SETTING

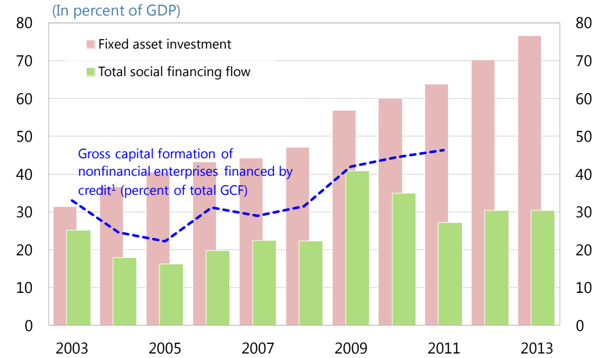
A. Background

1. **Decades of rapid growth are a testament to China's success in implementing reforms**. Since the start of economic liberalization in the early 1980s, China has grown at a rate of almost 10 percent per year, translating into higher living standards and raising over 600 million people out of poverty. This success was built on waves of major reforms, and frequent adjustment of policies in line with evolving conditions. With economic, social and environmental challenges rising, the need for another round of reforms has become ever more urgent. The new government leadership, which came to power early last year, has stated a strong commitment to reinvigorate the effort to transform the economy with a broad and ambitious reform agenda.

2. **The announced reform agenda is broadly consistent with past Fund advice.** The key message from the last few Article IV consultations was that a comprehensive package of reforms was needed to secure more balanced and sustainable growth. The reform blueprint announced after last autumn's closely-watched Third Plenum is a comprehensive package that includes the type of financial, fiscal, external, and social security reforms that were recommended in previous consultations (Appendix I). As would be expected from such an over-arching document, in many areas the blueprint is fairly general. However, this has not been followed up with details on the specific reforms or timetables other than the broad goal to implement the agenda by 2020. Recent measures that are in line with past advice include a widening of the exchange rate band, progress on interest rate liberalization, strengthened financial sector regulation and supervision, and efforts to rein in local government borrowing. Appendix II updates progress with regards to the key recommendations from the 2011 FSAP.

3. **Discussions this year focused on advancing reforms and addressing vulnerabilities, while ensuring that growth does not slow too sharply.** The global financial crisis hit China just as the dividends from the last major wave of reforms (late 1990s and early 2000s) were waning, especially the shift of resources from agriculture to manufacturing, and potential growth was slowing. Since then, growth has relied too heavily on investment and credit, a pattern that is not sustainable and resulting in rising vulnerabilities. The challenge is thus to implement reforms to unleash new sources of growth and address the growing risks, with demand management geared toward preventing growth from slowing too much without undermining adjustment and reforms.

Fixed Asset Investment and Total Social Financing
(In percent of GDP)

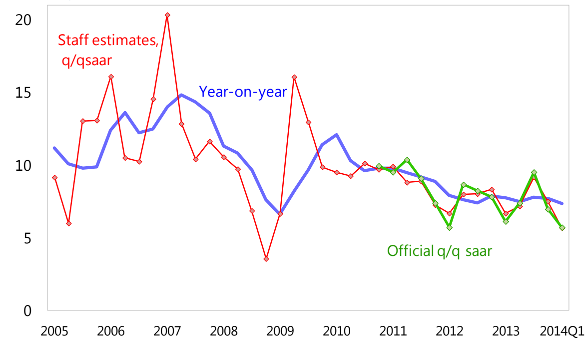


Sources: CEIC; and IMF staff calculations.
[1] Difference between use of gross capital formation and saving of nonfinancial enterprises (flow of funds data).

B. Developments and Outlook

4. **Growth in 2014 is expected to be around 7½ percent, in line with the authorities' target.** Last year, after a weak start, growth picked up in third quarter and the annual target of 7½ percent was exceeded. A similar pattern is emerging this year, as activity was again weak in the first quarter, while more recent data point to some firming, in response to policy action and stronger exports (Figure 1). Domestic demand moderated reflecting a welcome reduction in the growth of total social financing (a broad measure of credit), slower investment growth, and a correction in real estate activity. Despite this, consumption and the labor market have held up well. The authorities have taken a number of measures in the past few months to support activity, including targeted cuts in Required Reserve Ratios (RRRs), tax relief for SMEs, moral suasion on home mortgages, and accelerated fiscal and infrastructure spending. Looking ahead, the near-term growth outlook for China remains to an important extent a function of the government's targets. For 2015, the staff's baseline scenario projects growth to moderate to around 7 percent, assuming continued efforts to rein in vulnerabilities and steady, if slow, implementation of reforms. In particular, a further slowing of investment, especially in real estate, would be only partly offset by stronger external demand from the continuing global recovery.

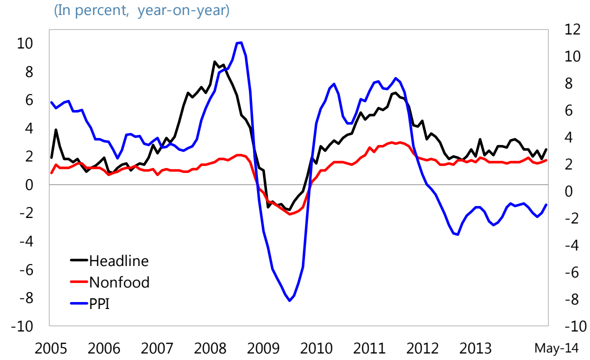
China: Real GDP Growth
(In percent)



Sources: CEIC; Haver Analytics; and IMF staff calculations.

5. **Inflation has been stable.** Nonfood price inflation, a proxy for core, has remained around 2 percent. Although headline CPI inflation has been somewhat more bouncy, this reflects volatility in food prices largely related to agricultural supply shocks. Producer prices, however, have been declining for over two years reflecting excess capacity and weak external demand. Inflation is projected to be around 2 percent this year, assuming no significant shocks to food prices.

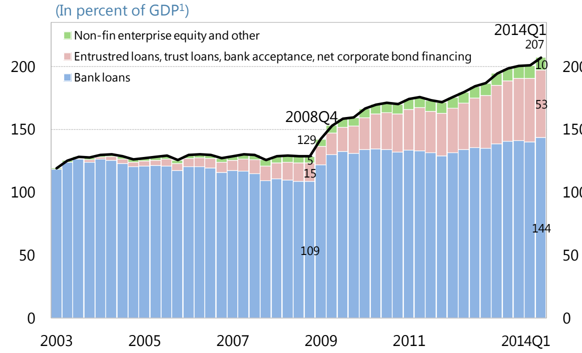
Inflation
(In percent, year-on-year)



Sources: CEIC; and IMF staff calculations.

6. **Although credit growth is still rapid, it has decelerated considerably**. Total social financing (TSF)—a broad measure of credit covering bank lending, funding from shadow banking, and equity—rose from 130 percent of GDP in 2008 to 207 percent of GDP in early 2014. However, growth in TSF decelerated from 22 percent in May 2013 to 16 percent in May 2014 (Figure 2). This coincided with a series of steps to strengthen regulation and supervision, especially of shadow banking, and a rise in interbank interest rates in the second half of

China: Social Financing Stock
(In percent of GDP[1])

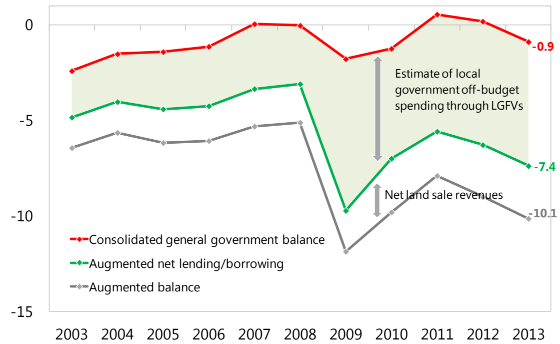


Sources: CEIC; and IMF staff calculations.
[1] In percent of 4Q rolling sum of quarterly GDP.

last year. Additional steps were taken in April and May of this year, mainly targeted at reining in interbank activity as a channel for funding shadow banking. While it is too early to gauge the full impact of these measures, trust financing has slowed considerably and activity appears to be shifting back to conventional bank loans as well as corporate bonds. Much of last year's rise in interbank interest rates was unwound earlier this year, though rates remain modestly higher than April 2013.

7. **Fiscal policy has supported growth significantly in recent years, mainly through off-budget spending.** Official budget data do not suggest much stimulus, but exclude a substantial amount of off-budget and quasi-fiscal activity, largely at the local-government level. To capture such activity, staff updated its estimates of augmented fiscal data, which expand the perimeter of government to include off-budget local government financing vehicles (LGFVs) (Appendix III). The augmented deficit—which is the broadest measure and indicates the impact of fiscal policy on aggregate demand—rose in 2013, indicative of a supportive fiscal stance. Augmented net borrowing—which treats land sale proceeds "above-the-line" and better measures debt creating flows—paints a similar picture and rose to 7.4 percent of GDP in 2013. This pushed augmented debt to 54 percent of GDP in 2013, up from 50 percent of GDP in 2012. A comprehensive audit conducted by the National Audit Office (NAO) found that government debt was close to 40 percent of GDP in 2012, which is lower than augmented debt mainly because the NAO excluded LGFV liabilities that under GFSM 2001 do not count as government debt, such as debts that LGFVs would likely be able to service themselves. The authorities, however, have not published a time series of government debt or data on deficits that are consistent with the NAO definition of government. In the absence of such data, the augmented debt (except for those years that NAO debt data are available) and balance data provide a useful complement to general government data. The actual deficit, consistent with the NAO definition of debt, is probably somewhere between the augmented and general government estimates, varying year-to-year depending on how much of LGFV activity is commercial.

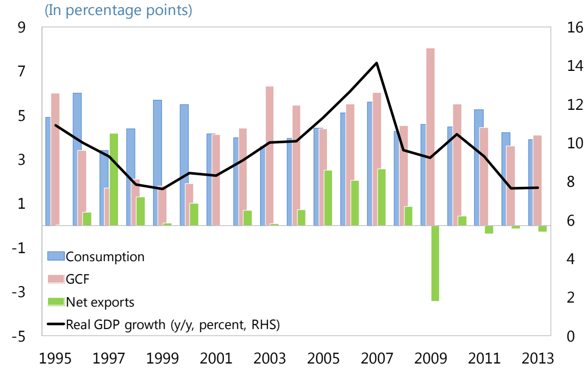
China: General Government Balance
(In percent of GDP; including state-administered SOE funds and social security)



Sources: CEIC; and IMF staff estimates.

8. **Progress on rebalancing has been mixed (Figure 3).** External imbalances have fallen considerably, with the current account surplus declining to 1.9 percent of GDP last year. The sharp decline of around 8 percent of GDP since 2007 reflects appreciation of the REER (30 percent since 2007), weak growth in advanced economies, terms of trade worsening, and rapid growth in domestic investment. On domestic rebalancing, the economy is still heavily dependent on investment, which was the largest contributor to growth in 2013. While consumption growth has been robust, household savings still continued to rise. On the

Contribution to Growth
(In percentage points)

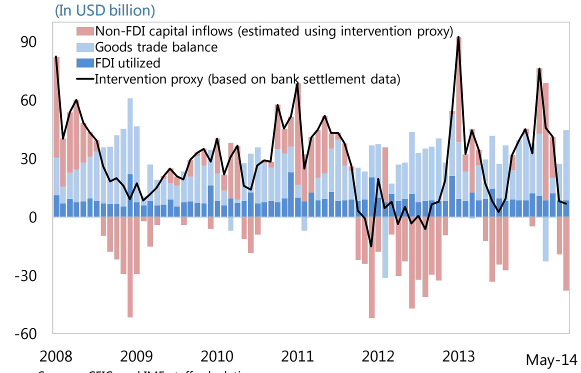


Sources: CEIC: and IMF staff calculations.

positive side, urban household income has been growing faster than GDP and the share of the service sector, both in output and employment, has been rising.

9. **Non-FDI capital flows have continued to be volatile.** Earlier this year, non-FDI capital was flowing into China fueled by loose monetary conditions in major advanced economies and carry-trade, with interest rate differentials compounded by expectations of continuing renminbi appreciation. Combined with FDI inflows and the trade surplus, these inflows led to a BOP surplus. Indeed, BOP data indicate that intervention (change in reserve assets) was over US$ 100 billion in the first quarter—on top of US$ 430 billion for last year (Figure 4). In late February, the renminbi started to depreciate against the U.S. dollar in what was widely considered to be a deliberate move by the PBC to make the carry-trade less attractive and break perceptions that renminbi appreciation was a one way-bet. Subsequently, market dynamics changed as non-FDI flows reversed direction and intervention appears to have fallen sharply. Moreover, in contrast to the usual pattern over the last several years, the renminbi has been closing mostly on the weaker side of the daily trading band.

Trade, FDI, and Foreign Exchange Intervention
(In USD billion)



Sources: CEIC; and IMF staff calculations.

10. **Authorities' view.** The authorities were confident that this year's target of around 7½ percent growth would be achieved. They broadly agreed with staff's inflation forecasts. The authorities emphasized that the fiscal position remained strong, as reflected in the official figures and confirmed by the NAO audit, and prompt actions have been taken to address potential risks. Staff's estimates following the Fund's widely adopted methodology of the Government Finance Statistics could provide complementary analysis of the fiscal developments in China. The use of augmented fiscal estimates, the coverage of which differs from that of the general government position as defined in the Government Finance Statistics, could easily cause confusion and misreading. Thus the augmented fiscal data should not be used, especially as the staff estimates were imprecise (due to key simplifying assumptions) and included items that should be excluded from the fiscal accounts (such as commercial activity by LGFVs). In particular, considering land sales as a financing item has led to significant exaggeration of fiscal deficit.

11. **On domestic rebalancing, the authorities pointed to strong growth of services relative to manufacturing and rapid increases in urban and rural household incomes.** The authorities also pointed to the slowdown of investment growth and lower contribution of investment to GDP over the last few years, compared to 2009/10 when the priority was to boost domestic demand in response to the Global Financial Crisis. They were confident that the reforms in the Third-Plenum blueprint would support the desired rebalancing to a more consumer-based economy. Regarding intervention, they noted that the change in reserve assets (the staff intervention measure) also includes the income on China's international reserves.

RISKS AND BUFFERS

12. **Although efforts have begun to address them, vulnerabilities are still rising, reflecting years of reliance on credit and investment to fuel growth.** Real estate, in particular, is posing a growing challenge as it has become a major engine of growth yet is also in need of adjustment. The authorities still have sufficient buffers to prevent a sharp growth slowdown in the near term, essentially by using public resources and state influence. However, repeated reliance on these buffers without addressing the underlying sources of risk and changing the growth model would further exacerbate vulnerabilities and reduce future growth prospects. In particular, continued efforts to sustain growth through additional credit and investment would vitiate the recent steps taken to rein in vulnerabilities (particularly in the area of shadow banking activities and local government finances). As a result, the risk of disorderly adjustment would continue to rise, especially as the size and complexity of the financial system are rising fast.

A. Domestic Vulnerabilities

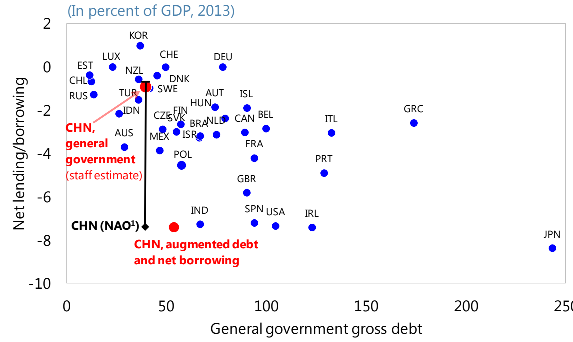
13. **A web of vulnerabilities exists across key sectors of the economy**. To finance rapid investment, firms and LGFVs have borrowed from both banks and shadow banks. This has resulted in rising corporate and local government indebtedness, which is the flip side of the large increase in TSF since 2008. Many strands of the web, moreover, run through the real estate sector. Banks and shadow banks are exposed to real estate directly through credit to developers and household mortgages, and indirectly through the use of real estate as collateral for other loans. Local government spending is also linked to the real estate sector, directly through land sales revenue and indirectly through the tax revenue generated by real estate related activity. Given these interconnections, a major shock to any part of the web would reverberate throughout the whole, creating a negative feedback loop that could considerably amplify the original shock. For example, a real estate shock would reduce growth directly (mainly through lower investment) and indirectly through the knock-on effect to related sectors and the impact on local government finances. The ensuing slowdown would hurt the ability of firms to repay loans, resulting in rising NPLs that would constrain banks' ability to lend and, in turn, lead to another round of less investment, lower growth, and worsening asset quality.

- **Real estate (Box 1).** Real estate has been a significant engine of the economy, but it has shown growing signs of imbalances and activity has softened in 2014. The challenge is to allow for the necessary correction while preventing an excessively sharp slowdown. The contribution of real estate and construction to growth has been rising; last year, it accounted directly for 12.8 percent of value added, and about 33 percent if upstream and downstream sectors are included. Residential real estate is marked by substantial regional differentiation. Large cities have enjoyed favorable demand conditions—reflecting both underlying and speculative demand—and prices show signs of overvaluation relative to fundamentals, despite measures aimed at restricting speculative demand. In contrast, many smaller cities have experienced oversupply as local governments promoted large-scale development to boost growth and used land sales to finance local government spending. Supply seems to have outpaced demand in many areas as evidenced by muted price increases and rising inventories. The commercial real estate market appears to be in oversupply in both smaller and bigger cities.

- **Corporate sector (Box 2).** Consistent with strong growth in TSF and investment, corporate debt has risen significantly, particularly in sectors which contributed most to post-crisis growth (mainly real estate and related industries). Data on the entire universe of the corporate sector are not available, but total debt of listed firms has increased by 10 percentage points of GDP since 2007 (to 35 percent of GDP), with about half of the increase coming from real estate and construction sectors. Reflecting regional differences in the property market, the financial situation of real estate companies varies, with big developers in large cities performing better than smaller companies in lower-tier cities. In aggregate, listed real estate and construction firms account for about 25 percent of total listed-firm liabilities, and most of this is held by a relatively small number of highly-leveraged firms (about 80 percent of total liabilities in listed real estate and construction firms are held by about 60 firms with liabilities more than three times of equity). There has also been a substantial increase in leverage among SOEs (including those operating in sectors with overcapacity), who enjoy privileged access to financing on the back of implicit state guarantees.

- **Local governments (Box 3).** Compared to other countries, China's fiscal debt—regardless of how measured—does not appear particularly large. The deficit, however, stands out somewhat more, especially the augmented net borrowing measure. Moreover, some local governments likely face more significant challenges with a combination of large off-budget borrowing and a limited revenue base. China has benefited from a very favorable interest-growth differential, which has allowed the economy to out-grow part of the increase in public debt. However, as shown in the Debt Sustainability Analysis (Appendix V), the increase in debt has made the fiscal position more vulnerable to shocks.

Public Debt and Fiscal Deficit
(In percent of GDP, 2013)



Sources: CEIC; IMF, *World Economic Outlook*; NAO; and IMF staff estimates and calculations.
[1] NAO audit indicates general government debt of 39.4 percent of GDP as of end-2012. The NAO audit does not provide a government deficit figure. Staff estimate that the corresponding deficit would be within the range shown.

- **Banks (Figure 5).** China's banking system is both an anchor of stability and a potential source of vulnerability. The financial system, especially banks, is still predominantly state-owned—benefitting from implicit backing of the government—and official data show that bank balance sheets are healthy. However, gross NPL formation is now picking up and the rapid post-crisis credit expansion raises risks of further asset quality deterioration (particularly in smaller banks heavily involved in funding the stimulus at the local government level, including local real estate developers). Banks are also involved in the expansion of shadow banking activity (see below), and liquidity risks have increased as some banks are persistent borrowers in interbank markets and liquidity demand and

Selected Banking Indicators
(In percent)

All commercial banks	2008	2009	2010	2011	2012	2013	2014:Q1
Total CAR ratio	12.0	11.4	12.2	12.7	13.3	12.2	12.2
NPL ratio	2.4	1.6	1.1	1.0	1.0	1.0	1.0
Substandard	1.1	0.7	0.4	0.4	0.4	0.4	0.5
Doubtful	1.0	0.7	0.5	0.4	0.4	0.4	0.4
Loss	0.3	0.2	0.2	0.2	0.1	0.1	0.1
Provision coverage ratio	117	155	218	278	296	283	274
Return on assets	1.1	1.0	1.1	1.3	1.3	1.3	1.4
Return on equity	19.5	18.0	19.2	20.4	19.8	19.2	...

Sources: CEIC; CBRC.

money market rates have been volatile. Bank stocks often trade at a discount to international peers, indicative of market concerns about bank balance sheets and the outlook for the sector.

- **Shadow banking (Box 4).** The authorities have taken important steps to contain shadow banking activity, but it remains a source of risk. Shadow banking emerged as an important source of funding for sectors involved in the post-crisis stimulus (real estate, local government infrastructure projects, and SOEs). It became the fastest-growing segment of the financial sector, reflecting in large part regulatory arbitrage as on-balance sheet bank lending has been constrained by financial safeguards (such as capital requirements and loan-to-deposit ratios) and the ceiling on deposit interest rates. Given weaker regulations and the lack of transparency, shadow banking could represent the weak tail of credit distribution. A significant portion of credit appears to be going to SOEs and LGFVs, limiting perceived risks to the extent that such assets are likely to benefit from government support. Moreover, shadow banking investment products have been offered or distributed by banks, strengthening the perception of implicit guarantees (in particular on deposit-like products for retail investors). Together with returns well above the statutory ceiling on deposit rates, this has attracted significant funding to the sector, often without due regard for the quality of underlying assets.

B. Domestic Risk Assessment

14. **Notwithstanding the rise in vulnerabilities, an abrupt adjustment in the near term is unlikely, given China's policy buffers.** Cross-country evidence suggests that credit booms of a similar size often led to sharp corrections (Box 5). However, in China the government still has the capacity to absorb shocks and prevent the kind of loss of confidence or sudden stop that have triggered major problems in other countries—such as a deposit run, freezing-up of the interbank market, collapse of the real estate market, or capital flight. Total public debt is relatively low; public sector assets are large (including foreign exchange reserves); domestic savings are high and foreign debt exposures low; capital controls limit the risk of capital flight; and the government retains substantial levers to control economic and financial activity. For these reasons, the probability of a hard-landing in the near term is low. At the same time, repeated use of this policy space—in particular, through credit-financed investment stimulus—risks compounding the underlying vulnerabilities.

15. **Thus, without a change in the pattern of growth, the likelihood of a shock triggering financial disruption and/or a sharp slowdown will continue to rise.** Overreliance on credit and capital accumulation to support growth would further weaken balance sheets and reduce investment efficiency. This would ultimately lead to a slowdown in growth, and put further pressure on corporate profits and the financial system. The more vulnerabilities accumulate, the more likely it is that a shock could trigger a negative feedback loop. Thus, although the near-term risk of a hard landing is low, it increases to medium over a medium-term perspective.

16. **Authorities' views.** There was consensus that the current pattern of growth was unsustainable, and that structural reforms were critical to unleash new engines of growth. The authorities recognized the importance of containing risks and were confident that vulnerabilities were well under control with the countervailing measures put in place, but would remain vigilant. On

the financial side, they considered the rapid growth in trust, WMP, and corporate bond activity as important shifts toward more market-based intermediation. They acknowledged that this process involved risks, but viewed these as manageable, especially after recent steps to improve supervisory oversight. While reported NPLs had been rising in some industries, they remained low and Chinese banks had some of the highest capital and provisioning ratios in the world. The authorities continued to monitor closely the real estate market, and would fine-tune policies as necessary to ensure the stable development of the market, including for low-income housing. At the same time, they acknowledged that rapid growth had helped mask some of the problems in the past, but with growth slowing, they were being especially vigilant, particularly with respect to risks in the fiscal and financial sectors. Local government debt had become a pressing issue in some jurisdictions, but was being addressed by further strengthening of local debt management, including the creation of a monitoring system to contain risks. Overall, the authorities emphasized that banks and other financial institutions appeared comfortable with their exposures and the underlying health of projects they had financed.

C. External Risks

17. **External shocks would impact China mainly through the trade channel.** Spillovers from potential financial market volatility in the course of exit from UMP in advanced economies (AEs), or from a protracted period of slower growth in advanced and emerging economies, would have the strongest repercussions for China's economy. In both cases the main impact would be through lower export demand, with some knock-on effects for corporate profits, employment, and domestic demand. If this or other external shocks were to slow near-term growth too sharply, on-budget fiscal stimulus should be used in a manner that supports rebalancing and helps protect vulnerable groups. The Risk Assessment Matrix (Appendix IV) summarizes the main external and domestic risks.

18. **Authorities' views.** The authorities remained concerned about the impact of continued slow growth in major AEs, which was having adverse spillovers for growth in China and the rest of the world. They also regard a slowdown in emerging markets as an important risk, given the contribution to China's export growth from this source. They considered turbulence related to monetary policy normalization in advanced economies as less of a direct risk for China. However, it could indirectly impact China through the effect on other economies, especially emerging markets.

SUSTAINING GROWTH AND MANAGING RISKS

A. Transition to a New Growth Model

19. **Implementation of the reform blueprint will move the economy to a more inclusive, environment-friendly, and sustainable growth path**. The aim is to use resources more efficiently and unleash new sources of productivity growth, in a way that better protects the environment and ensures that growing prosperity is widely shared. Key principles include giving the market a more decisive role, eliminating distortions, and strengthening governance and institutions. While the blueprint is comprehensive, it has not been followed up with details on the timing and specifics of the reforms. The discussions focused on the issues that staff considered to be the priorities. Staff urged the authorities to implement the priority reforms quickly and as a package, noting interdependencies, in particular, among

the financial sector, SOE, exchange rate, and local government reforms.

Financial sector, SOE, and monetary policies

20. **Financial sector reforms will help safeguard financial stability and improve the allocation of credit.** Widespread implicit guarantees—of savers, intermediaries, and borrowers—and the cap on deposit rates distort the pricing of risk and borrowing costs, contributing to the misallocation of credit and inefficient investment. Introducing deposit insurance is important to define the perimeter of state guarantees for investors (and thus clarifying what lies outside this perimeter). Removing implicit guarantees also requires greater tolerance of corporate defaults and bankruptcies, including of SOEs. With lending rates now liberalized and more savings vehicles in the market, conditions are ripe for the next step in deposit rate liberalization. Options include increasing upward flexibility or allowing higher rates for some types of deposits.

21. **SOE reforms are important in their own right, and a key complement to financial sector reforms.** The aim is to 'level the playing field' and generally allow markets rather than the state to allocate resources. Needed reforms include opening up to full and fair competition activities currently reserved to SOEs, properly pricing finance and other factor inputs, requiring adequate dividend payments to the budget, and imposing hard budget constraints. The latter means that those SOEs that cannot compete successfully on a level playing field should exit. This is critical for the government's strategy for SOE reforms—as long as SOEs are perceived to benefit from an implicit backing of the state, they will have preferential access to financing that will continue to tilt the playing field, distort competition, and misallocate resources. Opening up the service sector—in areas such as education, health, finance, telecom, and logistics—to more competition will also be key for generating the productivity gains needed to fuel growth and for boosting household income, as services tend to be more labor intensive than industry.

22. **As part of the move to a more market-based economy, the transition to a new monetary policy framework should continue.** Regardless of the ultimate framework that China adopts, it is becoming increasingly important to use interest rates as the primary instrument of monetary policy given the growth of shadow banking and planned deposit rate liberalization. This will require establishing a policy interest rate, such as the overnight or seven-day interbank repo rate. As an interim step, the volatility of these short-dated interbank rates should be reduced by introducing reserve averaging, improving communication with the market, and creating an interest rate corridor. Improving the functioning of standing liquidity facilities, to ensure that all qualified banks can directly and automatically access them at a predetermined price, will provide a ceiling for the corridor and also help strengthen liquidity management.

23. **Authorities' views.** The authorities agreed that financial sector reforms were critical, and highlighted the progress already made in this area. They planned to introduce deposit insurance in the near future and advance deposit rate liberalization as circumstances allowed. They also agreed that removing implicit guarantees, pervasive throughout the financial and corporate landscape, was key. This saw moral hazard as distorting the allocation of credit and investment, posing a risk to the success of financial liberalization which rested critically on hard budget constraints. Linked to this, the authorities explained that their strategy for SOE reforms included leveling the playing field and

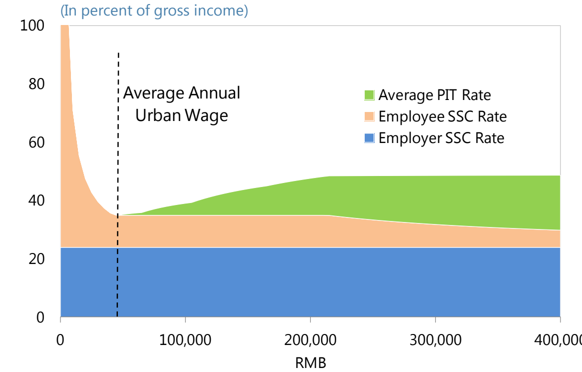
opening up to more competition, with the exception of some strategic sectors. Regarding the monetary policy framework, they agreed on the importance of relying more on interest rates over time. They welcomed the joint IMF-PBC conference that was held on this topic in March (see: http://www.imf.org/external/np/seminars/eng/2014/pbc/).

Fiscal and other reforms

24. **Improving fiscal management, especially of local government finances, will help contain risks and better allocate resources**. The blueprint highlights improving local government finances as a priority. This includes better aligning local revenue with expenditure responsibilities as well as strengthening oversight and management of local government borrowing. The plan to put in place a new framework to limit local borrowing, improve reporting, and establish an early warning system should be implemented as soon as possible. In this context, the authorities envisage selectively 'opening the front door' while 'closing the back door' to municipal borrowing, with a recent pilot allowing some local governments to borrow directly from the market, under strengthened rules for creditworthiness, accounting, and transparency. Improving the fiscal framework is a priority for the medium term, especially strengthening budget processes and adopting a medium-term fiscal plan.

25. **Tax reforms will promote more efficient and inclusive growth**. The ongoing extension of VAT to services as a replacement for the existing business operation (turnover) tax is welcome. It is more efficient and easier to collect, and will encourage investment in services and reduce distortions caused by the cascading of a turnover tax. The planned introduction of a recurrent property tax, beyond the limited pilots in Chongqing and Shanghai, will help reduce speculative real estate activity, efficiently raise revenue, and improve progressivity. China's revenue from real estate taxation is within the range of other countries; however, it comes almost entirely from transaction-related taxes and fees. Thus, there may be scope to offset some of the impact of introducing a property tax by reducing these transaction taxes and fees. The combined income tax and social contribution system is fairly regressive. Currently, social contributions raise nearly five times more revenue than the personal income tax, suggesting scope to rebalance toward PIT and make the combined system more progressive.

Average Tax Wedge, by Income Level
(In percent of gross income)



Sources: IBFD, CEIC and IMF staff calculations.

26. **Social security reform has the potential to boost consumption and address inequality.** On the expenditure side, further strengthening the pension and health insurance systems—including by improving and expanding coverage—would have macrobenefits such as reducing precautionary household savings. Social contribution rates, which are high and very regressive, should also be reduced as they distort the labor market, make growth less inclusive, and favor informal over formal employment. These reforms should be done in a way that ensures the sustainability of the social security system, including through parametric changes to the pension system and transferring the

welfare and legacy components to the budget. The resulting costs to the consolidated general government will need to be offset by revenue gains from the improvements in the tax system (described above) and cuts in lower-priority spending. Staff analysis shows that such reforms are consistent with securing sustainable public finances (Box 6). Together with household registration (hukou) and rural land reforms, strengthening the social security system will make a significant contribution to elevating living standards, improving the labor market, and boosting labor income.

27. **Rationalizing the use of natural resources will promote more environment-friendly growth.** Options include adjusting prices, including through better calibration of excise and other taxes (such as a carbon tax on coal, fuel, and gas) to capture the cost of externalities, strengthening emission taxes, and strict enforcement of environmental regulations and incentives to use greener technologies. China already has a broad set of environmental laws and regulations, whose strict enforcement would be major progress in protecting the environment (Box 7).

28. **Gradual further opening up the capital account is part of the reform agenda.** Capital account liberalization is listed as one of the key reforms in the Third-Plenum blueprint and RMB internationalization is advancing (Box 8). The approach could include further expanding the list of domestic and international investors qualified to engage in capital account transactions under existing quotas, and gradually increasing these quotas. More immediately, the Shanghai Pilot Free Trade Zone established in 2013 liberalized certain restrictions for residents and financial institutions in the Zone: allowing them to set up accounts with higher capital account convertibility, easing controls on outward investments including in securities and derivatives and restricting inward FDI only by an announced 'negative list.' The pilot is designed to 'test-drive' liberalization and administrative simplification in a more narrow setting, and to apply the lessons learned as liberalization is broadened progressively. Staff welcomed the goal of capital account liberalization as a key objective of the Third-Plenum blueprint, noting that it had to be carefully sequenced with other reforms, in particular, in the financial, SOE and fiscal sectors and exchange rate flexibility.

29. **Further improvements in data will help economic analysis and policymaking.** Staff encouraged the authorities to graduate from the General Data Dissemination Standard (GDDS) to the Special Data Dissemination Standard (SDDS) and participate in the Coordinated Portfolio Investment Survey (CPIS). In the macroeconomic area, priorities include improving fiscal data, both timeliness and coverage; quarterly and annual national accounts especially expenditure data and labor market statistics. Data issues are discussed in more depth in the Informational Annex.

30. **Authorities' views**. Fiscal reforms are central to the authorities' reform plans. The welcomed the ongoing technical cooperation with FAD on improving the fiscal framework. They agreed that improving management of local government finances was a priority and were confident that their announced strategy would achieve this. Regarding the property tax, the authorities were studying the experience in the pilot areas, which helped in preparing legislation. They agreed that there was room to better calibrate the PIT and SSC to address inequality, but noted the current PIT schedule was already progressive. They added that SSC would be reduced at an appropriate time and pace, while stressing that any reforms to benefits and contributions had to take into account the importance of securing the long-term sustainability of the system. They agreed that an environment tax would help address externalities from pollution. They considered that appropriate targets and measures were in place to reduce air, water,

and soil pollution, following the State Council's approval of the amendments to the Environment Protection Law in April. Regarding data, the authorities were actively considering subscription to SDDS and have been working with STA to conduct technical preparations.

External assessment, exchange rate policy, and rebalancing

31. **The external position is moderately stronger compared with the level consistent with medium-term fundamentals and desirable policy settings (Box 9).** On that basis, the renminbi is assessed as being moderately undervalued. In terms of the External Balance Assessment (EBA) model, China's policy gaps (policies different from desired ones, contributing to a moderately stronger external position) stem mainly from intervention, capital controls, and health spending. The pace of reserve accumulation slowed significantly in 2012, but picked up again in 2013 against the backdrop of large capital inflows induced by interest rate differentials, the relatively high real return of capital, and expectations of continued RMB appreciation. Reserves are above the range suggested by the Fund's metric, rendering further accumulation unnecessary from a reserve adequacy perspective.

32. **A flexible, market-determined exchange rate is an important part of the reform agenda.** A market-determined exchange rate—in which there is no sustained, large, and asymmetric intervention—is key for sustained rebalancing and as a shock absorber as the capital account is progressively liberalized. Moreover, given the rapid growth in offshore renminbi markets and growing opportunities for financial arbitrage, it is also becoming increasingly important for maintaining an independent monetary policy. The recent doubling of the daily trading band is a welcome step forward. Looking ahead, the goal should be to allow greater flexibility and reduce intervention, which could be achieved by further widening the band and ensuring the central parity better reflects market conditions.

33. **Sustained rebalancing will depend on successful implementation of the reform agenda.** Implementation of the blueprint would help close the policy gaps identified in the EBA model by moving to a more flexible, market-determined exchange rate (reducing intervention); opening the capital account; and strengthening the social security system. Therefore, as reforms are implemented, the external position should reach equilibrium. As regards domestic rebalancing, the package of reforms will increase the share of consumption in GDP, with a corresponding decline in investment. Consumption will rise, for example, as social security reforms decrease household saving; the opening-up of the service sector spawns more labor intensive growth that boosts household incomes; and fiscal reforms and currency appreciation support higher household spending.

34. **Authorities' views.** The authorities disagreed with the assessment that the real exchange rate was moderately undervalued and considered that it was close to equilibrium. They reiterated their previous concerns and strong reservations on EBA, and emphasized the importance of evenhandedness. In particular, they considered that the assessment failed to account for the impact of advanced economy monetary policies on global financial flows and emerging market economies, the continued narrowing of China's current account surplus, two-way fluctuations of the exchange rate, substantial appreciation of REER, and the movements of other currencies (such as the U.S. dollar). On the current account, they expected a flat or declining surplus over time as they considered

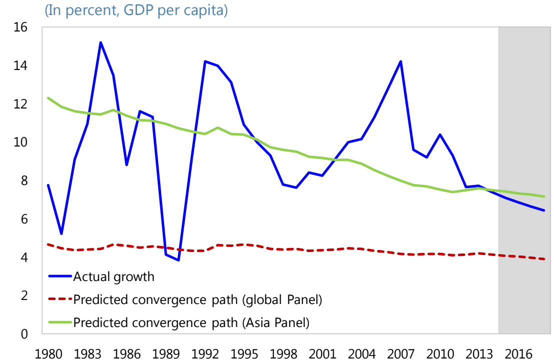
that the services deficit would likely continue to rise while the goods surplus would not increase significantly. On the exchange rate, they remained committed to moving toward greater flexibility and avoiding regular intervention. They reiterated that unconventional monetary policy in advanced economies was slowing progress in this regard. They agreed that external and domestic rebalancing would derive from successful implementation of the gamut of economic reforms in the Third-Plenum blueprint, and added that ongoing urbanization (with a target urbanization rate of 60 percent by 2020) would contribute to elevating living standards, improving the labor market, and boosting labor income.

B. Addressing Vulnerabilities and Managing Demand

35. **The challenge for demand management is to allow the necessary adjustments in the economy to proceed, while at the same time preventing too sharp a slowdown in growth.** Structural reforms will boost growth and help address vulnerabilities, but additional measures are also required. In particular, a reduction in off-budget spending, further reining in credit growth, and slower investment growth are required to contain risks. The drag on activity from these policies is bound to be felt right away, while the growth payoff from structural reforms will be down the road. Finding the right mix of reducing vulnerabilities and maintaining growth will be an ongoing challenge. For this year, the staff argued that the authorities' should accept somewhat slower growth and deploy a stimulus only if growth were set to slow significantly below their target. At this point, such a stimulus does not appear to be warranted.

China: Actual vs. Predicted Growth

(In percent, GDP per capita)



Source: IMF staff estimates and calculations.

36. **Quantifying the right speed for the economy is especially challenging at this juncture.** There is considerable uncertainty regarding the rate of potential growth and the degree of resource misallocation in the economy (Box 10). Against this background, and consistent with focusing on the right policies to achieve the highest sustainable growth rate, consideration should be given to targeting a range instead of a particular point for GDP growth. For 2015, the staff suggested a target range of 6½–7 percent as consistent with the goal of transitioning to a safer and more sustainable growth path. In setting the range, consideration should be given to the following:

- **Reforms are needed to sustain even the lower potential growth rate.** China's potential growth has been falling in line with the pattern observed in other fast-growing Asian economies. Achieving this growth path over the medium term, however, will depend on the success in implementing structural reforms to unleash new sources of productivity growth.

- **Containing vulnerabilities likely implies somewhat lower near-term growth**. Reducing unsustainable investment demand will affect key sectors, such as real estate (where adjustment has already started) and others with overcapacity. This will have a direct effect on economic activity, but also indirect effects as lower aggregate demand spills over to rest of the economy.

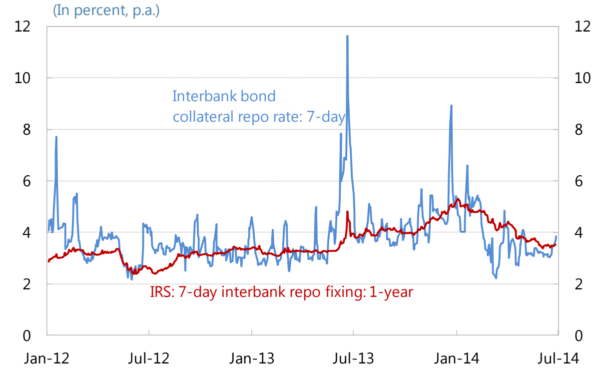
- **Policies will need to allow for correction in inefficient and overcapacity sectors**. Macro support—if needed to prevent a sharp drop in demand and buy time for labor and capital to move to more efficient sectors—should be consistent with the reform agenda.

37. **Fiscal adjustment should ensure that government debt is on a sustainable path.** This could largely be achieved by reining in local-government off-budget borrowing, which is a near-term priority and is consistent with other planned fiscal reforms (see Box 6). Consolidation in the augmented balance of about 1 percent of GDP a year on average over the next five years would put augmented debt on a declining path. The exact pace of adjustment each year should be calibrated to avoid an excessive slowdown—taking into account the growth impact of structural reforms and efforts to reduce vulnerabilities. If needed, fiscal support should preferably be deployed on-budget with measures aimed at protecting the vulnerable and advancing reform. Options include reducing social contributions, strengthening the social safety net, central government support for hukou reform, and priority infrastructure projects.

38. **Ensuring financial stability will require continued reduction in overall credit growth and improving its allocation.** TSF growth has slowed considerably since early-2013. The recent steps to strengthen supervision and regulation should help rein in shadow banking and shift activity to better-regulated formal banks (especially by prohibiting reliance of shadow banking on interbank market transactions). The measures are in the right direction, though continued vigilance is needed to ensure their effectiveness and to guard against the market finding new ways to circumvent the regulations. Further strengthening regulation and supervision remains a priority, particularly by ensuring a swift implementation of the already adopted measures. Ongoing financial sector reforms, such as liberalizing deposit rates and removing implicit guarantees, will also reduce credit growth and improve its allocation. In particular, average lending rate will likely increase and borrowing costs will rise for many SOEs benefitting from implicit guarantees, shifting lending to dynamic private firms that are currently rationed out of the formal credit market (yet able to afford higher interest rates given the value of their underlying projects).

39. **Monetary policy should be calibrated to support the ongoing reduction in TSF growth while continuing to ensure low inflation.** To help further slow and improve the allocation of TSF, monetary policy tools should complement the ongoing strengthening of regulations and supervision, financial sector reforms, and use of macroprudential tools. Consistent with the move to more price-based tools, liquidity management should increasingly target movements in interbank interest rates. Higher interbank rates in the second half of last year likely contributed to the slowing of TSF growth, although the extent is hard to assess in light of ongoing structural reforms and uncertainties about the evolving transmission mechanism. If TSF growth does not continue to slow, liquidity conditions should be tightened by gradually pushing interbank interest rates back up. However, this alone will not be sufficient to manage credit

Interbank Repo Rate and Interest Rate Swap
(In percent, p.a.)



Sources: CEIC; and IMF staff calculations.

growth in the present environment, especially as many SOE borrowers may not be interest rate-sensitive. Therefore, macroprudential tools should also continue to be deployed.

40. **In the real estate sector, the challenge is to prevent a further build-up of risks, while avoiding a disorderly correction in the market.** An adjustment in the market is needed and in line with the recommended slowing of credit growth. At the same time, preventing a sharp correction is important. Policies will have to vary by locality, but could include selective unwinding of demand control measures and building social housing. Care must be taken, however, to find the right mix of allowing adjustment to take place and supporting the market if necessary. Over time, the underlying pressure on real estate to expand should abate as (i) financial market reforms and capital account liberalization provide more investment alternatives; and (ii) reform of local government finances reduces incentives for real estate development as a source of revenues.

41. **Authorities' views.** While the authorities agreed that a major stimulus was not needed at this juncture, they emphasized that they were committed to achieving this year's growth target. On fiscal adjustment, they stressed the importance of controlling risks from local government borrowing and highlighted that this was flagged as a priority for 2014 in last December's Annual Economic Work Conference. The authorities emphasized progress in improving financial sector regulation and supervision, especially the recent steps to improve the functioning of the interbank market which should help contain risks from off-balance sheet and nonbank intermediation. On real estate, they viewed the long-run dynamics of the market to be healthy, and considered a near-term correction manageable.

SCENARIOS AND SPILLOVERS

42. **Fast implementation of reforms would have substantial benefits in terms of boosting living standards and reducing risks.** Staff prepared three scenarios (Box 11) to illustrate the costs and benefits of pursuing reforms at various speed and intensity.

- **Fast reform.** In a scenario with fast implementation of reforms growth would be somewhat slower in the near term. However, compared to alternative scenarios with slower or no reforms, income and consumption per capita would be higher by 2019. Debt is falling and credit growth is likely to be slower, leading to a faster reduction of vulnerabilities and eliminating the risk of a sharper slowdown.

- **Baseline (medium scenario).** The staff baseline, which is an intermediate scenario, assumes that the Third-Plenum reforms are implemented, but largely in the latter part of this decade. As a result, the economy would remain on a more risky trajectory in the near term. Growth remains dependent on investment, and fiscal adjustment is more gradual and back-loaded, with debt stabilizing around current levels.

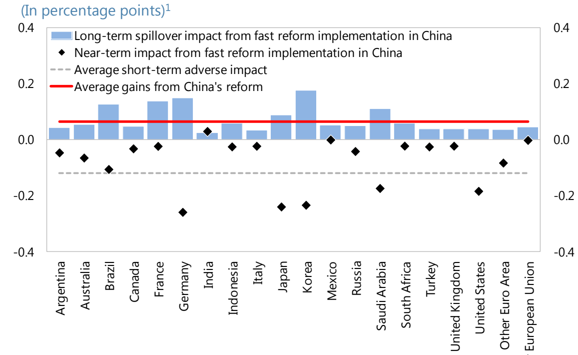
- **No reform.** This scenario combines little or no implementation of reforms with continued reliance on investment to support growth. The unsustainable gains in growth in the short-term come at a steep cost of foregone growth over the medium term. Activity would have to rely increasingly on public and quasi-public investment; the augmented fiscal balance would increase further, putting the augmented debt ratio on an increasing trajectory; and rapid credit growth would continue, further increasing leverage. Ultimately growth would drop, initially because of the declining efficiency of investment and lower TFP growth compared to the reform scenario. Over time, the probability of vulnerabilities coming to the surface—leading to a sharp slowdown in growth—would increase, as reflected in the widening projection range.

43. **The fast-reform scenario balances the goal of securing long-term growth, supporting activity in the near term, and reducing vulnerabilities.** The growth payoff from reforms is projected to be relatively fast, while the impact of the initial slowdown on the labor market is cushioned by reforms supporting labor-intensive activities in the services sector (the flexibility of China's labor market will facilitate the reallocation process). Regarding debt dynamics, staff analysis shows that the risk of unsustainable dynamics is high in the 'no-reform' scenario and, even with China's substantial cushion, debt is not robust to shocks in the intermediate (baseline) scenario, pointing to persistent vulnerabilities (see Appendix V).

44. **Fast reforms are good for China and good for the world.** In the near term, the spillovers to the global economy would be slightly negative in aggregate, with some variation across countries depending on the extent of trade linkages. However, over time, the benefits of stronger growth in China dominate. By 2019, global income is higher than in the baseline and most countries are better off, although the impact is differentiated by the nature of current trade exposures to China. In particular, while the growth of commodity consumption is unlikely to slow down sharply, its composition will change as the economy transits towards a more balanced growth (April 2014 *World Economic Outlook,* Chapter 1). Similarly, benefits from future China growth will accrue increasingly to countries with comparative advantage in the production of goods sought by increasingly sophisticated Chinese consumers (such as durable goods producers in advanced economies.[1]

Simulated Global Spillovers from China's Reform Blueprint

(In percentage points)[1]



Source: Preliminary staff simulation results based on FSGM-G20 model.

[1]Adjusted for a one percentage change in China's GDP growth.

45. **Authorities' Views.** The authorities agreed that deepening reforms will be critical for transitioning the economy to a more sustainable growth level. While implementation could be challenging, they remained committed to the reform blueprint, noting that China had a strong track record with reforms over the last three decades. They added that implementation would not necessarily slow growth, since reforms would unleash productivity gains that would boost growth.

STAFF APPRAISAL

46. **Last year's Third-Plenum reform blueprint marked the start of a new chapter in China's development.** Successful implementation of reforms will ensure that China can achieve the fastest

[1] See Lam, Maliszewski, Wang, and Wu (forthcoming), IMF Working Paper: "China's Reform Blueprint and Euro-Area Rebalancing: Impact and Spillovers."

sustainable growth going forward and continue to converge toward high-income status. The policy support deployed since 2008/09 in response to the GFC boosted domestic demand, which successfully sustained growth, provided a welcome lift to the global economy, and helped reduce external imbalances. However, five years of strong growth in capital spending and credit has resulted in declining investment efficiency and a significant buildup of debt. As recognized in the authorities' blueprint, the challenge now is to shift gears, reduce the vulnerabilities accumulated since the GFC and transition to a sustainable growth model, while at the same time avoiding too steep of a slowdown in activity.

47. **Growth in 2014 is expected to be in line with the authorities' target**. Domestic demand growth has been moderating, reflecting slower investment growth and a correction in real estate activity, partly in response to measures taken by the authorities to rein in credit growth and address financial market vulnerabilities. As activity slowed, the authorities have taken several measures to support growth, targeted at priority areas. As a result, staff projects annual growth this year around the authorities' target of around 7½ percent. Consumption and the labor market are holding up well, and the global recovery is expected to support external demand going forward. Inflation is expected to remain well below the authorities' target of 3 percent.

48. **Vulnerabilities, however, continue rising.** The post-GFC period has been marked by a large expansion in credit and investment. However, investment efficiency has been declining, casting doubt about the quality of assets underlying the build-up of debt. In particular, there are signs that important parts of the real estate market, a key driver of growth, are over supplied even though prices have yet to adjust significantly. Moreover, the vulnerabilities in the financial, fiscal, corporate, and real estate sectors are interconnected, so a shock in any one sector could be amplified through a negative feedback loop. However, if a shock were to occur that threatens to trigger a disorderly adjustment, the authorities have policy buffers to prevent a sharp slowdown in growth. Therefore, the probability of a hard landing in the near term is low. However, repeated reliance on these buffers without addressing the underlying vulnerabilities and changing the growth model compounds the risk of an eventual sharp slowdown and financial disruption, especially as the size and complexity of the financial system are rising fast.

49. **Implementation of the authorities' reform blueprint will secure higher-quality, sustainable growth**. Giving the market a more decisive role, eliminating distortions, and strengthening institutions will result in a more efficient use of resources, faster productivity growth, and rising living standards across the income spectrum. Priorities include:

- *Financial sector reforms* to support the real economy by better allocating savings and investment. This includes strengthened regulation and supervision, deposit rate liberalization, increasing reliance on interest rates as an instrument of monetary policy, and elimination of the widespread implicit guarantees across the financial and corporate landscape.

- *Fiscal and social security reforms* to strengthen public finances, boost consumption, and foster more inclusive and green growth. This includes reordering local government finances by better aligning local revenue with expenditure responsibilities, with strengthened oversight and management of local government borrowing; reducing social security contributions, which are high and regressive; and improving pension and health benefits. To ensure sustainability of public finances, this should be combined with parametric reforms to the social security system, shifting the welfare and legacy parts of the pensions to the budget, improvements in the tax system, and cuts in lower-priority spending.

- *Further progress toward a more flexible, market determined exchange rate* with no sustained, large, and asymmetric intervention. This will support domestic and external rebalancing, and is becoming increasingly important for China to have an independent monetary policy.

- *SOE reforms* to level the playing field between private and public sectors, by opening up more sectors, especially services, to competition; rationalize resource and financing costs; increase dividend payments to the budget; and harden budget constraints.

50. **Reforms will support sustained external and domestic rebalancing.** While external imbalances have been reduced considerably since the global financial crisis, the external position is still moderately stronger compared with the level consistent with medium-term fundamentals and desirable policy settings. On the domestic side, continued rapid investment growth underscores the priority of rebalancing toward more consumption. Successful implementation of the reform blueprint—including a more flexible exchange rate regime—will support the desired shift away from investment toward consumption, and further reduction in the current account surplus as aggregate savings fall by more than investment.

51. **Demand management needs to focus on reducing vulnerabilities while preventing growth from slowing too much.** In particular, a reduction in off-budget spending, further slowdown of credit growth, and less investment growth are required to contain risks. The drag on activity from these policies is likely to be felt immediately, while the full growth payoff from structural reforms will take more time. Finding the right mix of reducing vulnerabilities and maintaining adequate growth will be an ongoing challenge. Vulnerabilities, however, have risen to the point that containing them is a priority and, therefore, stimulus should only be deployed if growth risks slowing significantly below this year's target. Although stimulus does not appear warranted at present, if it were to become necessary, then fiscal policy should be the first line of defense, preferably deployed on-budget with measures aimed at protecting the vulnerable and advancing reform.

52. **Staff commends the authorities for initiating bold economic reforms to secure a more sustainable, inclusive, and environmentally-friendly growth in China.** The challenge is to implement the reforms, carefully yet with determination, and not to return to over-reliance on policy buffers as soon as the unavoidable cost of reforms begins to show. Macropolicies will need to be calibrated to avoid too sharp a slowdown, but not at the cost of adding to vulnerabilities and the risk of falling into a low-growth pattern. Growth expectations should be guided by the principle of achieving the *highest sustainable growth*: this means a focus on the needed reform policies, and accepting growth outcomes within a range that is likely to be somewhat below the current pace. The benefits will include much higher income in the future as the reforms unleash new sources of sustainable growth. A result that would be good for China and good for the global economy.

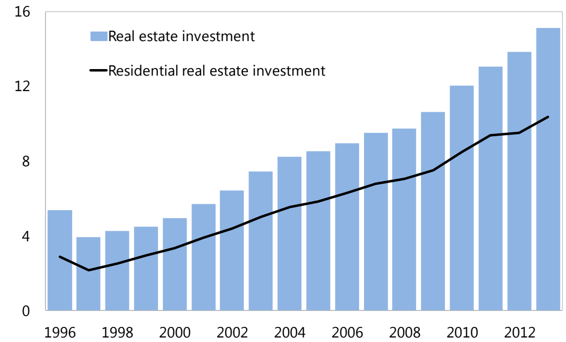
53. It is proposed that the next Article IV consultation with China take place on the standard 12-month cycle.

Box 1. Real Estate: Impact of a Market Correction

The real estate market appears to be undergoing a correction. While a slowing of investment and construction would have a significant impact on growth, an orderly adjustment is factored into the staff's baseline scenario.

Real estate has been a key engine of growth in China. Together with construction, it directly accounted for 15 percent of 2012 GDP, a quarter of fixed-asset investment, 14 percent of total urban employment, and round 20 percent of bank loans. In addition, the sector has close links to several upstream and downstream industries. Local governments rely on land sales—closely linked to activity in the sector—as an important source of funding (see Box 3), and real estate is extensively used as collateral for corporate sector borrowing. As a result, a decline in real estate investment could significantly disrupt financial and real activity in China. Ahuja and Myrvoda (2012) estimate that a reduction in real estate investment by 10 percent could reduce GDP growth by about 1 percentage point.

Real Estate Investment
(In percent of GDP)



Sources: CEIC; and IMF staff calculations.

Recent data suggest that several regions are in oversupply. Residential real estate inventories have increased sharply in Tier III and IV cities, as well as in the industrial Northeast (including Shenyang and Changchun) and parts of the Coast (including Hangzhou, Dalian, Fuzhou and Wenzhou). Commercial real estate, meanwhile, appears to be in oversupply across most regions. In terms of residential price dynamics, Tier II and Tier III/IV cities have performed the weakest, with prices in the latter group falling on month-on-month basis recently. The hardest-hit geographical areas include the industrial Northeast and the Coast. However, developers seem reluctant to cut prices because it may lead new buyers to stay on the sidelines and cause problems with those that bought earlier at higher prices.

Distortions weigh heavily on the property market. On the supply-side, the market is distorted by local governments' reliance on land sales to finance spending. This helps explain the over-supply in many Tier III/IV cities. On the demand side, the market is prone to speculation since housing is an attractive investment given low deposit rates, a lack of alternative financial assets, capital account restrictions, and a history of robust capital gains. This helps explains why, especially in top-tier cities, prices appear to be overvalued and price-to-income ratios remain high—even though, thanks to rapid income growth, affordability indicators have generally been improving.

Real estate appears to have entered a downturn. As of May, average residential price growth started to turn slightly negative, and there were declines in transactions (10 percent) and new starts (12 percent). Real growth in investment has fallen from almost 20 percent in 2012 and 2013 to around 10 percent by May. While the previous downturns, such as 2008 and 2012, were driven by policies to cool the market, the current one has come without a direct tightening of real estate policies and appears driven by overcapacity and concerns about future capital gains.

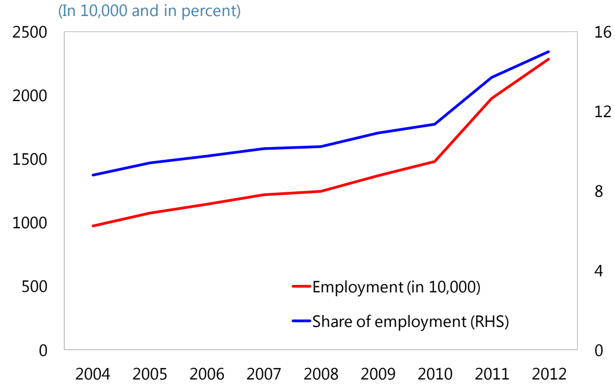
An orderly correction in real estate should be manageable. The staff baseline assumes that real estate investment slows to around 5 percent in 2014, stalls in 2015, and gradually recovers thereafter. It takes into consideration low leverage of homeowners, underlying housing demand fundamentals, and government ability to support developers if needed and take other measures (such as removing purchase and lending restrictions, and accelerate infrastructure and social housing construction). On the other hand, risk of large drop in final (investor) demand has increased even if underlying, medium-term home ownership demand is sound. If the market were to undergo a sharper correction—with new starts declining by, say, 30 percent for the year (compared to 20 percent year-to-date), which implies a -3½ percent year-on-year growth in residential investment—then GDP growth would likely be around ¾ percentage point lower than in the baseline (in the absence of offsetting measures).

Box 1 Figures: Real Estate: Impact of a Market Correction

The real estate sector has been an important driver of growth and employment…

Construction and Real Estate Employment

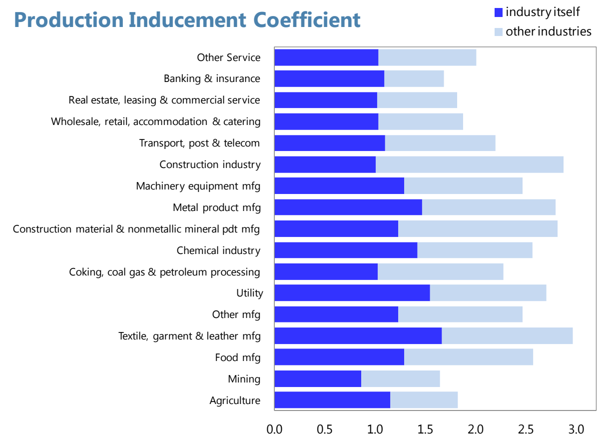
(In 10,000 and in percent)



Note: Employment data cover urban units.

…and it has important linkages to other sectors.

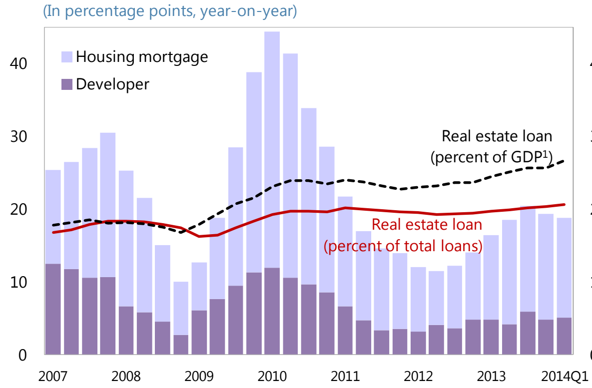
Production Inducement Coefficient



The sector also accounted for about 20 percent of total loans, mostly through individual mortgages…

Contribution to Real Estate Loan Growth

(In percentage points, year-on-year)

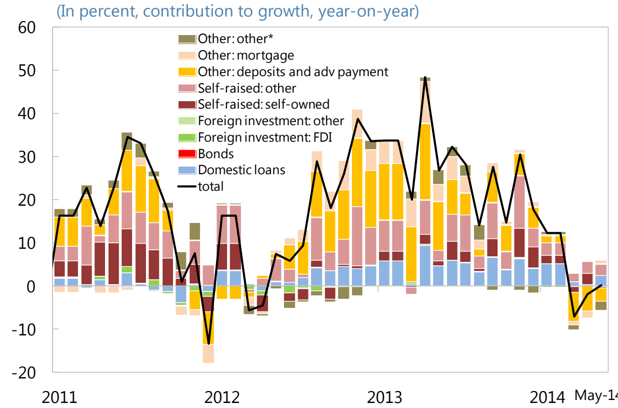


[1] In percent of 4Q rolling sum of quarterly GDP.

…while developers have relied more on nonbank financing and presale proceeds to finance their investment.

Real Estate Investment: Source of Fund

(In percent, contribution to growth, year-on-year)

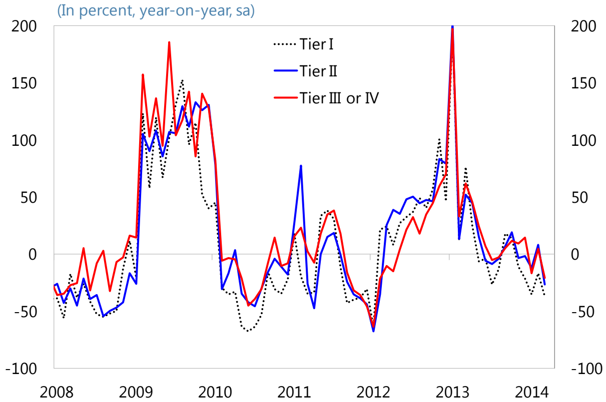


* may include mortgages before Oct 2009.

Residential sales growth has turned negative in all city tiers…

Residential Building: Floor Space Sold by Tier

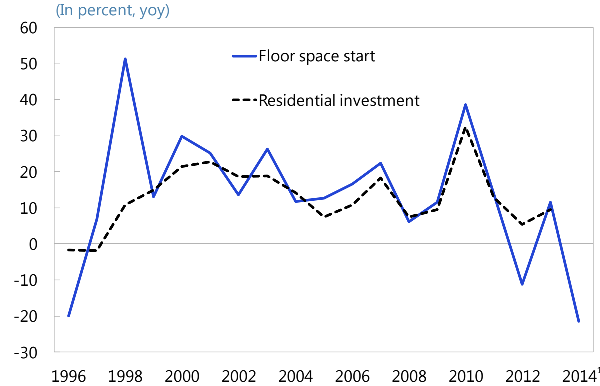
(In percent, year-on-year, sa)



…and a significant contraction in housing starts is pointing to slowing investment.

Residential Building Floor Space Start and Investment

(In percent, yoy)



[1] May 2014 year-to-date total, growth rate from same period previous year.

Sources: CEIC Data Company Ltd.; Haver Analytics; Housing Administration Bureau; and IMF staff calculations.

Box 2. Corporate Leverage in China

Staff analyzes listed-firm level data, which appear broadly to mirror China's overall corporate sector. While the level of corporate debt has increased, most firms have healthy leverage and interest rate coverage ratios. The build-up of debt is concentrated in a "fat tail" of highly leveraged large firms mostly in real estate and construction. Overall risk remains manageable given its concentration, which highlights the importance of the real estate sector.

Debt accumulation. Overall corporate debt has increased from 92 percent of GDP (average 2003–07) to about 110 percent of GDP in 2013. The level is among the highest in the region. Among listed companies (which hold about 30 percent of GDP in debt), a significant part of the increase in corporate debt after the global financial crisis concentrated in a few large firms in real estate and construction.

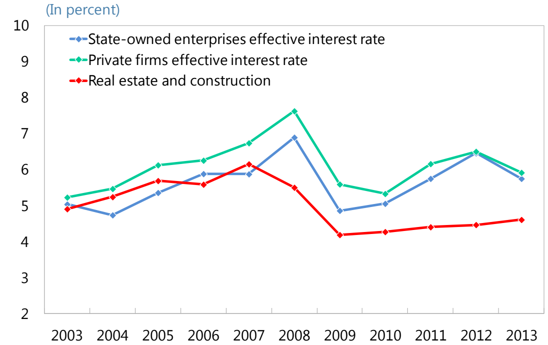
Leverage ratio. While private companies, with the exception of real estate and construction companies, have been deleveraging since 2007, SOEs' leverage ratios has edged up. Real estate and construction companies, especially the SOEs, however, have increased their leverage ratios significantly.

Fat tail of highly leveraged companies. The buildup of leverage is concentrated in a 'fat tail' of firms. The top 50 firms of some 2000 firms accounted for nearly half of the total liabilities of listed firms, a rise of over 20 percentage points of total corporate liabilities over the last decade. Most of the increase was in the real estate and construction sector where about 80 percent of total liabilities of the sector belong to about 60 firms with leverage ratios higher than 300 percent. Highly leveraged local SOEs in mining and utilities also increased their borrowing significantly.

Profitability. Private firms' profitability in listed firms peaked in 2007 and has fallen since, in line with the slowing economy. Profitability of SOEs, however, has remained stagnant over the last decade. The profitability of low-leveraged firms exceeded that of high-leveraged firms by a margin of 2–2½ percentage points, but the margin narrowed significantly in the past year.

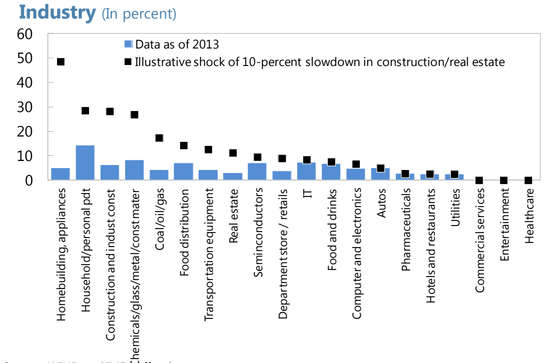
Effective interest rates. Effective interest rates do not seem to reflect the underlying risk profile of listed firms as real estate and construction firms, with higher leverage, enjoyed much lower interest rate levels after the global financial crisis.

Effective Interest Cost[1]
(In percent)



Sources: WIND; and IMF staff estimates.
[1]Including interest expenses on short-term and long-term loans, bonds, and debt.

Percentage of Firms that Faced Negative Earnings, by Industry (In percent)



Sources: WIND; and IMF staff estimates.

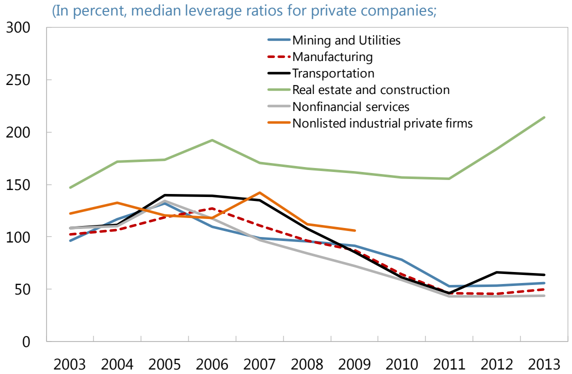
Sensitivity to shocks. Private firms' interest coverage ratios are less sensitive than SOEs' to a change in interest rates. Real estate and construction firms, however, are more sensitive to a rise in interest rate given the high level of debt. Firms with strong links to the real estate sector are most sensitive to a real estate sector downturn, including those oversupply sectors such as construction materials.

Overall assessment. While total debt level has increased, the corporate sector on average has deleveraged over the years, and risk appears manageable given its concentration. The level and concentration of risk highlights the importance of the real estate sector, and the need for focused efforts to deal with excess leverage areas and companies, including well-managed exits where appropriate.

Box 2 Figures: Corporate Leverage in China

Leverage ratios have fallen among private firms, except for those in real estate and construction…

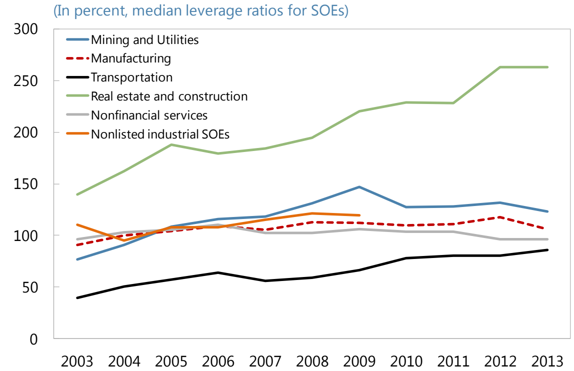
Leverage Ratios Across Industries
(In percent, median leverage ratios for private companies;



Sources: WIND; and IMF staff estimates.

…but the ratios have increased over the years for all SOEs.

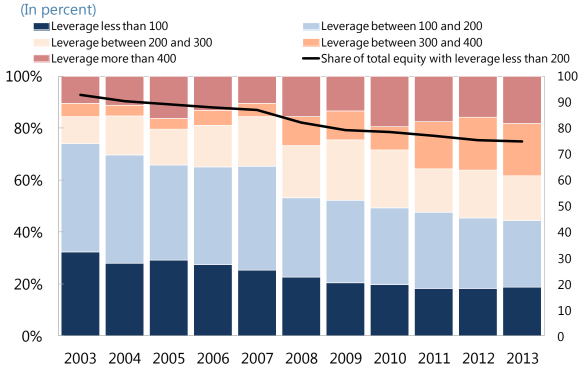
Leverage Ratios Across Industries
(In percent, median leverage ratios for SOEs)



Sources: WIND; and IMF staff estimates.

Companies with high leverage ratios increasingly accounted for higher share of total liabilities.

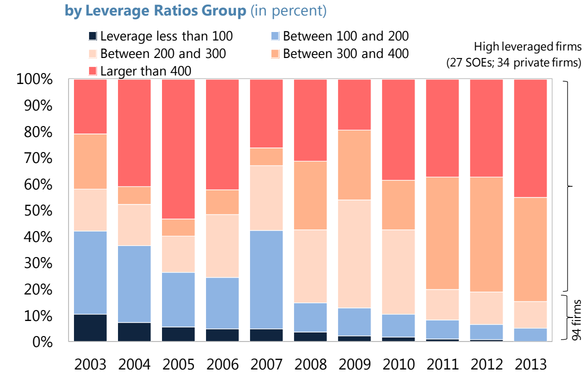
Share of Total Corporate Liabilities, by Leverage Ratios
(In percent)



Sources: WIND; and IMF staff calculations.

This is especially true among real estate and construction firms.

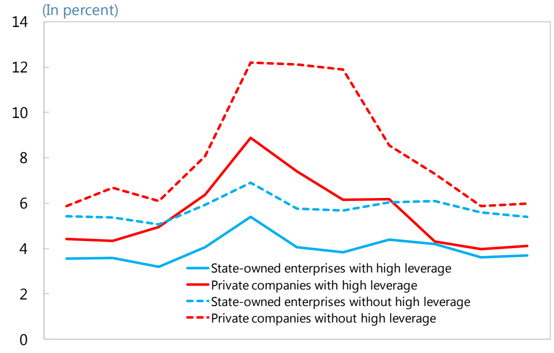
Share of Total Corporate Liabilities in Real Estate and Construction, by Leverage Ratios Group (in percent)



Sources: WIND database; and IMF staff estimates.

Firms' profitability appears to have converged as private firms' profits have declined from pre-crisis peak.

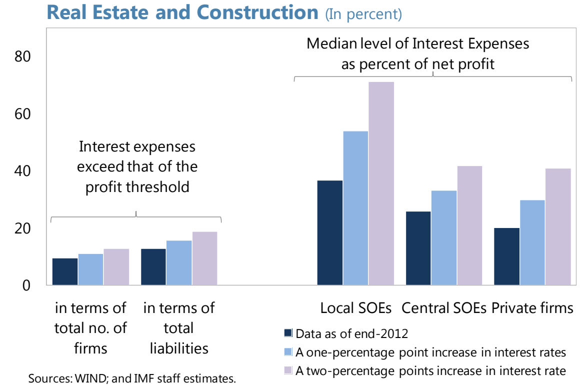
Profitability of Listed Firms, by Leverage Levels
(In percent)



Sources: WIND; and IMFstaff estimates.

Real estate and construction firms are more sensitive to changes in interest rates given their high level of debt.

Firms' Sensitivity to A Rise of Interest Rates: Real Estate and Construction (In percent)



Sources: WIND; and IMF staff estimates.

Sources: CEIC Data Company Ltd.; WIND database; and IMF staff calculations.

Box 3. Local Government Finances

Local governments were at the front lines of the post-GFC stimulus, supporting activity through a considerable rise in investment. Such investment, which has generally been financed off-budget through LGFVs, has remained large and, unless rationalized going forward, would put increasing strains on local government finances and pose risks to financial stability and growth.

During the post-GFC period, local government investement provided significant support the economy. Data for 2009 to 2013 suggest that growth in provincial LGFV liabilities was significantly correlated with provincial investment growth, especially in the central and western regions.[1] This underscores the role of LGFVs in supporting activity on the one hand, but also in exacerbating the reliance on credit and investment as an engine of growth. Such investment spending was usually financed off-budget, either through LGFVs (in order to circumvent borrowing restrictions) or land sales.

Local governments have continued to borrow at an unsustainable pace. Augmented net borrowing, which includes off-budget borrowing by LGFVs (but treats land sales "above-the-line"), has remained high and rose to 7½ percent of GDP in 2013. Based on provincial audit results, in 2013 outstanding provincial debt was equivalent on average to nearly 70 percent of consolidated fiscal revenue or around 23 percent of provincial GDP. Adding government guaranteed and contingent liabilities would push the average to about 33 percent of provincial GDP, and over 60 percent of GDP in some provinces—a high level given the small revenue base. The debt burden is often higher for those provinces that rely more on off-budget LGFV activity to support growth, heightening risks to debt dynamics.

Local government finances are exposed to a correction in the real estate market. Many local governments rely on net revenue from land sales to finance large public infrastructure investment. Though provincial-level land sales are not available, aggregate gross land sale revenue was sizeable at about 7 percent of GDP in 2013 (net land sale revenue was 2½–3 percent of GDP after accounting for expenses related to city construction, land development, and compensation for relocation). Land sales could slow considerably if real estate development cools. In addition, tax revenues could also shrink in face of a real estate slowdown. Excluding land sales, tax revenue from real estate and related sectors was about one-fifth of tax revenue in some provinces.

At the moment, risks appear manageable, although the system of local borrowing is nontransparent, making the assessment difficult. The snapshot of local government debt and contingent liabilities in last year's NAO report suggests that China's public sector still retains significant fiscal space. However, despite good social and commercial returns on some of the investments, many provinces and localities rely excessively on LGFVs to support growth. The overall trend in local government finances is unsustainable and needs to change, also because linkages to financial system and real estate sector are increasingly complex and potentially difficult to manage. Regular data updates and more information about forward spending commitments (for example, through PPP type arrangements) are needed to assess evolving risks.

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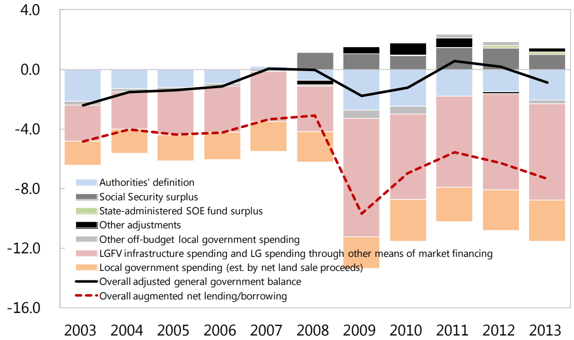
[1]The weaker relationship between growth in fixed asset investment and LGFV activity in coastal regions possibly reflects the fact that a larger share of coastal LGFVs operate on a commercial basis, engaging in noninvestment activities.

Box 3 Figures: Local Government Finances

The government has relied heavily on local government off-budget activity to support the economy despite the withdrawal of on-budget stimulus…

China: General Government Balance

(In percent of GDP; Consolidated and Augmented measure)

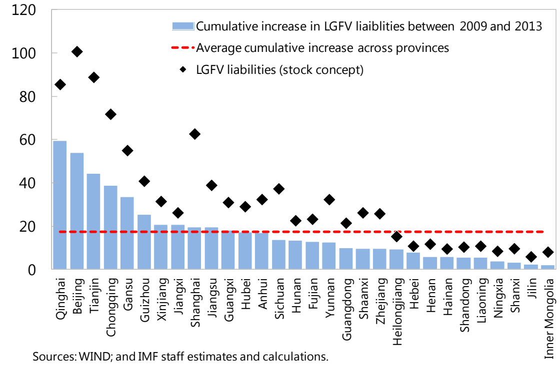


Sources: CEIC; NAO; and IMF staff estimates.

… with a large share of off-budget spending financed through through LGFV borrowing, which has increased by near 20 percent of GDP between 2009 and 2013.

Expansion of Local Government Financing Vehicles

(In percent of 2013 GDP)

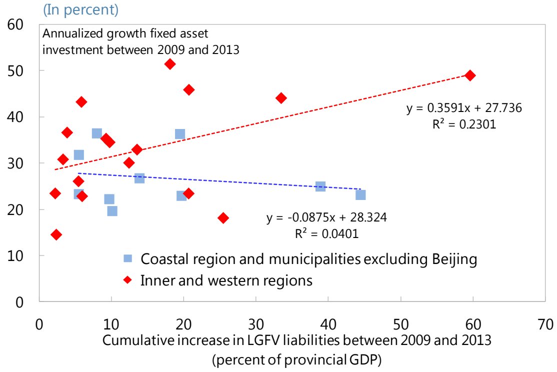


Sources: WIND; and IMF staff estimates and calculations.

The increase of LGFV activity has contributed to strong investment growth, particularly in the western and inner regions.

Off-budget LGFV Activity and Investment Growth

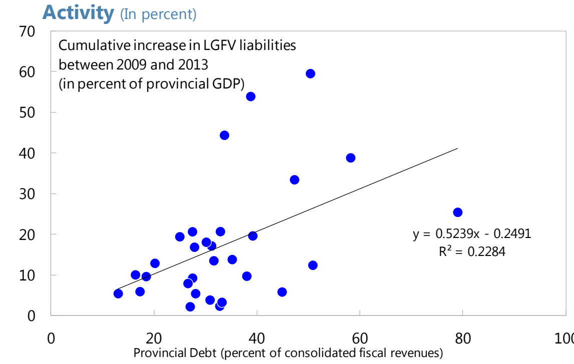
(In percent)



Sources: CEIC; WIND; and IMF staff estimates and calculations.

Off-budget borrowing has added to local government debt, to increasingly risky levels.

Relationship between Provincial Debt Burden and LGFV Activity (In percent)

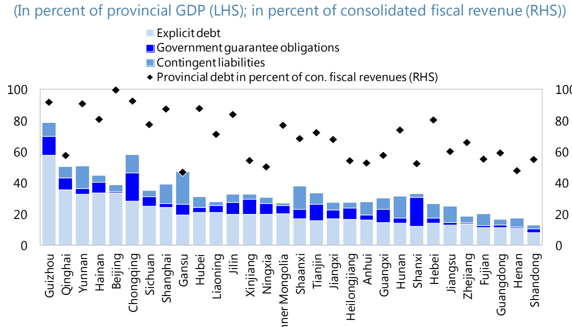


Sources: WIND; CEIC; and IMF staff estimates and calculations.

Although the overall debt burden is still managable, some local governments have faced a heavy debt burden as a share of their provincial GDP and fiscal revenues…

Local Government Explicit Debt and Other Obligations

(In percent of provincial GDP (LHS); in percent of consolidated fiscal revenue (RHS))



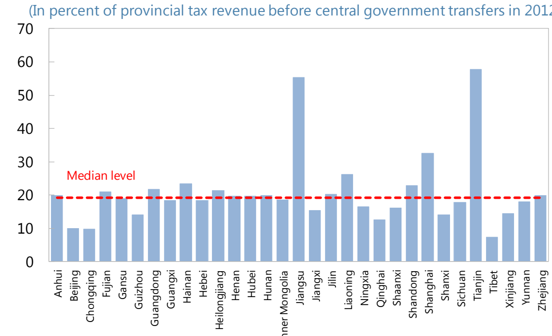
Sources: NAO; provincial audit offices; and IMF staff estimates and calculations.

[1]Includes explicit debt and all government guaranteed debt and contingent liabilities based on provincial audit results. The provincial debt audit considered that only part of government guarantee obligations and contingent liabilities would eventually become government debt based on historical evidence.

… and are particularly vulnerable to a real estate shock as local government revenue is highly dependent on real estate.

Land-related Tax Revenue in Local Governments[1]

(In percent of provincial tax revenue before central government transfers in 2012)



Sources: CEIC; and IMF staff estimates and calculations.

[1] Includes city maintenance and construction, stamp duties, house tax, value-added tax for land, and use of urban land revenues. The large shares in Jiangsu and Tianjin are driven by the large city maintenance and construction revenues.

Box 4. Rapid Growth in Shadow Banking and Internet Finance

"Shadow banking" has increased rapidly, contributing to the strong growth in credit (TSF) and posing new types of risks to the financial system. On the positive side, it marks a move toward more market-based instruments and represents, de facto, a liberalization of pricing and allocation of credit in the economy. However, it also reflects regulatory arbitrage, allowing intermediation to side-step prudential safeguards.

Shadow banking. Market analysts often define shadow banking in China as TSF less bank loans (and a small amount of equity-like items). It is comprised of trust loans, bankers acceptances, entrusted loans (corporate-to-corporate lending administered by a bank), and interbank corporate bonds (see Figure 2). As such, it includes direct credit extension by banks off-balance sheet and by nonbank financial institutions, especially trust companies and securities firms. After bank lending conditions were tightened following the 2009–10 credit boom, the shadow banking system took off. By March 2014, the stock of shadow banking had risen to nearly 53 percent of GDP, with annual growth rates averaging around 30 percent during 2012-13. China's shadow banking activities typically involve direct lending to the real sector and are often closely tied to commercial banks. For example, trusts rely on banks for funding, banks are also allowed to hold controlling shares in trust companies, and entrusted loans also are administered by banks.

Internet financing. Since mid-2013, internet-based money market funds have experienced exponential growth, albeit from a low base (as of Q1:2014, they were the equivalent of about 0.5 percent of total bank deposits). The growth reflects low transaction costs, access to a large network of potential customers, and the ability of small investors to acquire new financial products. However, it also benefitted from interest rate and regulatory arbitrage. Currently, close to 100 percent of the funds are reinvested in the banking sector either in the form of nonstandardized certificates of deposit (so-called agreement deposits) or via the interbank market (bonds and repos), limiting systemic risk, but as competition in the sector increases, money market funds are likely to invest in riskier assets, including in commercial paper.

Risks. Wealth management products (WMPs)—deposit-like instruments used to fund parts of shadow banking—have grown rapidly and risen to over 10 percent of GDP. Notwithstanding safeguards such as minimum investment thresholds and risk disclosures, investors may believe that WMPs are implicitly guaranteed. As such, even though in principle the risk is transfered to the investor, in practice many investors are unlikely to undertake adequate due diligence on the underlying assets in the WMP. Moreover, losses on fixed-income WMPs are almost unheard of, exacerbating this risk. Shadow banking assets, including those funded by WMPs, may be of lower quality (such as claims on highly leveraged LGFVs or real estate firms). Shadow banking also involves maturity transformation, using lengthened intermediation chains that run through the interbank market. This reliance on short maturities to fund lending for long-term projects could contribute to spikes in liquidity demand and volatility in the interbank market. On the positive side, although China's shadow banking system is neither simple in structure nor transparent, it is not dominated by complex derivatives and massive leverage.

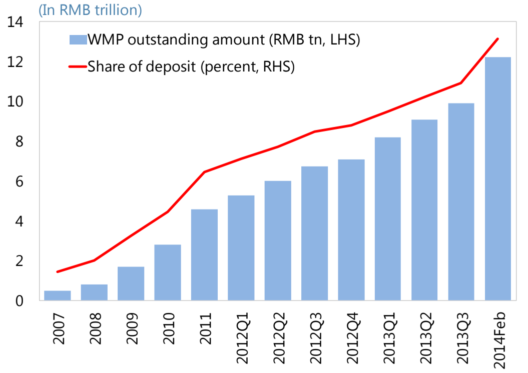
Regulation. The authorities have strengthened regulation of shadow banks, including tightening regulation of nonstandard credit products, forbidding trusts from funding cash payouts on maturing products with the proceeds from new WMP sales, and restricting ways to fund off-balance sheet credit through the interbank market. Although parts of internet financing is regulated by various agencies, the rapid growth warrants more comprehensive and coordinated regulation.

Finding the right balance. Financial innovation is benefiting both savers and investors, but the rapid growth also poses challenges for (i) investors to assess the risk of the products they are buying, especially given the rarity of defaults; (ii) regulators and supervisors to keep up with the pace of innovation; and (iii) policymakers, as traditional measures of monetary and credit aggregates become less reliable. The authorities' intention to liberalize interest rates, strengthen regulation and supervision (including of shadow banking), and use more market-based instruments to control credit will reduce the incentive for shadow banking activities.

Box 4 Figures: Rapid Growth in Shadow Banking and Internet Finance

WMPs have grown rapidly…

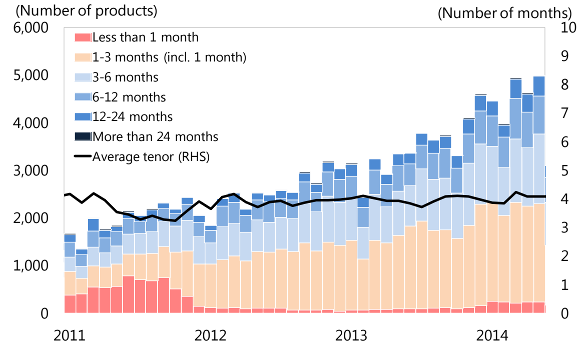
WMP Outstanding Amount and Share of Deposits
(In RMB trillion)



Sources: CBRC, CEIC, local media, and IMF staff calculations.

…with mostly short-term maturities.

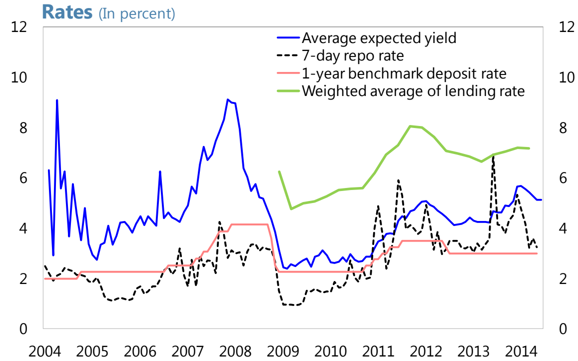
Monthly WPM Issuance by Tenor[1]



Sources: Wind; and IMF staff calculations.
[1]Sample covers all products issued by banks covered in WIND.

Average WMP yields are well above deposit rate…

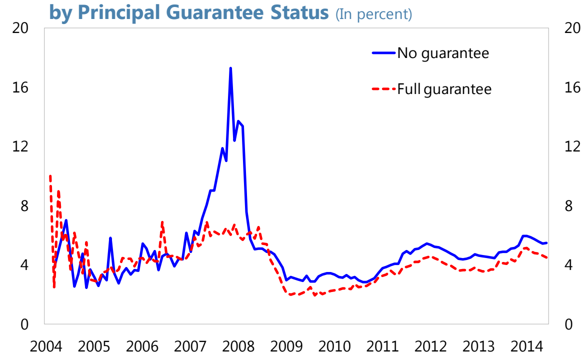
Average Expected Yield of New WMPs and Key Interest Rates (In percent)



Sources: Wind; PBoC; and IMF staff calculations.

…with a fairly steady risk premium for nonguaranteed products.

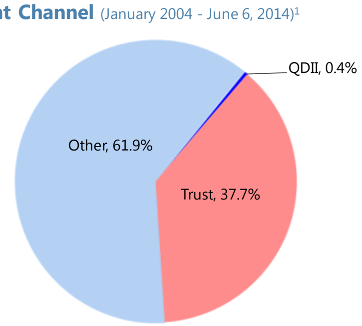
Average Expected Yield of New WMPs by Principal Guarantee Status (In percent)



Sources: Wind; and IMF staff calculations.

About 40 percent of WMPs are issued through trust…

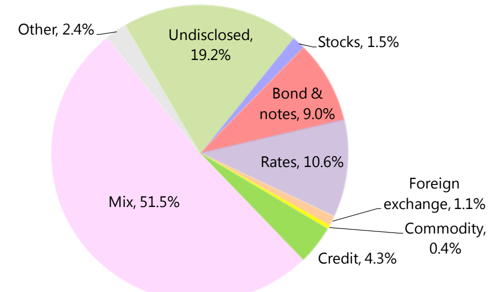
Wealth Management Product Issuance by Investment Channel (January 2004 - June 6, 2014)[1]



Sources: Wind; and IMF staff calculations.
[1]Total number of wealth management products issued during the reviewing period amounts to 155,893.

…with about half having a mix of underlying assets.

Wealth Management Product Issuance by Type of Basic Underlying Asset (January 2004 - June 6, 2014)[1]



Sources: Wind; and IMF staff calculations.
[1]Total number of wealth management products issued during the reviewing period amounts to 155,893.

Sources: WIND information; and IMF staff estimates and calculations.

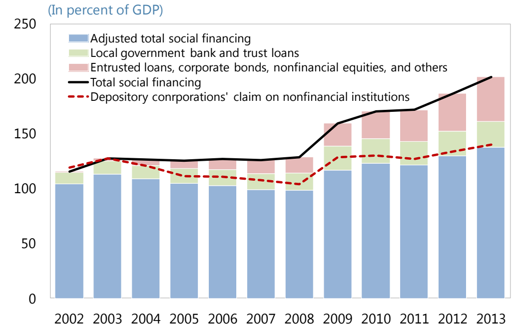
Box 5. International Perspective on China's Credit Boom

China's recent credit boom is not unprecedented from an international perspective. However, the precedents also illustrate the risk, as most of them led to a recession, banking crisis, or both.

Credit measurement. Three measures of credit are used in the analysis. While the closely monitored TSF is a more comprehensive measure of credit to the economy, it has some shortcomings for international comparison. Specifically, it includes nonbank components of lending and some equity-like instruments. Bank credit to the nonfinancial sector is a more conventional and internationally comparable measure, defined as depository corporation's claims on nonfinancial institutions. Compared to TSF, it excludes items such as trust financing, corporate bonds not purchased by depository corporations, and entrusted loans. A third measure is 'adjusted TSF' which, aside from some components of nonbank credit, also subtracts credit to the public sector (mainly LGFVs) that is included in the augmented fiscal debt. This avoids double-counting LGFV debt as both private and public sector, and provides a clearer picture of credit flowing to the private sector.

Adjusted Total Social Financing, by Components

(In percent of GDP)

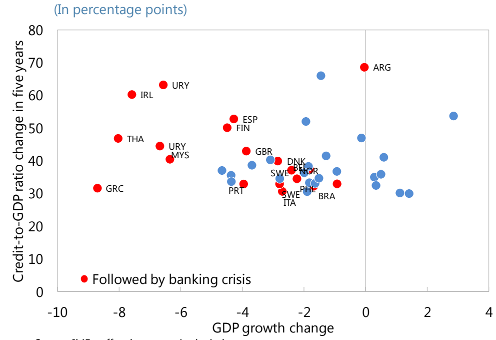


Sources: CEIC; and IMF staff estimates.

Credit boom: deviation from gap. Dell'Ariccia, Igan, and Laeven (2012) find the deviation in percentage points of credit-to-GDP from trend ("credit gap") to be a good predictor of a financial crisis.[1] They used deviation from cubic trend, which applied to China shows signs of credit boom only during 2008–09. Using instead the deviation from real-time HP trend suggest a large boom in 2008–09 and a smaller one 2012–13. These general results hold across different measurement of credit. However, because trend credit growth in China is so fast, these "credit gap" techniques may understate China's credit boom.

Credit Booms and Change in GDP Growth Rates

(In percentage points)



Source: IMF staff estimates and calculations.

Size and pace of credit accumulation. Previous studies suggest that a credit boom that starts from a higher level of credit-to-GDP ratio and lasts for longer period is more likely to precede a systemic banking crisis. In the past five years, China's TSF stock increased by 73 percent of GDP,[2] while adjusted TSF and bank credit to nonfinancial sector increased by around 30 percent of GDP. Looking at a sample covering 43 countries over 50 years, staff identified only four episodes that experienced a similar scale of credit growth as China's recent TSF growth. Within three years following the boom period, all four countries had a banking crisis. With a lower threshold of a 30-percent-of-GDP increase in credit over five years, there are 48 episodes of credit boom, half of which were followed by banking crises.

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[1] G. Dell'Ariccia, D. Igan, and L. Laeven, "Credit Booms and Lending Standards: Evidence from the Subprime Mortgage Market," *Journal of Money, Credit and Banking*, Vol. 44, No. 2–3 (2012), pp. 367–84.

Box 6. Fiscal Options: Reducing the Deficit and Promoting Inclusive Growth

A menu of fiscal measures could be used to reduce the augmented deficit, by around 5 percent of GDP over the medium term (as recommended by staff), while at the same time increasing social spending and fostering more inclusive growth.

Revenue measures

Extending VAT to servcies. In 2013, revenue from the VAT and business operation tax was 8.1 percent of GDP. If the VAT was extended to services (replacing the business operation tax) at the current standard rate of 17 percent rate on goods—as opposed to the 6 or11 percent being applied to some services—revenue would likely go up by over 2 percent of GDP. Given the benefits of minimizing the use of exemptions and multiple rates, a case could be made for using a single VAT rate for all goods and services. For example, applying a single VAT rate of around 13-14 percent for all goods and services would likely raise an additional ½–1 percent of GDP in revenue.

Personal income tax (PIT) and social security contributions (SSC). The PIT currently raises only 1 percent of GDP in revenue, which is low by international standards. While it already embeds a strong progressive schedule, the top marginal rates apply only to very high income brackets. Applying the top marginal rates to more households, combined with stronger enforcement and compliance, would increase revenue while also mitigating inequality. In addition, a broader reform could reduce the highly regressive SSC. Bringing PIT revenue closer to international levels would leave scope to reduce SSC for low income groups, and still raise an additional 2–3 percent of GDP in revenue.

Recurrent property tax. While the share of tax revenue from property is not low by international standards, China differs in that such revenue is mostly levied on transations. A gradual shift towards a recurrent property tax would yield higher and more stable revenue. For example, bringing the level close to the OECD average could raise additional revenue of 1–1½ percent of GDP.

Environmental tax and fees. China collected around 1½ percent of GDP in 2011 in environmental taxes and fees (mostly fees and penalties). An additional 1 percent of GDP could be raised by moving up to the advanced economy average. Also, switching from fees to taxes could help better protect the environment.

		Middle Income		
Expenditure	OECD	Upper Middle	Lower Middle	China
Total outlays	41.6	33.1	36.1	25.7
Socia epxenditures	26.9	16.2	15.4	9.4
Health	6.3	3.3	3.1	1.0
Education	5.4	3.9	5.4	3.7
Social protection	15.2	9.0	6.9	4.7
Other	14.7	16.9	20.7	16.3

Note: World Bank China 2030; data as of 2007, except for China as of 2008.

Expenditure measures

Less reliance on public investment. Public investment and infrastructure spending (including by LGFVs) could be reduced by about 5–6 percentage points of GDP over the medium term, returning it to roughly the same level that prevailed before the GFC.

Increase in social spending. A reform scenario in *China 2030*[1] proposed to increase public expenditures by 7–8 percent of GDP by 2030, including the effect of population aging (demographic changes are discussed in more detail in Box 4 of the previous year's staff report) 1 percent of GDP for education; 2–3 percent of GDP for healthcare; and 3–4 percent of GDP to fully finance the basic old-age pension and meet the legacy costs of current obligations. If done gradually, social expenditure could reach 15–16 percent of GDP by 2020, which is around the average for middle income countries.

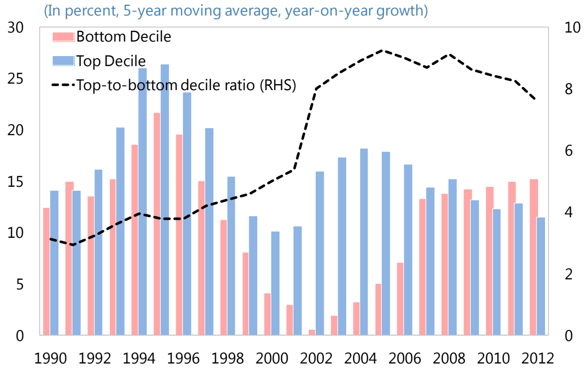
[1]World Bank and the Development Research Center of the State Council, P. R. China. 2013. *China 2030: Building a Modern, Harmonious, and Creative Society.* Washington, DC: World Bank.

Box 6 Figures: Fiscal Options: Reducing the Deficit and Promoting Inclusive Growth

Income of the bottom decile of China's urban population has been growing fast in recent years…

Urban Household Income

(In percent, 5-year moving average, year-on-year growth)

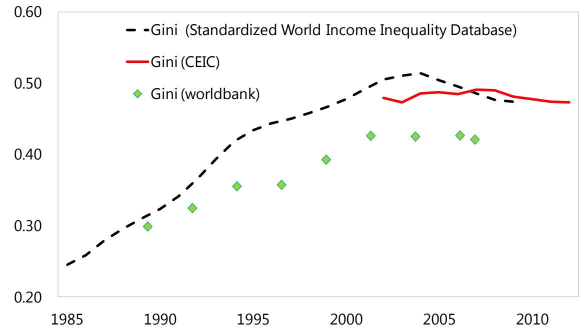


Sources: CEIC; and IMF staff calculations.

…but indicators suggest that income inequality has stabilized at a relatively high level.

Urban Hoseholds: Gini Coefficient

(Index)

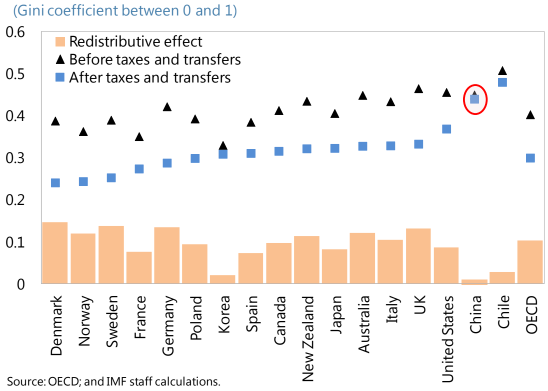


Sources: CEIC; World Bank; Standardized World Income Inequality Database; and IMF staff calculations.

Taxes and transfers achieve relatively little redistribution in China…

Redistributive Effect of Taxes across OECD relative to China

(Gini coefficient between 0 and 1)

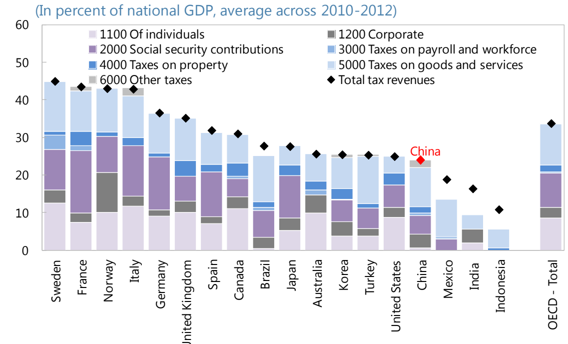


Source: OECD; and IMF staff calculations.

…in part due to the high reliance on indirect taxes and social security contribution.

Decomposition of Tax Revenues across Countries [1]

(In percent of national GDP, average across 2010-2012)

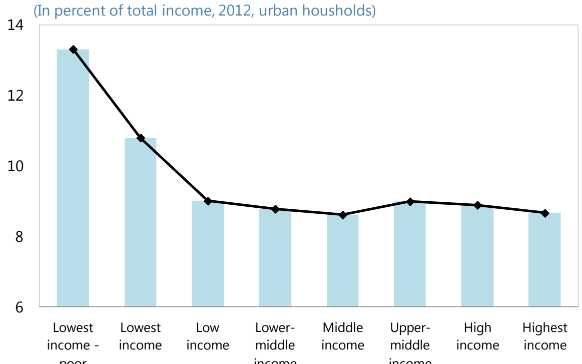


Sources: OECD, Haver Analytics, and staff estimates.
[1] Including social security contributions, average across 2010-2012 where data are available.

The effective tax burden is highest for the poorest households…

Average Effective Tax Rate by Income Group

(In percent of total income, 2012, urban housholds)

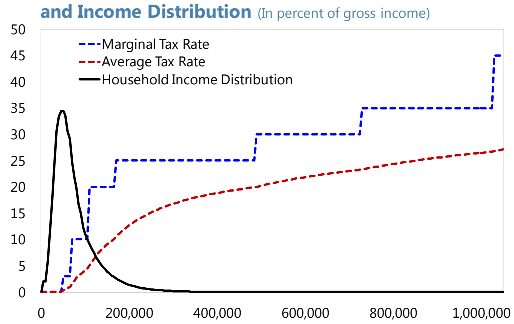


Source: CEIC: and IMF staff calculations.

…while the effective tax rates for most individuals are less progressive than the tax schedule suggests.

Individual Income Tax Marginal and Average Tax Rates and Income Distribution

(In percent of gross income)



Source: CEIC; IBFD; and IMF staff calculations.

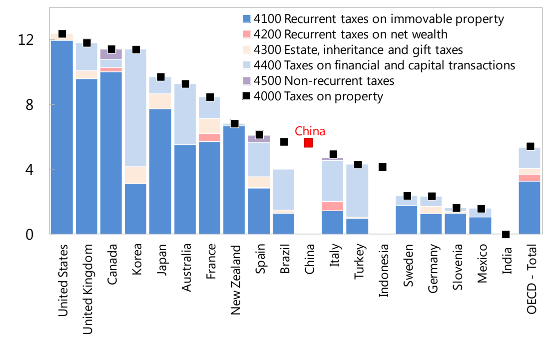
Box 6 Figures: Fiscal Options: Reducing the Deficit and Promoting Inclusive Growth *(concluded)*

Taxes collected from property are comparable to OECD average, but most come from transactions levies.

There is scope to increase social spending to reduce risk and ensure equality of opportunity.

Property Tax across Countries

(In percent of total taxation revenues[1])

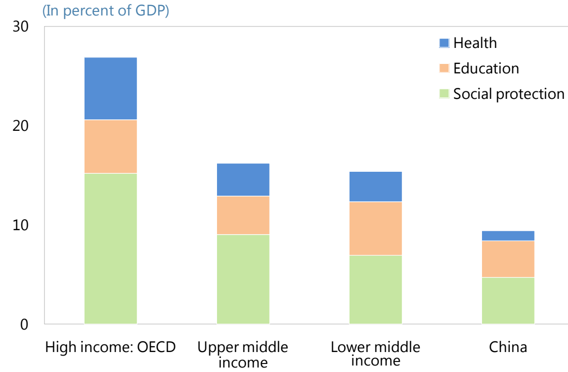


Sources: OECD, Haver, and staff estimates.

[1]Average over 2010-2012 where data are available.

Social Spending by Country Group

(In percent of GDP)



Sources: China 2030, World Bank; and IMF staff calculations.

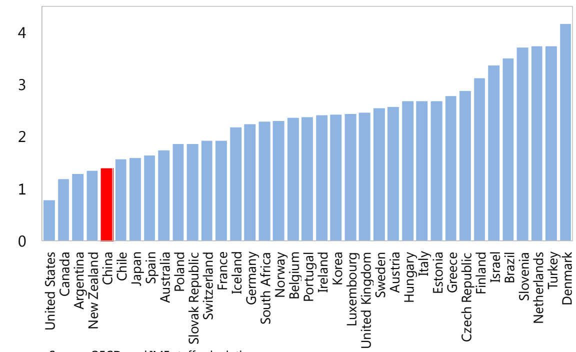
Fiscal Adjustment	(Percent of GDP)	
Revenue measures	**4.5**	**-6.5**
Transition and extension VAT to services	0.5	-1.0
More progressivity of personal income tax and reduction in social security contributions	2.0	-3.0
Property tax	1.0	-1.5
Environment tax		1.0
Expenditure measures	**0.5**	**-1.0**
Reduction of local government off-budget spending		-5.5
Increase of social spending	5.0	-6.5
Of which:		
Education		1.0
Health	2.0	-2.5
Social security	2.0	-3.0
Net adjustment from above measures	**4.0**	**-5.5**
Financing towards consolidation of augmented fiscal balance		*-5.0*

Box 7. Fiscal Policy for Greener Growth

China's economic success has come at a high cost to the environment.[1] The authorities have recognized the need for reform and have taken steps to reduce the economy's reliance on natural resources and energy. Market-driven reforms could complement the traditional more administrative approach.

Collection of environmental taxes and fees is low. While China levies a variety of resource and vehicle taxes and pollution fees, total collection is low compared to OECD countries and only a fraction of the levels required to fully internalize the costs of climate change, local pollution, and congestion externalities. The Third-Plenum blueprint calls for the prices of water, oil, natural gas and electricity to be deregulated. However, taxes and other market mechanisms should be used as well to ensure prices reflect the full cost of externalities from energy and resource use.

Environmentally-Related Taxes in China
(In percent of GDP, 2011)



Source: OECD; and IMF staff calculations.

Several tax policy instruments are available to complement the government's current reform agenda.

Carbon tax. An upstream tax on fossil fuels based on carbon emission rates could be considered. A tax imposed at the pollution's point of entry in the economy (such as coal mine, energy plants, petroleum refineries) would reduce the number of agents to tax and thereby reduce the administrative burden. It would also build off the administrative structures already in place for China's resource taxes. A carbon tax levied upstream would also provide the necessary incentives for emission-reducing behavior throughout the economy since energy prices would increase uniformly across all sectors of activity.

Tax on local air pollutants: The current pollution levies on SO2 and NOx emissions and small particulates could also be significantly increased, and their legal status upgraded to full fledge taxes. This would facilitate enforcement and would ensure they provide the necessary incentives to reduce emission levels as their current rates are only a fraction of estimated health costs of local pollution.

Fuel taxes: Excise duties on gasoline and other petroleum products could be further increased to cover the negative externalities associated with greenhouse gas emissions, local pollution, congestion and accidents. To cover these costs, the effective tax rate on gasoline could increase from its current level of 40¢ per liter to roughly 55¢ per liter. This would be comparable to other countries' current tax levels on gasoline and significantly lower than Japan (75¢ per liter) and South Korea (85¢ per liter).

Vehicle taxes: China's current sales taxes on vehicles are based on engine capacity. While this provides a reasonable proxy for the environmental damage caused by cars, an alternative would be to use a graduated system based on vehicles' emissions level. This could take the form of an ad valorem excise tax on vehicle value to meet revenue objectives and revenue neutral 'feebate' on emission rates to promote environmental objectives. This feebate structure would impose an additional fee on cars that are more polluting than some predetermined reference threshold and provide a rebate for cars that generate less emissions than the threshold.

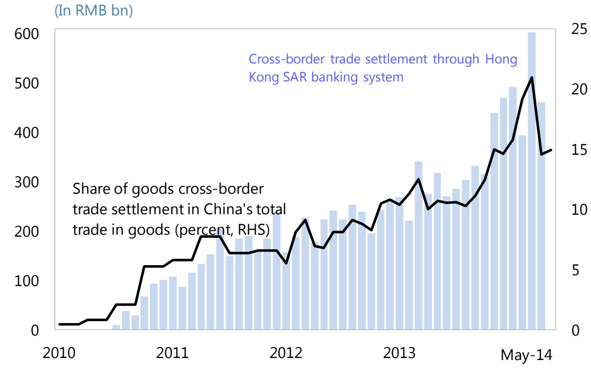
[1]See IMF Country Report No. 13/211, Box 3.

Box 8. RMB Internationalization

RMB internationalization continued to advance with trade and FDI settlement in RMB expanding rapidly in recent years. In 2013, RMB business further expanded to other financial centers beyond Hong Kong SAR. However, while growing fast, offshore RMB deposits are still a small share of total Mainland RMB deposits.

Strong growth in RMB settlement. According to SWIFT payment data, the RMB is now ranked seventh in the global payments. RMB trade settlement continued to increase in 2014 with the share of trade in goods settled in RMB up from 12 percent in 2013 to 17 percent from January–May 2014. However, the settlement share slowed in most recent months, possibly reflecting the depreciation of the RMB. The share of FDI settled in RMB increased to about 22 percent by end 2013.

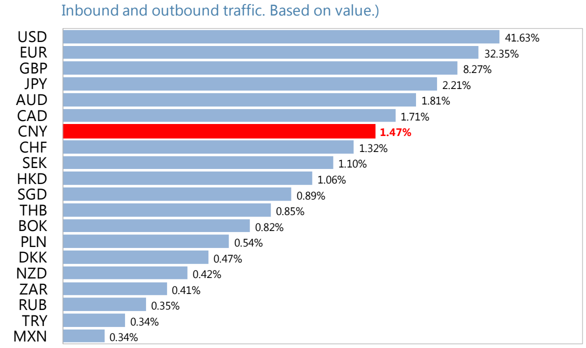
Cross-Border Trade Settlement
(In RMB bn)



Sources: CEIC; and IMF staff calcualtions.

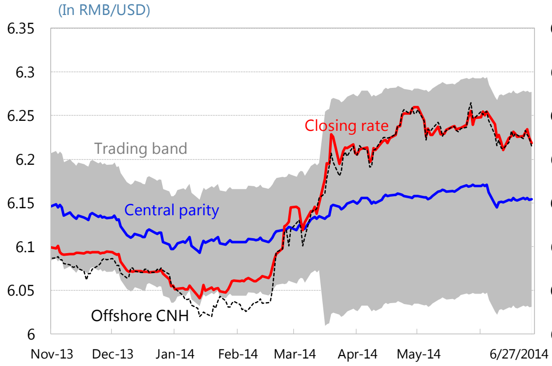
Offshore centers. Hong Kong SAR is a leading hub for RMB payment with a market share of over 70 percent, followed by Singapore (about 7 percent) and London (about 6 percent). Reflecting the growing cross-border use of RMB, RMB clearing banks have been set up in a number of financial centers including Seoul, Singapore, and Taiwan Province of China, Hong Kong SAR, and Macao SAR in Asia and the Pacific, and Frankfurt and London in Europe. Offshore RMB (CNH) in Hong Kong SAR became one of the most heavily traded EM currencies. CNH and CNY (onshore RMB) generally track each other closely. The dim sum bond market continued its strong growth with the value of year-to-date issuance almost reaching the total of 2013. RMB deposits in Hong Kong SAR increased to about 13 percent of deposits in the Hong Kong SAR banking system. For perspective, however, this represents just 0.9 percent of RMB deposits in the Mainland.

RMB as World Payments Currency in Value
(May, 2014; customer initiated and institutional payments. Inbound and outbound traffic. Based on value.)



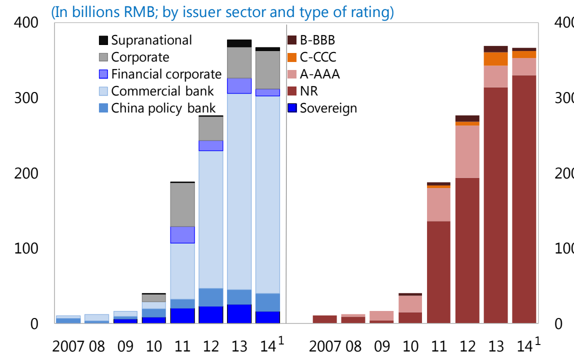
Source: SWIFT watch.

Spot Exchange Rate
(In RMB/USD)



Sources: Haver Analytics; Bloomberg; and IMF staff calculations.

CNH Bonds: New Issuance
(In billions RMB; by issuer sector and type of rating)



Sources: Bloomberg; and IMF staff estimates.
[1] YTD June, 2014

Box 9. External Assessment

Staff's assessment is that the external position is moderately stronger compared with the level consistent with medium-term fundamentals and desirable policy settings.

Recent balance of payments developments. The current account surplus fell to 1.9 percent of GDP in 2013 from 2.6 percent of GDP in 2012, on account of larger service and income account deficits while the trade surplus remained broadly unchanged. A significant part of the increased service deficit was driven by strong growth in outbound tourism spending. The current account surplus is projected to worsen slightly in 2014, and to increase to around 3 percent of GDP over the medium term. This is about 1 percent of GDP lower than projected at the time of the last external assessment, largely due to a revised outlook for the services account in light of recent developments. The average REER appreciated by 6 percent, similar to the 2012 appreciation. By May 2014, the REER was at about the same level as its 2013 average.

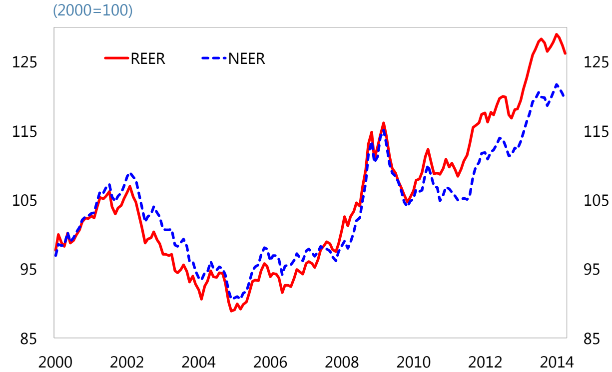
Foreign assets and liabilities. Gross foreign assets, at 65 percent of GDP at end-2013, are dominated by foreign reserves (42 percent of GDP), while gross liabilities, at 43 percent of GDP, mainly represent FDI liabilities (26 percent of GDP). The net IIP ratio (21 percent of GDP) has declined since the global financial crisis in light of the smaller current account surpluses, valuation changes, and still-fast growth of GDP. Given the large net IIP, international investment vulnerabilities are low.

FX intervention and reserves level. The pace of reserve accumulation slowed significantly in 2012, but picked up again in 2013 against the backdrop of large capital inflows induced by interest rate differentials, the relatively high real return of capital, and expectations of continued RMB appreciation. Further accumulation is unnecessary from a reserve adequacy perspective.

Estimate of Current Account and REER Gaps (EBA)

- *Current account gap*. The External Balance Assessment (EBA) current account balance approach estimates that China's 2013 surplus, adjusted for cyclical factors, is 1.6 percent of GDP above the level consistent with fundamentals and desirable policies (compared with 1.8 percent of GDP in last year's EBA). The gap is mainly attributed to a lower-than-desired level of social spending and excess reserve accumulation. Accounting for uncertainty about the cyclical adjustment adds a range of +/-1 percent to the point estimate, which implies a current account gap of about 1–3 percent of GDP.
- *REER gap*. The current account gap translates to an undervaluation of the REER of about 4-12 percent (applying the same trade elasticities as in the 2013 EBA). The EBA REER regression points to undervaluation of 12 percent (similar to last year's EBA). On balance, recent developments and available quantitative estimates suggest that the renminbi remains moderately undervalued, by 5–10 percent, relative to a level consistent with fundamentals and desired policies. The REER appreciation has been consistent with changing underlying fundamentals (especially faster productivity growth than in trading partners), but not sufficient to eliminate a moderate undervaluation.

Real Effective Exchange Rate
(2000=100)



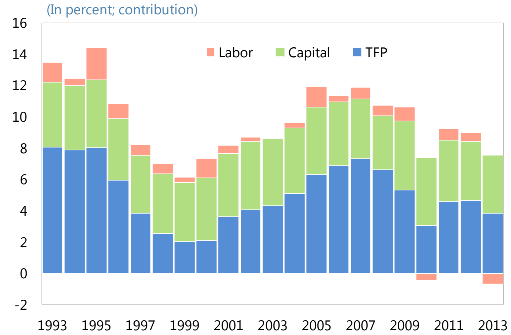
Sources: IMF, Information Notice System; and IMF staff calculations.

Box 10. Potential Growth and Output Gap[1]

There is strong evidence that potential growth has slowed. Going forward, how fast the economy can grow will depend on reforms, especially those to boost productivity. The estimates of a small negative output gap do not call for a policy stimulus, but instead point to the need for domestic rebalancing to contain vulnerabilities.

Potential growth has declined. Several estimation methods point to a slowdown in potential growth to around 7½ percent. A cross-country convergence regression, moreover, suggests that this would be in line with the convergence path of fast-growing Asian economies.

China: Potential growth decomposition
(In percent; contribution)



Source: IMF Staff estimates and calcuations.

The slowdown and future path of potential GDP are determined in large part by productivity growth. Estimates using a production function indicate that the slowdown in potential GDP largely comes from lower productivity growth (investment becomes less efficient). Continuing along a fast convergence path will require boosting productivity growth, which points to the importance of structural reforms.

The estimates suggest a small negative output gap, but stimulus to close it is not warranted in China's case. Univariate filters or multivariate filters that link the output gap to inflation generally find a small negative gap. However, adding information about capacity utilization to the multivariate filters yield different results. A time series on capacity utilization is not available and the results are sensitive to the measure used. Measuring capacity utilization by diffusion indices points to a small negative gap, while the gap derived from extrapolating sector-specific capacity utilization—showing much more overcapacity—is large. This variation in the results highlights the degree of uncertainty, but on balance the smaller output gap seems more consistent with the dynamics of broad price indices (CPI and GDP deflator). However, such economy-wide measures of the gap hide differences between sectors: (i) several sectors (such as mining, steel, cement, and glass) suffer from overcapacity, with excess supply pushing down producer prices (PPI); (ii) other manufacturing sectors are more efficient, with productivity growth supporting low inflation, solid profits, and growing wages (suggesting little slack in the labor market); and (ii) the service sector expands steadily, with higher inflation reflecting strong demand and wage growth.

Including financial-cycle information highlights vulnerabilities in the structure of demand and the need for domestic rebalancing. Borio (2013) argues that while growth may be considered sustainable if it is consistent with low and stable inflation, in reality it may be on an unsustainable path when financial imbalances are building up. Including credit growth in the estimates for China yields a large positive output gap. This result, combined with the sectoral pattern discussed above, illustrates the potential imbalances between supply and demand. Credit-driven investment has increased economy-wide capacity without generating new sustainable sources of demand other than the investment itself, which cannot continue given growing inefficiencies and high leverage. Solving this requires rebalancing toward a more consumer-based growth model. One where rising household income—fueled by strong growth in the more labor-intensive service sector, supported by reforms—generates sustainable growth in demand for consumption, including for more services.

____

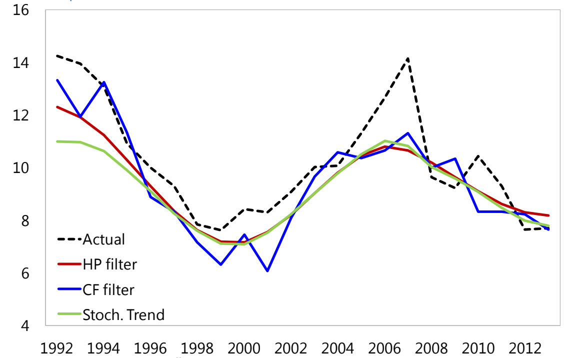
[1] Based on Maliszewski and Zhang (forthcoming), IMF Working Paper: "'China's Growth: Can Goldilocks Outgrow Bears?"

Box 10 Figures: Measures of Output Gap

Potential growth estimated by standard statistical filters has declined.

China: Actual and potential GDP growth

(In percent, univariave)

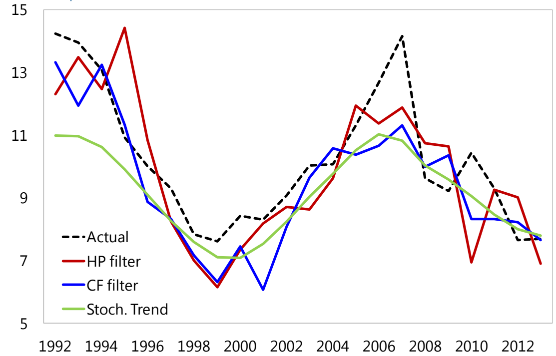


Sources: CEEIC; and IMF staff estimates.

Multivariate filters—utilizing information in related series—indicate similar dynamics.

China: Actual and potential GDP growth.

(In percent, multivariate)

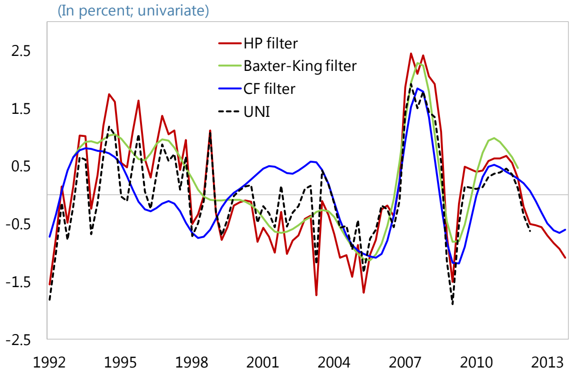


Sources: CEIC; and IMF staff estimates and calculations.

Univariate filters show small negative output gap at the end of the sample.

China: Output Gap

(In percent; univariate)

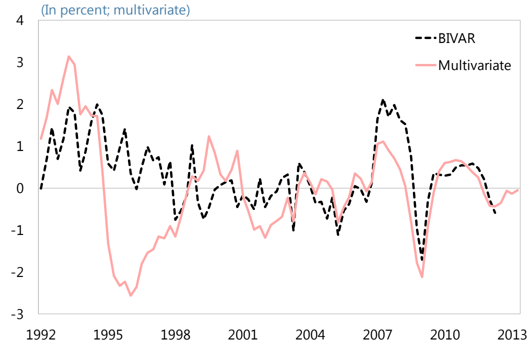


Source: IMF staff estimates and calculations.

Multivariate filters point in the same direction…

China: Output Gap

(In percent; multivariate)

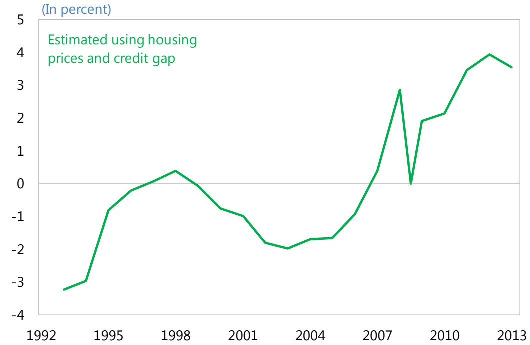


Source: IMF staff estimates and calculations.

…but including information about the financial cycle yield a positive gap.

China: Output Gap

(In percent)

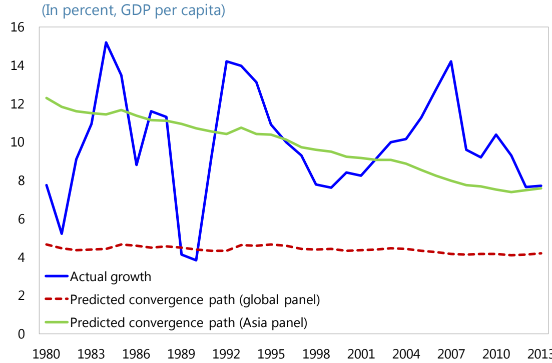


Source: IMF staff estimates and calculations.

The slowdown is consistent with growth convergence.

China: Actual vs. Predicted Growth

(In percent, GDP per capita)



Source: IMF staff estimates and calculations.

Sources: CEIC Data Company Ltd.; and IMF staff calculations.

Box 11. Giving Credit for China's Slowdown—The Third-Plenum Reform Blueprint[1]

Reforms would put growth on a sounder footing with higher per capita income and consumption over the medium term, benefitting China and the global economy.

Three scenarios. The staff's baseline scenario, which assumes gradual implementation of reforms, is compared to scenarios of "fast reform" and "no reform." The baseline and fast reform scenarios include:

- **Financial sector reforms** include accelerating deposit rate liberalization, establishing a formal deposit insurance system, and strengthening financial supervision and resolution framework. These would encourage a better pricing of risk (increasing average cost of credit) and redirect credits to more efficient uses.

- **Fiscal reforms** include a gradual unwinding of borrowing from LGFVs, improving coverage and portability of basic pensions and health insurance, strengthening social safety nets, and more efficient and redistributive taxes. These measues (see Box 6 for details) would reduce investment, creating room to increase social spending for a gradual reduction of the augmented deficit by about 5 percentage points of GDP over the medium term. They would also gradually reduce the household saving rate due to a lower incentive for precautionary saving.

- **Structural reforms.** Opening up markets, and SOE and resource pricing reforms would shift resources to the more efficient private sector, lifting economy-wide productivity. Urbanization through hukou reforms would increase the participation rate and also help raise productivity. Previous research (IMF 2013) suggests that these reforms would bring productivity gains of 1½–2 percentage points.

- **Exchange rate reforms** include widening the trading band and allowing the currency to move more in line with market forces. Together with other reform measures these would contribute to continued domestic and external rebalancing, by reducing the savings rate by more than the targeted reduction of the investement/GDP ratio.

The "fast reform" scenario assumes that financial, exchange rate and structural reforms are implemented promptly, and fiscal reforms are phased in over a two-year lag (this compares to about five-year lag for reforms in the baseline).

"Fast reform". Fast implementation would slow China's growth in the near-term (by about ½ percentage point, largely due to faster fiscal adjustment and higher interest rates), but the long-run income is much higher and private consumption grows faster. With less LGFV borrowing, augmented debt is falling and credit growth is likely to be slower, leading to a faster reduction of vulnerabilities. The fast implementation would also generate sizeable benefits to the global economy. Simulation suggests that global growth could increase by 0.2 percentage points over the medium term, although growth may be slower in the near term, reflecting the upfront cost of reforms and steps to reduce vulnerabilities.

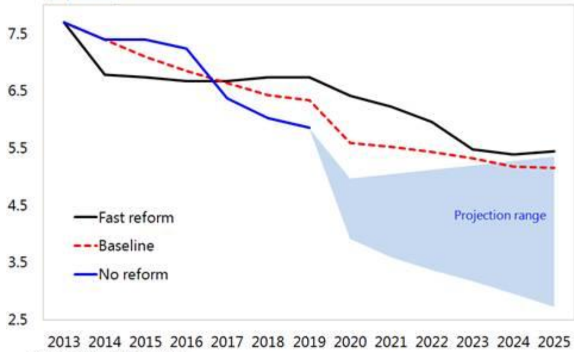
"No reform". Without reforms, growth would be weaker (as productivity growth slows and investment becomes increasingly inefficient) and the likelihood of a sharp slowdown in the future higher, with knock-on effects to the global economy. Repeated reliance on credit and government intervention to prop up growth without reforms would boost near-term growth, but reduce future growth and exacerbate vulnerabilities, increasing the risk of a disorderly adjustment, stalling the convergence process, and adversely affecting the global economy. This would map into annual growth of less than 4 percent by 2030, with considerable risk of an even sharper slowdown.

[1] This note uses the Flexible System of Global Models (FSGM) to assess the spillover impact. The model is also used in Spillover Reports by the International Monetary Fund. For details, see forthcoming working paper.

Box 11 Figures: China's Third-Plenum Reform Blueprint

Reforms would first slow growth but help make it more sustainable in the long run…

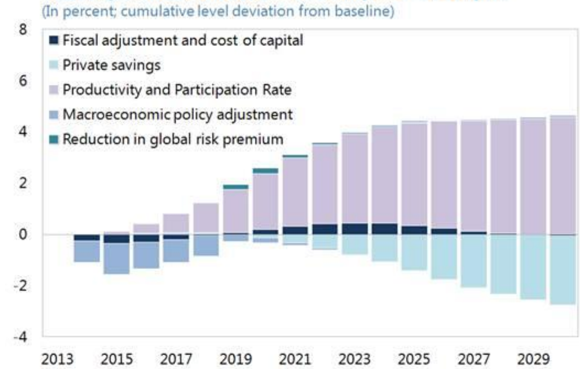
China: GDP Growth Under Various Scenarios
(In percent)



Source: IMF staff simulations.

…driven by reining in credit in the near term and sizeable productivity gains over the long term.

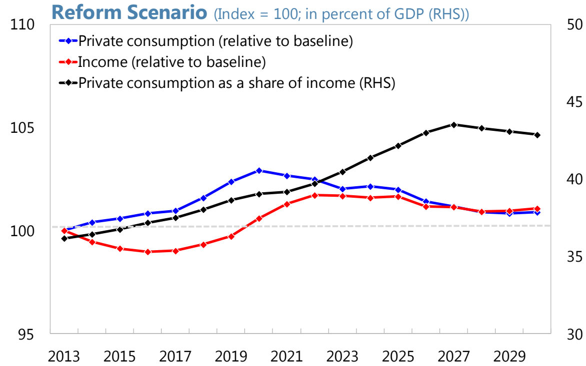
Decomposition of Fast Reform Impact on Output
(In percent; cumulative level deviation from baseline)



Source: IMF staff estimates.

…while consumption would rise significantly despite initial growth slowdown.

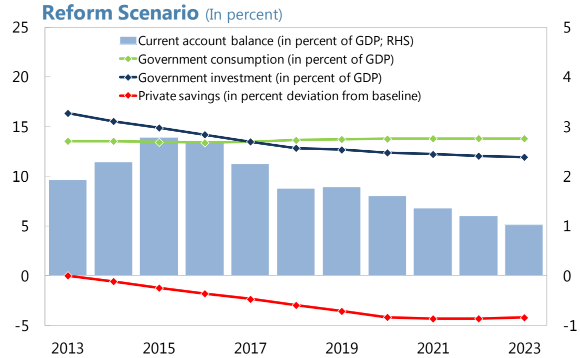
China: Private Consumption and Income Under Fast Reform Scenario (Index = 100; in percent of GDP (RHS))



Source: IMF staff estimates.

Rebalancing would reduce the saving and investment balance, reducing the current account surplus over time.

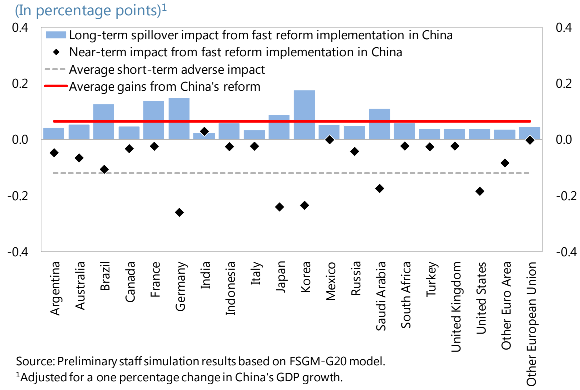
China: Saving and Investment Balance Under Fast Reform Scenario (In percent)



Sources: IMF staff simulations.

A moderate near-term growth slowdown in China would have knock-on effect on other economies, but compensated by long-term benefits.

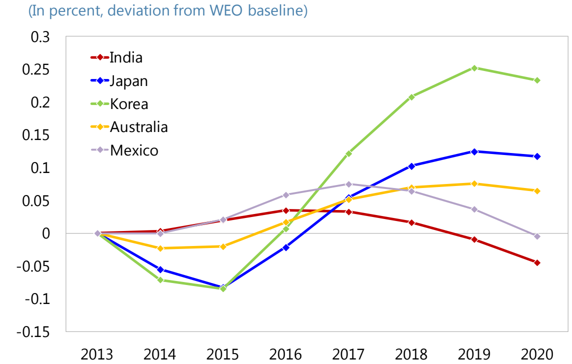
Simulated Global Spillovers from China's Reform Blueprint
(In percentage points)[1]



Source: Preliminary staff simulation results based on FSGM-G20 model.
[1]Adjusted for a one percentage change in China's GDP growth.

The adjustment dynamics would vary across economies.

Spillovers from China's Fast Reform Implementation
(In percent, deviation from WEO baseline)



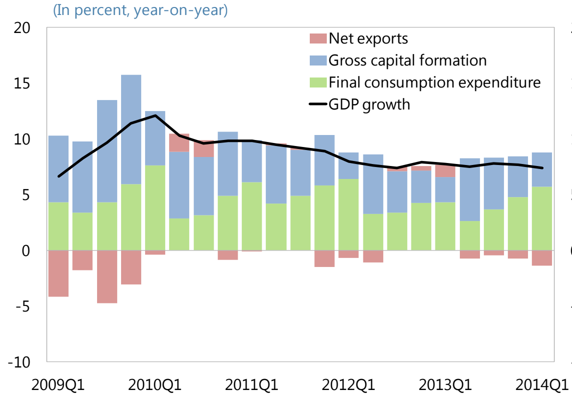
Source: IMF staff estimates.

Figure 1. China: Growth and Inflation

Growth moderated, pulled down by net exports. Resilience in consumption offset slower gross capital formation…

Contribution to GDP Growth

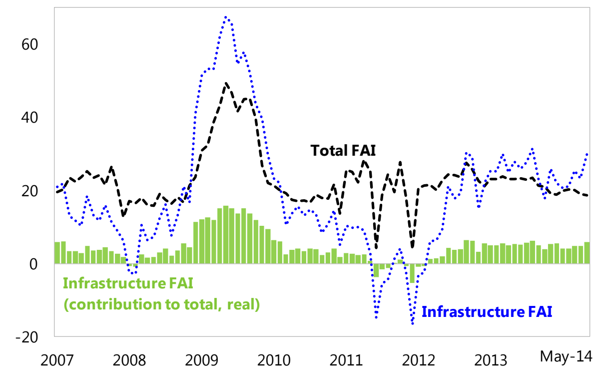
(In percent, year-on-year)



…consistent with a slowing in total fixed asset investment (FAI), notwithstanding a recent pick-up in infrastructure FAI.

Real Fixed Asset Investment

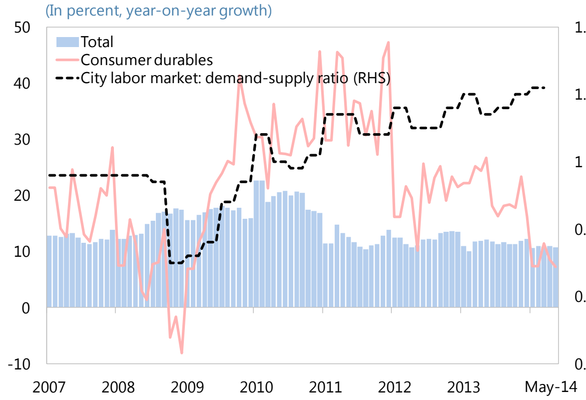
(In percent, year-on-year)



Retail sales remained strong, though sluggish real estate is impacting consumer durables. The labor market is holding up, with demand for workers outpacing supply.

Retail Sales and City Labor Market

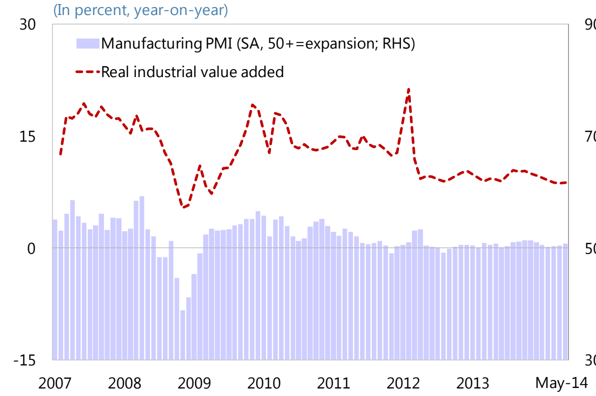
(In percent, year-on-year growth)



Recent industrial indicators point to a stabilization in activity…

Industrial Value Added

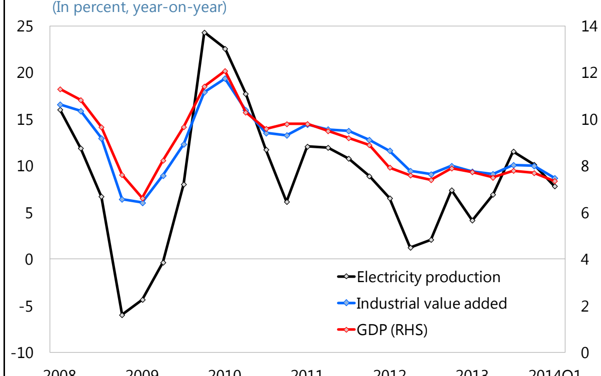
(In percent, year-on-year)



…which suggest that Q2 growth is also likely to stabilize (given the high correlation between GDP and VAI).

Real GDP and Industrial Value Added

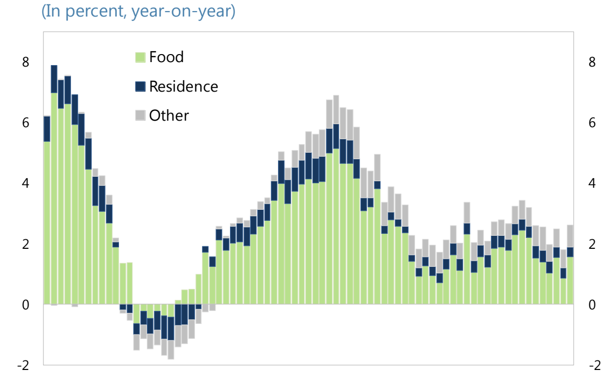
(In percent, year-on-year)



Inflation remained low and volatility has mainly been driven by food prices.

Contribution to Inflation

(In percent, year-on-year)

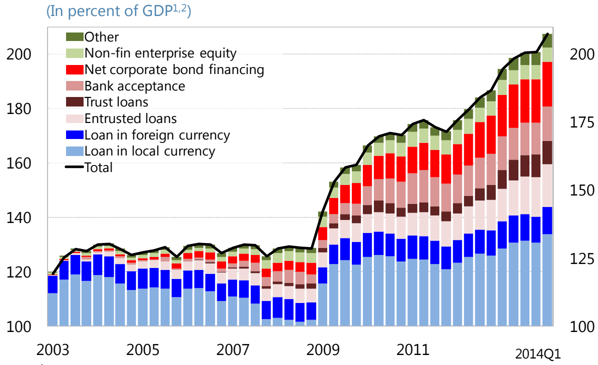


Sources: CEIC Data Company Ltd.; and IMF staff calculations.

Figure 2. China: Financial Sector Development

Level of total social financing (TSF), a broad measure of credit, remained high.

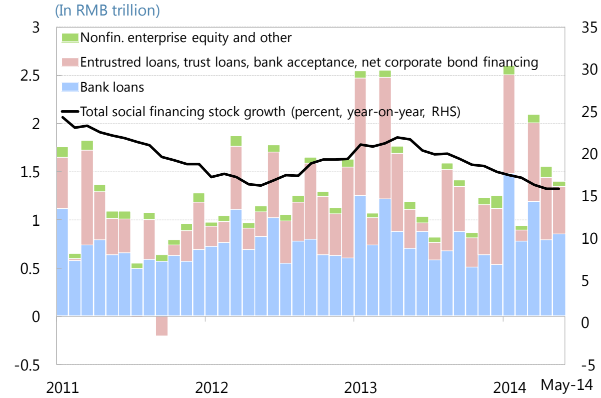
China: Social Financing Outstanding
(In percent of GDP[1,2])



[1]In percent of 4Q rolling sum of quarterly GDP.
[2]Outstanding loans end-2001 and cumulative social financing since 2002.

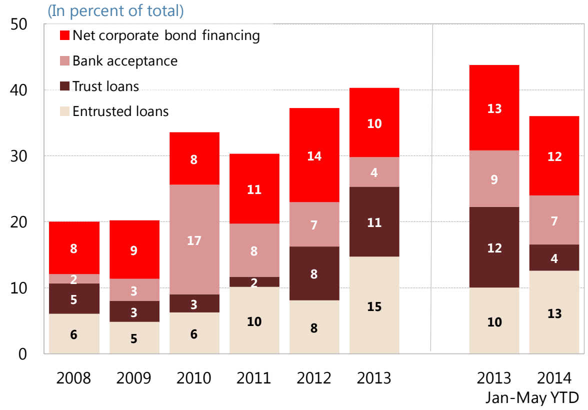
Growth in TSF (stock) declined, as "shadow banking" expanded at a slower pace…

Social Financing Flow
(In RMB trillion)



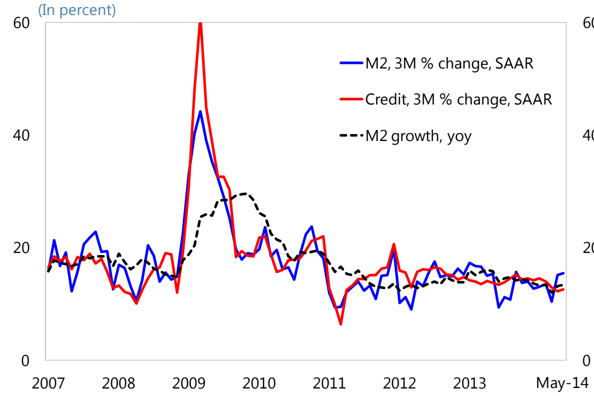
…and the share of "shadow banking" in the flow of TSF dropped, especially that of trust loans.

China: Social Financing Flow
(In percent of total)



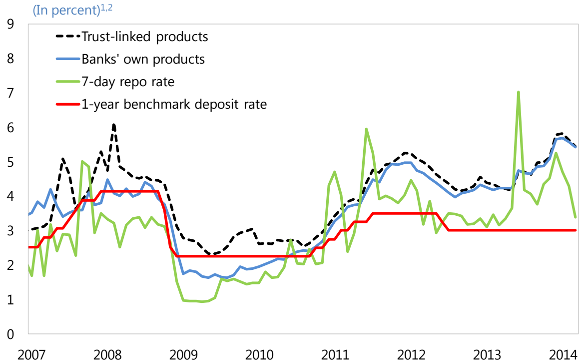
Money growth has moderated somewhat.

Money Growth
(In percent)



…while interest rates have declined from high levels seen in the second half of 2013, with WMP rates declining by less than interbank rates…

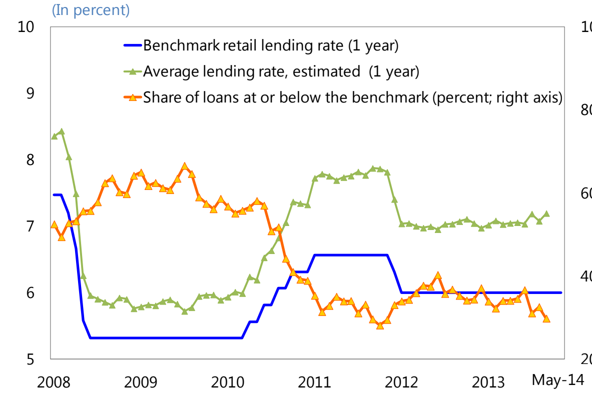
Selected Interest rates
(In percent)[1,2]



[1]For WMPs, calcualted for products with 1-6 moths' tenor.
[2]Sample covers all products issued by banks covered in WIND.

…at the same time bank lending rates have edged up slightly.

Nominal Lending Rates
(In percent)

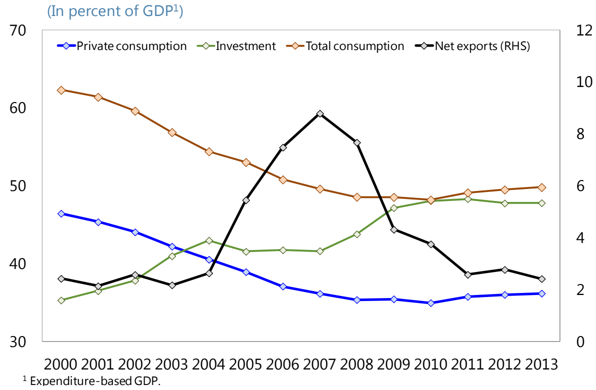


Sources: CEIC Data Company Ltd.; Haver Analytics; Bloomberg; and IMF staff calculations.

Figure 3. China: Rebalancing

There has been significant progress with external rebalancing, but less so with domestic rebalancing.

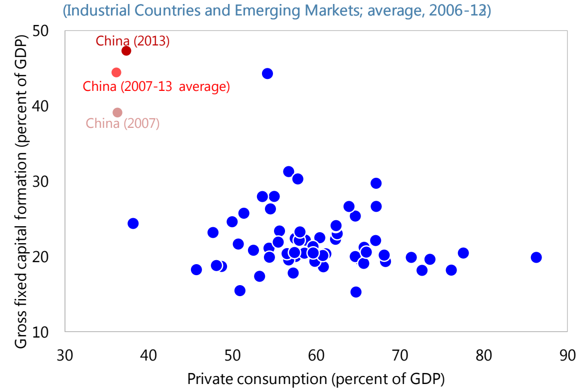
GDP Expenditure Components
(In percent of GDP[1])



[1] Expenditure-based GDP.

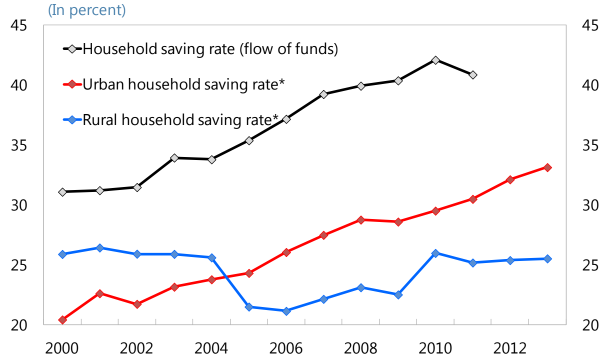
Investment share has been increasing and is high relative to other countries…

Private Consumption and Investment
(Industrial Countries and Emerging Markets; average, 2006-13)



…and the urban household saving rate continued to rise

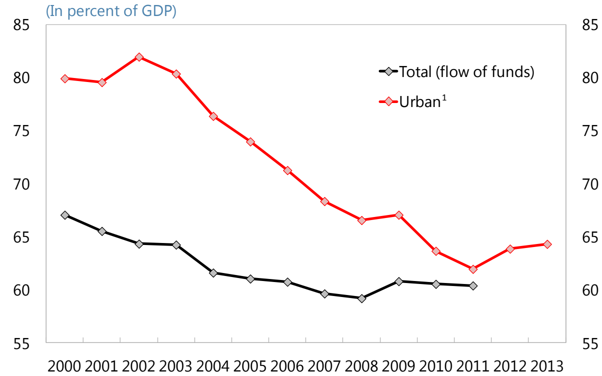
Household Saving Rate
(In percent)



* Rural household saving rate =(net income -living expenditure)/net income, percent; urban household saving rate = (disposable income-consumption)/disposable income, percent; household survey.

However, household survey data indicate that urban household income is growing faster than GDP.

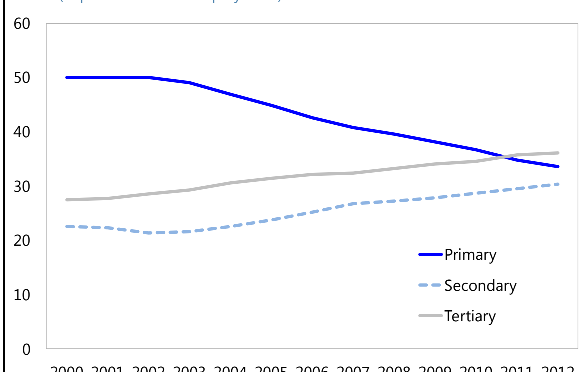
Household Disposable Income
(In percent of GDP)



[1] Per capita as a share of per capita GDP; household survey.

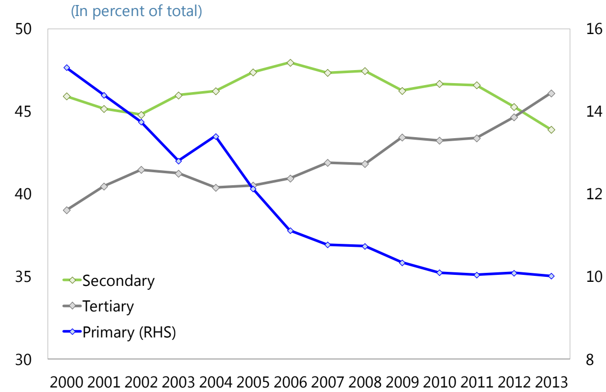
As employment in the services (tertiary) industry continued to grow, and surpassed the secondary sector as the largest source of employment…

China: Employment Shares by Sector
(In percent of total employment)



…and the share of services in GDP also surpassed the secondary sector

China: GDP Shares by Sector
(In percent of total)

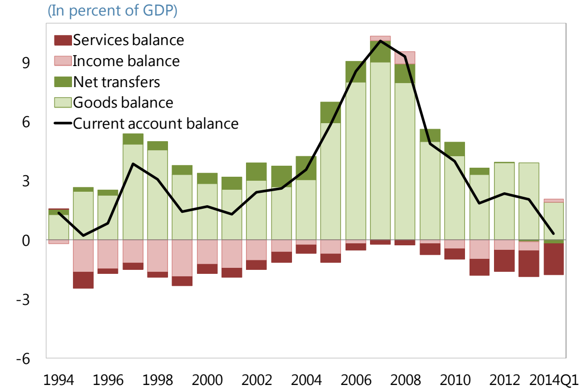


Sources: CEIC Data Company Ltd.; WEO; and IMF staff calculations.

Figure 4. China: Balance of Payments

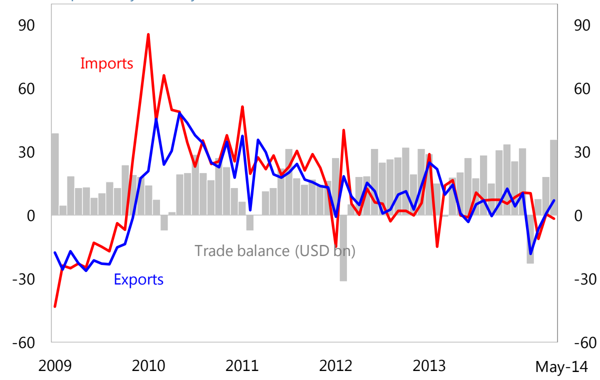
Current account surpluses have declined...

Current Account and Components
(In percent of GDP)



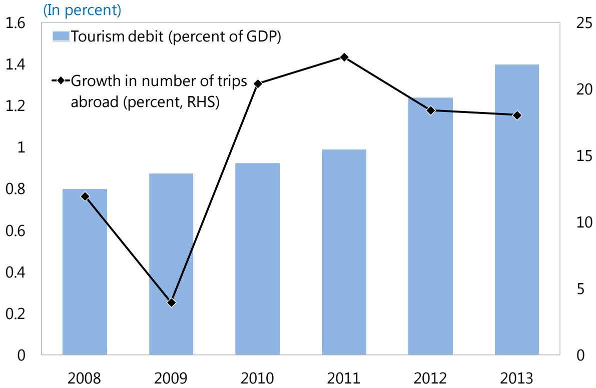
...with trade balance remaining about the same.

Trade balance
(In percent, year-on-year)



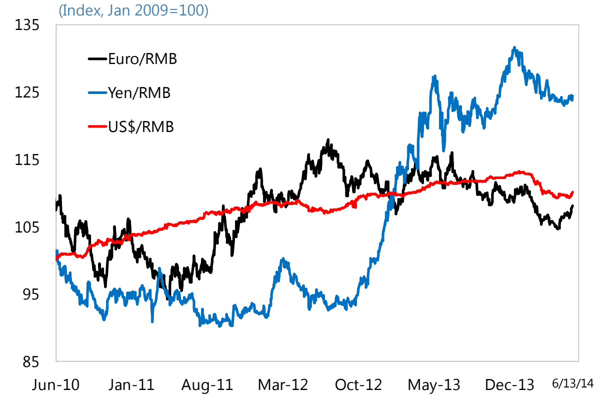
Service deficits, especially from outbound tourism, contributed to declining current account surpluses.

Outbound Tourism Development
(In percent)



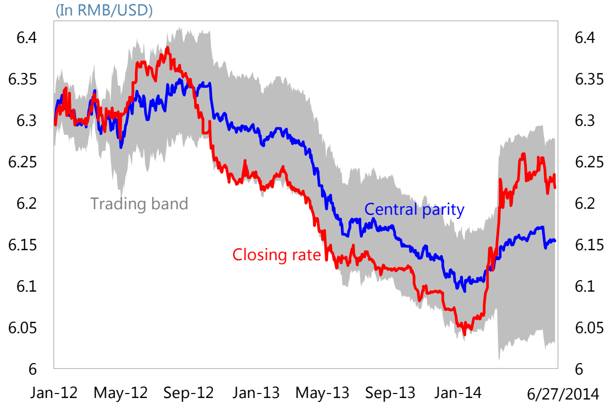
The currency has been depreciating against the U.S. dollar this year...

Bilateral Exchange Rate
(Index, Jan 2009=100)



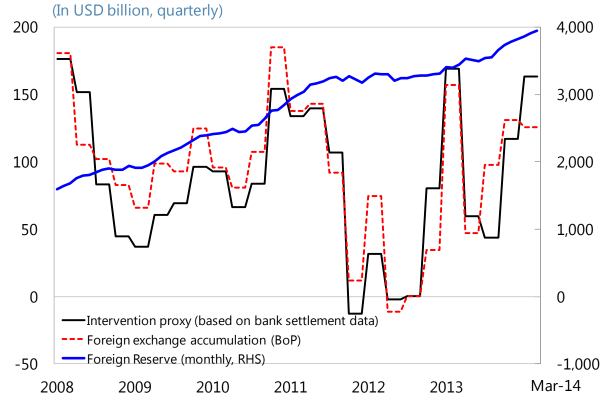
...and, for the past few months, closing on the weaker side of the daily trading band.

Spot Exchange Rate
(In RMB/USD)



BOP data point to continued intervention through Q1, leading to a further build-up in foreign exchange reserves.

Foreign Exchange Accumulation and Intervention
(In USD billion, quarterly)

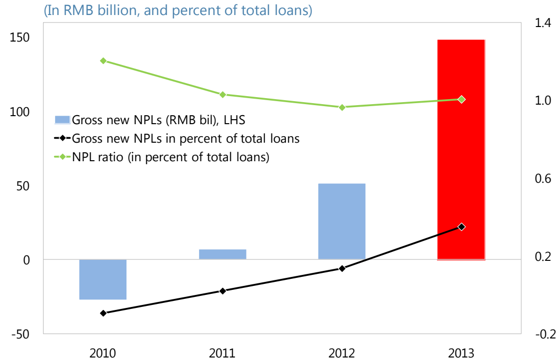


Sources: CEIC Data Company Ltd.; Haver Analytics; Bloomberg; WEO; and IMF staff calculations.

Figure 5. China: Banking Sector 1/

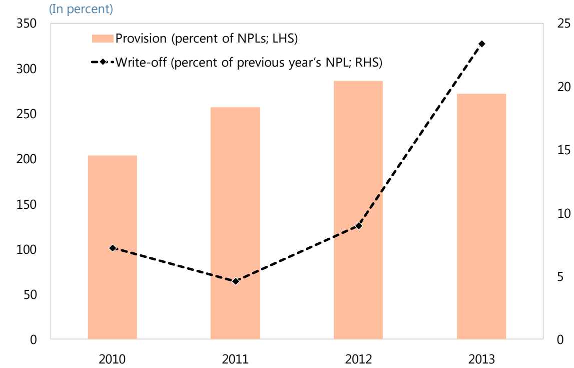
Gross new NPL flows rose significantly, but NPL ratios remain low…

Gross New NPLs and NPL Ratios
(In RMB billion, and percent of total loans)



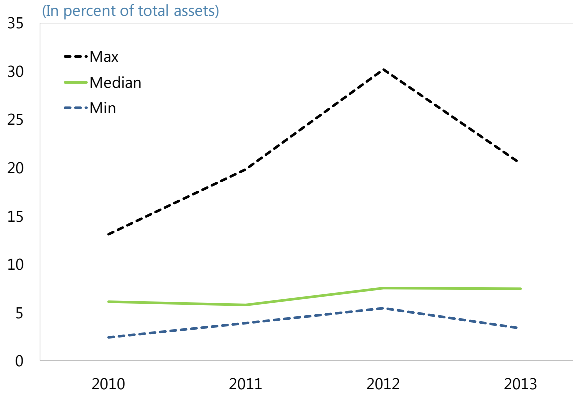
…helped by a large pick-up in charge-offs while provisions remain high.

Write-off and Provisions
(In percent)



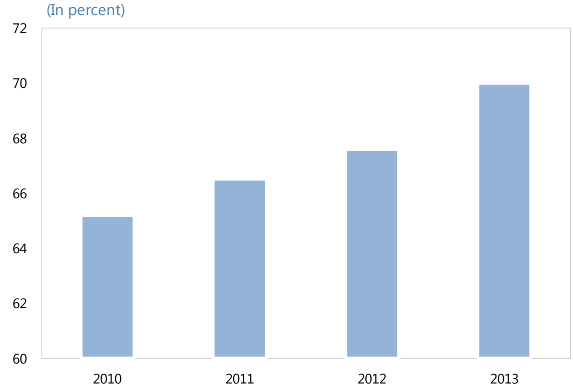
Banks, especially medium sized join-stock ones, have used the interbank market as a conduit for "shadow banking."

Interbank Assets
(In percent of total assets)



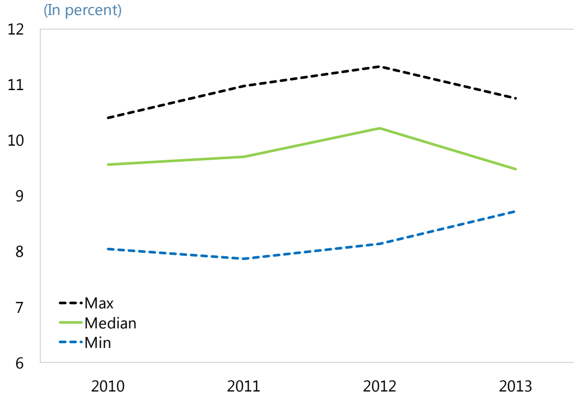
In part this is an attempt to overcome loan-to-deposit ratio constraints, which have become binding for some banks.

Loan-to-Deposit Ratio
(In percent)



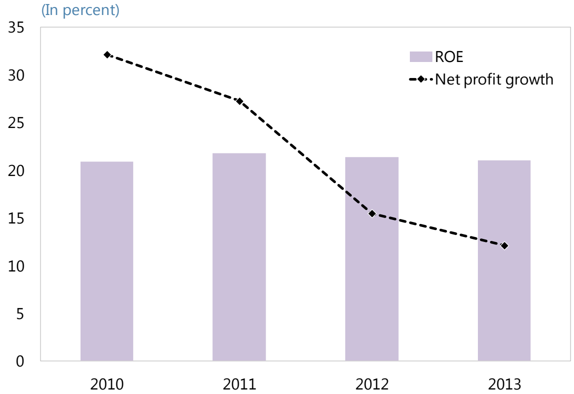
Capital adequacy ratios have declined but remained high.

Tier 1 Capital Adequacy Ratio
(In percent)



Profit growth has declined while ROE has not changed much.

Net Profit Growth and Return on Equity (ROE)
(In percent)



Sources: CEIC Data Company Ltd.; and Banks' reports; and IMF staff calculations.

1/ Based on the results of the eight largest banks listed in Hong Kong SAR, which account for 55 percent of both domestic deposits and loans.

Table 1. China: Selected Economic Indicators

	2009	2010	2011	2012	2013	2014	2015
						Projection	
	(In percent, year-on-year growth, unless otherwise noted)						
National accounts and employment							
Real GDP	9.2	10.4	9.3	7.7	7.7	7.4	7.1
Total domestic demand	13.9	10.5	10.2	8.2	8.3	7.6	7.0
Consumption	9.4	9.2	10.9	8.6	7.9	7.5	7.1
Investment	19.2	12.0	9.5	7.7	8.8	7.7	6.9
Fixed	22.6	11.5	9.1	9.1	9.2	8.1	7.2
Inventories 1/	-0.7	0.5	0.4	-0.4	0.0	0.0	0.0
Net exports 1/	-3.4	0.4	-0.4	-0.2	-0.3	0.0	0.3
Consumer prices							
End of period	1.9	4.6	4.1	2.5	2.5	1.9	2.5
Average	-0.7	3.3	5.4	2.6	2.6	2.0	2.5
Unemployment rate (annual average)	4.3	4.1	4.1	4.1	4.1	4.1	4.1
	(In percent of GDP) 2/						
External debt and balance of payments							
Current account	4.8	4.0	1.9	2.6	1.9	1.8	2.0
Trade balance	4.9	4.3	3.3	3.8	3.8	3.8	3.9
Exports of goods	23.6	26.6	26.0	24.5	23.4	22.7	22.1
Imports of goods	18.7	22.3	22.7	20.7	19.6	18.8	18.1
Gross external debt	8.4	9.2	9.5	8.8	9.1	9.7	10.2
Saving and investment							
Gross domestic investment	47.2	48.1	48.3	47.7	47.8	47.7	47.4
National saving	51.9	52.1	50.2	50.3	49.7	49.5	49.4
Public sector finance							
General government debt 3/	35.8	36.6	36.5	37.4	39.4	40.8	41.9
General government net lending/borrowing 4/	-1.8	-1.2	0.6	0.2	-0.9	-1.0	-0.8
Real effective exchange rate	*(In percent, year-on-year growth)*						
Annual average	3.4	-0.4	2.7	5.2	6.2	...	...
End of period	-5.0	5.3	5.9	0.7	8.2	...	...

Sources: CEIC Data Co., Ltd.; IMF, Information Notice System; and IMF staff estimates and projections.

1/ Contribution to annual growth in percent.

2/ Expenditure-based nominal GDP is used throughout in calculations of shares.

3/ The 2013 NAO audit indicated the debt to GDP ratio as of end-2012 is 39.4 percent of GDP. Staff estimates are based on the explicit debt and fractions (ranging from 14–19 percent according to the NAO estimate) of the government guaranteed debt and liabilities that the government may incur. Staff estimates exclude the central government debt issued for China Railway Corporation.

4/ Adjustments are made to the authorities' fiscal budgetary balances to reflect consolidated general government balance, including government-managed funds, state-administered SOE funds, adjustment to the stabilization fund, and social security fund.

Table 2. China: Balance of Payments

(In billions of U.S. dollars, unless otherwise noted)

	2009	2010	2011	2012	2013	2014	2015
Current account balance	243.3	237.8	136.1	215.4	182.8	185.3	220.4
Trade balance	249.5	254.2	243.5	321.6	359.9	396.4	443.6
Exports	1,203.8	1,581.4	1,903.8	2,056.9	2,219.0	2,349.4	2,492.5
Imports	954.3	1,327.2	1,660.3	1,735.3	1,859.1	1,952.9	2,048.9
Services	-29.4	-31.2	-61.6	-89.7	-124.5	-154.3	-175.1
Income	-8.5	-25.9	-70.3	-19.9	-43.8	-51.0	-43.5
Current transfers	31.7	40.7	24.5	3.4	-8.7	-5.8	-4.7
Capital and financial account balance	198.5	286.9	265.5	-31.8	326.2	215.2	161.0
Capital account	3.9	4.6	5.4	4.3	3.1	3.9	3.9
Financial account	194.5	282.2	260.0	-36.0	323.2	211.3	157.1
Net foreign direct investment	87.2	185.7	231.7	176.3	185.0	151.8	121.1
Portfolio investment	27.1	24.0	19.6	47.8	60.5	53.9	38.6
Other investment	80.3	72.4	8.7	-260.1	77.6	5.6	-2.6
Errors and omissions 1/	-41.4	-52.9	-13.8	-87.1	-77.6	0.0	0.0
Overall balance	400.3	471.7	387.8	96.6	431.4	400.5	381.4
Reserve assets	-400.3	-471.7	-387.8	-96.6	-431.4	-400.5	-381.4
Memorandum items:							
Current account, as percent of GDP	4.8	4.0	1.9	2.6	1.9	1.8	2.0
Export growth (value terms)	-16.1	31.4	20.4	8.0	7.9	5.9	6.1
Import growth (value terms)	-11.2	39.1	25.1	4.5	7.1	5.0	4.9
FDI (inward), as a percent of GDP	2.6	4.1	3.8	2.9	2.7	2.2	1.9
External debt 2/	428.6	548.9	695.0	737.0	863.2	1,008.9	1,153.7
As a percent of GDP	8.4	9.2	9.5	8.8	9.1	9.7	10.2
Short-term external debt (remaining maturity) 2/	259.3	375.7	500.9	540.9	676.6	786.4	882.4
Gross reserves 3/	2,453.2	2,914.2	3,255.8	3,387.9	3,880.4	4,280.9	4,662.3
As a percent of ST debt by remaining maturity	946.2	775.7	650.0	626.3	573.5	544.4	528.4
Real effective exchange rate (2005 = 100)	100.4	100.0	102.7	108.1	114.8	...	...
Net international investment position	1,490.5	1,688.0	1,688.4	1,866.5	1,971.6	...	...
In percent of GDP	29.2	28.4	23.1	22.3	20.8	...	...
Nominal GDP	5,105.8	5,949.6	7,314.5	8,386.7	9,469.1	10,367.4	11,289.8

Sources: CEIC Data Co., Ltd.; IMF, Information Notice System; and IMF staff estimates.

1/ Includes counterpart transaction to valuation changes.

2/ Data provided by the Chinese authorities, unless otherwise indicated.

3/ Includes gold.

Table 3. China: Indicators of External Vulnerability

	2006	2007	2008	2009	2010	2011	2012	2013
Monetary and financial indicators								
General government debt (in percent of GDP) 1/	31.5	34.8	31.7	35.8	36.6	36.5	37.4	39.4
Broad money (M2: annual percentage change)	17.0	16.7	17.8	28.4	18.9	17.3	14.4	13.6
Foreign currency deposits to broad money (percent)	3.6	2.9	2.6	2.3	2.1	2.0	2.6	2.4
Credit (annual percentage change)	15.1	16.1	18.7	31.7	19.9	15.8	15.0	14.1
Foreign currency loans to credit to the economy (in percent)	4.5	4.8	4.4	5.2	5.1	5.0	5.3	5.1
Stock exchange index (end-of-period, December 19, 1990 = 100) 2/	2,815	5,521	1,912	3,437	2,940	2,304	2,376	2,214.5
Stock exchange capitalization (percent of GDP)	48.9	130.2	46.0	81.1	76.7	56.1	55.6	54.0
Number of listed companies (A-share)	1,398	1,507	1,581	1,678	2,041	2,320	2,472	2,468
Balance of payments indicators								
Exports (annual percentage change, U.S. dollars)	27.2	25.8	17.6	-16.1	31.4	20.4	8.0	7.9
Imports (annual percentage change, U.S. dollars)	19.7	20.2	18.8	-11.2	39.1	25.1	4.5	7.1
Current account balance (percent of GDP)	8.3	10.1	9.2	4.8	4.0	1.9	2.6	1.9
Capital and financial account balance (percent of GDP)	1.8	2.7	0.9	3.9	4.8	3.6	-0.4	3.4
Of which : gross foreign direct investment inflows	4.4	4.5	3.8	2.6	4.1	3.8	2.9	2.7
Reserve indicators								
Gross reserves (billions of U.S. dollars) 3/	1,081	1,547	1,966	2,453	2,914	3,256	3,388	3,880
Gross reserves to imports of GNFS (months)	-12.5	-15.1	-21.2	-19.4	-18.3	-19.4	-18.6	-20.0
Gross reserves to broad money (M2) (percent)	24.9	29.2	28.8	27.5	27.2	24.7	22.0	...
Gross reserves to short-term external debt by remaining maturity (percent)	542.5	656.5	868.9	946.2	775.7	650.0	626.3	573.5
Gross reserves to proposed new IMF metric (percent) 4/	140.2	155.2	165.3	190.5	200.1	208.2	200.9	...
External debt and balance sheet indicators								
Total external debt (percent of GDP)	12.1	11.1	8.6	8.4	9.2	9.5	8.8	9.1
Total external debt (billions of U.S. dollars) 5/	338.6	389.2	390.2	428.6	548.9	695.0	737.0	863.2
Of which : public and publicly guaranteed debt 6/	34.4	34.9	33.3	36.9	38.8	37.4	36.6	34.3
Banking sector debt	120.0	126.6	126.3	132.4	183.5	266.0	256.6	327.6
Short-term external debt by original maturity (billions of U.S. dollars)	199.2	235.7	226.3	259.3	375.7	500.9	540.9	676.6
Net foreign assets of banking sector (billions of U.S. dollars)	204.7	188.3	250.8	204.5	170.6	259.9	300.4	177.3
Total debt to exports of GNFS (percent)	31.9	29.0	24.7	32.2	31.5	33.3	32.8	35.6
Total debt service to exports of GNFS (percent) 7/	19.3	17.9	14.6	19.8	21.8	24.2	24.3	28.1
Of which : Interest payments to exports of GNFS (percent) 7/	0.5	0.4	0.3	0.4	0.3	0.2	0.2	...
Bond spread (EMBI China, end of period, basis points)	58.0	57.0	68.0	51.0	120.0	228.0	64.0	...
Foreign-currency LT sovereign bond ratings (eop)								
Moody's	A2	A1	A1	A1	Aa3	Aa3	Aa3	Aa3
Standard and Poor's	A	A	A+	A+	AA-	AA-	AA-	AA-
Memorandum items:								
International investment position	640.2	1,188.1	1,493.8	1,490.5	1,688.0	1,688.4	1,866.5	1,971.6
Nominal GDP (billions of U.S. dollars)	2,793	3,505	4,548	5,106	5,950	7,314	8,387	9,469
Exports of GNFS (billions of U.S. dollars)	1,062	1,342	1,582	1,333	1,744	2,090	2,248	2,425
Real effective exchange rate (annual percentage change)	1.6	3.9	9.2	3.4	-0.4	2.7	5.2	6.2

Sources: CEIC Data Co.; Bloomberg; IMF, Information Notice System; and IMF staff estimates.

1 /The 2013 NAO audit indicated the debt to GDP ratio as of end-2012 is 39.4 percent of GDP. Staff estimates are based on the explicit debt and fractions (ranging from 14–19 percent according to the NAO estimate) of the government guaranteed debt and liabilities that the government may incur. Staff estimates exclude the central government debt issued for China Railway Corporation.

2/ Shanghai Stock Exchange, A-share.

3/ Includes gold.

4/ Metric proposed in "Assessing Reserve Adequacy," IMF Policy Paper (February 2011); the suggested adequacy range is 100–150 percent.

5/ Data provided by the Chinese authorities.

6/ Debt of banking sector not included.

7/ IMF staff estimates.

Table 4. China: Monetary Developments
(In billions of RMB, unless otherwise noted)

	2009	2010	2011	2012	2013	2013												2014				
						Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
Net foreign assets	19,853	22,604	25,164	25,885	28,099	26,491	26,686	26,948	27,184	27,225	27,268	27,175	27,204	27,274	27,665	27,970	28,099	28,311	28,359	28,403	28,558	...
Net domestic assets	41,169	49,981	59,995	71,530	82,554	72,722	73,174	76,638	76,071	76,992	78,172	78,047	78,922	80,464	79,359	79,955	82,554	84,041	84,817	87,665	88,324	...
Domestic credit 1/	49,589	58,732	68,797	80,559	92,701	81,435	82,000	84,643	84,531	85,120	86,800	86,979	87,896	89,923	89,615	90,327	92,701	94,122	94,797	97,233	97,947	...
Net credit to government	3,229	3,460	4,236	5,068	4,904	4,748	4,667	4,855	4,477	4,128	4,157	3,802	3,851	4,158	3,592	3,535	4,904	4,924	4,523	4,841	4,331	...
Credit to nongovernment	46,360	55,272	64,561	75,491	87,796																	
Other items, net 1/	107	-1,188	-3,306	-5,742	-6,091	-6,118	-6,108	-7,360	-7,037	-7,456	-7,065	-6,750	-6,927	-6,549	-5,866	-5,804	-6,091	-6,280	-6,635	-7,433	-7,588	...
Broad money	61,022	72,585	85,159	97,415	110,652	99,213	99,860	103,586	103,255	104,217	105,440	105,221	106,126	107,738	107,024	107,926	110,652	112,352	113,176	116,069	116,881	118,230
Reserve money	14,399	18,531	22,464	25,235	27,102	25,294	25,197	25,365	25,151	24,946	25,778	25,442	25,732	26,314	25,841	26,012	27,102	28,773	27,400	27,474	27,296	...
Of which:																						
Excess reserves	1,871	1,436	1,862	3,028	...	1,859	1,874	1,959	2,054	2,086	2,119	2,114	2,131	2,165	2,362	2,374	2,401	1,862	1,898	1,964	...	...
Net foreign assets of PBC	18,457	21,470	23,520	23,995	27,015	24,727	25,020	25,283	25,565	25,672	25,673	25,673	25,746	25,974	26,457	26,818	27,015	27,521	27,671	27,818	27,958	...
Net domestic assets of PBC	-4,059	-2,939	-1,056	1,239	88	568	176	82	-413	-726	105	-231	-14	339	-616	-805	88	1,252	-271	-344	-661	...
Net foreign assets 2/	4.1	4.5	3.5	0.8	2.3	1.3	1.3	1.3	1.4	1.4	1.2	1.0	1.0	1.1	1.7	2.1	2.3	1.8	1.7	1.4	1.3	...
Net domestic assets growth (percent)	39.0	21.4	20.0	19.2	15.4	20.8	19.6	20.2	20.6	20.2	17.8	18.8	19.1	18.0	17.5	16.7	15.4	15.6	15.9	14.4	16.1	...
Domestic credit 3/	30.7	18.4	17.1	17.1	15.1	17.8	17.1	17.2	17.6	17.4	16.3	17.0	16.9	16.4	16.4	16.0	15.1	15.6	15.6	14.9	15.9	...
Of which: loans	34.2	19.4	15.1	15.6	14.7	16.2	15.9	16.0	16.5	15.9	15.3	15.5	15.3	15.6	15.3	14.9	14.7	14.6	14.3	13.9	13.3	...
Other items, net 2/ 3/	-1.4	-2.1	-2.9	-2.9	-0.4	-3.3	-2.7	-3.1	-2.9	-2.7	-1.5	-1.3	-1.7	-1.3	-1.0	-0.6	-0.4	-0.2	-0.5	-0.1	-0.5	...
Broad money 4/	27.7	19.7	13.6	13.8	13.6	15.9	15.2	15.7	16.1	15.8	14.0	14.5	14.7	14.2	14.3	14.2	13.6	13.2	13.3	12.1	13.2	13.5
Including foreign currency deposits	27.3	19.4	17.3	15.0	13.4	16.4	15.5	16.0	16.2	15.7	13.8	14.1	14.4	13.9	14.0	14.0	13.4	13.3	13.4	12.1	13.3	...
M1 4/	32.4	21.2	7.9	6.5	9.3	15.3	9.5	11.8	11.9	11.3	9.0	9.7	9.9	8.9	8.9	9.4	9.3	1.2	6.9	5.4	5.5	5.7
M0 4/	11.8	16.7	13.8	7.7	7.2	4.4	17.2	11.8	10.8	11.0	9.7	9.5	9.3	5.7	8.0	7.7	7.2	22.5	3.3	5.2	5.4	6.7
Quasi money 4/	25.2	18.9	16.8	17.6	15.6	16.2	17.7	17.4	17.9	17.8	16.2	16.6	16.9	16.5	16.7	16.4	15.6	18.8	16.0	14.9	16.5	16.7
Reserve money growth (percent)	11.4	28.7	21.2	12.3	7.4	6.6	12.8	11.9	12.1	12.4	13.0	12.8	12.6	11.5	10.2	10.7	7.4	13.8	8.7	8.3	8.5	...
Net foreign assets of PBC 5/	17.6	20.9	11.1	2.1	...	4.4	5.6	6.2	7.8	8.5	7.8	7.9	8.1	8.8	10.9	12.5	12.0	11.0	10.5	10.0	9.5	...
Net domestic assets of PBC 5/	-6.2	7.8	10.2	10.2	...	2.2	7.2	5.7	4.3	3.9	5.2	4.9	4.6	2.7	-0.7	-1.8	-4.6	2.7	-1.8	-1.7	-1.0	...
Reserve ratios 6/																						
Required reserves	15.0	18.0	20.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5
Excess reserves	3.1	2.0	2.3	3.3	2.3	2.0	2.0	2.0	2.1	2.1	2.1	2.1	2.1	2.1	2.3	2.3	2.3	1.8	1.8	1.8	...	...
Memorandum items:																						
Money multiplier	4.2	3.9	3.8	3.9	4.1	3.9	4.0	4.1	4.1	4.2	4.1	4.1	4.1	4.1	4.1	4.1	4.1	3.9	4.1	4.2	4.3	...
Forex deposits of residents (US$ billion)	208.9	228.7	275.1	406.5	438.6	410.3	417.9	441.6	443.1	440.8	441.5	424.5	434.5	448.7	446.1	449.1	438.6	483.2	493.0	507.4	529.1	565.8
In percent of total deposits	2.3	2.1	2.1	2.7	2.5	2.7	2.7	2.7	2.7	2.7	2.6	2.5	2.6	2.6	2.6	2.6	2.5	2.8	2.8	2.8	2.9	3.1
Forex loans of residents (US$ billion)	379.5	453.4	538.7	683.6	776.9	712.0	730.3	754.3	767.9	773.7	775.8	757.1	751.3	765.7	766.6	768.6	776.9	802.9	824.2	846.4	849.4	846.8

Sources: CEIC Data Co., Ltd.; and IMF staff estimates.

1/ Includes foreign currency operations of domestic financial institutions and domestic operations of foreign banks. In addition, some items were moved from "other items net" to "net credit to government."

2/ Twelve-month change as percent of beginning-period stock of monetary liabilities.

3/ The growth rates are corrected for the transfer of NPLs from banks to the AMCs.

4/ The growth rates are based on official announcements, which correct for the definitional changes in the series.

5/ Annualized contribution to reserve money growth, percent.

6/ In percent of total bank deposits.

Table 5. China: General Government Fiscal Data

In RMB billions	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
						Projection					
Fiscal balance											
Authorities' definition											
Revenue 1/	6902	8320	10537	12020	13029	13953	15455	16838	18372	20084	21879
Expenditure 2/	7852	9320	11387	12820	14229	15364	16832	18381	20030	21780	23650
Fiscal balance (Authorities) (1)-(2)	-950	-1000	-850	-800	-1200	-1411	-1377	-1543	-1658	-1695	-1771
In percent of GDP	*-2.7*	*-2.5*	*-1.8*	*-1.5*	*-2.0*	*-2.2*	*-2.0*	*-2.0*	*-2.0*	*-1.8*	*-1.8*
Staff estimates											
Revenue	8310	10103	13081	15016	16531	17632	19321	20900	22641	24570	26593
Authorities definition of revenue	6902	8320	10537	12020	13029	13953	15455	16838	18372	20084	21879
(+) Social security contributions	1458	1707	2576	3141	3452	3624	3805	3996	4195	4405	4625
(+) Transfers from state-administered SOE fund	0	86	118	150	165	182	200	220	242	266	293
(-) withdrawal from stabilization funds	51	10	150	295	115	126	139	153	168	185	204
Expenditure	9675	11733	13912	16356	18663	19977	21627	23361	25018	26782	28675
Authorities definition of expenditure	7852	9320	11387	12820	14229	15364	16832	18381	20030	21780	23650
Of which: interest payment	*149*	*184*	*238*	*264*	*275*	*304*	*322*	*337*	*354*	*371*	*387*
(+) Social security expenses	1099	1331	1888	2393	2862	2976	3095	3219	3348	3482	3621
(+) Transfers to state-administered SOE fund	0	82	116	50	61	61	61	61	61	61	61
(+) Adjustment for local government spending 3/	200	200	-112	-123	150	150	150	150	150	150	150
(+) Local government spending (est. by net land sale proceeds) 4/	747	1133	1095	1440	1617	1693	1769	1844	1739	1637	1539
Land sale revenue	1992	2940	3317	2852	4125						
Acquisition and compensation cost	1245	1807	2222	1411	2508						
(-) contribution to stabilization funds	10	226	289	25	116	128	141	155	170	188	206
(-) Other adjustment 2/	212	107	173	200	138	138	138	138	138	138	138
General government net lending/borrowing (4) - (5) + (5f)	-619	-497	265	100	-516	-652	-537	-617	-638	-576	-543
(In percent of GDP)	-1.8	-1.2	0.6	0.2	-0.9	-1.0	-0.8	-0.8	-0.8	-0.6	-0.5
Fiscal balance (staff estimate) (4)-(5)	-1365	-1630	-831	-1340	-2132	-2345	-2306	-2461	-2377	-2212	-2082
(In percent of GDP)	*-3.9*	*-4.0*	*-1.8*	*-2.5*	*-3.6*	*-3.6*	*-3.3*	*-3.2*	*-2.8*	*-2.4*	*-2.1*
Estimates of augmented balances											
Overall fiscal balance	-1365	-1630	-831	-1340	-2132	-2345	-2306	-2461	-2377	-2212	-2082
(-) Estimate of local government infrastructure spending 5/	2770	2318	2898	3422	3812	4170	4563	4932	5306	5687	6078
Augmented balance	-4136	-3948	-3729	-4762	-5944	-6515	-6870	-7393	-7684	-7899	-8160
(In percent of GDP)	*-11.9*	*-9.8*	*-7.9*	*-9.0*	*-10.1*	*-10.1*	*-9.7*	*-9.6*	*-9.1*	*-8.6*	*-8.2*
of which: interest payment on LGFV borrowings	*211*	*293*	*428*	*564*	*664*	*828*	*991*	*1155*	*1336*	*1538*	*1750*
(+) Net land sale proceeds 4/	747	1133	1095	1440	1617	1693	1769	1844	1739	1637	1539
Augmented net lending/borrowing 6/	-3389	-2814	-2634	-3322	-4327	-4822	-5101	-5549	-5945	-6263	-6621
(In percent of GDP)	*-9.7*	*-7.0*	*-5.6*	*-6.3*	*-7.4*	*-7.5*	*-7.2*	*-7.2*	*-7.1*	*-6.8*	*-6.6*
General government debt											
Central government debt	**7424**	**8155**	**9025**	**9577**	**10495**	**11147**	**11684**	**12301**	**12939**	**13515**	**14058**
In percent of GDP	*21.3*	*20.2*	*19.1*	*18.1*	*17.9*	*17.3*	*16.6*	*16.0*	*15.4*	*14.7*	*14.0*
Outstanding debt by Ministry of Finance	6024	6755	7204	7757	8675						
Of which: domestic	5974	6699	7141	7675	8584						
Of which: foreign	50	56	63	82	91	91.1	91.1	91.1	91.1	91.1	91.1
AMCs and bank recapitalization funds 7/	1400	1400	1820	1820	1820						
Local government debt 8/	**8434**	**10951**	**13737**	**17036**	**20998**	**25167**	**29731**	**34663**	**39969**	**45656**	**51735**
In percent of GDP	*24.2*	*27.2*	*29.1*	*32.2*	*35.8*	*39.1*	*42.2*	*45.0*	*47.5*	*49.7*	*51.7*
Of which:											
Bank loans	6972	8468	9510	10470	11738						
LGFVs corporate bond issuance	541	793	1092	1885	2216						
Trust loans	372	441	743	1118	1649						
Local government bonds	549	749	637	514	664	664	664	664	664	664	664
Others (new funding sources since 2010)	0	500	1757	3049	4731						
Augmented debt	**15857**	**19106**	**22762**	**26613**	**31493**	**36315**	**41415**	**46964**	**52908**	**59171**	**65792**
In percent of GDP	*45.5*	*47.4*	*48.2*	*50.3*	*53.7*	*56.4*	*58.8*	*61.0*	*62.9*	*64.4*	*65.7*
General government debt (staff estimate) 9/	*12484*	*14726*	*17267*	*19799*	*23094*	*26248*	*29523*	*33099*	*36921*	*40908*	*45099*
In percent of GDP	*35.8*	*36.6*	*36.5*	*37.4*	*39.4*	*40.8*	*41.9*	*43.0*	*43.9*	*44.6*	*45.1*
General government debt if including only LG bonds	***7973***	***8904***	***9662***	***10091***	***11159***	***11811***	***12348***	***12964***	***13603***	***14178***	***14721***
In percent of GDP	*22.9*	*22.1*	*20.4*	*19.1*	*19.0*	*18.3*	*17.5*	*16.8*	*16.2*	*15.4*	*14.7*
Memorandum item:											
General government debt (NAO audit) 9/				*20874*	*...*						
In percent of GDP				*39*							

Sources: CEIC, Data Co. Ltd.; China Ministry of Finance; NAO; and IMF staff estimates.

1/ Includes central and local governments' withdrawal from budget stabilization funds.

2/ Includes adjustments for local government balance carried forward and redemption of local government bonds.

3/ Estimated from local government bond market financing.

4/ Net land sale proceeds refer to the portion used to finance current and infrastructure spending, which is estimated by subtracting the acquisition cost, compensation to farmers, and land development from the gross land sale proceeds.

5/ Derived from net changes in estimated market financing of local government financing vehicles (LGFVs).

6/ The overall net lending/borrowing includes net land sale proceeds as a decrease in nonfinancial assets recorded above the line.

7/ Includes bonds issued for bank recapitalization and asset management companies.

8/ Include major components of market financing of local governments, including bank loans, corporate bonds, trust loans, and LG bonds issued by central government on their behalf. Beginning 2009-10, local governments expanded market borrowing through the use of local government financing vehicles (LGFVs). The NAO 2013 report also lists out other new funding sources of local governments, including build-to-transfers (BT), credit and wages payable, lease financing etc.

9/ The 2013 NAO audit indicated the debt to GDP ratio as of end-2012 is 39.4 percent of GDP. Staff estimates are based on the explicit debt and fractions (ranging from 14-19 percent according to the NAO estimate) of the government guaranteed debt and liabilities that the government may incur. Staff estimates exclude the central government debt issued for China Railway Corporation.

Table 6. China: Illustrative Medium-Term Scenario 1/

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
							Projections				
					(Percent change)						
Real GDP	9.2	10.4	9.3	7.7	7.7	7.4	7.1	6.8	6.6	6.4	6.3
Total domestic demand	13.9	10.5	10.2	8.2	8.3	7.6	7.0	6.6	6.4	6.2	6.2
Consumption	9.4	9.2	10.9	8.6	7.9	7.5	7.1	6.8	6.7	6.6	6.6
Investment	19.2	12.0	9.5	7.7	8.8	7.7	6.9	6.4	6.0	5.8	5.8
Fixed	22.6	11.5	9.1	9.1	9.2	8.1	7.2	6.6	6.2	6.0	6.0
Inventories 2/	-0.7	0.5	0.4	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net exports 2/	-3.4	0.4	-0.4	-0.2	-0.3	0.0	0.3	0.4	0.5	0.4	0.4
Consumer prices (average)	-0.7	3.3	5.4	2.6	2.6	2.0	2.5	3.0	3.0	3.0	3.0
					(In percent of GDP)						
Total capital formation	47.2	48.1	48.3	47.7	47.8	47.7	47.4	47.0	46.6	46.3	45.9
Gross national saving	51.9	52.1	50.2	50.3	49.7	49.5	49.4	49.3	49.1	48.9	48.8
Current account balance	4.8	4.0	1.9	2.6	1.9	1.8	2.0	2.3	2.5	2.7	3.0
					(In billions of U.S. dollars)						
Current account balance	243.3	237.8	136.1	215.4	182.8	185.3	220.4	279.9	326.6	382.5	457.5
Trade balance	249.5	254.2	243.5	321.6	359.9	396.4	443.6	486.0	539.3	590.0	640.0
Exports	1,204	1,581	1,904	2,057	2,219	2,349	2,493	2,660	2,852	3,058	3,272
(Percent change)	-16.1	31.4	20.4	8.0	7.9	5.9	6.1	6.7	7.2	7.2	7.0
Imports	954	1,327	1,660	1,735	1,859	1,953	2,049	2,174	2,313	2,468	2,631
(Percent change)	-11.2	39.1	25.1	4.5	7.1	5.0	4.9	6.1	6.4	6.7	6.6
Capital and financial account, net	198.5	286.9	265.5	-31.8	326.2	215.2	161.0	95.6	48.6	-8.6	-92.7
Capital account	3.9	4.6	5.4	4.3	3.1	3.9	3.9	3.9	3.9	3.9	3.9
Direct investment, net	87.2	185.7	231.7	176.3	185.0	151.8	121.1	85.9	50.6	11.3	-47.9
Portfolio investment, net	27.1	24.0	19.6	47.8	60.5	53.9	38.6	22.4	12.3	2.5	-11.6
Other investment, net	80.3	72.4	8.7	-260.1	77.6	5.6	-2.6	-16.6	-18.3	-26.3	-37.1
Errors and omissions	-41.4	-52.9	-13.8	-87.1	-77.6	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserves (- indicates increase)	-400.3	-471.7	-387.8	-96.6	-431.4	-400.5	-381.4	-375.4	-375.2	-373.9	-364.8
Gross reserves	2,453	2,914	3,256	3,388	3,880	4,281	4,662	5,038	5,413	5,787	6,152
					(In percent of GDP)						
General government net lending/borrowing 3/	-1.8	-1.2	0.6	0.2	-0.9	-1.0	-0.8	-0.8	-0.8	-0.6	-0.5
Revenue	23.8	25.1	27.7	28.4	28.2	27.4	27.4	27.1	26.9	26.8	26.6
Expenditure	27.7	29.1	29.4	30.9	31.8	31.0	30.7	30.3	29.7	29.2	28.6
Finance by net land sales proceeds	2.1	2.8	2.3	2.7	2.8	2.6	2.5	2.4	2.1	1.8	1.5
General government debt 4/	35.8	36.6	36.5	37.4	39.4	40.8	41.9	43.0	43.9	44.6	45.1
General government structural balance	-1.2	-0.7	1.2	1.1	0.1	0.0	0.1	-0.2	-0.4	-0.5	-0.5
Memorandum item:											
Nominal GDP (in billions of yuan)	34,878	40,282	47,262	52,940	58,667	64,380	70,476	76,991	84,159	91,821	100,098
GDP Deflator (2012 = 100)	85.6	89.5	96.1	100.0	102.9	105.2	107.5	109.9	112.7	115.5	118.4
Real effective exchange rate growth rate											
Annual average	3.4	-0.4	2.7	5.2	6.2	...	...	...	...	...	...
End of period	-5.0	5.3	5.9	0.7	8.2	...	...	...	...	...	...
Terms of trade 5/	8.5	-10.0	-3.5	2.8	1.2	1.3	0.9	0.0	0.1	0.0	0.0
Augmented debt 6/	45.5	47.4	48.2	50.3	53.7	56.4	58.8	61.0	62.9	64.4	65.7
Augmented net lending/borrowing 6/	-9.7	-7.0	-5.6	-6.3	-7.4	-7.5	-7.2	-7.2	-7.1	-6.8	-6.6

Sources: CEIC Data Co., Ltd.; IMF, Information Notice System; and IMF staff estimates and projections.

1/ Following convention, the scenario assumes a constant real exchange rate and a continuation of the current policy framework.

2/ Contribution to annual growth in percent.

3/Adjustments are made to the authorities' fiscal budgetary balances to reflect consolidated general government balance, including government-managed funds, state-administered SOE funds, adjustment to the stabilization fund, and social security fund.

4/The 2013 NAO audit indicated the debt to GDP ratio as of end-2012 is 39.4 percent of GDP. Staff estimates are based on the explicit debt and fractions (ranging from 14-19 percent according to the NAO estimate) of the government guaranteed debt and liabilities that the government may incur. Staff estimates exclude the central government debt issued for China Railway Corporation.

5/ Percentage change of annual average.

6/Augmented fiscal data expand the perimeter of government to include local government financing vehicles and other off-budget activity.

Appendix I. Summary of Staff Recommendations and Announced Reform Initiatives Following the Third Plenum

Advice in 2013 Article IV Report	Announced Reforms by the Authorities	Timing Indicated by the Authorities	Sources 1/	Progress
Strategic levels				
1. Give a greater role to markets through continued liberalization and reduced government involvement	• Markets will play decisive role in resources allocation in deepening reforms	To achieve significant results in core reform areas by 2020	Communiqué; Decisions	
2. Embed strong governance in local governments, banks, and SOEs	• Set up a reform leading group to oversee reforms implementation			
3. Boost household incomes and consumption				
Fiscal reforms				
• Ensure medium-term fiscal sustainability through gradual fiscal adjustment (including in off-budget and quasi-fiscal activity)	• Improve budget transparency through spending controls, multiyear budget adoption, and strengthening transfers system		Decisions; MOF budget 2014; NAO audit	National and provincial audit on government debt announced
• *Local government finances* : (i) aligning revenue responsibilities with expenditure mandates; (ii) limit off-budget borrowing; and (iii) integrate government and LGFV investment spending	• Better align local government revenue and spending responsibilities		Decisions; Budget 2014	Disclose detailed account of fiscal operations; rules for municipal bond issuance announced with 10 pilot areas
• Upfront reduction in social security contributions, while ensuring sutainability of the system by shifting legacy and welfare costs to the budget	• Move towards the basic pension insurance system and basic medical insurance on a national basis while ensuring equity and sustainability		Decisions	
	• Improve the coverage of basic urban social services; consolidate the rural area old-age and medical insurance of migrants into the urban social security system			
	• Lower social contributions at an appropriate time		Decisions; MoF work report	
• Continue tax reforms (e.g., broaden tax base, minimize cascading, reduce evasion) and expand property and environment-related taxes	• Continue tax reforms by raising the share of direct taxes; broadening the VAT; simplifying tax rates; introducing environmental taxes; and rolling-out a property tax	Early 2014 for VAT reform, with completion by 2015	Communiqué; Decisions	Further extend VAT on more services
• Increase SOE dividend payments to the budget; improve financial discipline	• Require SOEs to submit 30 percent of profits to the budget; establish state asset management companies to manage SOEs	By 2020	Decisions	
	• Allocate some SOE capital to social security funds			

Appendix I. Summary of Staff Recommendations and Announced Reform Initiatives Following the Third Plenum *(continued)*

Advice in 2013 Article IV Report	Announced Reforms by the Authorities	Timing Indicated by the Authorities	Sources 1/	Progress
Financial reforms				
• Fully liberalize interest rate	• Expedite interest rates liberalization, while removing deposit rate controls as the last step	Governor speech noted within two years	Decisions; Gov. Zhou and DG Hu	Liberalized lending rates
• Strengthen regulation and supervisory oversight	• Better define supervisory responsibilities and continue strengthen regulation and supervision		PBC; CBRC; CSRC;	New regulations issued in Q2 that covered trust companies, interbank activity, banks, and other areas
	• Reopen IPO market and move from an approval to a registration (disclosure) system	End-2016	CSRC	IPO restarted and transition to registration system ongoing
• Establish explicit deposit insurance	• Establish a deposit insurance system	Planned for 2014	Decisions; Governor Zhou	
• Improve the resolution framework for financial institutions • Removing moral hazard stemming from the implicit guarantees on financial assets	• Improve the exit mechanism of financial institutions and correct for moral hazard problems		Decisions	Has been default on corporate bond and credit events in trust products
• Use interest rates as the primary tool for monetary policy	• The PBC will develop more established market interest rates, thereby strengthening the policy rate monetary framework and its transmission mechanism	Over the near to medium term	Gov. Zhou	
• Establish a policy interest rate and improve the framework of sovereign yield curve or interbank markets	• Improve the market determination of sovereign yields, including through bond issuance and improving liquidity and yield structure	Over the medium term	Gov. Zhou	
External sector reforms				
• Reduce interventios and move to flexible exchange rates	• The PBC will basically withdraw from regular intervention, eventually leading to a flexible exchange system		PBC	
• Allow exchange rate to move in line with market forces by widening the trading band	• Gradually expand the RMB trading band and encourage flexibility in both directions while ensuring overall RMB stability	March 2014	Decisions and PBC	Trading band was widened to 2 percent
• Further open capital account, but carefully timed and sequenced with other reforms	• Reduce the approval procedures of QFII eligibility and quotas in a timely manner		Gov. Zhou	The RQFII and RQDII quotas were expanded
	• Gradually liberalize cross-border capital and financial flows; establish a macroprudential framework on external debt and capital flow management		Decisions; CSRC	Cross-border stock investment pilot program between Shanghai and Hong Kong SAR announced in April

Appendix I. Summary of Staff Recommendations and Announced Reform Initiatives Following the Third Plenum *(concluded)*

Advice in 2013 Article IV Report	Announced Reforms by the Authorities	Timing Indicated by the Authorities	Sources 1/	Progress
Structural reforms				
• Open up markets for more competition (e.g., services and upstream industries) to generate TFP gains	• Qualified private capital can set up commercial banks		Decisions, Gov. Zhou and DG Yi articles	
	• Eliminate investment approvals in all areas except involving national security and strategic resources; encourage private and foreign participation in service sectors		Decisions	
	• Advance the Shanghai pilot Free Trade Zone and explore other free-trade areas		Communiqué; Decisions; PBC	Further operational details by PBC on SFTZ; separate accounting system implemented
	• Strengthen intellectual property rights protection		Decisions	
• Raise factor input costs including through environment-related taxation and rationalizing investment	• Introduce market-based pricing mechanism in utilities, transport, and telecommunication sector		Decisions	
	• Reform resource prices		Decisions	
	• Increase emphasis on environmental protection in assessing local officials performance		Decisions; State Council	Environmental Protection Law amended in April; targets of 15–25 percent reduction in air pollutants announced
	Other key announced reforms			
	• Hukou reform: gradually expand benefits for rural migrants	Interim target by 2020	State Council's document on urbanization plans	Target urbanization rate of 60 percent by 2020; pilot areas on rural land reforms in Zhejiang
	• Rural land reform—standardize urban/rural land markets and allow 'collectives' land use rights to be transferred or used as collateral			
	• Further relax the 'one-child' policy	Beginning 2014	Decisions and subsequent policies	Effective in selected provinces

Source: Chinese national authorities.

1/ 'Communiqué' refers to the Third Plenum of the 18th CCP Central Committee Communiqué (Nov 12). 'Decisions' refers to the Decisions on Major Issues Concerning Comprehensively Deepening Reform (November 15).

Appendix II. China: Progress on Key Recommendations of the FSAP, 2013–2014 1/

Recommendations	Priority	Time Frame	Progress
Improving commercialization			
1. Continue to advance the process of interest rate and exchange rate reform (¶8, 11, 50, 51, 52, 68, 79), while ensuring that appropriate credit risk management practices in financial institutions are in place.(¶5, 8, 11, 50, 51, 57, 58, 79)	High	MT	*Reforms on interest rate liberalization* ● On July 20, 2013, the People's Bank of China (PBC) removed the lending rate floor for banks. ● Further improved the market mechanism on interest rates by launching the concentrated quotation and disclosure mechanism on the loan prime rate in 2013. ● On December 8, 2013, the PBC issued the Provisional Rules on the Management of Negotiable Interbank Certificates of Deposit (NCD), steadily promoting the issuance and trading of NCD. *Reforms on exchange rate liberalization* ● On March 17, the renminbi's trading band against the U.S. dollar in spot foreign exchange market would be widened to 2 percent from 1 percent. ● Further strengthen the exchange rate risk management tools.
2. Clearly delineate the roles and functioning of policy financial institutions from commercial financial institutions. (¶6, 8, 12, 15, 55)	Medium	MT	The reform plan for the Agricultural Development Bank of China is expected to be announced in 2014, while the plan for Export-Import Bank of China has been ongoing. The reforms will clearly lay out the mandates of policy banks, better define the boundaries between commercial and policy banks, and strengthen their policy functions.
3. Transform the four Asset Management Companies (AMCs) into commercial entities and, as a first step, require them to publish periodic financial statements and management reports. (¶49)	Medium	MT	● China Cinda had an initial public offering (IPO) in Hong Kong SAR in December 2013, and will regularly publish an annual report, including its financial statement and management report. ● Other AMCs have taken steps on reforms: China Huarong Assets Management Corporation seeks strategic investors to improve its equity structure; the MoF has taken the lead in reforming China Orient Assets Management Corporation and China Great Wall Assets Management Corporation.
Increasing efficiency of the institutional, regulatory, and supervisory framework			
4. Empower the PBC and three supervisory commissions with focused mandates, operational autonomy and flexibility, increased resources and skilled personnel, and strengthen interagency coordination to meet the challenges of a rapidly evolving financial sector. (¶5, 6, 39, 53, 54)	High	MT	● Regulatory resources have been strengthened by improving the quality of staffing through training and bringing in overseas expertise, expanding the staffing budget, and improving the compensation structure. Established on-site and off-site regulatory and monitoring information system and harmonized the early warning system on risks. ● On cross-agency cooperation, the cross-ministerial financial regulatory coordination committee, which was established in August 2013, has held four meetings to strengthen regulatory coordination, standardized regulatory standards, prevent regulatory arbitrage, and prevent systemic risks (see No.13 below).
5. Develop a framework for regulation and supervision of financial holding companies (FHCs), financial conglomerates, and informal financial firms (¶54). In the interim, acquisition of a regulated institution should be approved by the regulatory commission responsible for	Medium	NT	● Regulatory rules on financial holding companies were clarified through a joint effort of regulatory agencies. The rules aim to 1) strengthen regulation of capital adequacy to avoid double-counting and arbitrage; 2) regulate related-party transactions to rein in risk contagion across financial institutions; 3) strengthen corporate governance on ownership and management structures to protect minority interests.

the underlying financial institution. (¶54)			● The CSRC is formulating licensing rules on the financial companies which provide securities and futures services, the pilots on consolidated financial services will be launched and relevant regulatory arrangements will be clarified. ● The CIRC strengthens the regulation on insurance companies, including preparing the Guidelines of Consolidated Supervision for Insurance Groups related to solvency and group supervision; preparing the Regulation Rule for Non-insurance Subsidiary Corporation of Insurance Corporation to strengthen the risk monitoring and management on cross-industry investment. Both will be published in 2014; and publishing the Regulation Rules of M&A for Insurance Corporations in March 2014.
6. Introduce a more forward-looking assessment of credit risk in the China Banking Regulatory Commission (CBRC) risk rating system and eliminate deviations from the capital framework for credit and market risk. (¶56)	Medium	NT	● The "Internal Guidelines of Supervising and Rating for Commercial Banks" is under the final stage of revision by the CBRC to improve the credit risk regulatory ratings, including: (1) incorporate the trend on risk assessment and require banks with deteriorating quarterly trend to undertake a comprehensive assessment on NPLs and other nonperforming assets; (2) further improve the quantitative indicators on risks exposures, loan classification, loan concentration to better assess the risks for on-and-off balance sheet assets. New indicator on "ratio of overdue loans 90 days or more to NPLs" was introduced; and (3) and quarterly averaging benchmark was used to assess risks to avoid banks' quarter-end adjustment to meet the quantitative targets. ● Meanwhile, the CBRC has provided guidance to banks on macroeconomic risks (e.g., quarterly briefing) and required banks to strengthen risk assessment with respect to their impact on industry structure, industry policy, and asset price fluctuations.
7. Introduce a formal program whereby the China Securities Regulatory Commission (CSRC) conducts regular comprehensive on-site inspections of the exchanges to improve oversight. (¶60)	Medium	NT	● The CSRC has adopted and formalized the on-site inspection system to regulate securities and futures exchanges. For example, the CSRC has undertaken information system on-site inspections on stock and futures exchanges (the latest comprehensive inspection was conducted in August 2013).
8. Introduce a risk-based capital (RBC) solvency regime for insurance firms with suitable transition period and restrict new businesses by insurance companies operating below the 100 percent solvency level. (¶61)	Medium	MT	● Steady progress on the second version of RBC solvency regime is being made. The switch to the new regime and all technical standards are expected to be completed by end-2014.
9. Develop explicit and clear regulation for facilitating the exit of insurance companies from the market via run off or portfolio transfers. (¶61)	Medium	NT	● No updates.
10. Enact a payment system law to give full protection to payments, derivatives and securities settlement finality. (¶63)	Medium	MT	● The PBC is promoting the enactment of the "Payment and Settlement System Management Regulations", which would provide full protection on payments, derivatives, and securities settlement. Since the Regulations involve multiple ministries, there has been no concrete time table for final implementation. ● The amendments to the Securities Law are being revised under the leadership of the Financial Committee of the National People's Congress. The amendment bill will be submitted to the Standing Committee for preliminary review in December 2014.
11. Ensure that beneficial ownership and control information of legal persons is adequate, accurate, and readily accessible to competent authorities. (¶67)	High	MT	● The PBC Anti-money Laundering Bureau is drafting the "Specific Non-financial Institutions Anti-money Laundering Provisions" (currently under consultation), which specifies responsibilities of "certain non-financial institutions" that they should verify the client identity and identify the ultimate beneficiary and

			control for legal entities. The rule is expected to be implemented in three years.
12. Improve information sharing and coordination arrangements among the PBC and other agencies on anti-money laundering (AML) and other supervisory issues. (¶39, 53, 54, 67)	High	MT	● China has established an anti-money laundering interministerial meeting system, which is responsible to formulate and coordinate policies and measures related to international cooperation arrangements on anti-money laundering. ● The PBC Anti-money Laundering Bureau is assessment the information sharing and exchange among PBC,CBRC,CSRC and CIRC.
Upgrading the framework for financial stability, systemic risk monitoring, systemic liquidity, and crisis management			
13. Establish a permanent committee of financial stability, with the PBC as its secretariat. (¶6, 39)	High	MT	● In August 2013, the State Council approved the establishment of a cross-ministerial financial regulation and coordination committee (led by the PBC), which includes PBC, CBRC, CSRC, CIRC, and SAFE, together with participation from the NDRC and MoF if needed. The key responsibilities will be to maintain financial stability and prevent regional and systemic risks, similar to that of the financial stability committee. The cross-ministerial committee is led by the PBC.
14. Upgrade data collection on financial institutions including their leverage, contingent liabilities, off balance sheet positions, unregulated products, and cross-border and sectoral exposures. (¶40)	Medium	NT	● For the banking center, the Rules on Liquidity Risk Management of Commercial Banks (Provisional) was published in 2014. The methodology in calculating the liquidity coverage ratio is consistent with that of the final decision of the Basel Banking Supervision Committee. ● The financing companies and small-loan companies were included in the statistics category; a new entrusted loans special statistics system will be established, while the statistics system on loan and deposit, wealth management, and fund trust will be standardized.
15. Build a macroprudential framework for measurement and management of systemic risks; this should include increasing the resources and capacity of the PBC and regulatory agencies to monitor financial stability and to carry out regular stress tests. (¶41)	High	NT	● The standards and assessment framework of the domestic systemically important financial institutions (D-SIFIs) is being formulated. The framework of the global and domestic systemically important insurance companies is under analysis (expected to be introduced in a year). ● Strengthening the monitoring, assessment, and early warning of systemic risks. The PBC has published the 2014 Financial Stability Report, which monitored key risks on industries, markets, and across-the-border. The PBC also started a financial stability stress test in 2014. ● The CSRC focuses on systemic risk prevention in capital markets and plans to publish regularly a report on capital markets stability. ● The CIRC will promote the second generation of the risk-based capital (RBC) solvency regime, with emphasis on wealth management and return-guaranteed products and cross-market transactions. It plans to strengthen the regulation on cross-market and cross-institution equity investments, establish a platform for information sharing, and undertake regular stress test of insurance companies.
16. Enhance the sterilization of structural liquidity through market-based instruments and manage systemic liquidity spillovers via indirect monetary policy instruments. (¶42, 51)	High	NT	● The PBC used various tools various tools to manage liquidity, including open-market operations, which have improved its ability to address volatility in short-term liquidity in the interbank money markets. The refinancing and rediscount tools are also available to satisfy liquidity needs in the financial system.
17. Introduce reserve averaging to facilitate liquidity management and enhance stability and efficiency.(¶43)	High	NT	● The PBC is studying the reserve averaging system, including data provision and reporting.
18. Start targeting a short-term repo rate on a pilot basis, as a trial of indirect liquidity management, and	High	NT	● The authorities considered that market was not yet mature enough to start targeting a short-term repo rate. The PBC has used bi-weekly open-market operations and the newly-established Short-term

commence daily open market operations. (¶44, 45)			Liquidity Operation (SLO) to meet liquidity demand.
19. Ensure that PBC's standing facilities operate immediately and automatically, with specified collateral requirement identical across all domestically incorporated institutions. (¶46)	Medium	NT	● The PBC has introduced several pilots on branch-level standing facilities operation in early 2014 and will expand the pilot areas as needed.
20. Introduce a deposit insurance scheme to assist in the orderly wind-down of financial institutions and to help clarify the contingent liability. (¶7, 48)	Medium	NT	● Establishing a deposit insurance system and resolution framework for financial institutions is a key task in the 2014 financial reform agenda. Preparation work is basically ready, and the next step is to implement as soon as possible.
Developing securities markets and redirecting savings to contractual and collective investment sectors			
21. Ensure regulations are consistent and clarify regulatory responsibilities to support fixed income market development. (¶69)	Medium	MT	● N/A
22. Continue to improve bond issuance strategies between Ministry of Finance (MOF) and PBC to help improve the existing market-making across all maturities of the yield curve. (¶70)	High	MT	● (1) In 2013, the PBC, the MOF, and the CSRC established a pilot mechanism for market-making of sovereign bonds and a presale mechanism for book entry sovereign bond futures began in 2013.
23. Upgrade regulatory and operational repo market framework to increase market liquidity, enhance risk management and reinforce the money and bond market interest rate nexus. (¶68)	Medium	NT	● N/A
24. Ease the 40 percent of net assets limit applicable to corporation's market based debt issuance to expand their direct funding capacity. (¶72)	Medium	MT	● The PBC and related institutions have recommended abolishing the net asset limit (see recommendation 10).
25. Upgrade links between China Central Depository Trust & Clearing Co., Ltd (CCDC) and Securities Depository and Clearing Corporation Limited (SD&C) to enhance connectivity among Interbank Bond Market (IBBM), Shanghai Stock Exchange (SSE), and Shenzhen Stock Exchange (SZSE), support further development, and contribute to efficiency in all three markets. (¶72)	Medium	MT	● The PBC is promoting the development of the listed bond market and, for example, in 2013, approved a RMB 30 billion bond issuance by the China Development Bank, and RMB 30 billion were already issued. ● About 92 percent of sovereign and 57 percent of corporate bonds were in market circulation as of end-June 2013. In the first half of 2013, the total custodian transfers across banks and listed exchanges reached RMB 261.3 billion (an 140 percent increase year-on-year). ● CCDC and SD&C are exploring ways to cooperate and improve efficiency.
26. Consolidate the multi-pillar pension system, with emphasis on the funded component. (¶75)	Medium	MT	● In February 2014, the State Council issued "Views on the establishment of a unified basic pension system for urban and rural residents."
Improving alternative financing channels and access			
27. Review existing government programs to determine their effectiveness in promoting rural and micro and small enterprise (MSE) finance and formulate an integrated and coherent rural and MSE finance strategy. (¶76)	High	MT	● *Optimizing the use of monetary and credit instruments*. The PBC supported rural financial institutions—such as by providing liquidity and reducing reserve requirement ratios—to help expand credit to the agriculture sector and small and micro enterprises. ● *Improve rural agriculture financial system*. As of end-2013, rural agriculture finance consisted of 1,071 village banks, 14 loan companies, 49 union funds, which accounted for 90 percent of all

			agricultural and small microenterprise loans, of which private capital accounted for over 70 percent. ● *Improve the financial infrastructure*. Expanded access to financial services in rural areas, such as by increasing the number of outlets and ATMs. A credit profile was established for over 148 million farmers, of which 98 million also had a credit rating. Consumer protection was enhanced and the infrastructure for the small and micro enterprises credit and financing guarantees system was improved. ● *New financing channels.* Encourage SMEs to issue corporate debt as a means of finance, support qualified financial institutions to raise funding specific for SME loans. Further improve financing conditions of SMEs by reducing financing costs and unreasonable fees and charges.
28. Further reform the rural credit cooperatives to enhance their efficiency and sustainability as commercial providers of financial products and services. (¶76)	Medium	MT	● *Consolidate equity base and shareholding reforms.* Reforms of rural credit cooperative property rights by bringing in key shareholders and increasing the quality and adequacy of capital. Encouraging rural credit cooperatives to become rural banks. As of end-2013, rural (commercial and cooperative) banks for the first time exceeded 50 percent of rural financial institution total assets. ● *Access to financial services.* Improved the coverage and network of financial access and services. As of end-2013, rural agriculture finance (including rural commercial and cooperative banks) had about RMB 6.2 trillion in agriculture-related loans and RMB 3 trillion (up 15 percent year-on-year) in credit to farmers.
29. Complete the reform of the Postal Savings Bank (PSB) by optimizing equity ownership, overhauling the bank to become a corporation, and building effective corporate governance. (¶76)	Medium	MT	● In accordance to the requirements of the "Reforms on the shareholding of the China Postal Savings Bank Limited (CPSB)—MoF, PBC, and CBC", the CPSB are undertaking steps to bring in institutional investors and further optimize the ownership and governance structure.
1/ NT (Near Term) means implementation completed within three years; MT (Medium Term) means implementation completed in three to five years. Paragraph numbers in parentheses attached to recommendations refer to CR 11/321—People's Republic of China: Financial System Stability Analysis			

Appendix III. China: Augmented Fiscal Data[1]

This Appendix describes the method for estimating the augmented fiscal data, which expand the perimeter of government to include off-budget activity and local government financing vehicles (LGFVs). The estimates have been updated to incorporate information from the latest budget and NAO audit. The revised augmented net lending/borrowing widened in 2013, in part due to expansion of off-budget quasi-fiscal activity, and augmented debt reached 54 percent of GDP. In addition, the general government fiscal data have also been revised to incorporate previously excluded items.

A. Revised Estimate on Augmented Balance and Debt

1. **General government fiscal data have been revised from previous staff reports.** Specifically, three previously excluded items—social security funds, government managed funds (which include off-budget spending that are regularly reported), and the state-administered SOE funds. It also updates the estimate of augmented fiscal data, which were introduced in the last Article IV staff report.[2] The revisions generally show a somewhat smaller historical augmented deficit, but the deficit for 2013 is somewhat higher than previously forecast. The revised augmented debt reconciles remaining differences on general government debt with official audits in 2011 and 2013.

2. **The revision uses two-step approach to estimate the augmented deficit.**

i. *Estimate consolidated general government.* This approach estimates the general government balance. Starting with the authorities' definition of national government budgetary balance, the estimate adds (i) transfers to and from stabilization funds; (ii) state-administered SOE funds and social security contributions and expenses (about 1¼–1½ percent of GDP per year after 2008); (iii) off-budget spending by local governments—estimated by net local government bonds issued by the central government on their behalf, and net land sale proceeds (net of acquisition cost) available for local governments to use aside from budget spending (about 3 percent of GDP). Relative to the authorities' definition (a deficit of 2 percent of GDP as of end-2013), the consolidated general government net borrowing (excluding the financing by net land sale revenue) indicates a deficit of 0.9 percent of GDP as of end-2013 (Table 1)—reflecting the fact that the funds not included in the budget often show a surplus.

ii. *Add off-budget fiscal activity of LGFVs and local governments that is not financed by government bonds.* To arrive at the augmented measure, the consolidated general government balance is adjusted with the off-budget LGFV infrastructure spending and spending by local governments through other means of market financing (e.g., trust loans). The adjustment is large, at about 6½ percent of GDP per year since 2010, bringing the augmented net lending/borrowing to -7½ percent of GDP as of end-2013.

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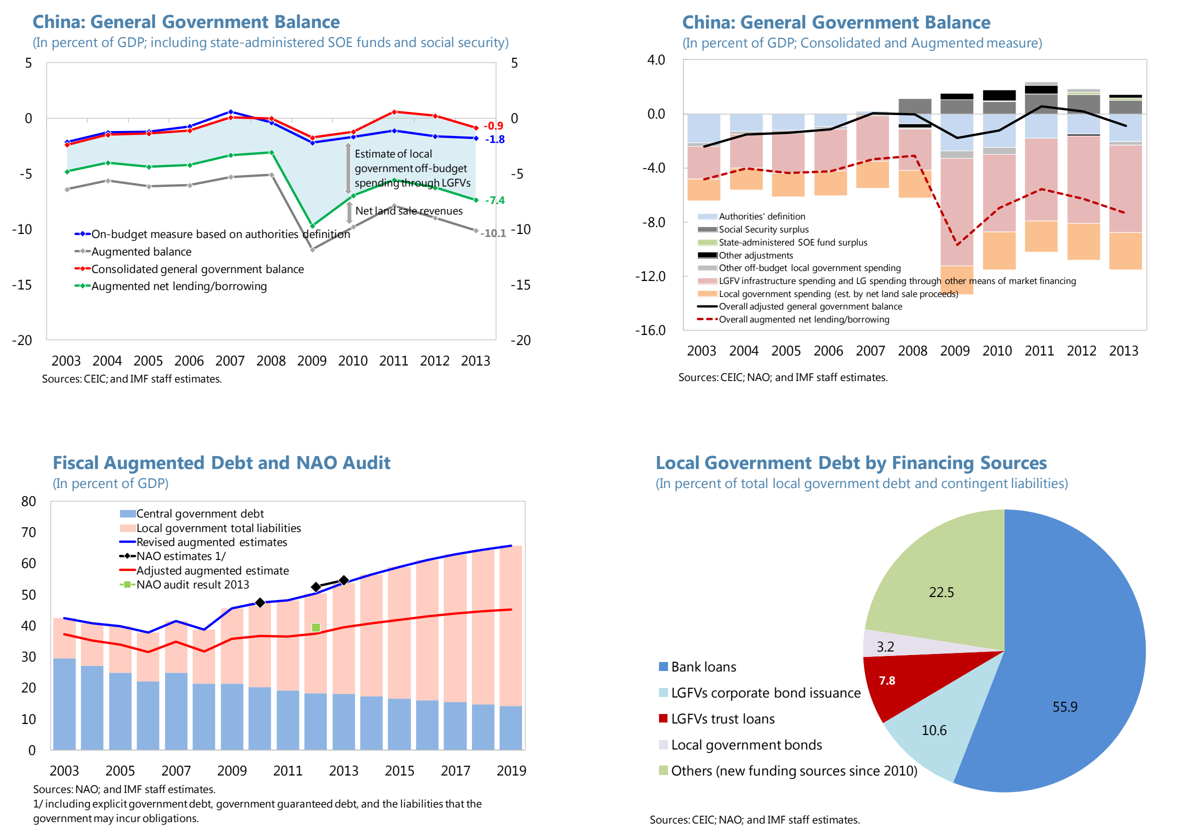
[1] Prepared by W. Raphael Lam (APD) and Philippe Wingender (FAD).

[2] Augmented fiscal data expand the perimeter of government to include local government financing vehicles and other off-budget activity. See IMF Country Report No. 13/211 and IMF Working Paper No.14/4, 'Fiscal Vulnerabilities and Risks from Local Government Finance in China'.

3. **The augmented debt estimate incorporates the findings of the recent NAO audit.** Augmented debt covers central and local government liabilities and quasi-fiscal activity by LGFVs, but excludes the debt issued for China Railway Corporation (about 3 percent of GDP).[3] The local government debt is estimated by each financing component (such as bonds issued by central government on their behalf, LGFV corporate bonds, bank loans, trust products, and other financing sources), taking into account details available in the 2013 NAO report (see Section C). The estimate of land sale revenue and acquisition cost—a key component in local government finance—has been revised and is based on data in previous budget speeches.

Figure 1. Revision to Augmented Deficit and Debt



[3] The augmented debt expands the perimeter of general government to include off-budget activity and borrowings by local government financing vehicles. The NAO, however, reported government obligations into three groups: explicit debt, government-guaranteed obligations, and liabilities that the government may incur. Based on historic data, the NAO reported that around 14 percent of government guaranteed debt and 19 percent of liabilities the government may incur would eventually become government obligations. Under the GFS system, a contingent liability that does not result in transactions or other economic flows is not recorded unless the event or condition referred to actually occurs. Contingent liabilities, however, can be reported as memorandum items.

China: General Government Fiscal Data

						Projection					
In RMB billions	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Fiscal balance											
Authorities' definition											
Revenue 1/	6902	8320	10537	12020	13029	13953	15455	16838	18372	20084	21879
Expenditure 2/	7852	9320	11387	12820	14229	15364	16832	18381	20030	21780	23650
Fiscal balance (Authorities) (1)-(2)	-950	-1000	-850	-800	-1200	-1411	-1377	-1543	-1658	-1695	-1771
In percent of GDP	*-2.7*	*-2.5*	*-1.8*	*-1.5*	*-2.0*	*-2.2*	*-2.0*	*-2.0*	*-2.0*	*-1.8*	*-1.8*
Staff estimates											
Revenue	8310	10103	13081	15016	16531	17632	19321	20900	22641	24570	26593
Authorities definition of revenue	6902	8320	10537	12020	13029	13953	15455	16838	18372	20084	21879
(+) Social security contributions	1458	1707	2576	3141	3452	3624	3805	3996	4195	4405	4625
(+) Transfers from state-administered SOE fund	0	86	118	150	165	182	200	220	242	266	293
(-) withdrawal from stabilization funds	51	10	150	295	115	126	139	153	168	185	204
Expenditure	9675	11733	13912	16356	18663	19977	21627	23361	25018	26782	28675
Authorities definition of expenditure	7852	9320	11387	12820	14229	15364	16832	18381	20030	21780	23650
Of which: interest payment	*149*	*184*	*238*	*264*	*275*	*304*	*322*	*337*	*354*	*371*	*387*
(+) Social security expenses	1099	1331	1888	2393	2862	2976	3095	3219	3348	3482	3621
(+) Transfers to state-administered SOE fund	0	82	116	50	61	61	61	61	61	61	61
(+) Adjustment for local government spending 3/	200	200	-112	-123	150	150	150	150	150	150	150
(+) Local government spending (est. by net land sale proceeds) 4/	747	1133	1095	1440	1617	1693	1769	1844	1739	1637	1539
Land sale revenue	1992	2940	3317	2852	4125						
Acquisition and compensation cost	1245	1807	2222	1411	2508						
(-) contribution to stabilization funds	10	226	289	25	116	128	141	155	170	188	206
(-) Other adjustment 2/	212	107	173	200	138	138	138	138	138	138	138
General government net lending/borrowing (4) - (5) + (5f)	-619	-497	265	100	-516	-652	-537	-617	-638	-576	-543
(In percent of GDP)	-1.8	-1.2	0.6	0.2	-0.9	-1.0	-0.8	-0.8	-0.8	-0.6	-0.5
Fiscal balance (staff estimate) (4)-(5)	-1365	-1630	-831	-1340	-2132	-2345	-2306	-2461	-2377	-2212	-2082
(In percent of GDP)	*-3.9*	*-4.0*	*-1.8*	*-2.5*	*-3.6*	*-3.6*	*-3.3*	*-3.2*	*-2.8*	*-2.4*	*-2.1*
Estimates of augmented balances											
Overall fiscal balance	-1365	-1630	-831	-1340	-2132	-2345	-2306	-2461	-2377	-2212	-2082
(-) Estimate of local government infrastructure spending 5/	2770	2318	2898	3422	3812	4170	4563	4932	5306	5687	6078
Augmented balance	-4136	-3948	-3729	-4762	-5944	-6515	-6870	-7393	-7684	-7899	-8160
(In percent of GDP)	*-11.9*	*-9.8*	*-7.9*	*-9.0*	*-10.1*	*-10.1*	*-9.7*	*-9.6*	*-9.1*	*-8.6*	*-8.2*
of which: interest payment on LGFV borrowings	*211*	*293*	*428*	*564*	*664*	*828*	*991*	*1155*	*1336*	*1538*	*1750*
(+) Net land sale proceeds 4/	747	1133	1095	1440	1617	1693	1769	1844	1739	1637	1539
Augmented net lending/borrowing 6/	-3389	-2814	-2634	-3322	-4327	-4822	-5101	-5549	-5945	-6263	-6621
(In percent of GDP)	*-9.7*	*-7.0*	*-5.6*	*-6.3*	*-7.4*	*-7.5*	*-7.2*	*-7.2*	*-7.1*	*-6.8*	*-6.6*
General government debt											
Central government debt	**7424**	**8155**	**9025**	**9577**	**10495**	**11147**	**11684**	**12301**	**12939**	**13515**	**14058**
In percent of GDP	*21.3*	*20.2*	*19.1*	*18.1*	*17.9*	*17.3*	*16.6*	*16.0*	*15.4*	*14.7*	*14.0*
Outstanding debt by Ministry of Finance	6024	6755	7204	7757	8675						
Of which: domestic	5974	6699	7141	7675	8584						
Of which: foreign	50	56	63	82	91	91.1	91.1	91.1	91.1	91.1	91.1
AMCs and bank recapitalization funds 7/	1400	1400	1820	1820	1820						
Local government debt 8/	**8434**	**10951**	**13737**	**17036**	**20998**	**25167**	**29731**	**34663**	**39969**	**45656**	**51735**
In percent of GDP	*24.2*	*27.2*	*29.1*	*32.2*	*35.8*	*39.1*	*42.2*	*45.0*	*47.5*	*49.7*	*51.7*
Of which:											
Bank loans	6972	8468	9510	10470	11738						
LGFVs corporate bond issuance	541	793	1092	1885	2216						
Trust loans	372	441	743	1118	1649						
Local government bonds	549	749	637	514	664	664	664	664	664	664	664
Others (new funding sources since 2010)	0	500	1757	3049	4731						
Augmented debt	**15857**	**19106**	**22762**	**26613**	**31493**	**36315**	**41415**	**46964**	**52908**	**59171**	**65792**
In percent of GDP	*45.5*	*47.4*	*48.2*	*50.3*	*53.7*	*56.4*	*58.8*	*61.0*	*62.9*	*64.4*	*65.7*
General government debt (staff estimate) 9/	*12484*	*14726*	*17267*	*19799*	*23094*	*26248*	*29523*	*33099*	*36921*	*40908*	*45099*
In percent of GDP	*35.8*	*36.6*	*36.5*	*37.4*	*39.4*	*40.8*	*41.9*	*43.0*	*43.9*	*44.6*	*45.1*
General government debt if including only LG bonds	***7973***	***8904***	***9662***	***10091***	***11159***	***11811***	***12348***	***12964***	***13603***	***14178***	***14721***
In percent of GDP	*22.9*	*22.1*	*20.4*	*19.1*	*19.0*	*18.3*	*17.5*	*16.8*	*16.2*	*15.4*	*14.7*
Memorandum item:											
General government debt (NAO audit) 9/				*20874*	*...*						
In percent of GDP				*39*							

Sources: CEIC, Data Co. Ltd.; China Ministry of Finance; NAO; and IMF staff estimates.

1/ Includes central and local governments' withdrawal from budget stabilization funds.

2/ Includes adjustments for local government balance carried forward and redemption of local government bonds.

3/ Estimated from local government bond market financing.

4/ Net land sale proceeds refer to the portion used to finance current and infrastructure spending, which is estimated by subtracting the acquisition cost, compensation to farmers, and land development from the gross land sale proceeds.

5/ Derived from net changes in estimated market financing of local government financing vehicles (LGFVs).

6/ The overall net lending/borrowing includes net land sale proceeds as a decrease in nonfinancial assets recorded above the line.

7/ Includes bonds issued for bank recapitalization and asset management companies.

8/ Include major components of market financing of local governments, including bank loans, corporate bonds, trust loans, and LG bonds issued by central government on their behalf. Beginning 2009-10, local governments expanded market borrowing through the use of local government financing vehicles (LGFVs). The NAO 2013 report also lists out other new funding sources of local governments, including build-to-transfers (BT), credit and wages payable, lease financing etc.

9/ The 2013 NAO audit indicated the debt to GDP ratio as of end-2012 is 39.4 percent of GDP. Staff estimates are based on the explicit debt and fractions (ranging from 14-19 percent according to the NAO estimate) of the government guaranteed debt and liabilities that the government may incur. Staff estimates exclude the central government debt issued for China Railway Corporation.

4. **The revised estimates of augment fiscal data are similar to the previous ones.**

- *Augmented net lending/borrowing.* The overall trend looks similar to previous estimates, including the stimulus in 2008–09 and the deterioration due to 'quasi-fiscal' activity beginning 2012. For years before 2010, the revised estimates show a deficit that is smaller by 1–1½ percent of GDP each year between 2000 and 2010. Nonetheless, the augmented net borrowing appears to have widened in 2013, unlike the forecast in last year's staff report (Figure 1).

- *Augmented debt.* The trend again looks similar to previous estimate, with a rapid rise since 2008. The augmented debt is now closer to the NAO audit of total explicit government debt (text table), guaranteed debt, and other liabilities the government may incur. It rose to 54 percent of GDP as of end-2013, including explicit debt and other debt incurred by LGFVs.

5. **Staff estimates of the augmented debt essentially is the same concept in the NAO audit of total debt** (the sum of (i) explicit government debt; (ii) government guaranteed debt, and (iii) liabilities that the government may be obliged to repay). The total debt in all three categories was 53.5 percent of GDP as of end-2012, which was close to last year's Staff Report estimate of 46.2 percent of GDP as of end-2012 (IMF 2013).[4] The main differences are:

- Unlike staff, the NAO included debt by China Railway Corporations (about 3.2 percent of GDP) and debt issued for bank recapitalization (around 4 percent of GDP) in the central government debt. Adjusting for these, the augmented debt estimate was very close to NAO audit total debt. Staff's revised estimate of the augmented debt in 2012 is now 50.3 percent of GDP because staff estimate excludes the debt by the China Railway Corporation (see text table).

- The NAO audit considered only part of the guaranteed debt and the liabilities that the government may be obliged to pay to be included in general government debt. They applied a fraction (19.1 percent of guaranteed debt and 14.6 percent of the liabilities that the government may be obliged to repay) of those debt as government debt, based on the historical data.

As a result, the government debt according to the NAO audit was 39.4 percent of GDP in 2012. Applying a similar method on the augmented debt would suggest that staff estimate of general government debt is 37.4 percent of GDP. The lower figure in staff estimate relative to the NAO audit is due to the exclusion of debt by China Railway Corporation.

[4] See IMF Country Report No. 13/211.

Reconciliation of Staff Estimates and National Audit Office on General Government Debt

(As of end-2012; in percent of GDP)	Total	Central Government				Local Government			
Staff estimate of augmented debt 1/									
Last year's staff report (IMF Country Report No. 13/211) 2/	46.2	14.4				31.8			
Revised staff estimate this year for debt in 2012	50.3	18.1				32.2			
Staff estimate of general government debt 3/									
As of end-2012	37.4								
As of end 2013	39.4								
National Audit Office (2013) 4/				Contingent Liabilities				Contingent Liabilities	
		Total	Explicit debt	Guaranteed debt	May incur liabilities	Total	Explicit debt	Guaranteed debt	May incur liabilities
Total debt as of end-2012	**53.5**	*22.9*	18.2	0.5	4.2 5/	*30.6*	18.5	4.8	7.3
Government debt as of end-2012 6/	**39.4**	*18.9*	18.2	0.1	0.6	*20.5*	18.5	0.9	1.1
Memorandum item:									
Fraction of contingent liabilities NAO considered as government debt				*19.1*	*14.6*			*19.1*	*14.6*

Sources: NAO; and IMF staff estimates.

1/ Augmented debt expands the perimeters of general government to include off-budget activity and local government financing vehicles activity.

2/ Staff estimate of augmented debt in 2012 excluded debt by China Railway Corporation and debt for bank recapitalization (about 7 percent of GDP in total).

3/ Staff estimate of general government debt is based on applying a similar share of total debt as government debt according to the NAO audit. Staff estimate excludes the debt by China Railway Corporation.

4/ National Audit Office report (2013).

5/ National Audit Office report included the debt raised by China Railway Corporation (4.2 percent of GDP) as a contingent liabilities.

6/ National Audit Office report applied a fraction (19.1 percent of guaranteed debt and 14.6 percent of the liabilities that the government may be obliged to repay) of those debt as government debt, based on the historical data.

B. LGFVs: Government Units or Nonfinancial Public Corporations?

6. **The augmented concept is an attempt to expand the perimeter of general government beyond what the authorities currently use.** A large portion of the recent increase in infrastructure spending has been financed off-budget through borrowing by LGFVs. Many of these are registered legally as corporations. The crucial question is whether to classify these LGFVs as part of the general government or as nonfinancial public corporations. Nonfinancial public corporations, while part of the broader public sector, would generally not be included in government statistics. Moreover, some LGFVs could be considered as part of the financial (as opposed to nonfinancial) public sector.

7. **Under the 2001 GFS Manual, the key to classify a unit as a corporation is not its legal status** but rather its characteristics of producing goods and services for the market and being able to generate profits. Corporations, as opposed to government units, are defined as entities that (i) are a source of profit or other financial gain for their owners; and (ii) produce goods and services for the market at economically significant prices.[5]

8. **For China, LGFVs appear to be a distinct type of entity with typically fiscal objectives in contrast to other state-owned enterprise (SOEs) that generally function on a commercial basis.**

- In many cases, the local government directly or indirectly shares the LGFVs debt servicing responsibilities and sometimes subsidizes their losses. Some LGFV debts were implicitly, if not explicitly, guaranteed by local governments and LGFVs could also collateralize their borrowing with land or other assets, either owned by the LGFV itself, pledged by the local government, or provided

[5] Economically significant prices are prices that have a significant effect on the amounts that producers are willing to supply and on the amounts purchasers wish to buy. Prices set on administrative, social, or political grounds that do not cover capital and other costs would not be considered economically significant. For details, see 2001 GFS Manual.

by another entity.

- Projects financed by LGFVs may have nominal source of revenue, such as road tolls or usage fees for a water treatment facility, but quite often not enough to meet future debt servicing needs. And, important for classification purposes, LGFVs are typically established for the sole purpose of infrastructure spending and are therefore distinguishable from local state-owned enterprises (SOEs) that provide a broader set of goods and services mostly on a commercial basis.

9. **Augmented fiscal data should serve as a complement and not a substitute for general government data.** While some LGFVs may operate on a primarily commercial basis, and should thus be excluded from government, it is also likely that some SOEs are carrying-out quasi-fiscal activity. The authorities have recently reclassified LGFVs into categories based on their revenue-generating capacity and level of dependence on government subsidies. This information could be used in the future to further refine the boundaries of General Government by classifying LGFVs that operate on a commercial basis as SOEs and others as part of general government.

C. Technical Details on Augmented Estimates:

Fiscal Balance

10. **Difference in the on-budget balance between authorities and staff estimates on general government deficit:**

The staff estimate of the general government balance makes several adjustments to the authorities' budgetary balance. First, the staff estimate includes the surplus/deficit of the social security and state-administered SOE funds. The estimate also differs in to the treatment of the stabilization fund. The authorities do not include the stabilization fund as part of the general government but instead treat transfers to/out of the fund as revenue and expenditure. The stabilization fund works analogously to a government bank account, in which the government makes yearly deposits and withdrawals. In line with the Government Finance Statistics practices, the stabilization fund is part of the general government, recording cash transactions 'below the line'. Off-budget local government spending is also estimated from changes in local government bonds issued by the central government and net proceeds from land sales. The staff general government balance takes out the financing from net land sale revenues. Finally, other small adjustments explained below complement the staff estimate of general government balance.

a) Social security funds. Data are available for national government starting from 2008. The fund has maintained a surplus each year, with the amount around RMB 590 billion for 2013. Inclusion improves the general government balance.

b) State-administered SOE funds. Data are available for national government starting from 2010. The fund has maintained a surplus each year of around RMB200 billion. Inclusion slightly improves the general government balance.

c) Off-budget local government spending is estimated from net change in local government bonds outstanding. These may be issued on a discretionary basis approved by the State Council. The amount that central government bonds issued on behalf of local governments is not part of central government debt and therefore also adds to local government debt. The net issuance is included as financing towards the general government balance, while the outstanding amount counts towards local government debt. The amount is fairly small at around 1 percent of GDP.

d) Net proceeds from land sales—the portion used to finance current and infrastructure spending—is included in the general government balance calculation. The amount is obtained by subtracting the acquisition cost, compensation to farmers, and land development from the gross land sale proceeds. Data are available from Soufun, Ministry of Finance, and previous budget speeches. The net proceeds are treated as financing, not revenue, since it is analogous to privatization proceeds. This also includes the small net surplus/deficit under other funds, such as government-managed funds (GMFs). As part of the financing, it is excluded in the general government balance.

e) Other adjustments such as balance carried forward in local government funds, and redemption of local government bonds included in the expenditures are cash transactions 'below the line.'

Construction of Augmented Net Lending/Borrowing and Fiscal Balance

11. **The augmented deficit adds off-budget fiscal activity of LGFVs and local governments through other means of market financing.** The augmented net lending/borrowing counts the proceeds from net land sales revenue "above-the-line."

12. **Major components of market financing of local government.** This refers to the borrowing by local government entities from commercial banks, trust companies, financing institutions other than securities firms and insurance companies, and corporate bond market related to the LGFVs.

a) Beginning in 2009–10, local governments expanded market borrowing through the use of LGFVs. They are legally distinct entities, often receiving public credit enhancement, that engage in long-term infrastructure projects. Some LGFV debts were informally guaranteed by local governments, often the local governments are perceived to stand behind the LGFVs if needed. Those borrowings could be collateralized. Our estimate assumes that all LGFV debt warrants inclusion in the augmented deficit and debt, given most LGFVs do not necessarily operate on a primarily commercial basis. Local-government owned SOEs are not included. *Corporate bonds* are derived from the WIND database and NAO estimates, which provides data on gross amount and maturity dates of corporate bonds issued by LGFVs.

b) *Bank loans* accounts for over half of total local government debt by 2013, down from near 80 percent by 2010, equivalent to RMB 10 trillion. Market financing by bank loans on local government is estimated to be around 30–40 percent (based on historical data) of the change in medium- and long-term loans for domestic use. It is about 1–1.5 trillion between 2010 and 2013.

c) *Trust finance* amounted to RMB 1.4 trillion based on the NAO 2013 estimates. For other years, the amount is estimated by the trust amount of infrastructure projects (amounted to RMB 2.6 trillion by end 2013) available from China Trustee Association after 2010, as well as applying the growth rate of the trust loans outstanding under the total social financing.

d) *Other market financing options* are available mostly beginning 2010. The NAO 2013 provided details on these alternative financing sources, including build-to-transfer, credit and wage payable, lease financing, financing from securities firms and insurance (other than those listed above). Data between 2010 and 2012 are assumed to following the same aggregate growth rate of other market financing components (a) to (d).

Fiscal Debt

13. **Debt data are based on public sources or cumulated financing flows.**

- Central government debt is readily available from official sources. It includes the government debt issued by the Ministry of Finance, and the debt incurred for asset management companies and bank recapitalization. We exclude the debt of China Railway Corporation.

- For the augmented debt, the NAO audits (2010 and 2013) provided the starting point. Data for previous and subsequent years are then calculated based on the financing assumptions described above. Differences with the NAO total liabilities of government (explicit debt, guaranteed government liabilities, and liabilities that the government may incur) are minor.

Appendix IV. China: Risk Assessment Matrix 1/

Main Sources of Risks		Overall Level of Concern	
		Likelihood (Over next one to five years)	**Impact and Policy Response**
Global	**Side-effects from global financial conditions such as surges in financial market volatility from monetary policy normal-ization**	**High** Surges in global financial market volatility, triggered by geopolitical tensions or revised market expectations on UMP exit in the United States or emerging market fundamentals. Volatility might be exacerbated by reduction in risk appetite, and the balance sheet effect will vary with the extent of leverage. The adverse effect would be more pronounced should higher rates not be associated with stronger growth in the US.	**Medium** Main impact would be through lower export demand. GDP growth would slow relative to baseline by close to ½–¾ percentage points. *Policy response:* If growth were to slow too sharply, on-budget fiscal stimulus should be used in a manner that supports rebalancing and helps protect vulnerable groups.
Global	**Protracted period of slower growth in advanced and emerging economies**	**High** Lower-than-anticipated growth and persistently low inflation in advanced economies due to a failure to fully address legacies of the financial crisis would lead to secular stagnation, and potentially complicate efforts on rebalancing and restoring fiscal sustainability. For emerging economies, lower trend growth arising from misallocation of investment and incomplete structural reforms could affect confidence, FDI flows, and eventually lead to a permanent reduction of growth.	**High** External trade would be affected due to slower recovery of global demand. Capacity utilization rates in export sectors would decline, leading to a fall in profitability, rising unemployment, and diminished ability to service corporate debt. Deterioration in banks' asset quality, together with tighter financing conditions, would further slow investment and growth. *Policy response:* Advance structural reforms to accelerate the transition towards greener, more inclusive, and sustainable growth. If growth were to slow too sharply, on-budget fiscal stimulus should be used in a manner that supports rebalancing and helps protect vulnerable groups.
Global	**Bond market stress from a reassessment of sovereign risk**	**Medium** Though the fiscal outlook is different in the United States, Euro-area, and Japan, bond market stress in these economies would materialize through an increased sovereign risk premium, and higher government bond yields in the medium-term. Such developments could undermine the recovery of private domestic demand, lead to a weakening of financial fragmentation and credit transmission, and have severe global financial market repercussions. The sovereign risk premium could increase by 200 bps (April 2013 WEO scenario).	**High** Main impact would be through lower export demand, driven by a sharp loss of market confidence and delaying the global recovery. *Policy response:* If near-term growth were to slow too sharply, then on-budget fiscal stimulus should be used in a manner that supports rebalancing and helps protect vulnerable groups.
Global	**Sustained decline in commodity prices over the medium term**	**Medium** New sources of supply, such as shale gas and a ramping up of production in some emerging economies may generate global excess capacity, while global demand remains weak.	**Medium** A sustained decline of commodities prices over a period of several years could benefit China against the background of rising demand various commodities, which could help offset part of the adverse effect from rising resource and factor prices under the third-plenum reforms (WEO April 2014). *Policy response:* Advance structural reforms to accelerate the transition towards a greener, more inclusive, and sustainable growth.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Nonmutually exclusive risks may interact and materialize jointly.

Appendix IV. China: Risk Assessment Matrix *(concluded)*

Main Sources of Risks		Overall Level of Concern	
		Likelihood (Over next one to five years)	**Impact and Policy Response**
Domestic	➢ **Near-term hard landing 2/**	**Low** Notwithstanding the rise in vulnerabilities, an abrupt adjustment in the near term is unlikely, given China's policy buffers. Cross-country evidence suggests that credit booms of a similar size often led to sharp corrections (Box 5). However, in China the government still has the capacity to absorb shocks and prevent the kind of loss of confidence or sudden stop that have triggered major problems in other countries—such as a deposit run, freezing-up of the interbank market, collapse of the real estate market, or capital flight. Total public debt is relatively low; public sector assets are large (including foreign exchange reserves); domestic savings are high and foreign debt exposures low; capital controls limit the risk of capital flight; and the government retains substantial levers to control economic and financial activity.	**High** If a shock were to occur that threatens to trigger a disorderly adjustment, the authorities have the policy space and levers to act quickly to prevent it from leading to a sharp slowdown in growth.
	➢ **Medium-term hard landing 2/**	**Medium** Without a change in the pattern of growth, the likelihood of a shock triggering financial disruption and/or a sharp slowdown will continue to rise. Overreliance on credit and capital accumulation to support growth would further weaken balance sheets and reduce investment efficiency. This would ultimately lead to a slowdown in growth, and put further pressure on corporate profits and the financial system. The more vulnerabilities accumulate, the more likely it is that a shock could trigger a negative feedback loop. Thus, although the near-term risk of a hard landing is low, it increases to medium over a medium-term perspective.	**High** While buffers could still be used in the case of a hard landing, growth could remain low for a protracted period of time given stretched private and public sector balance sheets.

2/ See paragraph 13–14 of the staff report.

Appendix V. Debt Sustainability Analysis

Staff performed public debt sustainability analyses for both general government debt and augmented debt, which represent the lower and upper bound of fiscal obligations. While China's general government debt remains low and sustainable, augmented debt is on a slight upward trajectory in the baseline. Augmented debt is sensitive to fiscal balance and contingent liability shocks, but the risk of debt distress is low given China's favorable debt profile. The sensitivity underscores the importance of reform to reduce fiscal risks and to generate a more sustainable growth path.

China's public debt sustainability analysis (DSA) is based on the following assumptions:

- **Public debt coverage.** Two definitions of government debt and deficits are used. General government debt includes central government debt and local government bond. Augmented debt adds other types of local government debt, including off-budget borrowing by LGFVs via bank loans, bonds, and trust loans. Augmented deficit is the flow counterpart of augmented debt. Augmented debt and deficit should be seen as the upper bound of government fiscal position as it includes both the explicit and contingent part of general government debt (see further explanation of the coverage in Appendix III).

- **Macroeconomic assumptions:**

  - In the baseline, growth is forecasted at 7.4 percent in 2014 and medium-term growth gradually declines to 6.3 percent by 2019. Inflation is projected at 2 percent in 2014 and gradually rises to 3 percent in the medium term. The projection assumes a gradual and back loaded implementation of reforms.

  - The "no reform" scenario assumes little to no reforms and continued accommodative policies, especially through local government spending and rapid credit growth to boost near term growth. Growth remains around 7.2–7.4 percent in 2014–2016, but drops to 5.9 by 2019 as the growth strategy runs out of steam. The scenario is consistent with the no reform scenario in the main text of the staff report.

- **Fiscal assumptions:**

  - *Fiscal balance assumptions*. In the baseline, the general government deficit[1] is projected to narrow slightly in line with the authorities' gradual withdrawal of fiscal stimulus. The augmented deficit is also projected to decline from 10.1 percent of GDP to 8.2 percent of GDP by 2019. The decline is driven by the reduction in local government expenditure to GDP ratio due to: (i) lower expenditure financed by net land sales; and (ii) the authorities' reforms to limit local government borrowing, which kicks in towards the end of the projection period. In the no reform scenario, however, general government deficit is projected to

[1] The general government deficit refers to net lending/borrowing, which is the consolidated government balance, including the budgetary balance, surpluses on government-managed funds, accounting adjustment for the stabilization fund, and social security funds.

increase to 4 percent of GDP by 2019, and the augmented deficit to widen to 11.6 percent by 2019, as the public sector continues to increase spending to boost growth.

- *Local government financing*. While many local governments have relied on net revenue from land sales and LGFV borrowing to finance their investment, the DSA assumes that future financing needs will be met by bond issuance, in line with the authorities' intention. Three bond types are assumed: (i) central government bonds; (ii) local government bonds, and (iii) a separate bond to repay existing local government debt according to amortization scheme in the NAO 2013 report.

- *Interest rates and amortization*. The interest rate for central government bonds is assumed to follow the historical pattern. However, for local government bonds, it is expected to gradually rise over the medium term, reflecting a higher risk premium and more market-based interest rates. The rate for the last type of bond is assumed to be between the other two rates. Amortization is assumed to follow the 2013 NAO report with 55 percent of local government debt maturing by the end of 2014, and the rest spread over the next few years.

In the baseline, China's general government debt is on a declining path, but augmented debt continues to rise.

- Projected general government consolidation under the baseline implies declining gross financing needs. As a result, debt will fall to around 15 percent of GDP in 2019.

- Augmented debt, however, rises to 66 percent of GDP in 2019 from 54 percent of GDP in 2013. Even with the favorable interest rate-growth differential, the debt rises given that large deficits persist to 2019 under the assumption that government measures to contain local government borrowing are not in place until the end of the projection period.

China faces relatively low risks to debt sustainability under the baseline, but is vulnerable to fiscal balance and contingent liability shocks, especially under the no reform scenario.

- General government debt remains relatively low and on a declining path for all shocks except for the contingent liability one in the no reform scenario. A contingent liability shock will result in a sharp increase in debt level from below 20 percent of GDP in 2013 to 37 percent of GDP in 2015.[2] Over the medium term, the debt-to-GDP ratio will gradually moderate as the impact of shocks fades away. While debt would only rise to about 20 percent of GDP in the no reform scenario, if a contingent liability shock is also included, debt would rise to about 40 percent of GDP in 2019. While the debt level is manageable, the authorities would have to deal with a sudden surge of gross financing needs, which would be sensitive to market financing condition.

[2] A one-time increase in noninterest expenditures, equivalent to 10 percent of banking sector assets, leads to a real GDP growth shock, with growth reduced by 1 standard deviation for two consecutive years; unchanged revenue-to-GDP ratio; worsening in the primary balance that leads to higher interest rate; and lower inflation

- Augmented debt, however, is more sensitive to a primary balance or contingent liability shock. A scenario that keeps the primary balance constant would increase debt to 72 percent by 2019. A contingent liability shock, however, would push dept to around 80 percent of GDP in two years, increasing to almost 90 percent by 2019. A contingent liability shock, for example, could be a bank recapitalization or financial system bailout. In the no reform scenario, which features a growing primary deficit and lower medium-term growth, augmented debt would rise to around 76 percent of GDP by 2019. If a contingent liability shock is also incorporated in the alternative scenario in 2018, augmented debt will rise to nearly 100 percent of GDP in 2019.

- China's debt profile is favorable as most of the public debt is financed through a captive domestic investor base, and the small external debt is mostly from official creditors. In addition, China has ample foreign exchange reserves to meet any external financing needs.

China: Public Sector Debt Sustainability Analysis (General Government Debt—Baseline Scenario)

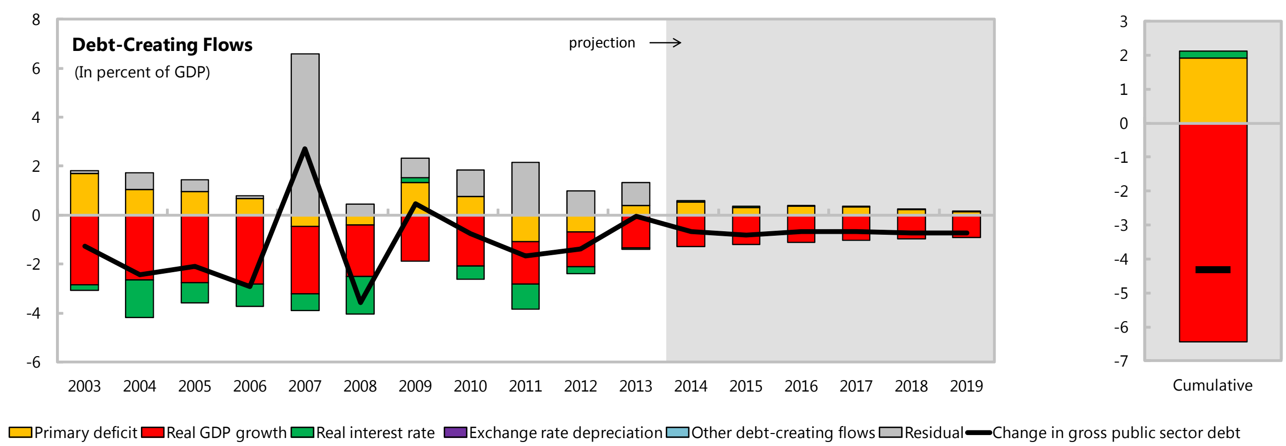
(In percent of GDP, unless otherwise indicated)

Debt, Economic, and Market Indicators 1/

	Actual			Projections						As of April 30, 2014		
	2003-2011 2/	2012	2013	2014	2015	2016	2017	2018	2019	Sovereign Spreads		
Nominal gross public debt	24.7	19.1	19.0	18.3	17.5	16.8	16.2	15.4	14.7	EMBIG (bp) 3/		155
Public gross financing needs	...	-0.2	0.9	1.0	0.8	0.8	0.8	0.6	0.5	5Y CDS (bp)		138
Real GDP growth (in percent)	10.8	7.7	7.7	7.4	7.1	6.8	6.6	6.4	6.3	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	5.1	4.1	2.9	2.2	2.2	2.2	2.5	2.5	2.5	Moody's	Aa3	Aa3
Nominal GDP growth (in percent)	16.4	12.0	10.8	9.7	9.5	9.2	9.3	9.1	9.0	S&Ps	AA-	AA-
Effective interest rate (in percent) 4/	2.1	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	Fitch	A+	A+

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	Cumulative	Debt-Stabilizing Primary Balance 5/
Change in gross public sector debt	-1.3	-1.4	0.0	-0.7	-0.8	-0.7	-0.7	-0.7	-0.7	-4.3	
Identified debt-creating flows	-2.7	-2.4	-1.0	-0.7	-0.8	-0.7	-0.7	-0.7	-0.7	-4.3	
Primary deficit	0.5	-0.7	0.4	0.5	0.3	0.4	0.3	0.2	0.2	1.9	-0.9
Primary (noninterest) revenue and grants	20.4	28.4	28.2	27.4	27.4	27.1	26.9	26.8	26.6	162.2	
Primary (noninterest) expenditure	20.9	27.7	28.6	27.9	27.7	27.5	27.2	27.0	26.7	164.1	
Automatic debt dynamics 6/	-3.2	-1.7	-1.4	-1.2	-1.1	-1.0	-1.0	-0.9	-0.9	-6.2	
Interest rate/growth differential 7/	-3.2	-1.7	-1.4	-1.2	-1.1	-1.0	-1.0	-0.9	-0.9	-6.2	
Of which: real interest rate	-0.8	-0.3	-0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.2	
Of which: real GDP growth	-2.4	-1.4	-1.3	-1.3	-1.2	-1.1	-1.0	-1.0	-0.9	-6.4	
Exchange rate depreciation 8/	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., drawdown of deposits) (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and euro area loans)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes 9/	1.4	1.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

6/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

7/ The real interest rate contribution is derived from the numerator in footnote 6 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

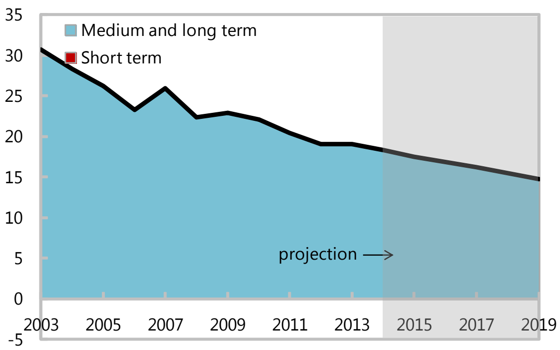
8/ The exchange rate contribution is derived from the numerator in footnote 6 as $ae(1+r)$.

9/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

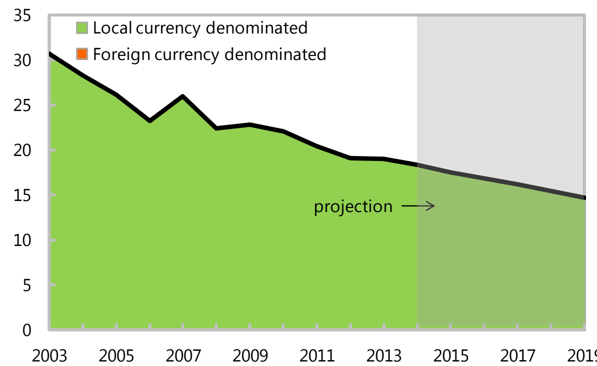
China: Public DSA—Composition of General Government Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(In percent of GDP)

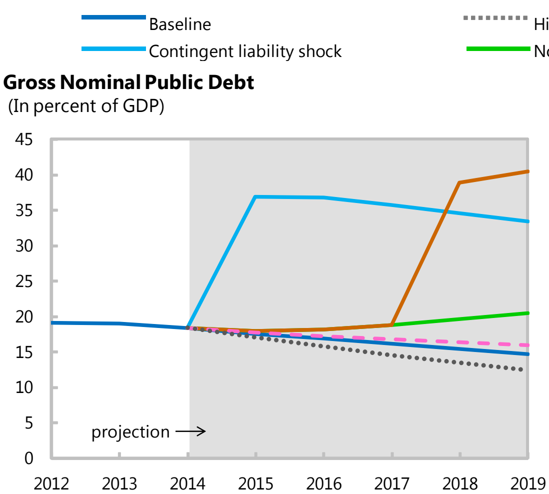


By Currency
(In percent of GDP)

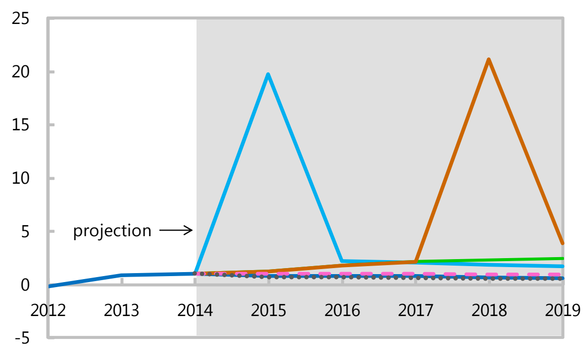


Alternative Scenarios

Gross Nominal Public Debt
(In percent of GDP)



Public Gross Financing Needs
(In percent of GDP)



Underlying Assumptions
(In percent)

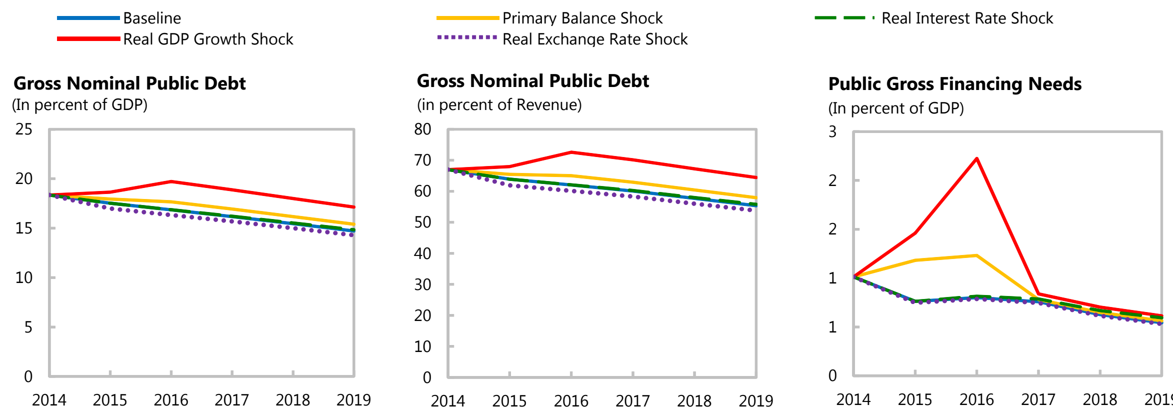
Baseline scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	7.4	7.1	6.8	6.6	6.4	6.3
Inflation	2.2	2.2	2.2	2.5	2.5	2.5
Primary balance	-0.5	-0.3	-0.4	-0.3	-0.2	-0.2
Effective interest rate	2.7	2.7	2.7	2.7	2.7	2.7
Constant primary balance scenario						
Real GDP growth	7.4	7.1	6.8	6.6	6.4	6.3
Inflation	2.2	2.2	2.2	2.5	2.5	2.5
Primary balance	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Effective interest rate	2.7	2.7	2.7	2.7	2.7	2.7
No reform						
Source: IMF staff.						
Real GDP growth	7.4	7.4	7.2	6.4	6.0	5.9
Inflation	2.2	2.2	2.3	2.5	2.5	2.5
Primary balance	-0.5	-0.8	-1.3	-1.7	-1.8	-1.9
Effective interest rate	2.7	2.7	2.7	2.7	2.7	2.7

Historical scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	7.4	10.2	10.2	10.2	10.2	10.2
Inflation	2.2	2.2	2.2	2.5	2.5	2.5
Primary balance	-0.5	-0.3	-0.3	-0.3	-0.3	-0.3
Effective interest rate	2.7	2.7	2.6	2.5	2.4	2.3
Contingent liability shock						
Real GDP growth	7.4	5.0	4.8	6.6	6.4	6.3
Inflation	2.2	1.7	1.7	2.5	2.5	2.5
Primary balance	-0.5	-19.1	-0.4	-0.3	-0.2	-0.2
Effective interest rate	2.7	3.5	5.2	5.1	5.0	4.8
Contingent liability shock plus no reform						
Real GDP growth	7.4	7.4	7.2	6.4	4.0	3.9
Inflation	2.2	2.2	2.3	2.5	2.0	2.0
Primary balance	-0.5	-0.8	-1.3	-1.7	-20.6	-1.9
Effective interest rate	2.7	2.7	2.7	2.7	2.7	5.3

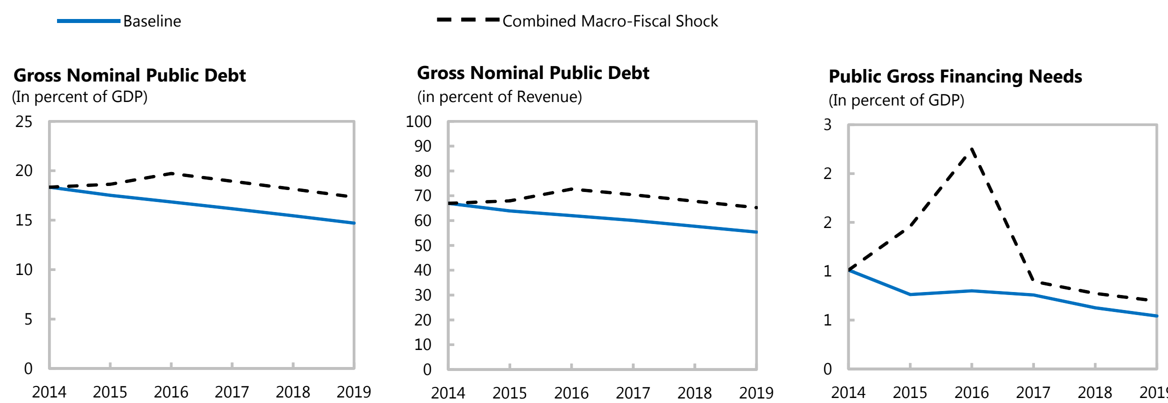
Source: IMF staff

China: Public Sector Debt Sustainability Analysis (General Government Debt-Stress Tests)

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	7.4	7.1	6.8	6.6	6.4	6.3
Inflation	2.2	2.2	2.2	2.5	2.5	2.5
Primary balance	-0.5	-0.7	-0.8	-0.3	-0.2	-0.2
Effective interest rate	2.7	2.7	2.7	2.7	2.7	2.7
Real Interest Rate Shock						
Real GDP growth	7.4	7.1	6.8	6.6	6.4	6.3
Inflation	2.2	2.2	2.2	2.5	2.5	2.5
Primary balance	-0.5	-0.3	-0.4	-0.3	-0.2	-0.2
Effective interest rate	2.7	2.7	2.8	2.9	3.0	3.1
Combined Shock						
Real GDP growth	7.4	5.0	4.8	6.6	6.4	6.3
Inflation	2.2	1.7	1.7	2.5	2.5	2.5
Primary balance	-0.5	-1.0	-1.7	-0.3	-0.2	-0.2
Effective interest rate	2.7	2.7	2.9	3.1	3.2	3.2

Real GDP Growth Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	7.4	5.0	4.8	6.6	6.4	6.3
Inflation	2.2	1.7	1.7	2.5	2.5	2.5
Primary balance	-0.5	-1.0	-1.7	-0.3	-0.2	-0.2
Effective interest rate	2.7	2.7	2.7	2.8	2.8	2.8
Real Exchange Rate Shock						
Real GDP growth	7.4	7.1	6.8	6.6	6.4	6.3
Inflation	2.2	5.6	2.2	2.5	2.5	2.5
Primary balance	-0.5	-0.3	-0.4	-0.3	-0.2	-0.2
Effective interest rate	2.7	2.7	2.7	2.7	2.7	2.7

Source: IMF staff.

China: Public Sector Debt Sustainability Analysis (Augmented Debt—Baseline Scenario)

(In percent of GDP unless otherwise indicated)

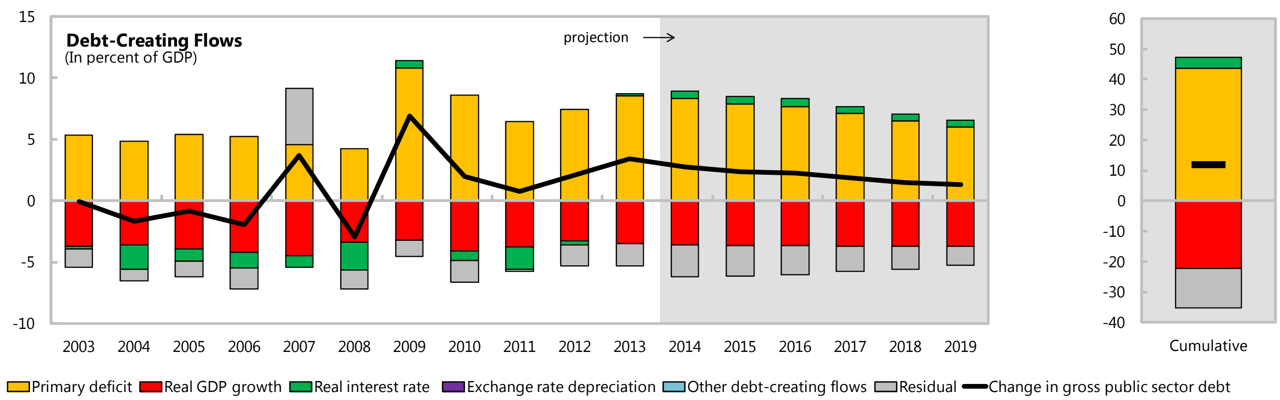
Debt, Economic, and Market Indicators 1/

	Actual			Projections					
	2003-2011 2/	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	42.4	50.3	53.7	56.4	58.8	61.0	62.9	64.4	65.7
Of which: guarantees	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public gross financing needs	...	9.0	10.1	28.0	14.8	13.4	11.9	15.7	8.2
Real GDP growth (in percent)	10.8	7.7	7.7	7.4	7.1	6.8	6.6	6.4	6.3
Inflation (GDP deflator, in percent)	5.1	4.1	2.9	2.2	2.2	2.2	2.5	2.5	2.5
Nominal GDP growth (in percent)	16.4	12.0	10.8	9.7	9.5	9.2	9.3	9.1	9.0
Effective interest rate (in percent) 4/	2.7	3.6	3.5	3.6	3.6	3.6	3.6	3.6	3.6

As of June 19, 2014		
Sovereign Spreads		
EMBIG (bp) 3/		155
5Y CDS (bp)		138
Ratings	Foreign	Local
Moody's	Aa3	Aa3
S&Ps	AA-	AA-
Fitch	A+	A+

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	Cumulative	Debt-Stabilizing Primary Balance 5/
Change in gross public sector debt	0.6	2.1	3.4	2.7	2.4	2.2	1.9	1.5	1.3	12.0	
Identified debt-creating flows	1.3	3.8	5.2	5.4	4.9	4.6	3.9	3.4	2.8	25.0	
Primary deficit	6.2	7.4	8.5	8.4	7.9	7.7	7.1	6.5	6.0	43.6	-3.2
Primary (noninterest) revenue and grants	20.4	28.4	28.2	27.4	27.4	27.1	26.9	26.8	26.6	162.2	
Primary (noninterest) expenditure	26.6	35.8	36.7	35.7	35.3	34.8	34.0	33.3	32.6	205.8	
Automatic debt dynamics 6/	-4.9	-3.6	-3.3	-3.0	-3.0	-3.0	-3.2	-3.2	-3.2	-18.6	
Interest rate/growth differential 7/	-4.9	-3.6	-3.3	-3.0	-3.0	-3.0	-3.2	-3.2	-3.2	-18.6	
Of which: real interest rate	-1.1	-0.3	0.2	0.6	0.6	0.6	0.5	0.5	0.6	3.5	
Of which: real GDP growth	-3.8	-3.3	-3.5	-3.6	-3.7	-3.7	-3.7	-3.7	-3.7	-22.1	
Exchange rate depreciation 8/	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., drawdown of deposits) (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and euro area loans)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including land sales 9/	-0.6	-1.7	-1.8	-2.6	-2.5	-2.4	-2.1	-1.9	-1.5	-13.0	



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as LGFVs.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

6/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

7/ The real interest rate contribution is derived from the numerator in footnote 6 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

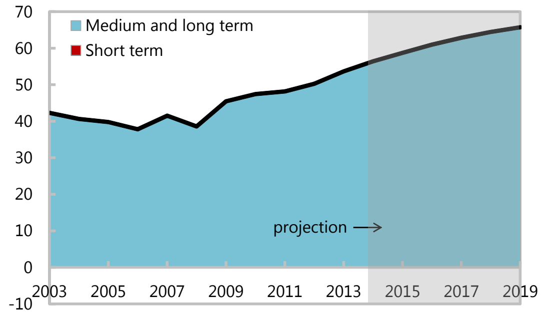
8/ The exchange rate contribution is derived from the numerator in footnote 6 as $ae(1+r)$.

9/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

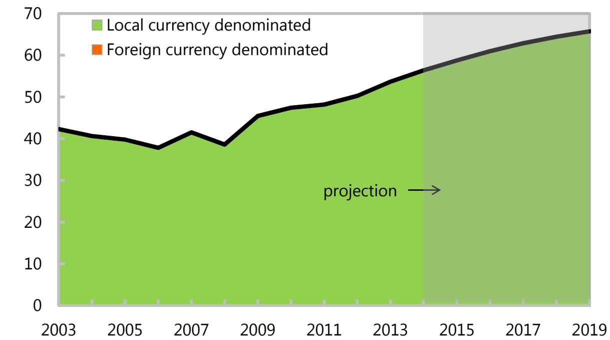
China: Public Debt Sustainability Analysis—Composition of Augmented Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(In percent of GDP)



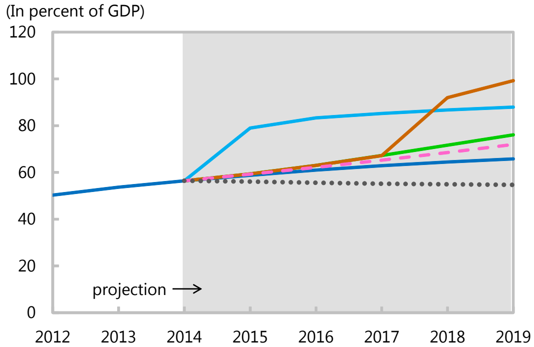
By Currency
(In percent of GDP)



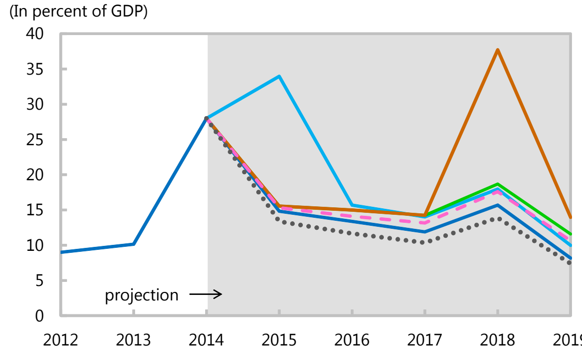
Alternative Scenarios

Baseline
Contingent liability shock
Historical
No reform
Constant primary balance
Contingent liability shock plus no reform

Gross Nominal Public Debt
(In percent of GDP)



Public Gross Financing Needs
(In percent of GDP)



Underlying Assumptions
(In percent)

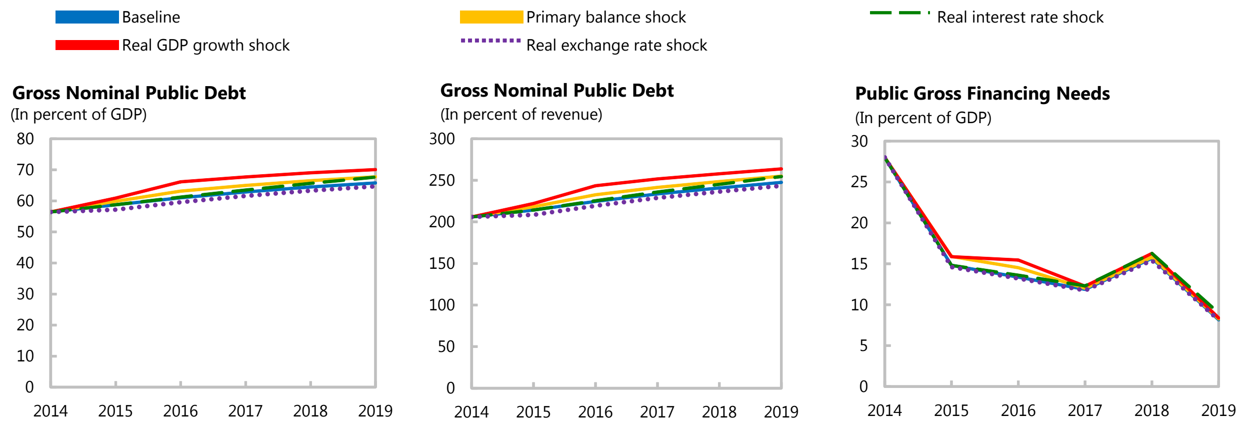
Baseline scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	7.4	7.1	6.8	6.6	6.4	6.3
Inflation	2.2	2.2	2.2	2.5	2.5	2.5
Primary balance	-8.4	-7.9	-7.7	-7.1	-6.5	-6.0
Effective interest rate	3.6	3.6	3.6	3.6	3.6	3.6
Constant primary balance scenario						
Real GDP growth	7.4	7.1	6.8	6.6	6.4	6.3
Inflation	2.2	2.2	2.2	2.5	2.5	2.5
Primary balance	-8.4	-8.4	-8.4	-8.4	-8.4	-8.4
Effective interest rate	3.6	3.6	3.6	3.6	3.6	3.6
No reform						
Real GDP growth	7.4	7.4	7.2	6.4	6.0	5.9
Inflation	2.2	2.2	2.2	2.5	2.5	2.5
Primary balance	-8.4	-8.6	-9.3	-9.4	-9.4	-9.2
Effective interest rate	3.6	3.6	3.6	3.6	3.6	3.6

Historical scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	7.4	10.2	10.2	10.2	10.2	10.2
Inflation	2.2	2.2	2.2	2.5	2.5	2.5
Primary balance	-8.4	-6.6	-6.6	-6.6	-6.6	-6.6
Effective interest rate	3.6	3.6	3.0	2.5	2.1	1.6
Contingent liability shock						
Real GDP growth	7.4	5.0	4.8	6.6	6.4	6.3
Inflation	2.2	1.7	1.7	2.5	2.5	2.5
Primary balance	-8.4	-26.7	-7.7	-7.1	-6.5	-6.0
Effective interest rate	3.6	3.9	5.5	5.3	5.1	5.0
Contingent liability shock plus no reform						
Real GDP growth	7.4	7.4	7.2	6.4	4.0	3.8
Inflation	2.2	2.2	2.3	2.5	2.0	2.0
Primary balance	-8.4	-8.6	-9.3	-9.4	-28.2	-9.2
Effective interest rate	3.6	3.6	3.6	3.6	3.6	5.5

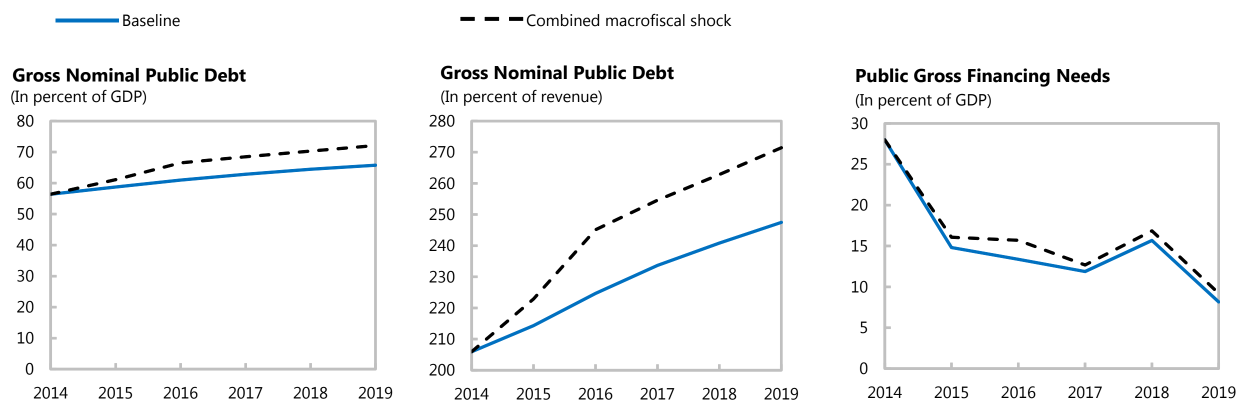
Source: IMF staff

China: Public Sector Debt Sustainability Analysis (Augmented Debt-Stress Tests)

Macrofiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(In percent)

	2014	2015	2016	2017	2018	2019
Primary balance shock						
Real GDP growth	7.4	7.1	6.8	6.6	6.4	6.3
Inflation	2.2	2.2	2.2	2.5	2.5	2.5
Primary balance	-8.4	-9.0	-8.7	-7.1	-6.5	-6.0
Effective interest rate	3.6	3.6	3.7	3.7	3.7	3.7
Real interest rate shock						
Real GDP growth	7.4	7.1	6.8	6.6	6.4	6.3
Inflation	2.2	2.2	2.2	2.5	2.5	2.5
Primary balance	-8.4	-7.9	-7.7	-7.1	-6.5	-6.0
Effective interest rate	3.6	3.6	4.0	4.3	4.6	4.9
Combined shock						
Real GDP growth	7.4	5.0	4.8	6.6	6.4	6.3
Inflation	2.2	1.7	1.7	2.5	2.5	2.5
Primary balance	-8.4	-9.0	-9.4	-7.1	-6.5	-6.0
Effective interest rate	3.6	3.6	4.0	4.4	4.6	4.9

	2014	2015	2016	2017	2018	2019
Real GDP growth shock						
Real GDP growth	7.4	5.0	4.8	6.6	6.4	6.3
Inflation	2.2	1.7	1.7	2.5	2.5	2.5
Primary balance	-8.4	-8.8	-9.4	-7.1	-6.5	-6.0
Effective interest rate	3.6	3.6	3.7	3.7	3.7	3.7
Real exchange rate shock						
Real GDP growth	7.4	7.1	6.8	6.6	6.4	6.3
Inflation	2.2	5.6	2.2	2.5	2.5	2.5
Primary balance	-8.4	-7.9	-7.7	-7.1	-6.5	-6.0
Effective interest rate	3.6	3.6	3.6	3.6	3.6	3.6

Source: IMF staff.

INTERNATIONAL MONETARY FUND

PEOPLE'S REPUBLIC OF CHINA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 8, 2014

Prepared By: The Asia and Pacific Department (In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of May 31, 2014)

Membership Status: Joined 12/27/45; Article VIII (December 1, 1996)

General Resources Account:

	SDR Million	% Quota
Quota	9,525.90	100.00
Fund holdings of currency	9,182.77	96.40
Reserve position in Fund	343.18	3.60
Lending to the Fund		
New Arrangements to Borrow	3,789.87	

SDR Department:

	SDR Million	% Allocation
Net cumulative allocation	6,989.67	100.00
Holdings	7,305.72	104.52

Outstanding Purchases and Loans: None

Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-by	11/12/86	11/11/87	597.73	597.73

Projected Payments to Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2014	2015	2016	2017	2018
Principal		0.00	0.00	0.00	0.00
Charges/interest		0.05	0.05	0.05	0.05
Total		0.05	0.05	0.05	0.05

Exchange Arrangements:

China's exchange rate regime has been classified as a crawl-like arrangement since June 21, 2010. De jure classification of the exchange rate is managed floating. On July 21, 2005, the People's Bank of China (PBC) announced that the exchange rate of the renminbi against the U.S. dollar would be revalued upward by about 2.1 percent (from RMB 8.28/US$ to RMB 8.11/US$) and the exchange rate regime would move to a managed float in which renminbi's value is set with reference to a basket of currencies. The stated intention of the Chinese authorities was to increase the flexibility of the renminbi's exchange rate. The authorities indicated that they will not publish the currencies in the reference basket and their relative weight. The PBC indicated that it would adjust the exchange rate trading band as necessary to reflect market developments and financial and economic conditions. Under the new regime, the band around the daily trading price of the U.S. dollar against the renminbi was kept at ± 0.3 percent around the central parity published by the PBC while the trade prices of the non-U.S. dollar currencies against the renminbi were allowed to move within a certain band announced by PBC, which was initially set at ±1.5 percent and increased to ±3 percent in September 2005. In August 2005, the governor of PBC revealed that U.S. dollar, Euro, Japanese yen, and Korean won were the main currencies included in the basket; and U.K. pound, the Thai baht, and the Russian ruble were among other currencies included in the basket. In May 2007, the band around the daily trading price of the U.S. dollar against the renminbi was widened to ± 0.5 percent. After maintaining the renminbi closely linked to the U.S. dollar between July 2008 and June 2010, the PBC announced on June 19, 2010 a return to the managed floating exchange rate regime prevailing prior the global financial crisis with the exchange rate allowed to move up to ±0.5 percent from a central parity rate to enhance the effectiveness of monetary policy. Further, on April 14, 2012, the PBC announced a widening of the renminbi's trading band against the U.S. dollar in the interbank foreign exchange market. As of today, the band has been widened to 2 percent, allowing daily fluctuations relative to the central parity rate. The trading prices for the renminbi against the euro, yen, Hong Kong dollar, and pound sterling on the one hand and against the ringgit and the ruble on the other hand float within a 3 percent and a 5 percent range of the day's middle exchange rates of the renminbi against these currencies, respectively.

On January 4, 2006, over-the-counter (OTC) trading of spot foreign exchange was introduced with 15 banks initially designated as market makers. The number of market makers has since risen to 31 with all the banks approved as spot market makers, and 27 approved as forward and swap trading market makers. The centralized spot foreign exchange trading system (CFETS) remains operative, but its central parity rate (renminbi against the U.S. dollar) is now based on a weighted average of CFETS and OTC transactions. Under the new system, CFETS first inquires prices from all market makers before the opening of the market on each business day, exclude the highest and lowest offers, and then calculates the weighted average of the remaining prices in the sample as the central parity for the renminbi against the U.S. dollar for the day. The weights for the market makers, which remain undisclosed, are determined by the CFETS using various factors, including the transaction volumes of the respective market makers in the market. The method for determining is as follows: The CFETS determines the middle rate for the renminbi against the ringgit, yen, and the ruble similarly. The middle exchange rates of the renminbi against the euro and Hong Kong dollar, and pound sterling, respectively, are determined through cross rates by the CFETS based on the day's foreign exchange middle rate for the renminbi against the U.S. dollar and the exchange rates for the U.S. dollar against the euro, yen, Hong Kong dollar, and pound sterling on international foreign exchange markets.

China accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement on December 1, 1996. There are repatriation requirements on proceeds from exports and from invisible transactions and current transfers. Starting on August 13, 2007, all enterprises (domestic institutions) having foreign exchange revenue from current operations may keep foreign exchange receipts according to their operational needs in their current foreign exchange accounts. With SAFE approval or registration, domestic institutions may open foreign exchange capital accounts and retain foreign exchange revenues from capital transactions. Domestic institutions that had no current foreign exchange revenue may purchase foreign exchange for imports in advance based on documentary proof of the payment and deposit the funds into their foreign exchange accounts. Individuals may, also open foreign exchange savings accounts and deposit foreign exchange purchased in accordance with the relevant regulations. There are no measures currently in force that have been determined to be exchange restrictions subject to Fund jurisdiction. However, China has notified measures to the Fund, pursuant to procedures under the Executive Board Decision 144-(52/51), which apply to measures imposed solely for national or international security reasons.

Exchange controls continue to apply to most capital transactions. Effective on July 1, 2006, quotas on foreign exchange purchases for foreign direct investment (FDI) were abolished, and domestic investors were allowed to purchase foreign exchange to finance pre-FDI activities. Since December 1, 2002, qualified foreign institutional investors (QFIIs) have been allowed to invest domestically in A shares, subject to certain restrictions, and all nonresidents have been allowed to purchase B shares, which are denominated in U.S. dollars or Hong Kong dollars. The overall investment limit for QFIIs was US$80 billion in 2012. As of the end of 2012, a cumulative total of 207 QFIIs had been approved, with a total investment limit of US$37.443 billion. The Qualified Domestic Institutional Investor (QDII) scheme was introduced in 2004, and measures have since been taken to promote its development. Since May 1, 2006, residents can freely purchase up to US$20,000 foreign exchange and this limit was raised to US$50,000 in September 2006. Above this amount, purchases require relevant documents. In May 2007, the QDII scheme was expanded to allow qualified banks to invest retail funds in foreign equities. Effective July 5, 2007 the China Securities and Regulatory Commission extended QDII to securities and fund-management companies. The firms have to meet certain capital and other requirements. From April 2006, qualified insurance companies were also allowed to invest their own foreign exchange externally under the QDII scheme up to 15 percent of their total assets. QDIIs may also invest in foreign derivative instruments.

The use of renminbi in international transactions has been expanded. In 2010, international financial institutions were approved to raise funds domestically in renminbi for use offshore. Since August 2011, trade transactions between all provinces and cities in the Mainland with other countries may be settled in renminbi. Since August 17, 2010, eligible foreign institutions may invest in the interbank bond market in renminbi. The eligible institutions include foreign banks engaged in cross-border trade settlements in renminbi, the Hong Kong SAR and Macao SAR region renminbi clearing banks, and foreign central banks and monetary authorities. These investments are subject to limits, but there is no minimum holding period. Starting from January 6, 2011, resident enterprises in 20 provinces and cities in the Mainland may use renminbi for outward FDI in those countries which accept such settlement. In December 2011, a new pilot scheme was announced to allow up to RMB20 billion in portfolio flows into the securities markets (through a renminbi Qualified Foreign Institutional Investor scheme), and in October, rules were published to allow overseas firms to invest renminbi raised offshore in the Mainland as foreign direct investment. Since 2012 all residents and non-residents can use RMB for FDI. Under the expanded RMB qualified foreign institutional investors (RQFII) scheme, Hong Kong subsidiaries of Chinese financial institutions, as well as financial institutions registered and operated in Hong Kong SAR, may invest in domestic securities markets using RMB proceeds raised overseas. Hong Kong-based banks may provide yuan loans to companies based in the Qianhai District of Shenzhen, with limits on the size of the loan. RMB internationalization has advanced further in 2013-14. RMB clearing banks were established in Singapore, Taiwan Province of China, Luxembourg, Australia, and the UK. Germany is also expected to establish RMB clearing banks soon. Average daily RMB turnover in Hong Kong SAR was about USD 50 billion in 2013, one of the highest among emerging market currencies.

External borrowing remains subject to permission by the respective authority except for FFEs which may borrow abroad within the difference between the enterprise's total investment and registered capital. Lending abroad generally requires approval, but domestic associated enterprises of multinational corporations may directly lend to offshore associated enterprises.

Article IV Consultation:

China is on the standard 12-month consultation cycle. The 2013 Article IV mission was concluded on May 29, 2013 and the staff report was published on July 17, 2013.

Technical Assistance:

Technical assistance provided from 2000 through May 2014 is summarized in Annex V.

Resident Representative:

The resident representative office in Beijing was opened in October 1991. Mr. Alfred Schipke is the Senior Resident Representative and Mr. Waikei Raphael Lam is the Deputy Resident Representative.

WORLD BANK-IMF COLLABORATION

(As of June 18, 2014)

1. **The IMF China Resident Representatives (Messrs. Schipke and Syed) held discussions with the World Bank team (Ms. Goh, lead Economist for China, and Mr. Smits) in June 2014** to exchange views on key areas of reform to ensure sustainable medium-term growth in China, minimize risks, and improve the inclusiveness of growth. The teams discussed their agendas for 2014-15. The last such meeting was held during May 2013 in Beijing.

2. **The teams agreed the focus of reform in China should be on shifting growth to a more balanced and sustainable path, along the line of the Third Plenum reform blueprint.** Reforms should aim at preventing further buildup of risks stemming from rapid credit growth and quasi-fiscal spending, and move the economy to a more inclusive, environment-friendly, and sustainable growth path. Giving the market a more decisive role, eliminating distortions, and strengthening institutions will result in a more efficient use of resources, faster productivity growth, and rising living standards across the income spectrum.

3. **Based on this assessment, teams identified the following reform areas as macro-critical:**

- ***Financial sector reforms.*** Further progress in financial sector reform is central to containing risks and boosting growth by facilitating better allocation of resources. Widespread implicit guarantees—of savers, intermediaries, and borrowers—and the cap on deposit rates distort the pricing of risk and borrowing costs, resulting in misallocation of credit and inefficient investment. Key measures in this area include deposit interest rate liberalization, stepped-up supervision and regulation of the financial system, overhaul of the system of resolving failed financial institutions, and the introduction of deposit insurance.

- ***Fiscal reforms.*** Off-budget spending, in infrastructure but also in other areas, undertaken by local-government owned entities have led to a significant buildup of debt. Bringing these projects on-budget and strengthening control over public financial management will help control fiscal risks. Improving the fiscal framework is a priority for the medium term, including strengthening budget processes, data transparency, local government finances, and medium-term budget planning. Tax reforms—many of them planned and some already partly in place or in pilot form—will promote more efficient and inclusive growth. These reforms include extending the VAT to services, improving the progressivity of the personal income tax, and implementing a property tax.

- ***Reform of social safety nets***. Further strengthening the pension and health insurance systems—including by improving and expanding coverage—would have macro-benefits such as reducing precautionary household savings. Addressing coverage issues in the Chinese health system would further reduce incentives to save, and help develop China's service sector. These reforms should be done in a way that ensures the sustainability of the social security system, including through parametric changes to the pension system and transferring the welfare and legacy components to the budget.

- ***SOE reform.*** Reforms include opening up to full and fair competition activities currently reserved to SOEs, properly pricing finance and other factor inputs, requiring adequate dividend payments to the budget, and imposing hard budget constraints. Opening up the service sector to more competition will also be critical for generating the productivity gains necessary to fuel growth and for boosting household income, as services tend to be more labor intensive than industry.

- ***Green growth.*** Air pollution, water quality and supply, and issues such as desertification, dependence on coal, and degradation of grasslands have social, health, and economic effects. Underpricing of energy and inadequate consequences for pollution have worsened these effects while contributing to China's dependence on industry. Raising these factor costs to capture the cost of externalities and investing in renewable energy will make growth more sustainable and inclusive.

- ***Infrastructure.*** Investment in infrastructure has been a key driver of the Chinese economy, particularly during the slowdown around the Global Financial Crisis. However, the rapid pace of investment has in some cases left communities behind, and in other cases has led to excessive investment in projects with relatively low social or financial returns. Filling in the gaps of investment in social projects will make growth more inclusive while improving the overall social and financial efficiency of infrastructure investment. Measures to improve the process of approving new infrastructure projects will ensure that investments are focused in areas of the highest social return.

4. **The teams agreed to the following division of labor.**

- ***Financial sector reforms.*** The Bank is working with the authorities on the development of a financial sector reform strategy. The Fund will continue to follow up on the recommendations of the 2011 FSAP and provide technical assistance to the Chinese authorities as needed.

- ***Fiscal reforms.*** The Bank will continue its work with the Shanghai municipal government to transfer technical assistance on Medium Term Expenditure Framework and debt sustainability analyses. The Bank will also continue its work on expenditure and revenue policies and on fiscal management in the context of its urbanization study, completed earlier in 2014. The Fund will continue its technical cooperation on strengthening the fiscal framework and streamlining budgetary preparation. The Fund will also continue to discuss the near- and medium-term implications of China's fiscal stance and policy choices on the broader economy as well as implications for global spillovers.

- ***Social safety nets.*** The Bank will continue to work with the Chinese authorities on both parametric and structural reforms to the Chinese pension system, with a view toward ensuring that the system protects the most vulnerable, ensures a fair return on savings for all participants, and is financially sustainable in the long term. The Fund will look at issues related to the balance between social contributions and other revenue sources, as well as how social safety nets fit into the overall fiscal and macroeconomic policy framework.

- ***Green growth.*** The Bank's focus on climate change and renewable energy in China will continue to emphasize cutting-edge renewable energy technologies, scale-up of energy conservation and investments in energy efficiency, and green building policies (for heat and energy efficiency). Engagements with a climate change focus will extend to expansion of distribution of electricity from natural gas generation, analysis of carbon capture and storage potential, and development of carbon markets. The Fund will continue to discuss options to capture the cost of externalities through the use of fiscal policy such as better calibration of excise and other taxes. It is ready to provide assistance on shifting the pricing and taxation of energy, and discussing the growth and fiscal implications of such a shift.

5. **Teams have the following requests for information from their counterparts:**

- The Fund team requests to be kept informed of progress in the above macroeconomic structural reform areas, as milestones are reached and at least on a semiannual basis.
- The Bank team requests to be kept informed of the Fund's assessments of macroeconomic policies and prospects in the context of the Article IV consultation and staff visits, and at least semiannually.

The following table lists the teams' separate and joint work programs for June 2014–June 2015.

Appendix I. China: Bank and Fund Planned Activities in Macrocritical Structural Reform Areas

	Products	Expected Delivery Date
Bank Work Program	• China Economic Reform Implementation Project (umbrella TA project, including various subprojects with MOF, PBoC, and provincial finance bureaus).	• Ongoing
	• China Economic Update	• Ongoing
	• "Just-in-time" Policy Notes for MOF	• Delivered on demand
	• TA on Mid-term Macrofiscal Framework	• Ongoing
	• Subnational Intergovernmental Fiscal Relationship	• Ongoing
	• Municipal Financing and Local Debt Management	
	• Inclusive Finance Academy	• Ongoing
	• Financial Consumer Protection and Consumer Literacy	• Ongoing
	• Financial Reform Strategy	• Ongoing
	• Capital Market Development	• Ongoing
	• Effective, Inclusive, and Sustainable Urbanization	• June 2014
	• The Role of Housing Provident Fund in Affordable Housing	• Ongoing
	• Deepening pension system reform through an integrated design	• September 2014
	• Actuarial projection of pension legacy cost and liabilities" – ongoing	• Ongoing
	• Deepening health reform in China-building high quality and value-based service delivery	• Ongoing
Fund Work Program	• December Staff Visit	• Dec 2014
	• 2015 Article IV Consultation	• May/Jun 2015
Joint Work Program	• No joint projects currently envisaged.	

RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]

1. The Asian Development Bank's (AsDB) partnership with the People's Republic of China (PRC) has grown in many ways since the PRC became a member of AsDB in March 1986. The PRC is AsDB's second largest shareholder among regional members and the third largest overall, as well as an important middle-income country client. By the end of 2013, the PRC's cumulative borrowing from AsDB reached $27.8 billion with 204 loans for public sector projects. Of the total public sector loans, 52.7 percent was allocated to the transport sector, followed by agriculture and natural resources (11.3 percent) and water and other municipal infrastructure services (11.3 percent), energy (11.0 percent), industry and trade (2.6 percent), finance (2.2 percent), and multisector (9.0 percent). Over the past 26 years, AsDB has helped finance 37 private sector projects in the PRC totaling $4.06 billion.

2. AsDB also funds Technical Assistance for the PRC. By the end of 2013, AsDB had provided a total of $419.1 million in grants for 727 technical assistance projects, consisting of $132.5 million for preparing projects and $286.6 million for policy advice and capacity development.

3. Overall, the PRC has demonstrated strong capabilities in implementing projects. The good performance shows the strong sense of project ownership among agencies involved in the design, implementation, and management of projects, as well as the rigorous screening process for development projects, particularly those proposed for external financing. Loan disbursement and contract award performance is good.

4. The PRC has demonstrated its strong partnership with AsDB by contributing to the Asian Development Fund, establishing the $20 million PRC Poverty Reduction and Regional Cooperation Fund (the PRC Fund), and replenishing another $20 million to the PRC Fund. The PRC Fund—the first fund established in AsDB by a developing member country—providing technical assistance projects to support subregional cooperation initiatives, particularly Central Asia Regional Economic Cooperation (CAREC) and Greater Mekong Subregion (GMS) programs.

5. The Asian Development Bank's Country Partnership Strategy (CPS) 2011–15 was endorsed by AsDB Board of Directors in May 2012. The CPS 2011–2015 is aligned with the priorities of the PRC's 12th Five-Year Plan 2011–15 that intersect with those of AsDB's long-term *Strategy 2020*, particularly the redoubling of efforts to promote socially inclusive and environmentally sustainable development. The CPS reflects the PRC's changing circumstances as a rapidly growing middle-income country with increasing emphasis on innovation and value addition and South-South cooperation to underpin the evolving AsDB-PRC partnership. The CPS is built on three strategic pillars: (i) inclusive growth, (ii) environmentally sustainable growth, and (iii) regional cooperation and integration. It identifies

[1] Prepared by Asian Development Bank staff.

four priority sectors for country operations during the CPS period: (i) energy, (ii) natural resources and agriculture, (iii) transport, and (iv) urban development. The sector selection reflects AsDB's comparative strengths and expertise through its longstanding operations in these sectors.

6. Projected public sector lending in 2014–2016 will total about $4.13 billion, of which 32 percent will support the transport sector; 27 percent for agriculture, rural development, and natural resource management; 30 percent for urban development, water supply, and sanitation improvement; and 11 percent for the energy sector. Over 90 percent of the projects are located in the western, central and north-eastern regions in line with the CPS's priorities of promoting inclusive growth and environmentally sustainable growth.

AsDB's technical assistance will complement the lending program to improve the sector policy environment, support governance and capacity development, and strengthen the knowledge base and innovative features of lending operations.

China: AsDB's Commitments and Disbursements (Public Sector Loans), 1993–2013
(In millions of U.S. dollars)

Year	Commitments 1/	Disbursements 2/
1993	1,031	371
1994	1,618	492
1995	2,304	558
1996	3,282	707
1997	4,033	715
1998	4,518	818
1999	5,337	792
2000	6,159	832
2001	6,748	1,313
2002	7,563	782
2003	8,075	705
2004	8,733	636
2005	11,060	892
2006	11,794	988
2007	13,214	1,190
2008	14,519	1,234
2009	15,623	1,342
2010	16,964	1,342
2011	18,244	1,580
2012	19,476	1,343
2013	20,416	1,063

1/ Refers to cumulative contract awards.
2/ Refers to disbursements for the year.

STATISTICAL ISSUES

Assessment of Data Adequacy for Surveillance

1. Data provision has some shortcomings, but is broadly adequate for surveillance. Most affected areas are: national accounts and government finance statistics. Progress has been made in meeting the SDDS standard, as most of data requirements are observed although several data categories are compiled but not disseminated in accordance to the SDDS standard (for instance, the GDP is compiled on a cumulative and not a discrete basis). Some planned improvements include strengthening the data dissemination by the National Bureau of Statistics (NBS), and revising the reporting codes and classification of BOP transactions to Balance of Payments Manual 6 by the State Administration of Foreign Exchange (SAFE). For a fuller discussion planned improvements see (http://dsbb.imf.org/Pages/GDDS/SummaryReport.aspx?ctycode=CHN&catcode=s1)

Real Sector Statistics

2. The National Bureau of Statistics (NBS) compiles and disseminates annual GDP by activity in current and constant prices (2010) and quarterly estimates of GDP. Both the annual accounts and quarterly accounts are based on the *System of National Accounts*, 1993 *(1993 SNA)*. The techniques for deriving volume measures of GDP are not sound and need to be improved. GDP by expenditure is compiled at current and constant prices, but the constant price estimates are not published. Data on the levels of expenditure components of real GDP are not available on a quarterly basis. Nevertheless, the NBS has made a number of improvements to the range and quality of national accounts data, the most important being improving the exhaustiveness of the GDP estimates by activity. Further improvements are intended for both the annual and quarterly accounts, however, no target dates have been set. As in other countries, rapid economic change, including the expansion of the private sector, presents new problems for data collection and compilation. The ability to change the data collection systems is restricted by the decentralized nature of the statistical system.

3. Monthly industrial production, retail sales, and fixed investment indices are compiled with the corresponding month of the previous year as a base period but, no chain-linked time series are produced. Data revisions tend to be made without publishing the entire revised series.

4. Labor market statistics—including employment and wage data—are not comprehensive, and are only available on a quarterly basis.

5. In January 2001, the NBS began to publish a Laspeyres price index that provides a time series for each January to December (with January each year = 100). This more accurately reflects consumer spending patterns (e.g., the weight of services increased, while the weight of food declined). The number of survey items has been expanded to at least 600 for small cities and counties and more for large and medium-size cities (e.g., 1800 for Beijing). The most recent weights of the major CPI components were provided to the staff in 2006.

Government Finance Statistics

6. Serious data shortcomings continue to hamper fiscal analysis. Budgetary data exclude spending associated with official external borrowing. Also, data on the social and extra budgetary funds are only provided annually and with a long lag. Expenditure classification remains poor, mainly because data are not classified by economic type. The authorities have indicated an intention to begin collecting these data and to develop accrual based measures of fiscal performance over the medium term while also strengthening the compilation of cash based GFS.

Monetary and Financial Statistics

7. In recent years, improvements have been made in monetary and financial statistics. However, the monetary and banking surveys lack sufficient detail with regard to bank claims on the government, hampering the estimation of the fiscal deficit from the financing side. The reported net foreign assets position of PBC does not include exchange rate valuation effects and interest earnings on foreign reserves. The PBC has also ceased to report separate data on central government deposits in its balance sheet since April 2005 because the MOF no longer distinguishes between central and other government deposit accounts. This change has led to breaks in data series of monetary base and monetary aggregates.

8. The April 2012 monetary and financial statistics mission made several recommendations for improvements in monetary data compilation, leading to the PBC's implementation of the standardized report forms (SRFs). However, monetary data reporting in SRFs has not initiated by the authorities due to ongoing issues related to instrument and sectoral classifications.

9. The April 2012 monetary and financial statistics mission also discussed with the authorities the possibility of expanding the data scope of FSIs to include encouraged FSIs for deposit-takers. The authorities indicated that the work on the compilation of the encouraged FSI data is at an early stage and, furthermore, they are working on adopting the Basel III at this stage and agreed to consider the mission's recommendations after the developmental work is completed for collecting data under the Basel III.

External Sector Statistics

10. The data are compiled (in U.S. dollars) largely in accordance with the fifth edition of the *Balance of Payments Manual* (*BPM5*). The authorities continue their efforts to improve the coverage of direct investment transactions in the balance of payments (BOP) and IIP statistics, and progress is being made in developing these statistics. Since the International Transactions Reporting System is the major data source for balance of payments (BOP) statistics, in order to ensure its smooth operation, regular training programs for staff in the provincial offices of SAFE have been recommended. In 2011, China commenced participation in the Coordinated Direct Investment Survey (CDIS).

11. Despite an ostensibly modest level of external vulnerability, there remains a need to strengthen external debt monitoring and compilation. In 2010, China started submitting total and public external debt data for the Quarterly External Debt Statistics (QEDS) database, a notable step forward.

Data Standards and Quality

12. China has participated in the General Data Dissemination System since April 2002, and the metadata posted on the Fund's Dissemination Standards Bulletin Board (DSBB) are regularly updated.

Data Reporting to STA for Publications

13. Despite improvements in reporting a number of breaks remain in the series, and comparable historical data are not available. Reporting of data to STA for publication in the *International Financial Statistics (IFS)* has, in the past, tended to be sporadic and with a considerable time lag. Following the introduction of new reporting arrangements, the timeliness of consumer price, industrial production, trade value, and total GDP data in *IFS* have improved substantially. No long-term time series are available for the consumer and producer price indexes and industrial production; rather the comparison is made each period with the same period of the previous year. However, the range of information is relatively limited, with no data published on wages, trade volumes, or prices/unit values.

14. China has reported general government cash-based budget data for 2003–09 following the *GFSM 2001* methodology for publication in the 2011 *Government Finance Statistics Yearbook*. However, these data are limited, with no data provided on government transactions in expense, assets, and liabilities. The revenue classification does not fully distinguish between revenue and grants, tax and nontax revenue, and current and capital revenue. The presentation of expenditure by function is largely aligned with international best practice.

15. Owing to source data issues, the authorities have not yet been able to report a *GFSM 2001* Statement of Sources and Uses of Cash for the budgetary central government accounts on a subannual basis. As a result, there are no fiscal data for China on the Principal Global Indicators website.

16. For reporting monetary data to the Fund, the authorities have not begun using SRFs. Monetary data continue to be reported using the old format.

17. The FSIs data currently posted on IMF's website are available only for core indicators and on an annual basis with data beginning from 2010. The April 2012 mission encouraged the authorities to compile and report the FSI data with quarterly periodicity. The authorities agreed with the improved periodicity for their FSI data, but indicated that they would prefer to move to semi-annual reporting prior to compiling the quarterly data.

18. The authorities have resumed reporting data on international reserves for publication in the *IFS*. However, the monthly time series are now submitted every three months, instead of every month. With regards to BOP and IIP data, the authorities started submitting quarterly data to STA for publication in the *IFS* and the *Balance of Payments Statistics Yearbook* (BOP data are available on a quarterly basis starting in 2010 and IIP starting in 2011). Additionally, China participates in the CDIS and data on inward investments are available for 2009 and 2010.

Data Dissemination to the Public

The publication of a quarterly statistical bulletin by the PBC has significantly improved the timing and coverage of publicly available data on the monetary accounts and the main real sector indicators. However, the monthly statistical publications do not contain many time series (e.g., unemployment) or the disaggregation necessary for analysis. Moreover, several important time series, particularly on the main fiscal variables, are not released in a systematic and timely manner. Extensive annual economic data are available in various statistical yearbooks, but these are published nine months or more after the end of the year. Nevertheless, in the case of BOP and quarterly external debt data disseminated in QEDS, time lag is around four to seven months.

China: Table of Common Indicators Required for Surveillance
(As of June 18, 2014)

	Date of Latest Observation	Date Received	Frequency of Data[9]	Frequency of Reporting[9]	Frequency of Publication[9]
Exchange rates	05/14	06/14	D	M[9]	D
International reserve assets and reserve liabilities of the monetary authorities[1]	05/14	06/14	M	M	M
Reserve/base money	05/14	06/14	Q, M	Q, M	Q, M
Broad money	05/14	06/14	M	M	M
Central bank balance sheet	05/14	06/14	M	M	M
Consolidated balance sheet of the banking system	05/14	06/14	M	M	M
Interest rates[2]	05/14	06/14	[10]	[10]	[10]
Consumer price index[3]	05/14	05/14	M	M	M
Revenue, expenditure, balance and composition of financing[4]—general government[5]	2013	03/14	A	A	A
Revenue, expenditure, balance and composition of financing[4]—central government	04/14	05/14	M	M	M
Stocks of central government and central government-guaranteed debt[6]	Q4/13	03/14	Q	Q	Q
External current account balance	Q1/14	05/14	Q	A, Q	A, Q
Exports and imports of goods and services[7]	05/14	05/14	M	M	M
GDP/GNP[8]	Q1/14	04/14	A, Q (cumulative)	A, Q (cumulative)	A, Q (cumulative)
Gross external debt	Q4/13	03/14	A, Q	A, Q	A, Q
International investment position	Q4/13	03/14	A, Q	A, Q	A, Q

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Only 12-month growth rates are reported (price indices are not available).

[4] Data on financing (foreign, domestic bank, and domestic nonbank financing) is not available.

[5] The general government consists of the central (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[6] Including currency and maturity composition.

[7] Goods trade data are provided monthly. Services trade data are released with the current account statistics.

[8] For real GDP, level data are available only on an annual basis (growth rates are available on a quarterly, cumulative basis).

[9] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

[10] Interest rates change only infrequently; these changes are publicly announced.

TECHNICAL ASSISTANCE

China: Summary of Technical Assistance, 2001–15 1/

Department	Purpose	Date
Tax System Reform		
FAD	Mission on VAT and inheritance tax	April 2001
FAD	Mission on tax preference	September 2001
FAD	Mission on financial sector taxation	Aug/Sep 2002
FAD	Mission on personal income tax reform	November 2003
LEG	Seminar on basic tax law	December 2005
FAD	Mission on VAT treatment of financial services	April 2006
FAD	Mission on estimation of VAT gap and capacity	June 2009
FAD	Mission on VAT treatment of financial services	June 2010
FAD	Mission on tax gap analysis	September 2011
FAD	Micro-simulation models	December 2013
Tax Administration Reform		
FAD	Five missions on computerizations	June 2000–Oct. 2002
FAD	Two missions on strategic planning	Nov. 2001–Aug. 2002
FAD	Seminar on Strategic Planning in Washington	October 2002
FAD	Mission on revenue administration	November 2003
FAD	Review of computerization project	September 2004
FAD	Mission on business process reengineering pilot	November 2005
FAD	Mission on IT modernization	June 2006
FAD	Mission on strategic planning, risk management, and taxpayer services	September 2006
FAD	Mission on VAT invoice cross-checking and other administration issues	March 2007
FAD	Mission on business process re-engineering and Golden Tax Project 3	August 2007
FAD	Seminar on Strategic Planning and Management	January 2008
FAD	Mission on VAT on services, resource tax policy	October 2009
FAD	Mission on project management Golden Tax Project 3	June 2010
FAD	Expert Visit on Strategic Planning	October 2010
FAD	Mission on Tax Administration: Large Taxpayers	October 2010
FAD	Peripatetic Expert Visit on Tax Administration	October 2010
FAD	Tax Policy and Administration	September 2011
FAD	Tax Administration (Peripatetic Expert Visit 4 of 5)	October 2011
FAD	Tax Administration (Peripatetic Expert Visit 5 of 5)	October 2011
FAD	Large Taxpayer Compliance	October 2011
FAD	Workshop on practical tax analysis for tax officials	December 2012
FAD	Large taxpayer administration	January 2013
FAD	Tax Administration Follow-Up	April 2014
FAD	Tax Collection Law Revision	May 2014

Public Financial Management		
FAD	Workshop on government fiscal management information system	February 2001
FAD	Mission on treasury/accounting reform; macrofiscal coordination	November 2001
FAD	Mission on budget preparation, classification, and treasury reform	June 2002
FAD	Mission on budget classification	March 2003
FAD	Workshop on Budget and Treasury Modernization in Washington	October 2003
FAD	Mission on treasury and accounting reforms	November 2003
FAD	Mission on Budget Law I	March 2004
FAD	Mission on cash management	April 2006
FAD	Mission on Budget Law II	September 2007
FAD	Discuss FAD's PFM program with authorities	September 2007
FAD/STA	Mission on Accrual Accounting	September 2007
FAD	Seminar on local government cash management	December 2009
FAD	Presentation of the Budget Institutions Paper	May 2010
FAD	Fiscal Medium-Term Budget Management Seminar	November 2011
FAD	Medium-Term Revenue Administration Program and Policies Discussion	June 2012
FAD	High-level Dialogue on PFM Institutions	November 2012
FAD	Treasury Modernization	February 2012
FAD	Treasury Modernization	February 2013
FAD	Modernization of Government Accounting	April 2014
FAD	Medium Term Expenditure Frameworks	July 2014
Intergovernmental Fiscal Relations		
FAD	Mission intergovernmental relations	November 2002
FAD	Mission on subnational fiscal risks	November 2003
FAD	Conference on Reforming Assignments and Next Steps in Intergovernmental Reforms	November 2007
Statistics		
STA	**SEMINAR ON GENERAL DATA DISSEMINATION SYSTEM**	April 2001
STA	Missions on trade price statistics	Jun. 2001–Jan. 2002
STA	Mission on GDDS	Feb./Mar. 2002
STA	Seminar on GDDS/SDDS in Washington	September 2002
STA	GDDS Review	December 2003
STA	Mission on government financial statistics	January 2005
STA	Mission on monetary and financial statistic	Feb./Mar. 2005
STA	Seminar on International Investment Position	April 2005
STA	Seminar on IIP Statistics	April 2005
STA	Seminar on External Debt Statistics	August 2005
STA	Macroeconomic statistics	May 2006
STA	Balance of Payments and IIP Course	June 2007
STA	Mission on monetary and financial statistics	August 2007

STA	Seminar on *Balance of Payments and International Investment Position Manual,* sixth edition (*BPM6*)	April 2008
STA	*BPM6* course	June2009
STA	Seminar on Services Statistics	November 2009
STA	Seminar on financial derivates, direct investment and external debt	September 2010
STA	Balance of Payments and IIP Course	June 2011
STA	Government Finance Statistics	September 2008
STA	Financial Soundness Indicators	June 2009
STA	Monetary and Financial Statistics	October 2010
STA	Workshop on Special Data Dissemination Standard	April 2011
STA	Government Finance Statistics	May 2011
STA	Quarterly National Accounts	November 2013
STA	SDDS Assessment	August 2014
STA	Data Work: Monetary Data Reported in SRF	September 2014
Monetary Policy, Bank Supervision, and AML/CFT		
MFD	Missions on banking supervision	October 2003
MFD	Bank Restructuring	April 2004
MFD	AML/CFT Issues	September 2003
MFD	AML/CFT Supervision	March 2004
MFD/LEG	AML/CFT advisory mission	January 2005
MFD/LEG	AML/CFT Issues	April 2005
LEG/MFD	AML/CFT Issues	April 2006
LEG	AML/CFT mission to discuss TA to the Monetary Authority of Macao SAR	July 2006
LEG	AML/CFT Legislative Drafting	July 2006
LEG	AML/CFT Legislative Drafting	August 2006
LEG	AML/CFT Legislative Drafting	September 2006
LEG	AML/CFT Legislative Drafting TA to the Monetary Authority of Macao SAR	September 2006
LEG	AML/CFT Financial Institutions Inspection STX advice mission, Macao SAR	December 2008
LEG	AML/CFT Financial intelligence Unit procedural improvements, Macao SAR	March 2010
LEG	AML/CFT Legislative Drafting	July 2010
LEG	AML/CFT Legislative Drafting	March 2011
LEG	Bank Resolution	May 2012
Review of Technical Assistance		
FAD	Visit to review UNDP/IMF/China fiscal reform TA program	February 2001
FAD/TAS	Two missions for tripartite review of the UNDP/IMF/China fiscal reform TA program	Jan. 2002/Feb. 2003
MFD	Mission on TA needs in banking sector reform	July 2002
MFD	Mission on TA needs in financial sector	October 2003
FAD	Participation in UNDP/DFID fiscal reform workshop	February 2004
FAD	Visit to discuss TA needs under UNDP/DFID fiscal reform project	December 2004
LEG	AML/CFT Mission to discuss future cooperation and TA	November 2009

Training		
INS	Courses on Financial Programming and Policies (3)	July 2000–June 2002
INS	Course on Banking Supervision	June 2001
INS	High-Level Seminar on Banking Reform	March 2001
STA	Seminar on Money and Banking Statistics	April 2001
MFD	Course on Banking Supervision (On-Site and Off-Site)	July 2001
MFD	Banking Risk Management	July 2001
INS	Course on Financial Programming and Policies	August 2001
MFD	Seminar on Capital Account Convertibility	October 2001
FAD	Course on Public Sector Expenditure Management	June/July 2002
STA	Seminar on Balance of Payments and IIP Statistics	August 2002
STA	Course on Government Financial Statistics	September 2002
INS	Course on Banking Supervision	September 2002
MFD	Central Bank Accounting	November 2002
STA	Course on Government Financial Statistics	September 2003
INS	Course on Financial Programming and Policies	October 2003
MFD	Course on Assessing Financial Systems	November 2003
INS	Course on Advanced Financial Programming (Washington)	November 2003
STA	Course on Monetary and Financial Statistics	Nov./Dec. 2003
FAD	International Experience with Budget Law and Budget Law Reform	March 2004
INS	High-Level seminar on Monetary Policy Transmission	April 2004
LEG/MFD	AML/CFT Workshop	April 2004
INS	High-Level seminar on China's Foreign Exchange System	May 2004
STA	Seminar on Coordinated Portfolio Investment Survey	April 2004
INS	Course on Financial Market Analysis	June 2004
MFD	Workshop on Ex and Balance of Payments Issues	June 2004
INS	Course on Macroeconomic Management and Financial Sector Issues	July 2004
STA	Seminar on Quarterly National Accounts	September 2004
INS	Course on Financial Programming and Policies	October 2004
STA	High Level Seminar on Macroeconomic Statistics	January 2005
MFD	AML/CFT Training for PBC Officials	February 2005
LEG	AML/CFT Symposium	May 2005
MFD	Workshop on Monetary Strategy and Operation	May 2005
INS	Course on Financial Programming and Policies	June 2005
INS	Course on Macroeconomic Management and Fiscal Issues	June 2005
LEG	National IT Symposium	July 2005
LEG	AML/CFT Workshop	July 2005
INS	Course on Macroeconomic Management and Financial Sector Issues	July 2005
STA	Course on External Debt Statistics	August 2005
STA	Course on Monetary and Financial Statistics	September 2005
MFD	AML/CFT Symposium	September 2005

Training		
MFD	AML/CFT and Internal Control Workshop	November 2005
LEG/MFD	Advanced Training on ML and TF Typologies and STRs	December 2005
LEG	AML/CFT Workshop	January 2006
MFD	Course on Foreign Exchange Operations	March 2006
INS	Course on Macroeconomic Management and Financial Sector Issues	May 2006
LEG	AML/CFT Workshop on Information Management Technology	June 2006
MFD	Course on Determining the Intermediate Target for Monetary Policy	June 2006
STA	Seminar on Banking Statistics on Cross-Border Flows	June 2006
MFD	Seminar on Capital Account Convertibility	October 2001
FAD	Course on Public Sector Expenditure Management	June/July 2002
STA	Seminar on Balance of Payments and IIP Statistics	August 2002
STA	Course on Government Financial Statistics	September 2002
INS	Course on Banking Supervision	September 2002
MFD	Central Bank Accounting	November 2002
STA	Course on Government Financial Statistics	September 2003
INS	Course on Financial Programming and Policies	October 2003
MFD	Course on Assessing Financial Systems	November 2003
INS	Course on Advanced Financial Programming (Washington)	November 2003
STA	Course on Monetary and Financial Statistics	Nov./Dec. 2003
FAD	International Experience with Budget Law and Budget Law Reform	March 2004
INS	High-Level seminar on Monetary Policy Transmission	April 2004
LEG/MFD	AML/CFT Workshop	April 2004
INS	High-Level seminar on China's Foreign Exchange System	May 2004
STA	Seminar on Coordinated Portfolio Investment Survey	April 2004
INS	Course on Financial Market Analysis	June 2004
MFD	Workshop on Ex and Balance of Payments Issues	June 2004
INS	Course on Macroeconomic Management and Financial Sector Issues	July 2004
STA	Seminar on Quarterly National Accounts	September 2004
INS	Course on Financial Programming and Policies	October 2004
STA	High Level Seminar on Macroeconomic Statistics	January 2005
MFD	AML/CFT Training for PBC Officials	February 2005
LEG	AML/CFT Symposium	May 2005
MFD	Workshop on Monetary Strategy and Operation	May 2005
INS	Course on Financial Programming and Policies	June 2005
INS	Course on Macroeconomic Management and Fiscal Issues	June 2005
LEG	National IT Symposium	July 2005
LEG	AML/CFT Workshop	July 2005
INS	Course on Macroeconomic Management and Financial Sector Issues	July 2005
STA	Course on External Debt Statistics	August 2005
STA	Course on Monetary and Financial Statistics	September 2005
MFD	AML/CFT Symposium	September 2005

INS	Course on Advanced Financial Programming	July 2006
INS	Course on Macroeconomic Management and Financial Issues	July 2006
LEG	National Workshop on IT for FIUs	September 2006
LEG	AML/CFT Workshop on Mutual Evaluation Process	October 2006
LEG	AML/CFT Symposium	November 2006
LEG	Workshop for APC Countries	December 2006
LEG	AML/CFT Workshop	May 2007
LEG	AML/CFT Training for Supervisors	May 2007
LEG	AML/CFT Training for Macao SAR Supervisors	May 2007
INS	Course on Financial Programming and Policies	May 2007
STA	Course on Balance of Payments Statistics	June/July 2007
INS	Course on Macroeconomic Management and Financial Sector Issues	July 2007
LEG	AML/CFT Training for Insurance and Securities Sectors Supervisors	October 2007
STA	Course on Monetary and Financial Statistics	October 2007
MCM	Workshop on FSAP and Financial Stability	December 2007
MCM	Workshop on Stress Testing	December 2007
LEG	AML/CFT Risks in the Casino Sector	December 2007
FAD	Seminar on Revenue Forecasting	March 2008
LEG	AML/CFT Legislative Drafting Workshop	January 2008
FAD	Seminar on Revenue Forecasting	March 2008
INS	Course on Financial Programming and Policies	April 2008
LEG	AML/CFT Supervision Workshop	May 2008
INS	Course on External Vulnerabilities	June 2008
STA	Course on Government Finance Statistics	September 2008
STA	Seminar on Financial Soundness Indicators and Money and Banking Statistics	September 2008
INS	Course on Macroeconomic Management and Financial Sector Issues	October 2008
LEG	AML/CFT Risk-Based Supervision Workshop	November 2008
INS	Course on External Vulnerabilities Analysis	February 2009
INS	Course on Financial Programming and Policies	May 2009
STA	Course on Balance of Payments and International Position Statistics	June 2009
INS	Course on Macroeconomic Management and Financial Sector Issues	November 2009
LEG	AML/CFT Risk-Based Supervision Workshop	November 2009
INS	Course on Financial Programming and Policies	January 2010
STA	Course on Monetary and Financial Statistics	March 2010
LEG	AML/CFT Risk-Based Supervision Workshop	April 2010
INS	Course on Macroeconomic Management and Financial Sector Issues	May 2010
LEG	AML/CFT Legislative Drafting Mission	July 2010
LEG	AML/CFT risk-based supervision Workshop	September 2010
STA	Seminar on Financial Soundness Indicators Reporting and Disseminating	September 2010
STA	Seminar on Balance of Payments Statistics	September 2010

MCM	Financial Regulation Workshop	October 2010
LEG	AML/CFT Legislative Drafting Mission	March 2011
INS	Course on Macroeconomic Management and Financial Sector Issues	March 2011
INS	Course on Macroeconomic Forecasting	April 2011
STA	Course on Government Finance Statistics	May 2011
A. STA	Course on Government Finance Statistics	June 2011
	E. Course on Balance of Payments Statistics	October 2011
B. INS	F. Course on Macroeconomic Diagnostics	November 2011
	Course on Monetary and Financial Statistics	February 2012
STA	Course on National Account Statistics	March 2012
C. STA	Course on Macroeconomic Management and Financial Sector Issues	May 2012
	Course on Macroeconomic Forecasting	September 2012
D. INS	Course on Financial Soundness Indicators	October 2012
	Training Financial Soundness Indicators	April 2013
FAD	Workshop on Methodologies for Tax Revenue Analysis	December 2012
STA	Workshop on Quarterly National Accounts	November 2013
STA	Sectoral Account and Data Work	September 2014
STA	Course on Macroeconomic Management and Financial Sector Issues	March 2015
	Course on Macroeconomic Diagnostics	September 2015
ICD	Advance Course on Monetary and Financial Statistics	September 2015
ICD	Course on Macroeconomic Forecasting	October 2015
ICD	Training on Monetary Policy Frameworks	October 2015
MCM	Workshop on External Accounts	July 2014

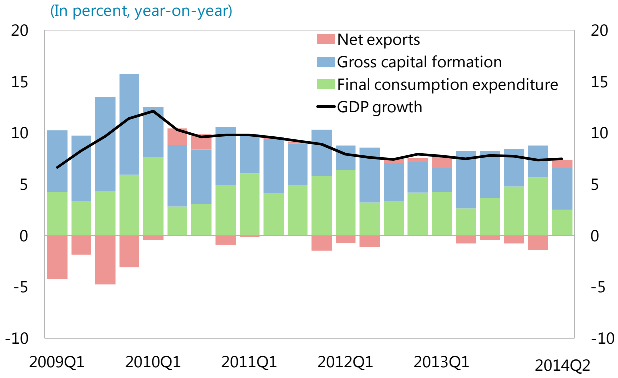
1/ The new Institute for Capacity Development (ICD) was formed from the merger of the former IMF Institute (INS) and Office of Technical Assistance Management (OTM) on May 1, 2012.

Statement by the Staff Representative on the People's Republic of China
July 25, 2014

1. This statement summarizes data releases since the staff report was finalized. The information does not alter the thrust of the staff appraisal.

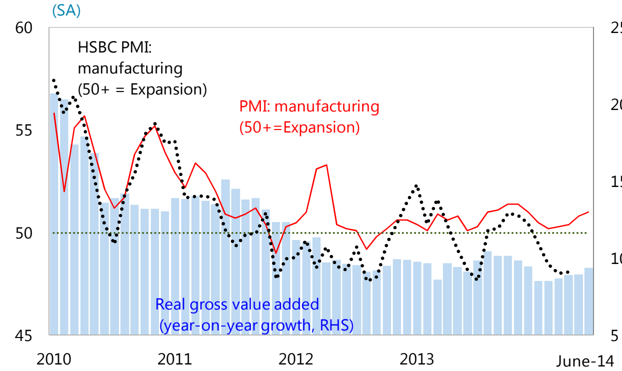
2. Real GDP growth was 7.5 percent (y/y) in the second quarter, up slightly from 7.4 percent in Q1 and broadly in line with staff's forecast. The contribution to growth from net exports turned positive reflecting improving demand from U.S. and European markets. Investment also rose in Q2, from a weak first quarter, similar to the pattern of recent years. Overall, growth in 2014 is on track toward the authorities target of 'around 7½ percent', and staff's growth forecast remains unchanged at 7.4 percent

Contribution to GDP Growth
(In percent, year-on-year)



Sources: CEIC; and IMF staff calculations.

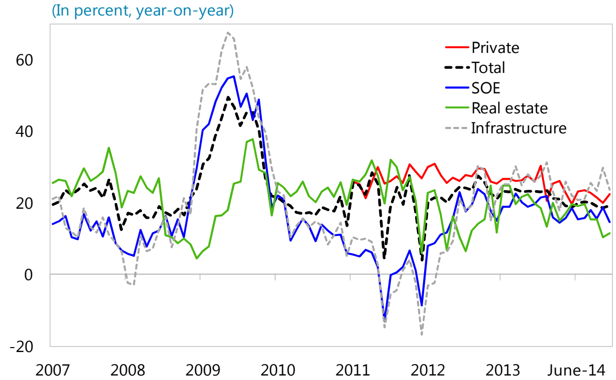
China: PMI and GVA
(SA)



Sources: CEIC; Haver Analytics; and IMF staff calculations.

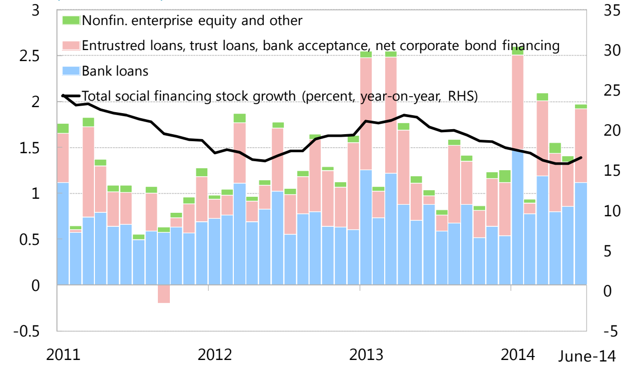
3. Many high-frequency indicators point to a pickup in growth momentum in May-June, although the property sector is still facing headwinds. Growth in value added of industry ticked up in June, and that of fixed asset investment stabilized after declining steadily since last year. Retail sales growth held up above 10 percent (y/y) and imports rose by 5½ percent, indicative of stabilizing domestic demand; exports increased by 7 percent, after much weaker figures in early 2014. After decelerating for more than a year, overall credit growth ('total social financing') increased in June, reflecting growth in both on-balance sheet bank loans and 'shadow banking' activities. Growth in housing starts and sales, however, remained negative, housing prices showed second straight decline for the first time since early 2012, and housing investment growth is down sharply from last year.

Real FAI Growth
(In percent, year-on-year)



Sources: CEIC; and IMF staff calculations.

Social Financing Flow
(In RMB trillion)



Sources: CEIC; and IMF staff calculations.

4. Consumer price inflation (CPI) moderated to 2.3 percent in June (2.5 percent in May), reflecting slowing food price increases, while nonfood inflation has been stable. Producer prices (PPI) continued to decline, but at a slower pace than before (1.1 percent, from 2.3 percent in March).

Press Release No. 14/369
FOR IMMEDIATE RELEASE
July 30, 2014

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2014 Article IV Consultation with the People's Republic of China

On July 25, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the People's Republic of China.

China's economy is expected to grow at around 7½ percent this year. Domestic demand has been moderating, reflecting slower investment and rising risks of a deeper adjustment in real estate activity. However, measures taken by the authorities to support growth are expected to bring it in line with the annual target of around 7½ percent. Consumption and the labor market are holding up well, and the global recovery is expected to support activity going forward. Inflation is forecast to remain below 3 percent.

Fiscal policy has been accommodative, with stimulus mainly through off-budget spending at the local-government level. As of end-2013, general government debt is estimated to have risen to close to 40 percent of GDP. Although credit growth is still rapid, it has decelerated considerably. Growth in total social financing—a broad measure of funding to the private sector—decelerated from 22 percent in May 2013 to 16 percent in May 2014. This coincided with a series of steps to strengthen regulation and supervision—especially relating to shadow banking—and a rise in interbank interest rates in the second half of last year, although much of it was subsequently unwound earlier this year.

External imbalances have fallen, with the current account surplus declining to 1.9 percent of GDP last year. The adjustment reflects the past Real Effective Exchange Rate (REER) appreciation, weak global demand, worsening of terms of trade, and strong domestic investment. On domestic rebalancing, while investment was the largest contributor to growth in 2013, consumption growth has been robust, urban household income has been growing faster than GDP, and the share of services in output and employment has been rising.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors noted that heavy reliance on capital spending and credit has sustained rapid growth, helped reduce external imbalances, and provided a welcome lift to the global economy. However, declining efficiency of investment, a significant buildup of debt, income inequality and environmental costs are threatening growth prospects. The challenge is to shift gears, reduce the vulnerabilities that have built up, and transition to a more sustainable growth path. In this regard, Directors welcomed China's Third-Plenum reform blueprint and agreed that the implementation of these reforms will help China achieve more balanced and inclusive growth.

Directors underscored the importance of strengthening the financial sector to safeguard stability and improve the allocation of credit. Key reforms include further strengthening regulation and supervision, freeing up bank deposit interest rates, increasing reliance on interest rates as an instrument of monetary policy, and eliminating implicit guarantees across the financial and corporate landscape. Directors also emphasized the need to reform state-owned enterprises with the aim of leveling the playing field between the private and public sectors. This can be achieved by opening up more sectors—particularly services—to competition, improving resource allocation and financing, increasing dividend payments to the budget, and hardening budget constraints.

Directors agreed that fiscal and social security reforms are needed to strengthen public finances, boost consumption, and foster more inclusive growth. Key reforms include reordering local government finances by better aligning local revenues with expenditure responsibilities and strengthening the management of local government borrowing; reducing social security contributions; and continuing to improve pension and health benefits. To ensure the sustainability of public finances, this should be combined with reforms to the social security system, shifting the legacy and welfare parts of pensions to the budget, improvements in the tax system, and cuts to lower-priority spending.

Directors considered that demand management should focus on reducing vulnerabilities while preventing growth from slowing too much. In particular, cutting off-budget spending, further reining in credit expansion, and containing investment growth would help mitigate risks, but would also affect growth. Nevertheless, Directors agreed that vulnerabilities have risen to the point that containing them is a priority and broad-based stimulus should only be deployed if growth risks slowing significantly below the authorities' target. If such stimulus becomes necessary, it should be applied through fiscal policy, on-budget, with measures aimed at protecting the vulnerable and advancing reforms. Regarding the growth target for 2015, while most Directors concurred that a range of 6½ to 7 percent would be consistent with the goal of transitioning to a safer and more sustainable growth path, a few other Directors considered a lower target more appropriate.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Taking note of the staff's assessment that the renminbi remains moderately undervalued, Directors agreed that a successful implementation of the reform blueprint will support continued domestic and external rebalancing. Directors supported the authorities' policy of moving toward a more flexible, market-determined exchange rate, with no sustained, large, and asymmetric intervention, which will allow greater degrees of freedom to monetary policy.

Directors welcomed the authorities' efforts to enhance data quality and encouraged them to make further progress in this area, including by subscribing to the Special Data Dissemination Standard (SDDS).

China: Selected Economic Indicators

	2009	2010	2011	2012	2013	2014	2015
						Projection	
	(In percent, year-on-year growth, unless otherwise noted)						
National accounts and employment							
Real GDP	9.2	10.4	9.3	7.7	7.7	7.4	7.1
Total domestic demand	13.9	10.5	10.2	8.2	8.3	7.6	7.0
Consumption	9.4	9.2	10.9	8.6	7.9	7.5	7.1
Investment	19.2	12.0	9.5	7.7	8.8	7.7	6.9
Fixed	22.6	11.5	9.1	9.1	9.2	8.1	7.2
Inventories 1/	-0.7	0.5	0.4	-0.4	0.0	0.0	0.0
Net exports 1/	-3.4	0.4	-0.4	-0.2	-0.3	0.0	0.3
Consumer prices							
End of period	1.9	4.6	4.1	2.5	2.5	1.9	2.5
Average	-0.7	3.3	5.4	2.6	2.6	2.0	2.5
Unemployment rate (annual average)	4.3	4.1	4.1	4.1	4.1	4.1	4.1
	(In percent of GDP) 2/						
External debt and balance of payments							
Current account	4.8	4.0	1.9	2.6	1.9	1.8	2.0
Trade balance	4.9	4.3	3.3	3.8	3.8	3.8	3.9
Exports of goods	23.6	26.6	26.0	24.5	23.4	22.7	22.1
Imports of goods	18.7	22.3	22.7	20.7	19.6	18.8	18.1
Gross external debt	8.4	9.2	9.5	8.8	9.1	9.7	10.2
Saving and investment							
Gross domestic investment	47.2	48.1	48.3	47.7	47.8	47.7	47.4
National saving	51.9	52.1	50.2	50.3	49.7	49.5	49.4
Public sector finance							
General government debt 3/	35.8	36.6	36.5	37.4	39.4	40.8	41.9
General government net lending/borrowing 4/	-1.8	-1.2	0.6	0.2	-0.9	-1.0	-0.8
	(In percent, year-on-year growth)						
Real effective exchange rate							
Annual average	3.4	-0.4	2.7	5.2	6.2	...	...
End of period	-5.0	5.3	5.9	0.7	8.2	...	...

Sources: CEIC Data Co., Ltd.; IMF, Information Notice System; and IMF staff estimates and projections.

1/ Contribution to annual growth in percent.

2/ Expenditure-based nominal GDP is used throughout in calculations of shares.

3/ Staff estimates based on the National Audit Office definition of government debt, excluding central government debt issued by China Railway Corporation.

4/ Adjustments are made to the authorities' fiscal budgetary balances to reflect consolidated general government balance, including government-managed funds, state-administered SOE funds, adjustment to the stabilization fund, and social security fund.

Statement by Tao Zhang
Executive Director for the People's Republic of China
July 25, 2014

On behalf of my authorities, I would like to thank staff for their candid and thoughtful dialogue held during the Article IV mission. I would also like to express my authorities' appreciation of this annual consultation with the Fund, which has been helpful in promoting a deeper understanding of the issues facing the Chinese economy.

Notwithstanding strong external and domestic headwinds, the Chinese economy continued to register solid growth, healthy labor market conditions, and subdued inflationary pressure, thanks to the support of a stable monetary environment and the targeted easing measures implemented. The banking sector also remains in good shape, and the financial supervisory and regulatory framework—including oversight of off-balance sheet and interbank and nonbank financing—has been strengthened further to ward off potential risks. Meanwhile, fiscal indebtedness remains at a moderate level, with local fiscal disciplines tightened, while differentiated policies, such as the housing mortgage policy, are enforced to safeguard the stability of the real estate market. Overall, the Chinese economy is on track to meet the 7.5 percent growth target this year, and my authorities will continue to implement macroeconomic policies in a forward-looking, targeted, and coordinated manner to maintain macroeconomic and financial stability.

At the same time, the Chinese economy continues to make progress on its structural adjustment and reform agenda. Manifesting a rebalancing in the economy, the role of private consumption and the tertiary sector in the economy continued to strengthen, while the current account surplus remained subdued. Meanwhile, notable progress has been made in deepening reforms along the lines of the Third Plenum reform blueprint, so as to give the market a decisive role in resource allocation. By striking a fine balance between stabilizing growth, on one hand, and adjusting the economic structure and promoting reforms, on the other, my authorities are confident that the Chinese economy will be able to settle on a more sustainable and balanced growth path, thus continuing to contribute to regional as well as global economic and financial stability.

Recent economic developments

The macroeconomic environment remains stable. After experiencing some moderation amidst the uncertain external environment, economic activities have stabilized recently on the back of targeted supportive measures. In particular, real GDP growth picked up to 7.5 percent in Q2 from 7.4 percent in Q1, while growth in retail sales, industrial value-added, and infrastructure investment strengthened respectively to 12.3, 8.9, and 25.7 percent from 12.0, 8.7, and 22.5 percent over the same period. Meanwhile, urban labor conditions continue to hold up well, with demand for labor staying firm and the unemployment rate remaining stable. Looking ahead, the purchasing managers' index, particularly that for the service sector, indicated that the Chinese economy will continue to grow at a stable pace in the near term. That said, my authorities are vigilant to the downward pressures facing the economy, and will stand ready to deploy targeted measures to support growth and the labor market as appropriate.

Inflationary pressures remain mild, with the year-on-year CPI inflation rate moderating to 2.3 percent in the first half of this year from 2.6 percent in 2013. Meanwhile, the producer price inflation rate continued to stay in the negative territory, reflecting stable international commodity prices and overcapacity in certain industries. While inflation has stayed subdued, my authorities are vigilant to the price pressures stemming from agricultural products and rentals, as well as from resource pricing reform. Thus, my authorities will continue to guide inflation expectations so as to stabilize CPI inflation in 2014 at a rate of around 3.5 percent.

Fiscal policy

My authorities maintain a proactive fiscal policy stance in order to promote stable and inclusive growth. Social spending continues to be prioritized, with spending on education, social security employment, medical treatment, and health all registering robust growth in the first half of this year, so as to improve social welfare and sustain the decline in income inequality. For 2014 as a whole, my authorities set the budget deficit at about 2.1 percent of GDP, the same as the actual deficit in 2013, and agree with staff that a major stimulus is not warranted.

Notwithstanding the pickup in local government indebtedness in recent years, my authorities' comprehensive audit indicated that the overall government debt level remained controllable at about 40 percent of GDP in mid-2013. In particular, the debt level remains comparatively moderate, and debts were incurred mainly to support infrastructure and social welfare spending. More importantly, the interest rate-growth differential and the government asset position of China remain very favorable.

In view of the increased prominence of the activities of local government financing vehicles (LGFVs) since the global financial crisis, my authorities have made devoted efforts in publishing comprehensive data on local government indebtedness consistent with international standards. Meanwhile, staff's augmented estimates are subject to a high degree of imprecision, as staff had made many simplifying assumptions—such as the inclusion of debt obligations of LGFV for commercially viable ventures, which are neither part of government debt nor contingent liabilities, into the estimates—so as to compile a time series of local government finance. Thus, staff's augmented estimates cannot reflect accurately the latest fiscal position and stance of China, and could pose the risk of market misperceptions.

Having said all that, my authorities agree that local fiscal disciplines have to be tightened, and have implemented a wide range of measures to improve the transparency and the sustainability of local indebtedness, including: (1) changing the performance assessment criteria of local governments; (2) enhancing private sector participation in infrastructure investment; (3) incorporating local government debt in the budgetary process; and (4) implementing a trial program to allow 10 local governments to issue their own bonds.

Going forward, my authorities will endeavor to establish an early warning system and adopt a medium-term fiscal plan, in order to strengthen fiscal management. My authorities will also continue to pursue fiscal reform in accordance with the Third Plenum blueprint, including better aligning responsibilities between the central and local governments, and undertaking tax reform. In this regard, my authorities aim to complete the value-added tax reform by the end of 2015, and will steadily push forward reforms in other areas of taxation.

Monetary policy

Monetary conditions remain stable under a prudent monetary policy stance, with growth in M2 and RMB loans fluctuating at around 14.0 percent for most of the time since December 2013. With strong policy efforts on improving the credit structure and achieving social and development objectives, growth in lending to the rural sector and small and micro enterprises both outpaced that of total lending, whereas growth in medium- and long-term lending to industries with overcapacity declined. Meanwhile, the share of bank loan, bond, and equity financing in total social financing has picked up, while interbank liquidity conditions have remained largely stable, thanks to continued policy efforts on promoting direct financing, tightening supervision of nonbank and interbank financings, and strengthening liquidity management.

With strong determination to maintain a stable monetary and financial environment, my authorities will continue to adjust credit and macroprudential policies to ensure reasonable growth in money, credit, and social financing. In this regard, my authorities will recalibrate the housing mortgage policy and other prudential measures as necessary which, together with the ongoing urbanization and hukou reform, should help facilitate an orderly adjustment in the real estate market. Meanwhile, my authorities will continue to monitor liquidity conditions closely and conduct liquidity operations as needed, so as to maintain an appropriate level of liquidity.

While maintaining stable monetary conditions, my authorities continue to push forward market-based interest rate reform. Lending rates are now fully liberalized, while caps on small amount foreign currency deposit rates have recently been lifted in Shanghai, marking another step in deposit rate liberalization. A self-regulatory pricing mechanism was established to ensure discipline in pricing market interest rates, while the loan prime rate centralized quote and release mechanism and the issuance and trading of interbank certificates of deposit were launched to provide market-based references for pricing credit products and Shibor rates. My authorities will build on the progress achieved to set up an effective market interest rate system and improve the monetary policy framework and its transmission mechanisms.

Financial sector

The banking sector continues to perform well, registering sound capital level, stable return, subdued nonperforming loan ratio, strong loan-loss provisioning, and—according to the latest stress-testing results conducted by the CBRC—high resilience to adverse credit and macroeconomic shocks. Meanwhile, regulatory prudence has been exercised to ensure reasonable growth in nonbank financing to enhance market-based financial intermediation. In this connection, my authorities would like to point out that staff's assessment of shadow banking has relied on the definition used by some market analysts, which is too broad and is not consistent with the Financial Stability Board's definition. Much of the shadow banking activities, as analyzed by staff, involves little leverage and is placed under close supervision.

While the financial sector remains firm, my authorities continue to act preemptively to safeguard financial stability. In this regard, a joint ministerial conference on financial regulatory coordination was set up to provide a regular rule-based platform to promote coordination, while new rules were issued to further tighten oversight of trust, wealth management products, and interbank business. Credit risks of lending to local government financing platforms, the real estate sector, and the overcapacity industry have also been monitored closely.

At the same time, my authorities continue to make progress on aligning the regulatory framework with international standards. For instance, the overall capital regulatory regime was assessed by the Basel Committee to be compliant with the Basel III capital requirements, while the disclosure requirements for systemically important banks were enhanced. Financial reforms also continue to proceed, as manifested by the proposed establishment of five privately-owned banks to facilitate innovation and competition, and the permission to issue preferred stocks by eligible listed and nonlisted companies to promote direct financing.

Going forward, my authorities will endeavor to establish a crisis management and resolution framework, including setting up a deposit insurance scheme. These, coupled with the interest rate reform and ongoing efforts to reduce moral hazard and implicit guarantees of financial products, will help shift activity back to banks' balance sheets and safeguard financial stability. My authorities will also strengthen the oversight of internet financing to ensure that the industry develops in a healthy and sustainable way to promote financial inclusion and innovation. Meanwhile, my authorities will continue the reform in financial institutions (i.e., commercial banks, policy banks, and asset management companies), while promoting capital market development under the guidelines released in May—including the registration reform of the new share offering system—so as to enhance the role of the market in allocating financial resources, thus better serving the real economy.

External sector

The current account surplus narrowed further from 2.6 percent in 2012 to 2.0 percent of GDP in

2013, and further to 0.3 percent of GDP in the first quarter of this year, as structural changes continue to proceed. Thanks to strong income growth, service imports continued to grow at a vibrant pace, dragging the service trade balance alongside. Growth in good exports did not register the same degree of resilience as growth in goods imports, in part reflecting the increasing share of final consumption goods in total goods imports. Meanwhile, the RMB exchange rate has become increasingly flexible, as more reform measures are in place. The daily trading band of the RMB/USD exchange rate was widened further in March, leading to more two-way movements as well as more divergent expectations of the rate since then. Banks have also recently been permitted for the first time to set the RMB/USD exchange rate freely in over-the-counter transactions, so as to further strengthen the market-driven nature of the rate. Looking ahead, the current account surplus is expected to remain moderate over the medium term amidst robust income growth and rising demand for services, and my authorities will continue to expedite reform of the exchange rate formation mechanism, in order to allow market forces to play the decisive role in driving the two-way movement in the exchange rate.

Regarding the external sector assessment results, my authorities continue to have strong concerns about the reliability and the soundness of the External Balance Assessment (EBA) methodology, given: (1) the arbitrariness and the lack of transparency in the setting of norms of policy and structural variables; (2) the continued presence of sizable unidentified factors in the estimated current account gaps in many countries; and (3) the inadequate consideration of the global implications of systemic economies' monetary policies. Thus, we urge staff to strengthen their efforts on improving the EBA methodology.

Capital account convertibility and cross-border use of the RMB continue to develop, with investment quotas under the QDII, QFII, and RQFII schemes expanded, rules governing foreign exchange transactions of multinational firms eased, and the Shanghai Pilot Free Trade Zone and the Shanghai–Hong Kong Stock Connectivity Mechanism established. My authorities will accelerate the pace of capital account convertibility while, at the same time, monitoring cross-border capital flows closely against the backdrop of a volatile global monetary environment.

Structural reforms

Reflecting the continuation of structural rebalancing in the Chinese economy, the size of the tertiary industry has exceeded that of the secondary industry since 2013. Meanwhile, labor income growth—including growth in per capita disposable income of urban household, per capita net income of rural household, and average monthly income of migrant workers—has been vibrant. Against such backdrop, the share of private consumption in GDP has continued to pick up over the past few years, with the growth contribution of final consumption expenditure surpassing that of gross capital formation during the first half of this year.

Substantial progress has been made in implementing reforms in other areas covered in the Third Plenum blueprint. Seeing the importance of urbanization and hukou reform in driving growth and promoting welfare, my authorities have set out a comprehensive urbanization plan which aims—in an environmentally and financially sustainable manner—to: (1) boost the urbanization ratios; (2) enhance social benefits, including the coverage of social housing, pension, and health in urban populations; and (3) implement hukou reform with reference to local circumstances. Plans on reforming medical care and integrating rural and urban pension schemes have also been announced. Meanwhile, my authorities have set up plans and measures to reduce energy consumption, carbon dioxide emission, and air pollution, and have amended the Environmental Protection Law in order to safeguard environmental sustainability. On the other hand, the one-child policy was eased in a number of provinces to counter the demographic pressure, while pilot programs of judicial reform—including the establishment of special intellectual property rights courts—have been approved to reform the court system and promote innovation. State-owned enterprise (SOE) reform also proceeds steadily to promote fair competition, with the dividend requirement for SOE enhanced, and some divestments of SOE made. By promoting structural adjustment and pushing forward reforms while—at the same time—supporting growth stability, my authorities are confident that China will transit smoothly to a sustainable, strong, and balanced growth path, thus contributing to regional and global monetary and financial stability.

Finally, my authorities will continue to enhance data standards in China, including revising the methodology of compiling GDP data in accordance with the System of National Accounts 2008, and actively considering the subscription to the Special Data Dissemination Standards and have been working with STA to conduct technical preparation.