International Monetary Fund

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China’s Rebalancing and External Sector Adjustment

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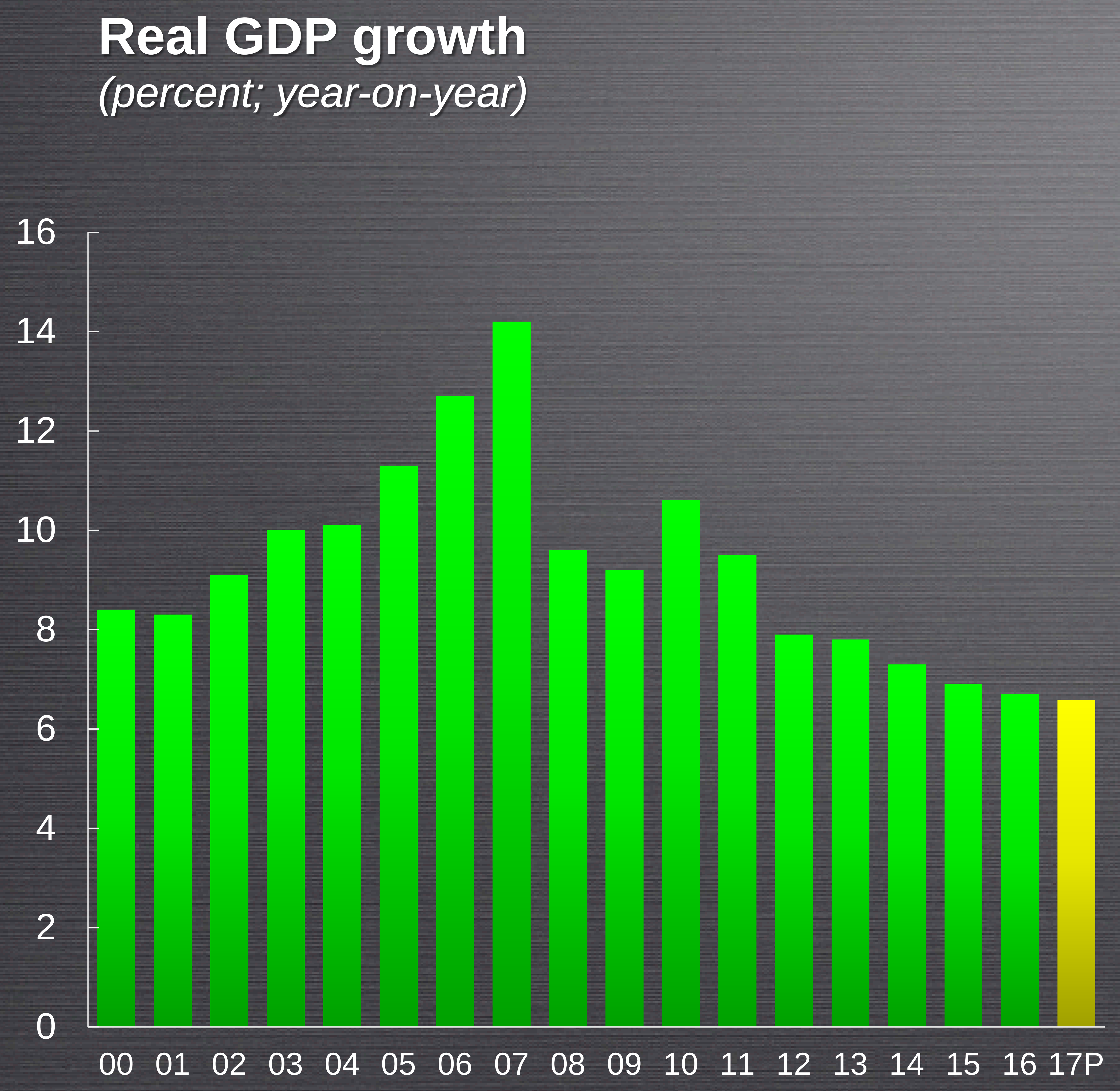
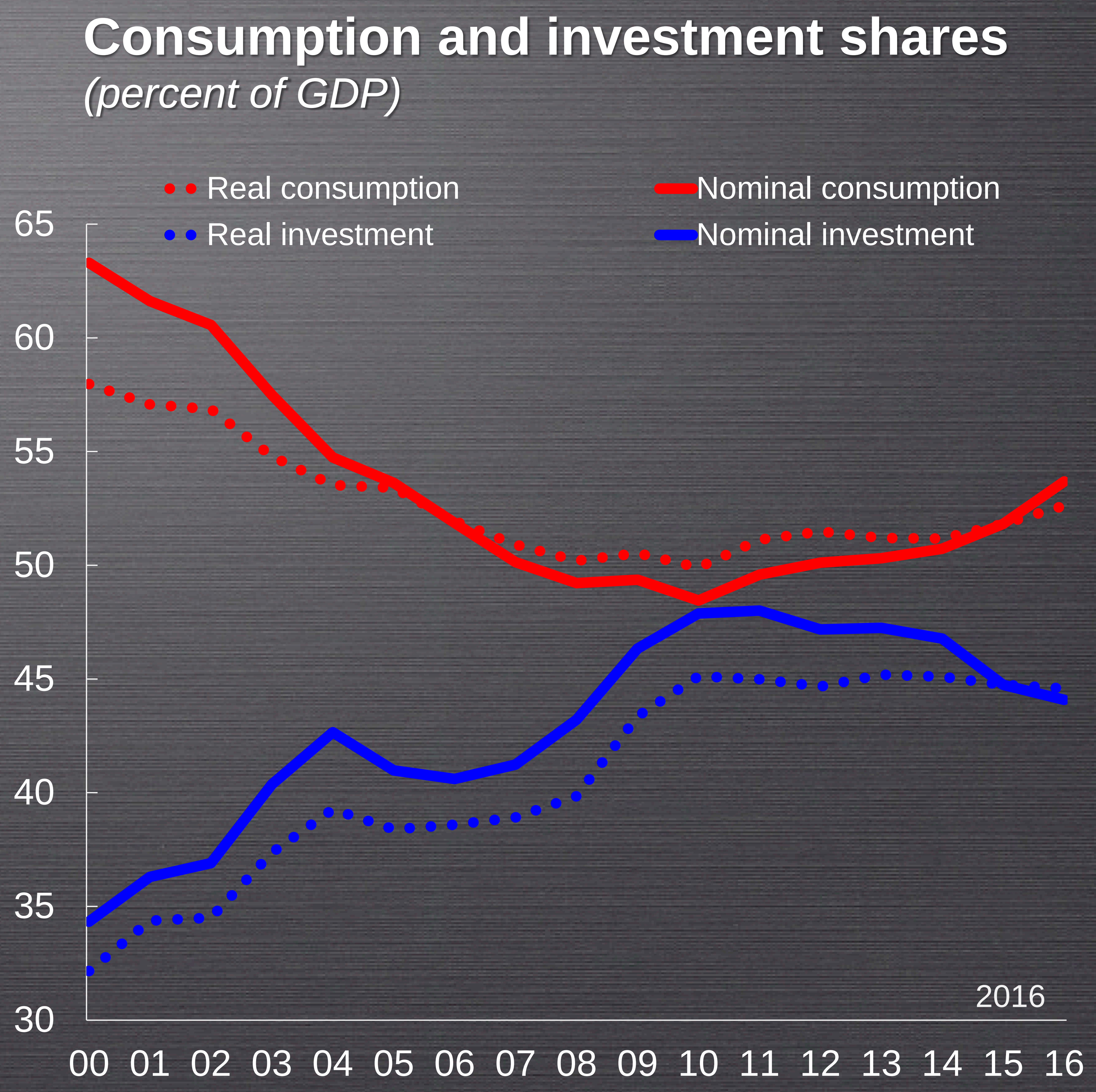
Economic Counsellor

China: Slowing down and rebalancing

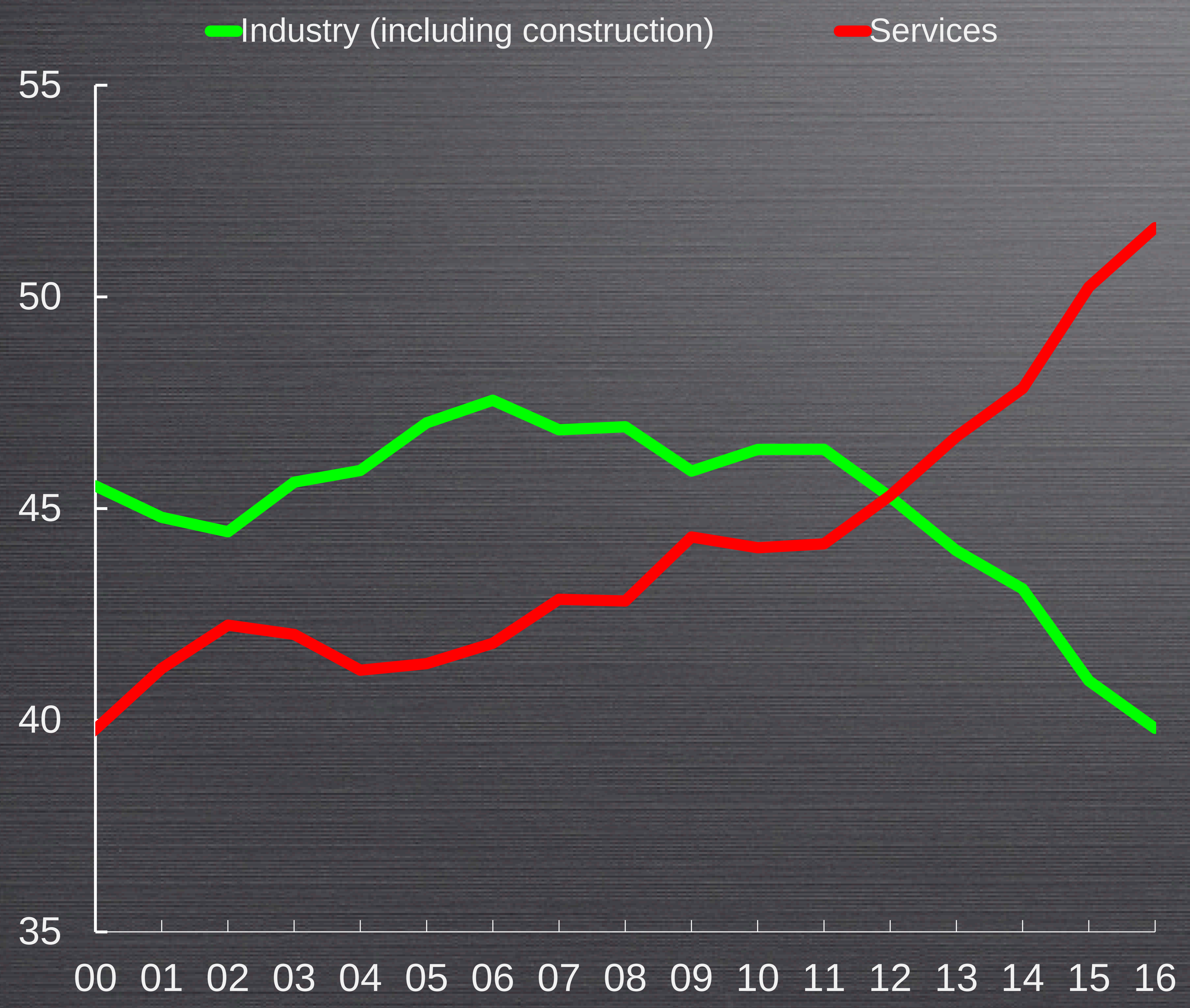




Sources: Haver Analytics, and IMF, *World Economic Outlook*.

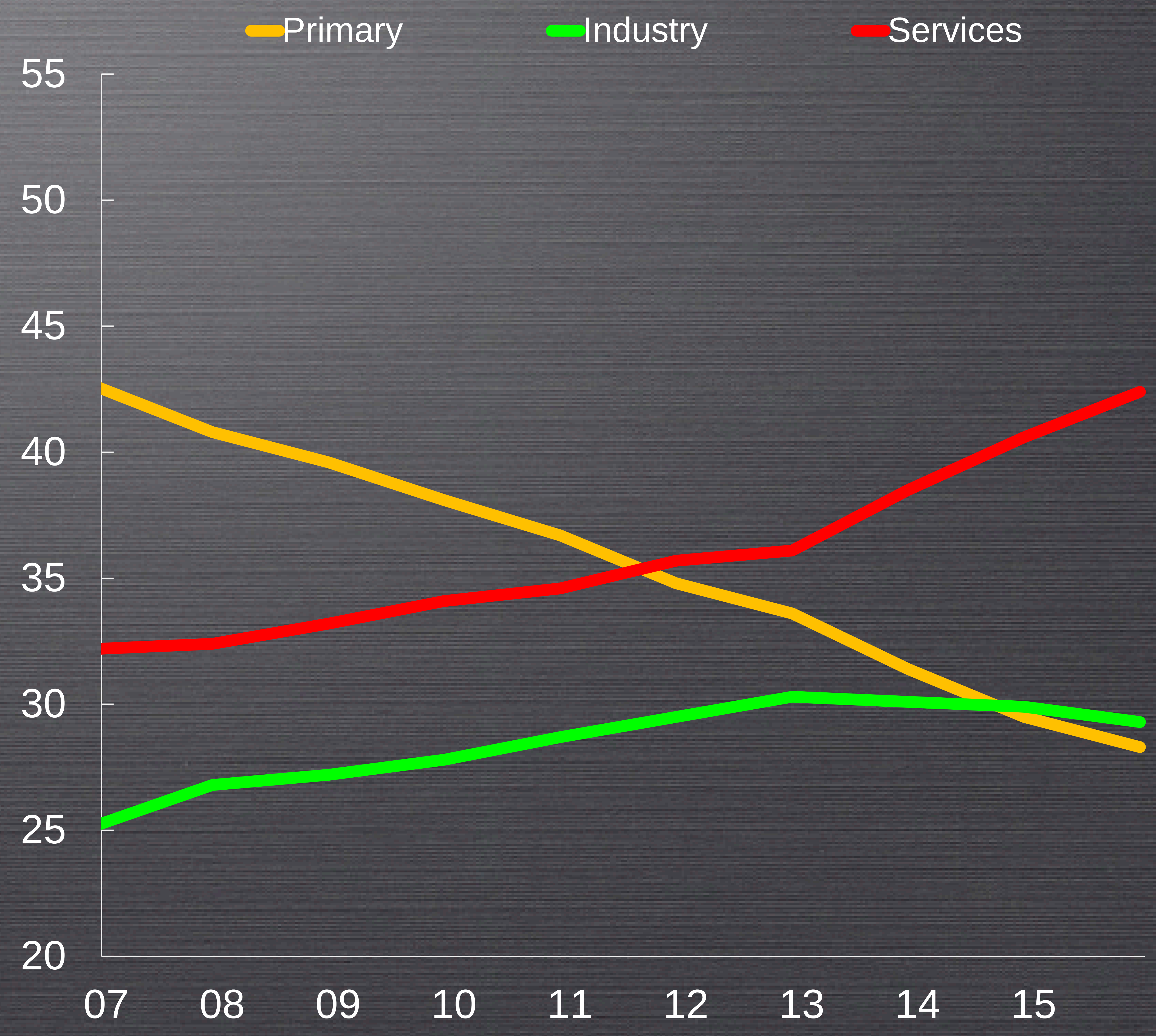
Service sector becoming more important

GDP by Production
(percent of GDP)

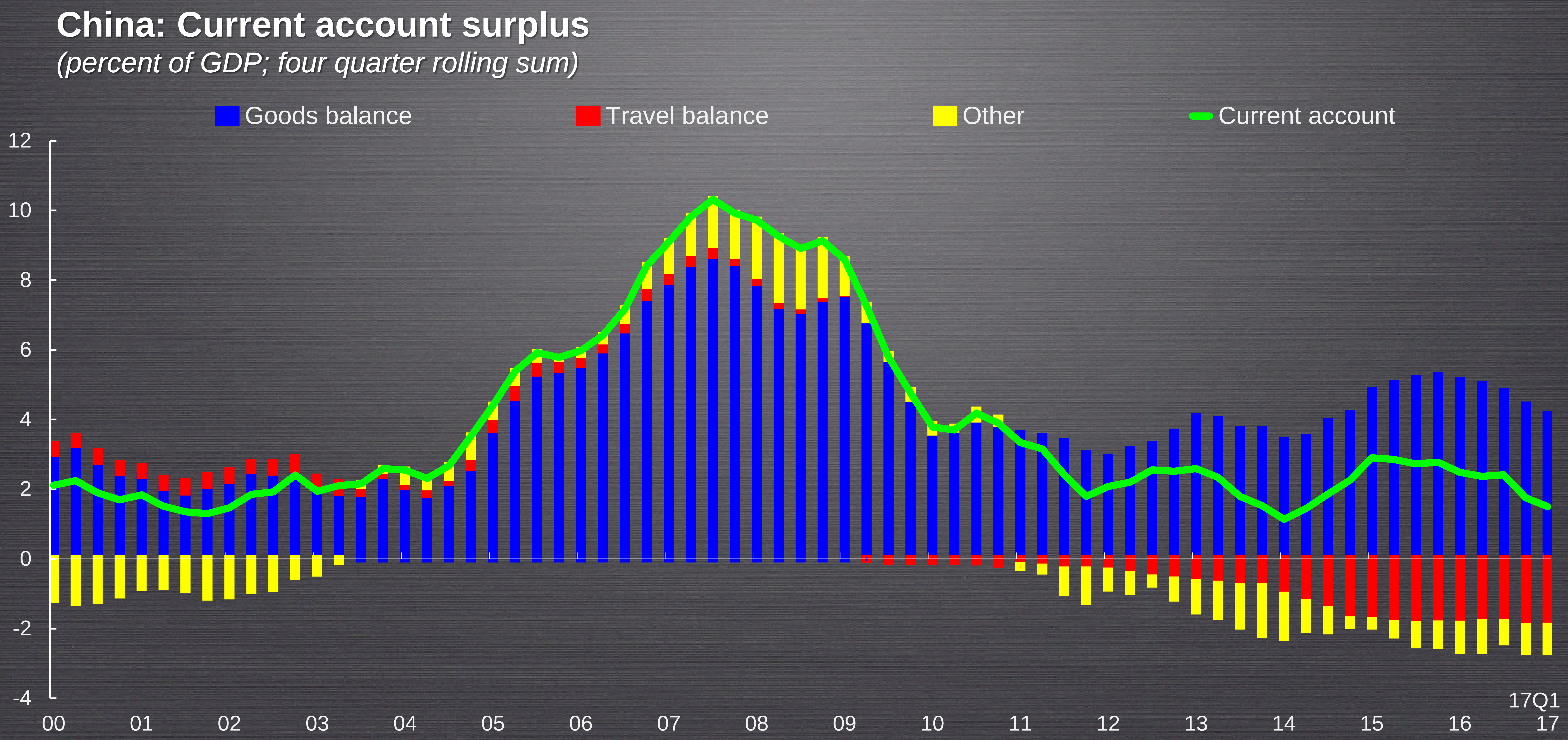


Source: Haver Analytics.

Employment by Sectors
(percent of total employment)



Strong domestic demand has helped reduce external balance



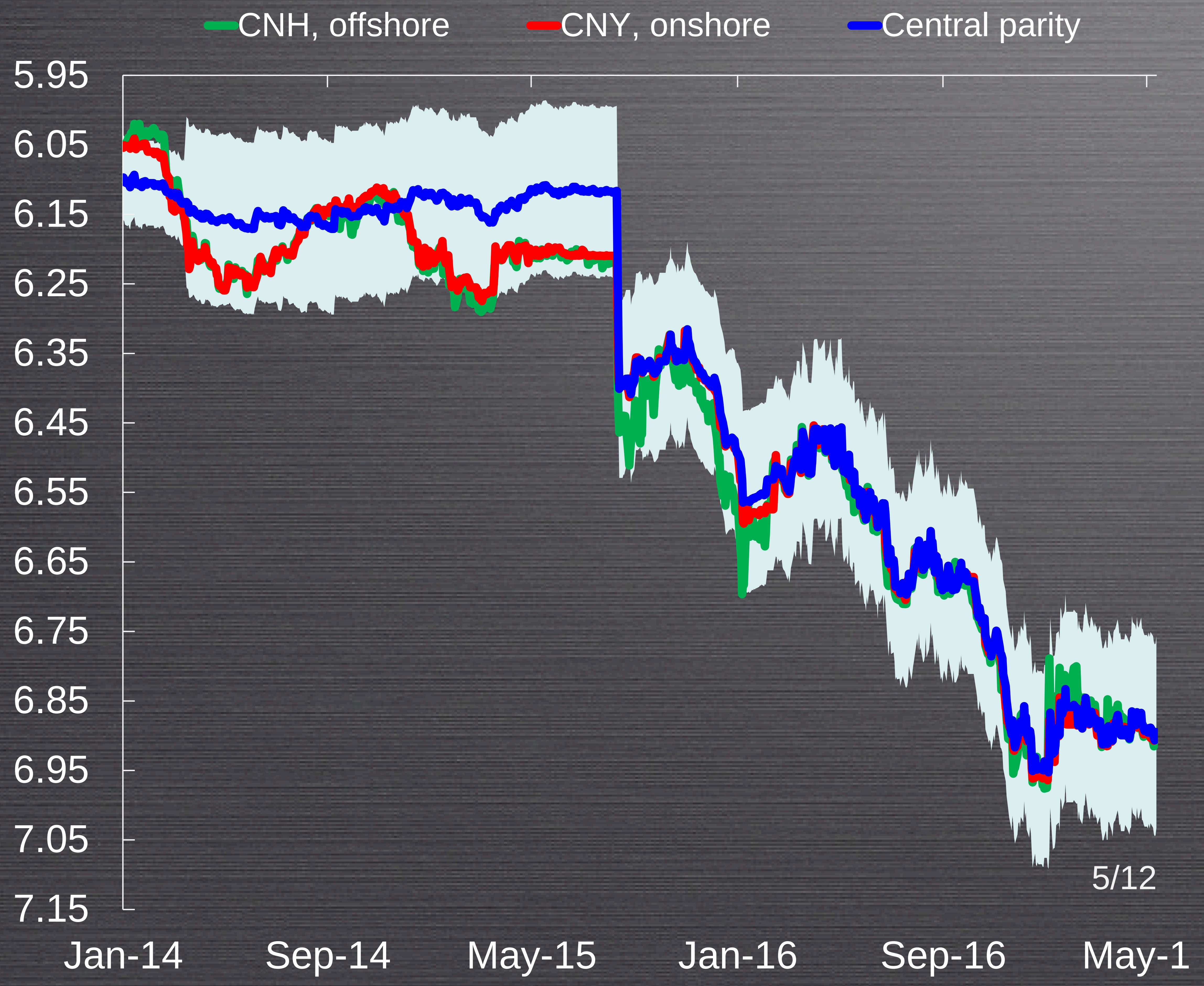
Source: Haver Analytics.

Gradual shift toward greater currency flexibility

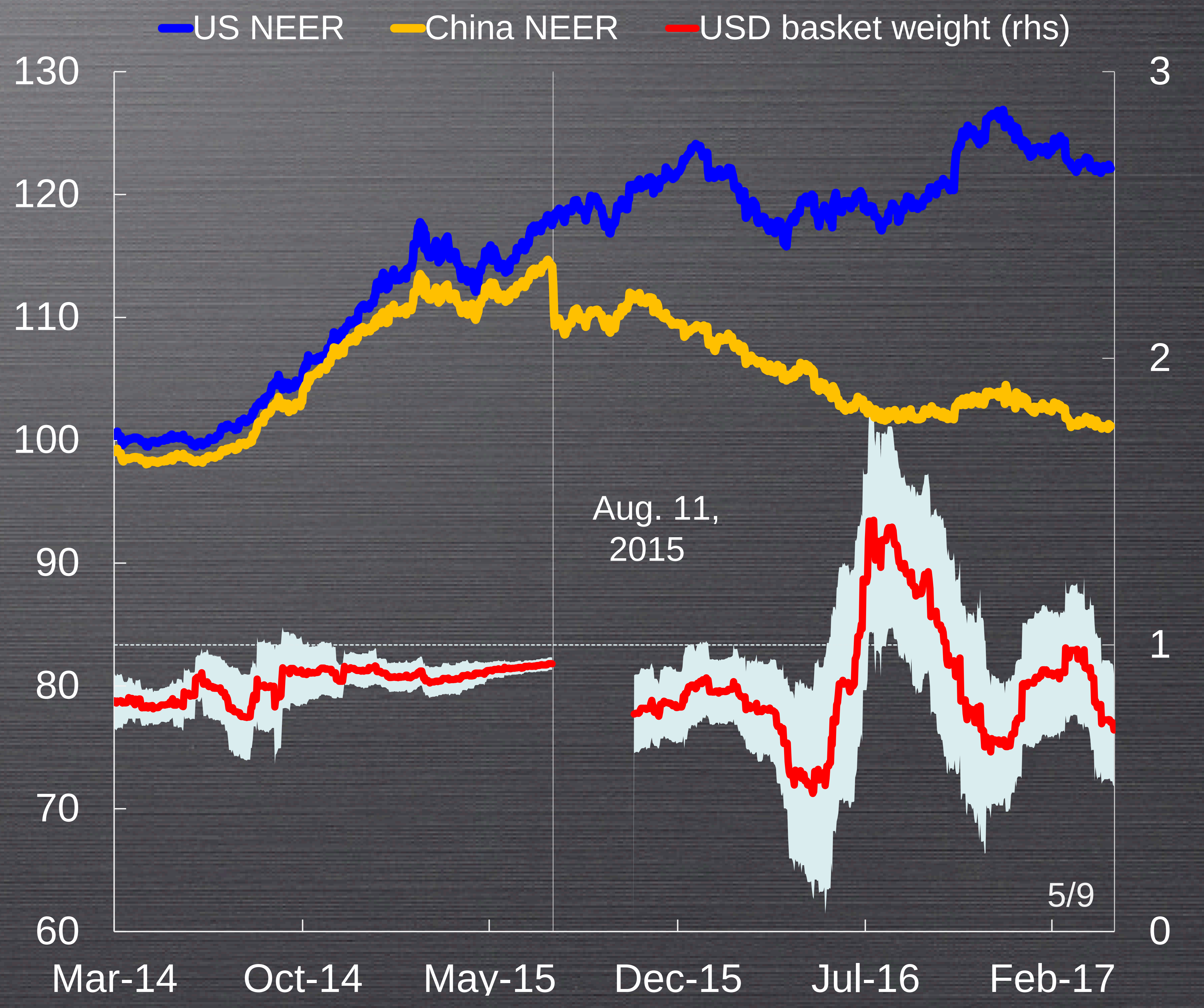
Source: Haver Analytics.

Recent changes in the currency regime

Exchange rate
(China renminbi per U.S. dollar)

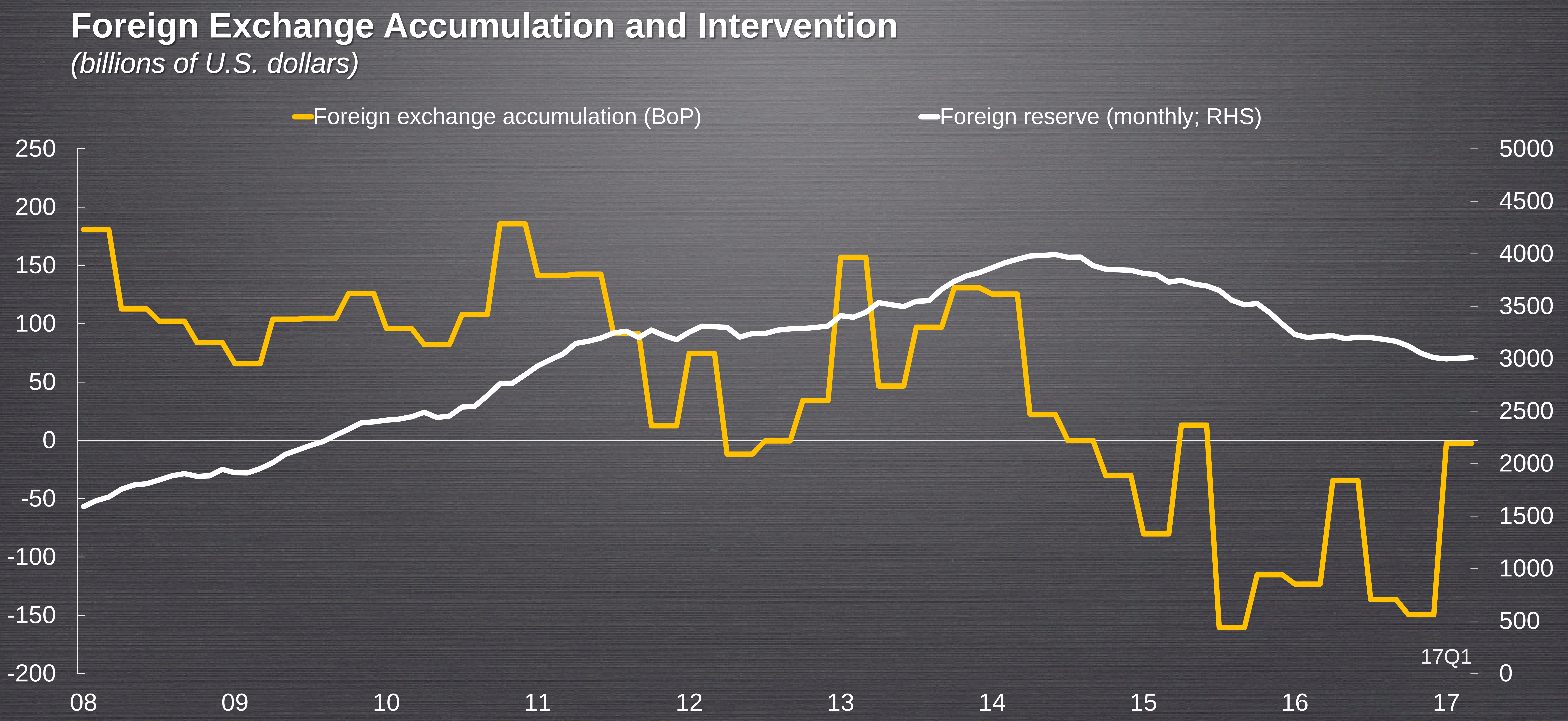


De facto USD weight in RMB basket vs. NEER 1/



Sources: Bloomberg, L.P.; Haver Analytics; IMF, *Global Data Source* ; and IMF staff calculations.
1/ Shaded region corresponds to 95 percent confidence bands around basket-weight estimate.

Reserves have fallen since 2014

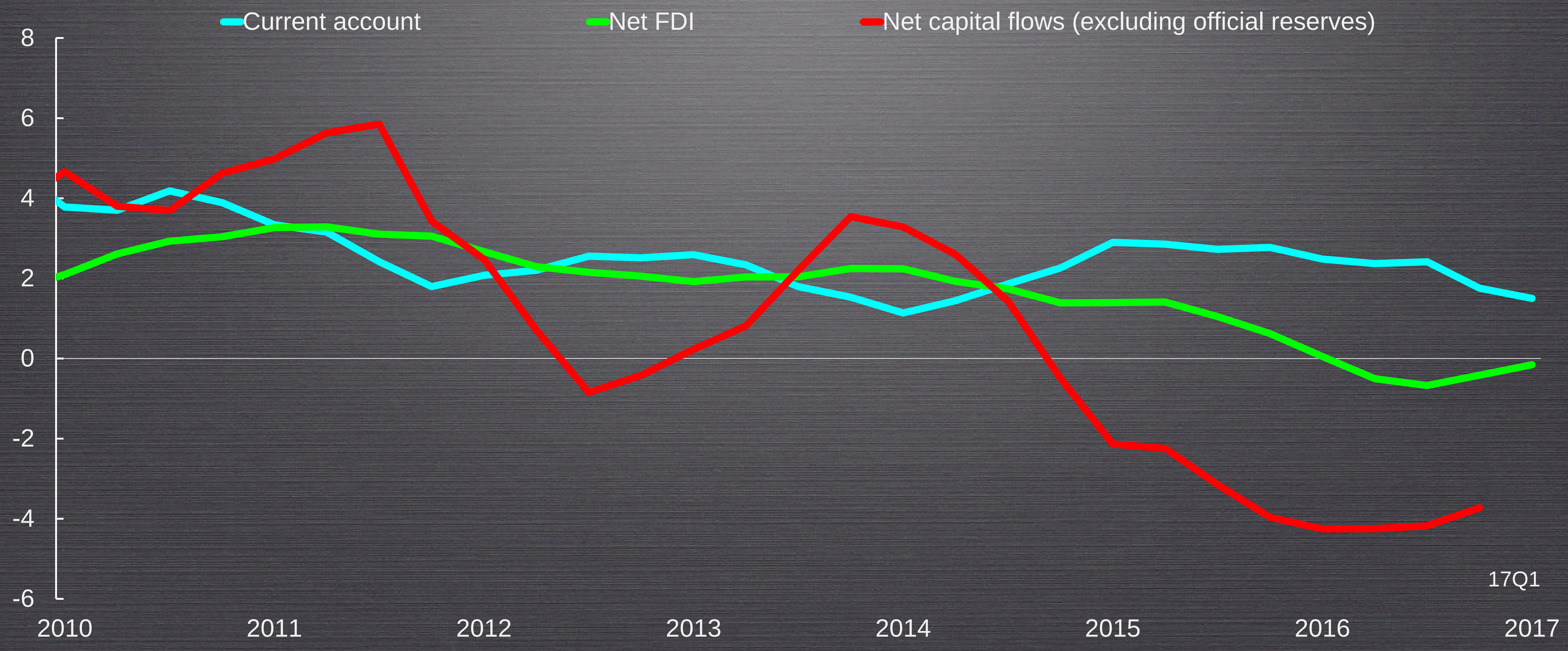


Sources: Bloomberg, L.P.; and CEIC.

Capital flows also play an important role

Record capital outflows

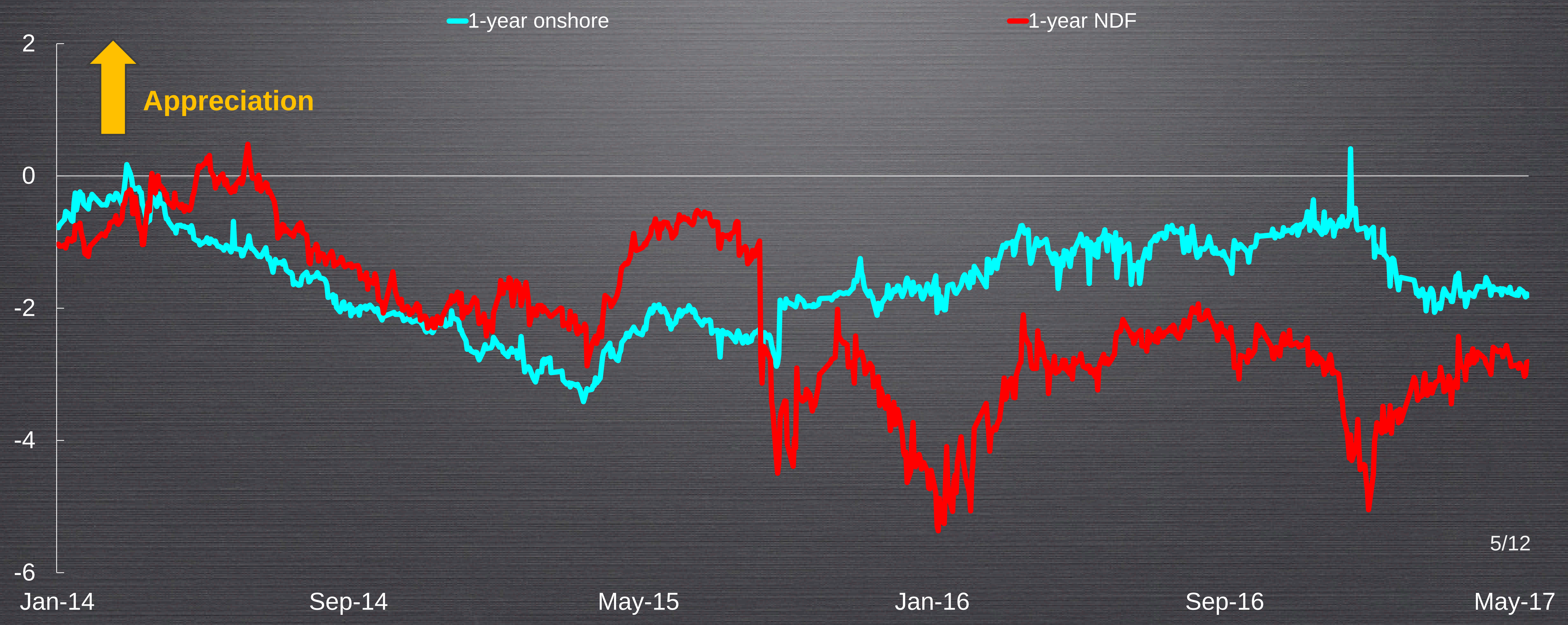
Current and capital account
(percent of GDP, four quarter rolling sum)



Source: Haver Analytics.

Drivers (I): Carry trade inflows stop with depreciation expectations

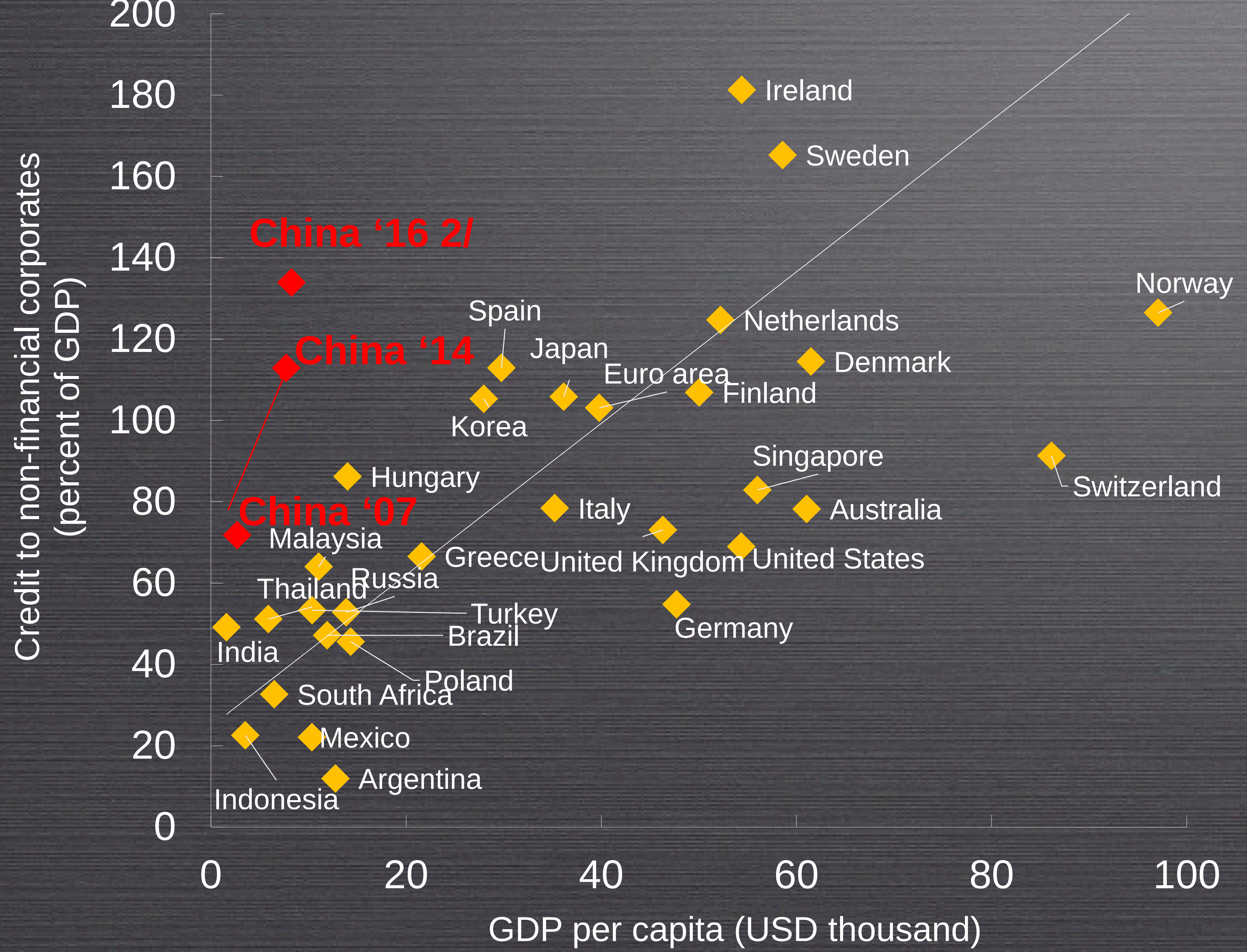
RMB implied 1-year appreciation/depreciation
(percent)



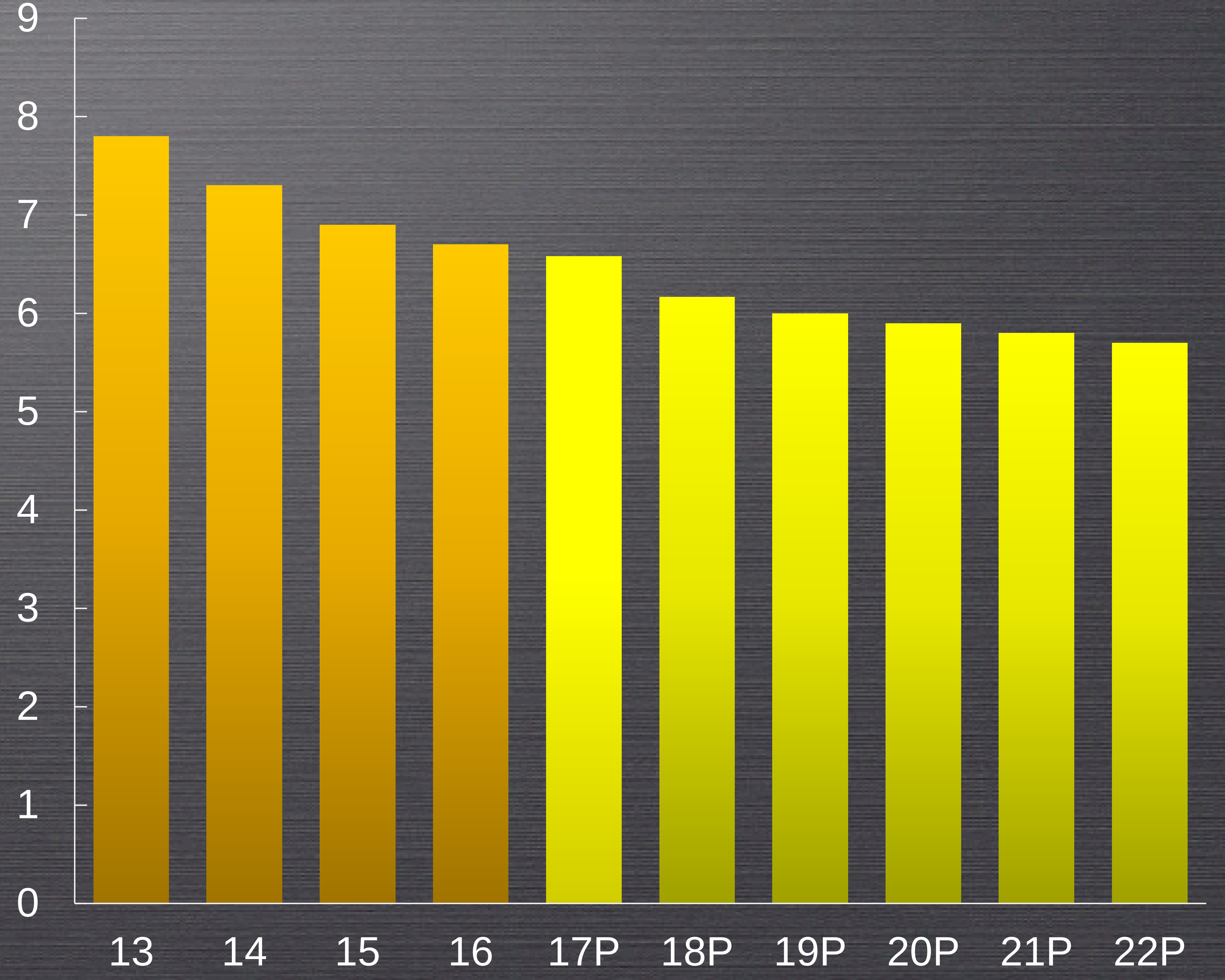
Sources: Bloomberg L.P.; and IMF staff calculations.

Drivers (II): Rising concern about the health of financial sector and slowdown in GDP growth

Corporate credit: High level relative to peers 1/
(selected economies; 2014)



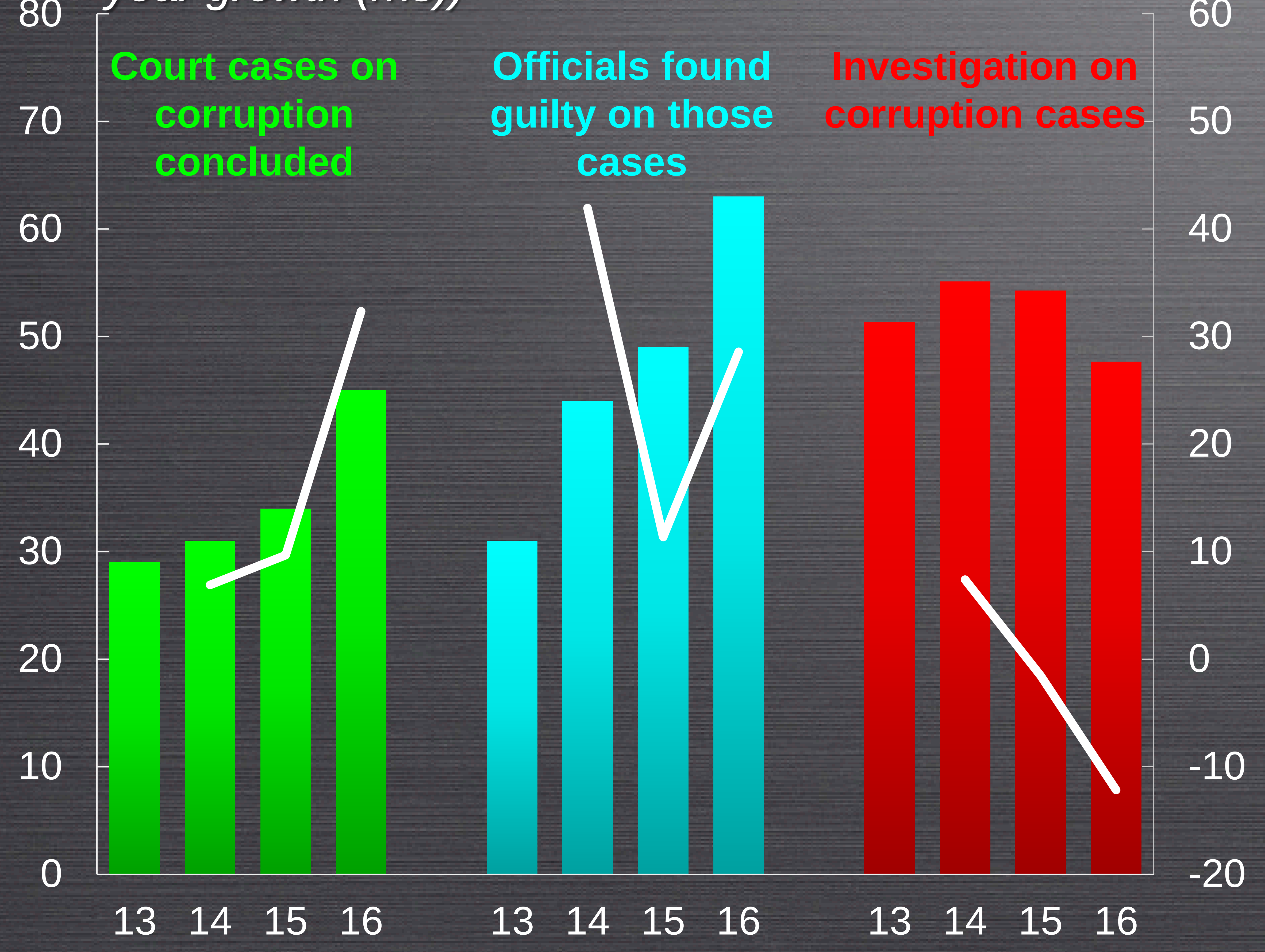
China: Real GDP Growth
(percent, year-on-year)



Source: CEIC Data Company Ltd.; IMF, *World Economic Outlook* and IMF staff estimates
1/ Luxembourg and Hong Kong SAR not shown; these have corporate credit-to-GDP ratios and GDP per capita of (118.2, 413.6) and (40.1, 216.6), respectively.
2/ Calculated as total social financing minus equity, LGFV and household loans.

Drivers (III): Continued anti-corruption campaign and changes in the enforcement of capital controls

Anti-corruption efforts: more court conclusions and less new investigations
(number in thousands (lhs) and in percent year-on-year growth (rhs))

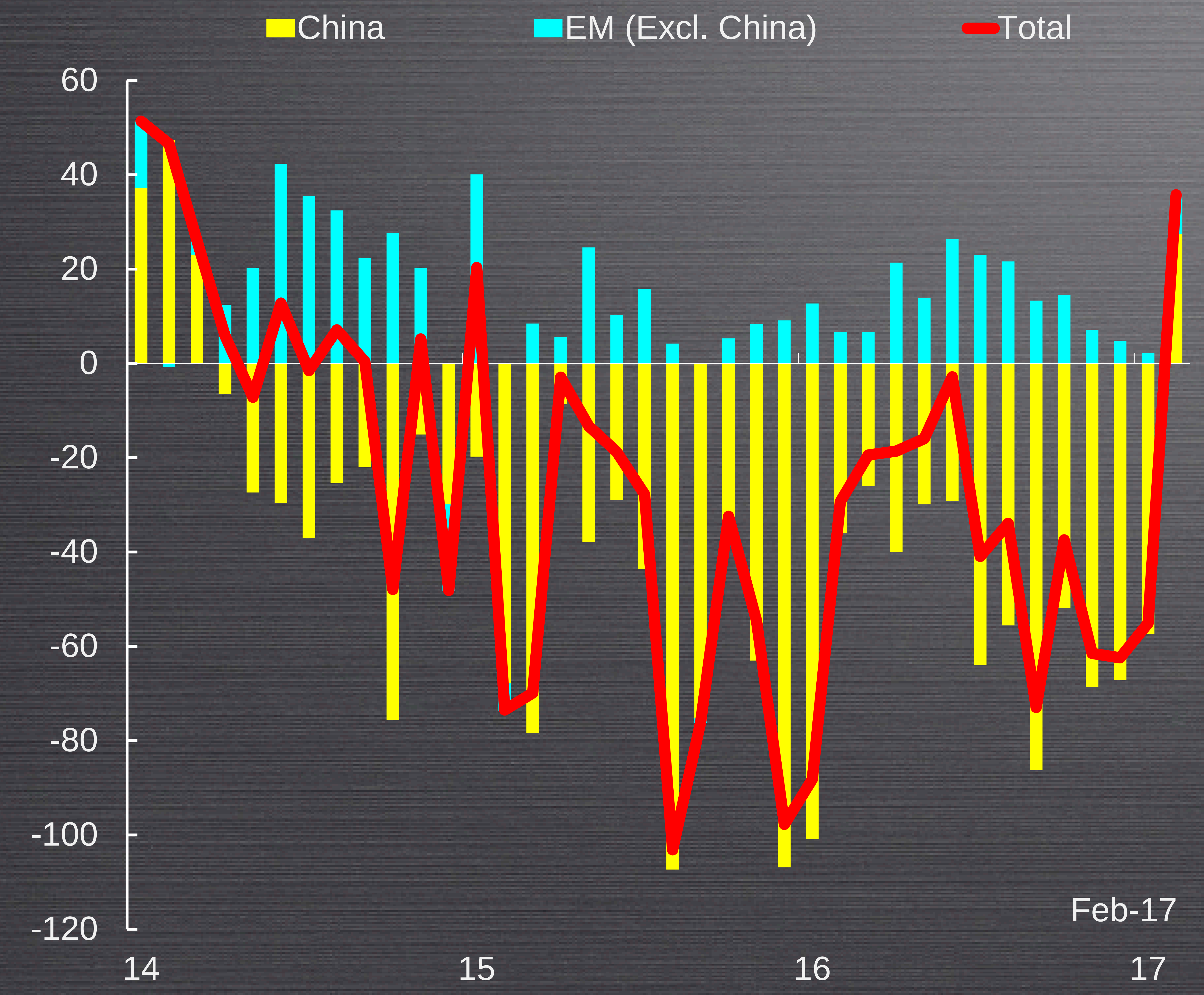


Foreign direct investment
(percent of annual GDP)

Sources: Supreme People's Procuratorate; IMF, Balance of Payments database; and IMF, *World Economic Outlook*.

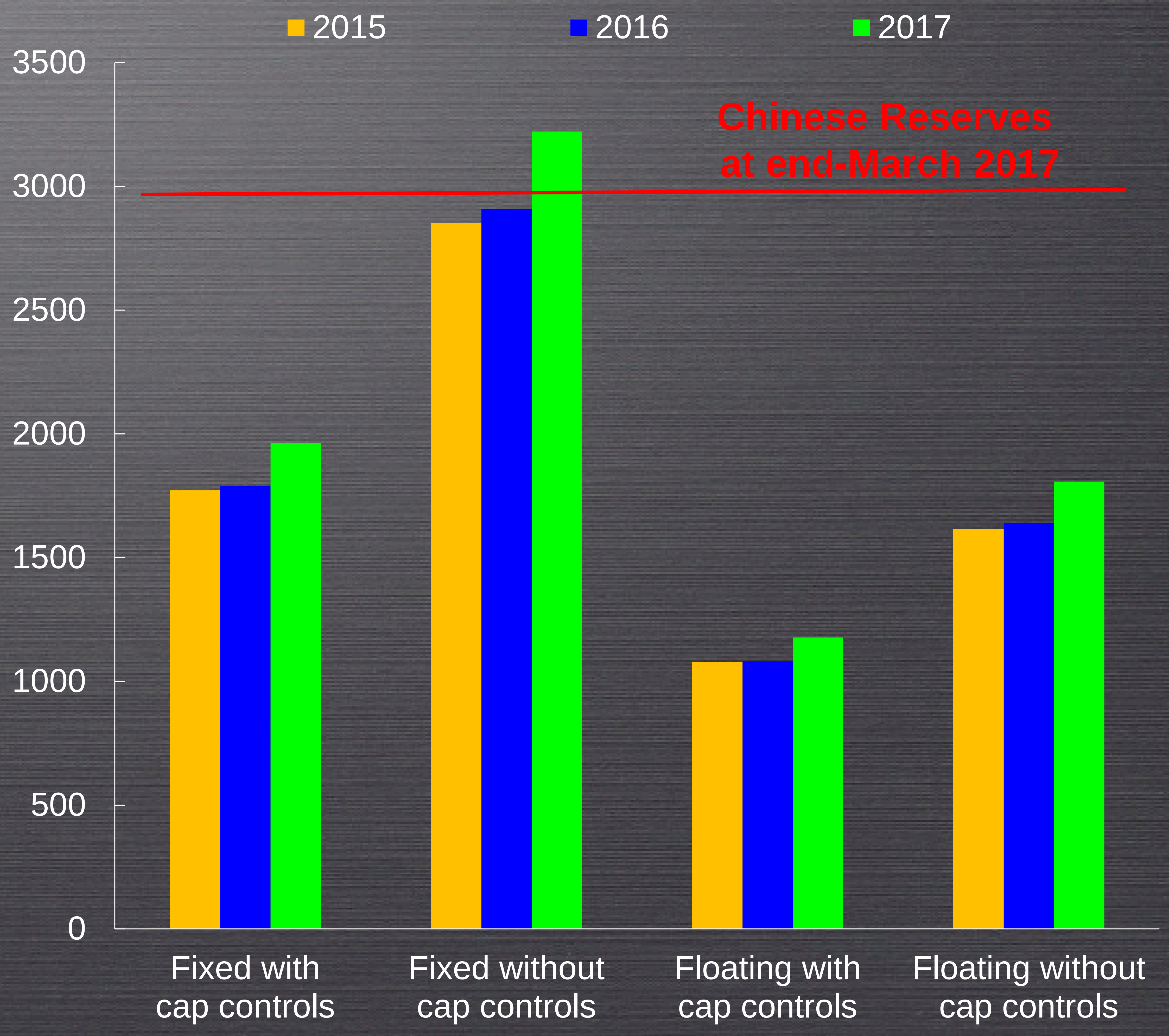
Net inflow reversal and reserves still ample in China

Net capital inflows to EMs
(U.S. billions)



Sources: Haver Analytics, and IMF, *World Economic Outlook.*

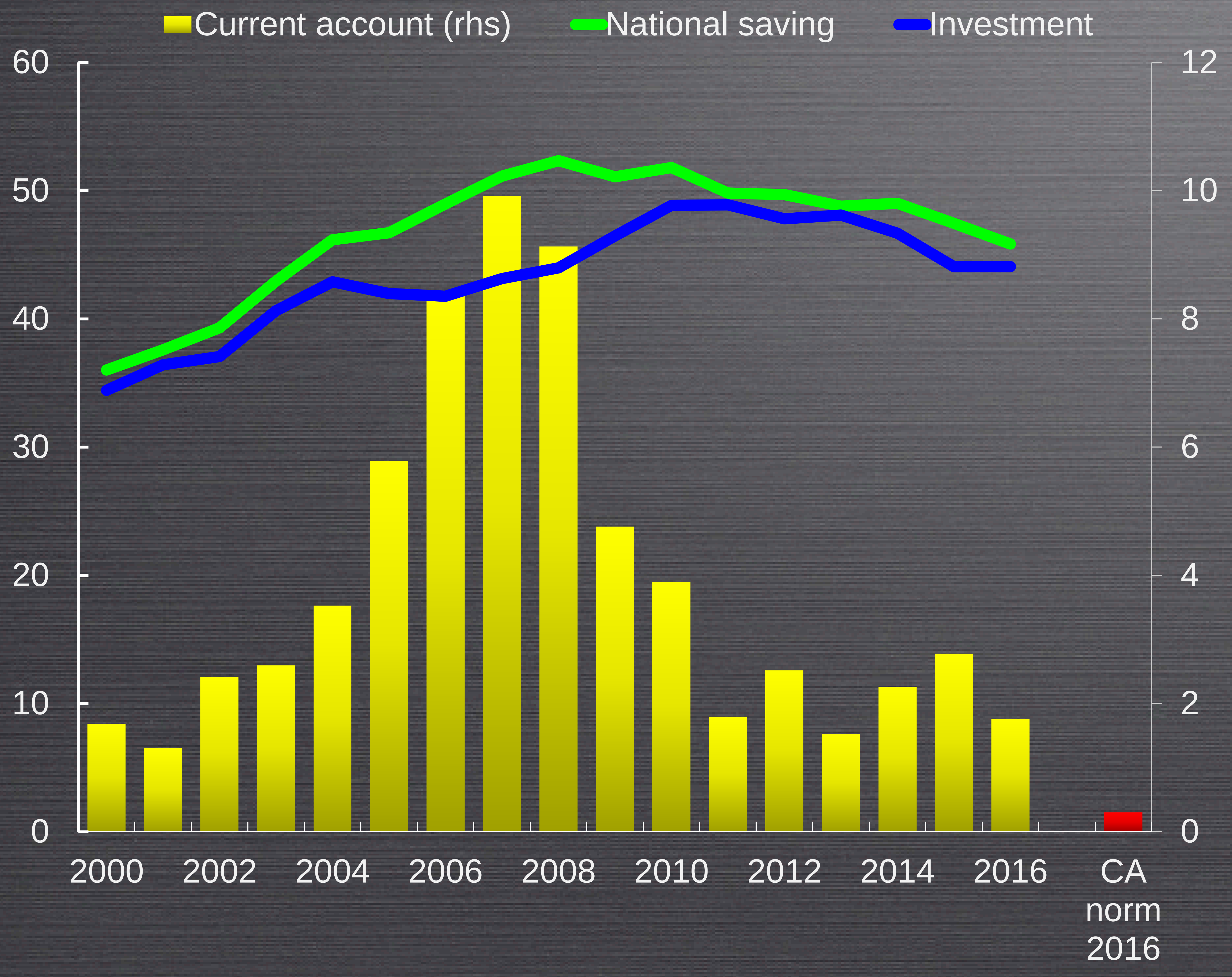
Chinese reserves well above relevant adequacy ratios
(U.S. billions)



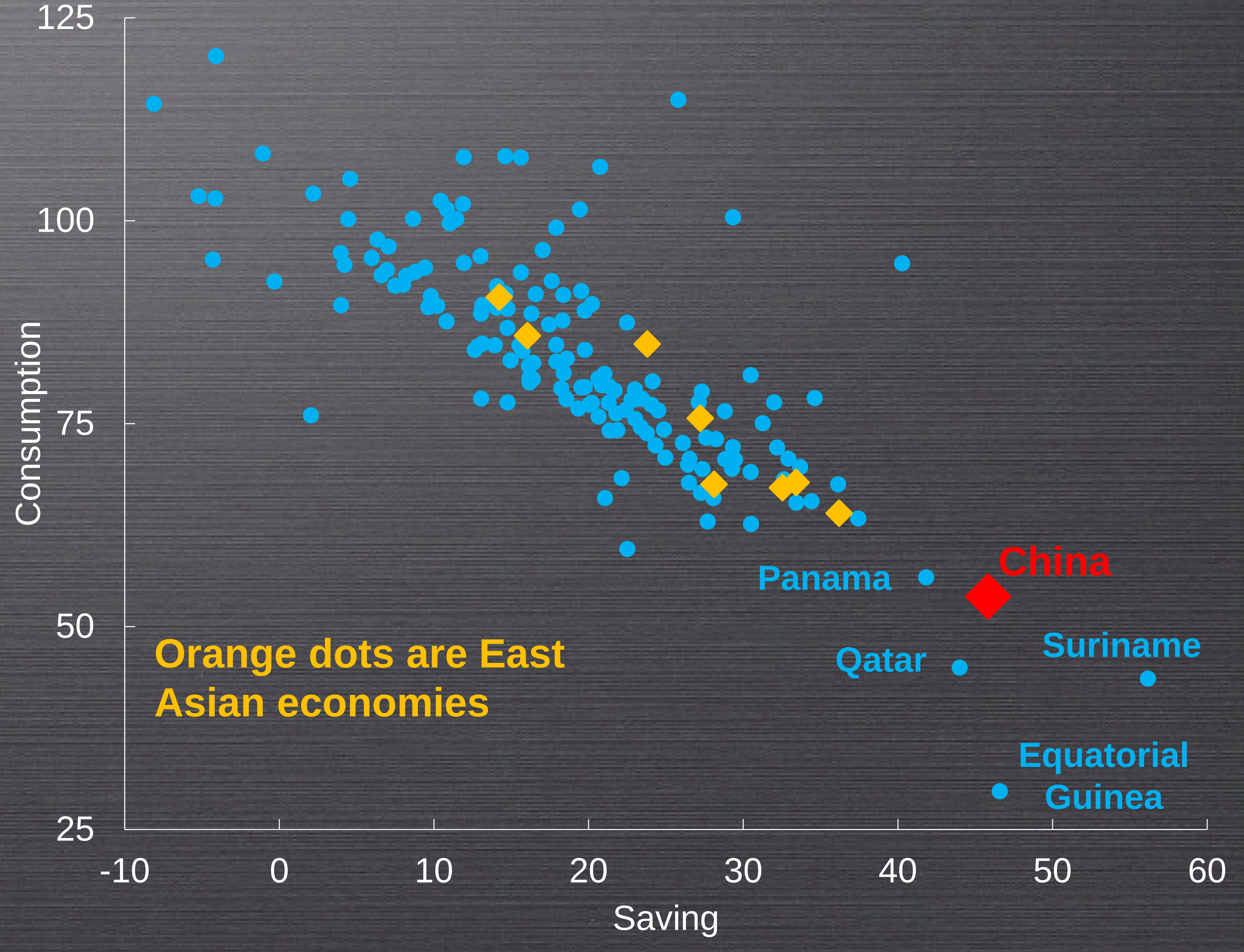
Process not over – Rebalancing still under way

Excess saving

Investment and saving
(percent of GDP)

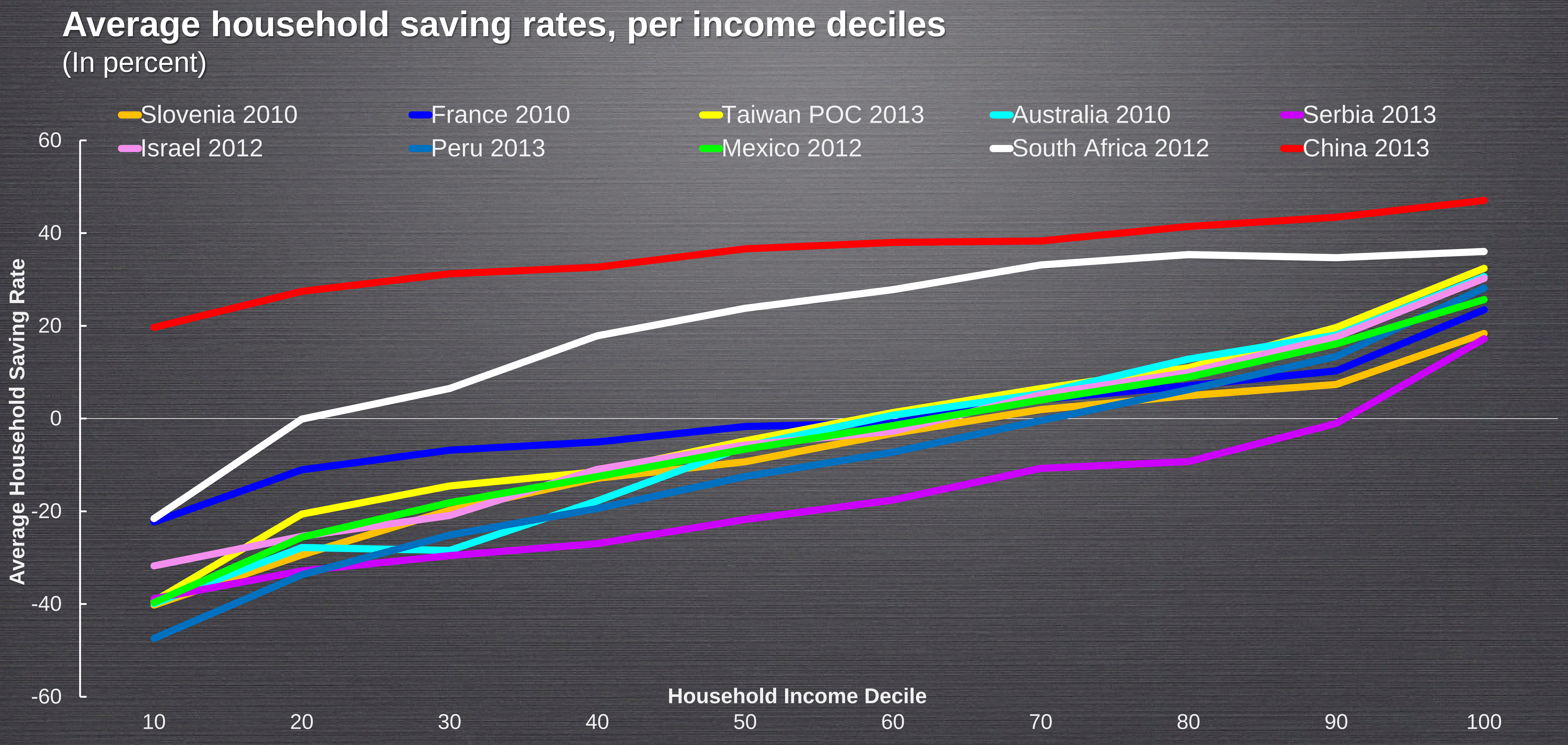


China is major outlier in saving and consumption
(percent of GDP, 155 countries)



Sources: Haver Analytics; IMF, *World Economic Outlook;* and IMF staff estimates.

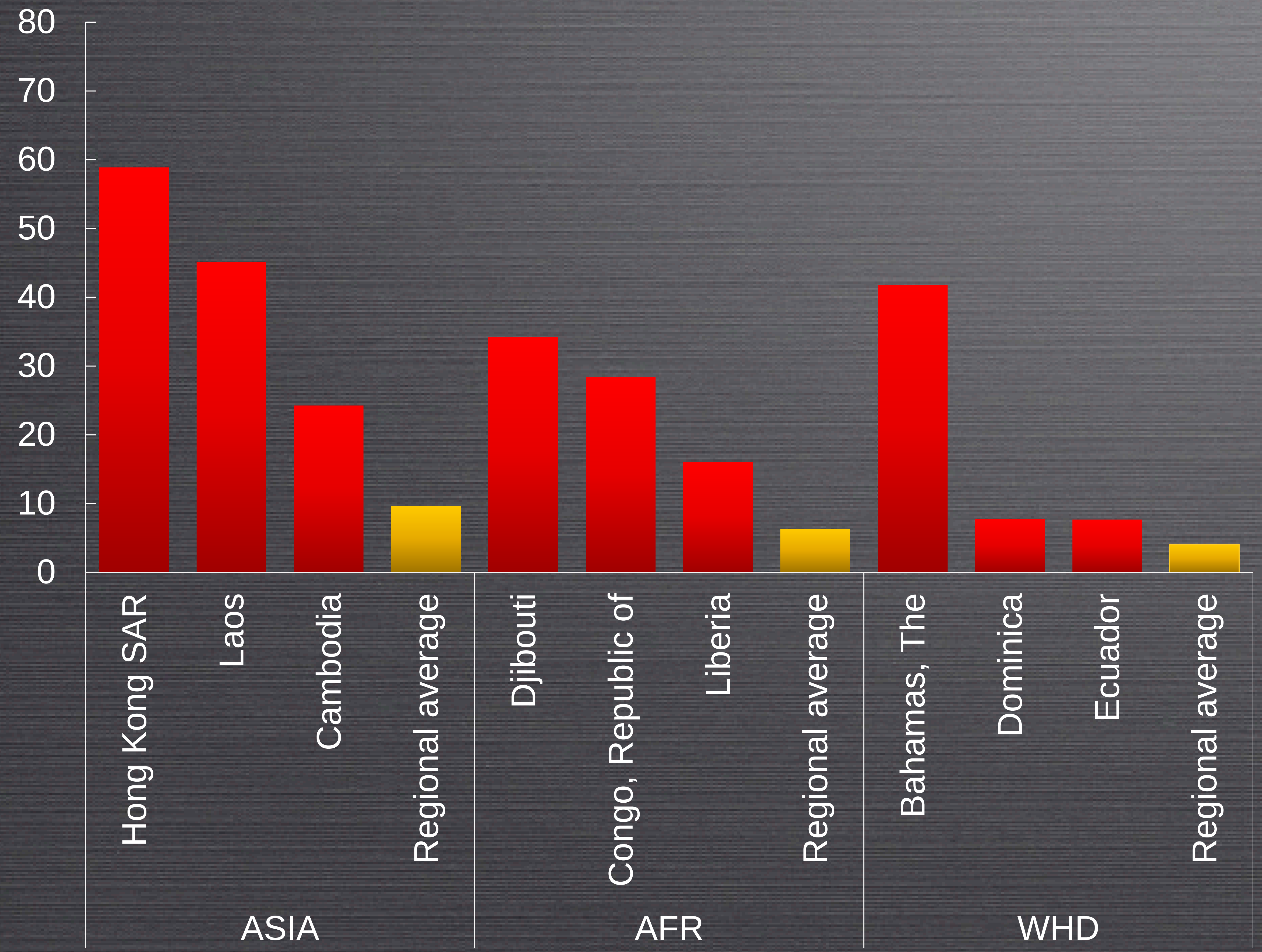
Higher saving, particularly at lower income deciles



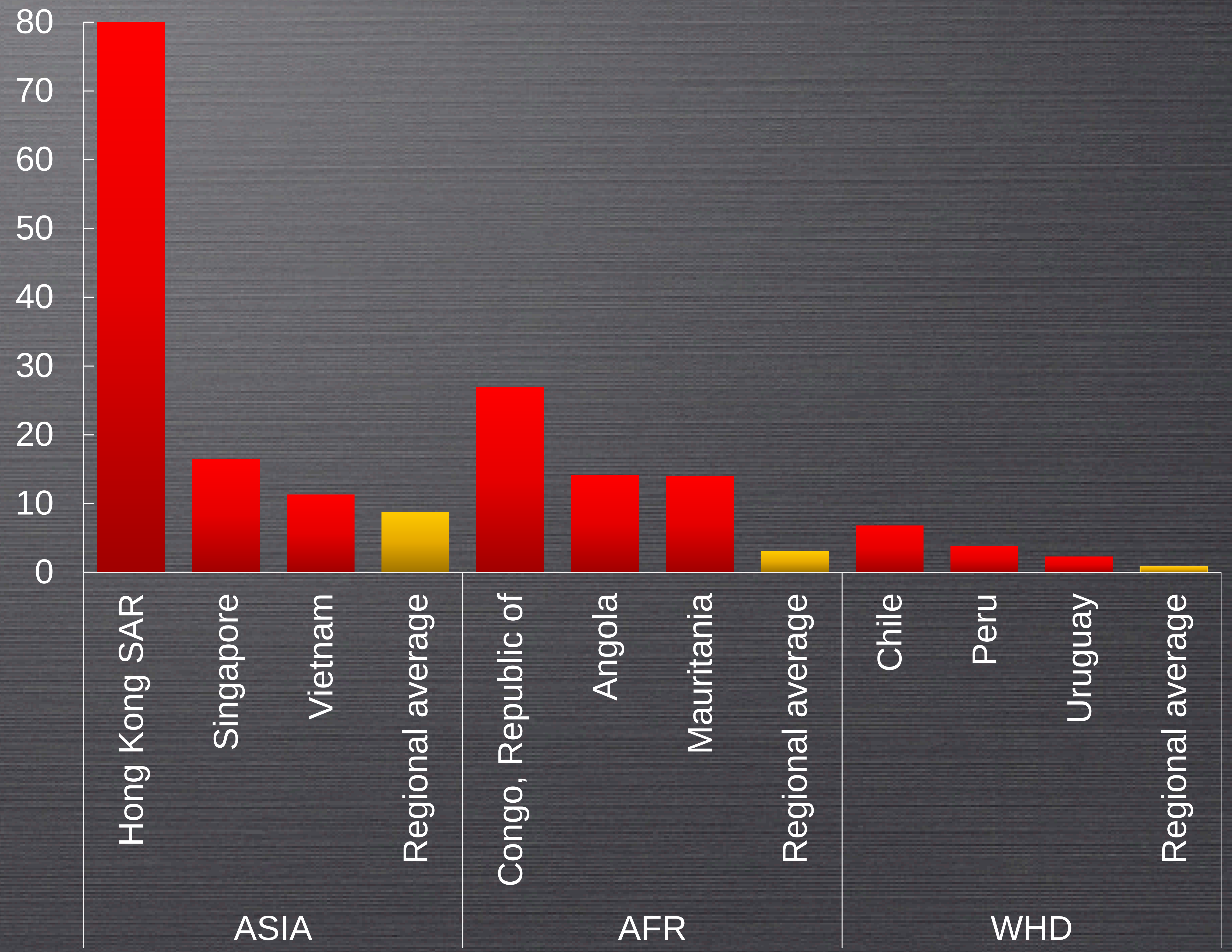
Sources: Luxemburg Income Study (LIS), and Chinese Household Income Project (CHIP) for China.

Spillovers to EMDEs: Chinese foreign asset appetite, along with trade, resulting in large exposures to China

Chinese banks' claims, 2016Q2 1/ 2/
(percentage of borrower country's GDP)



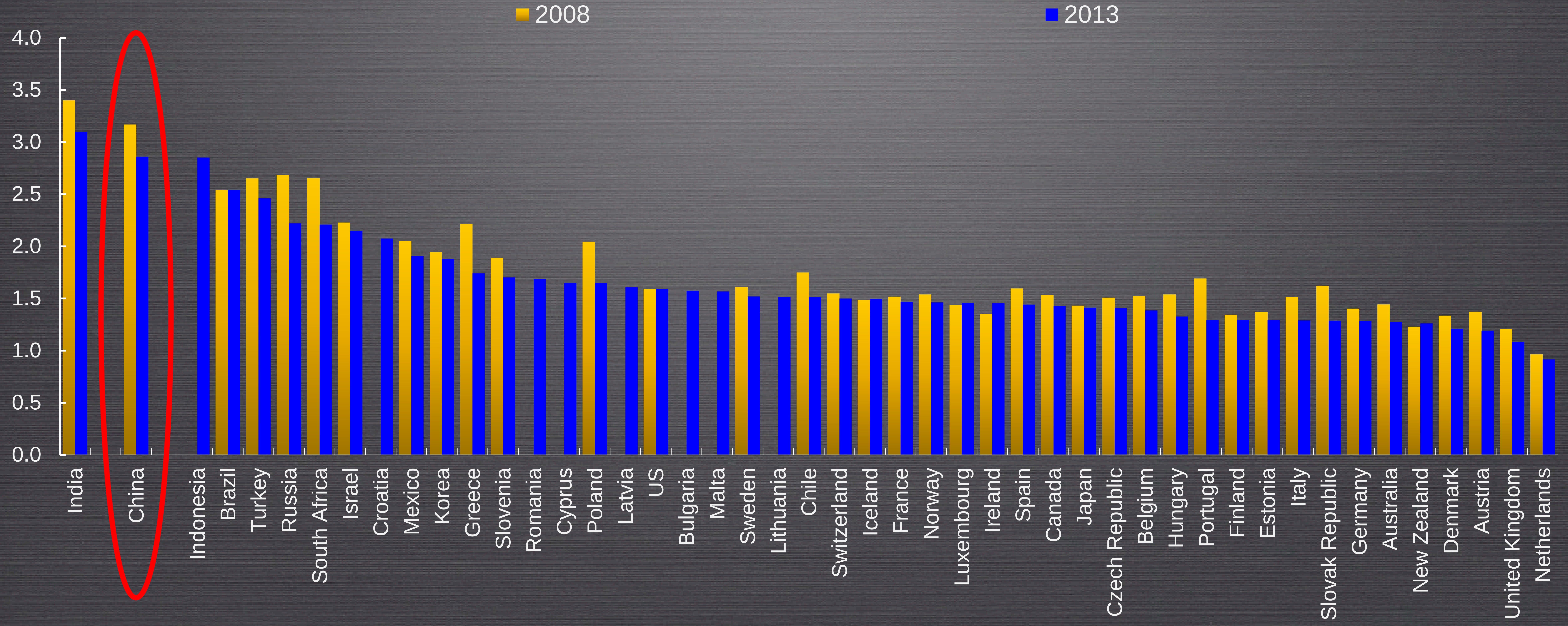
Exports to China, 2015 1/
(percentage of exporter country's GDP)



Sources: Bank for International Settlements; and IMF, *Direction of Trade Statistics.*
1/ The 3 countries with largest financial/trade exposures to China in each region are depicted in red.
2/Estimates for 2016Q2 based on the differences between two vintages of BIS Locational Banking statistics for the same quarter (one vintage before and the other after China and Russia were included as BIS reporting countries in November 2016).

Chinese economy is heavily managed

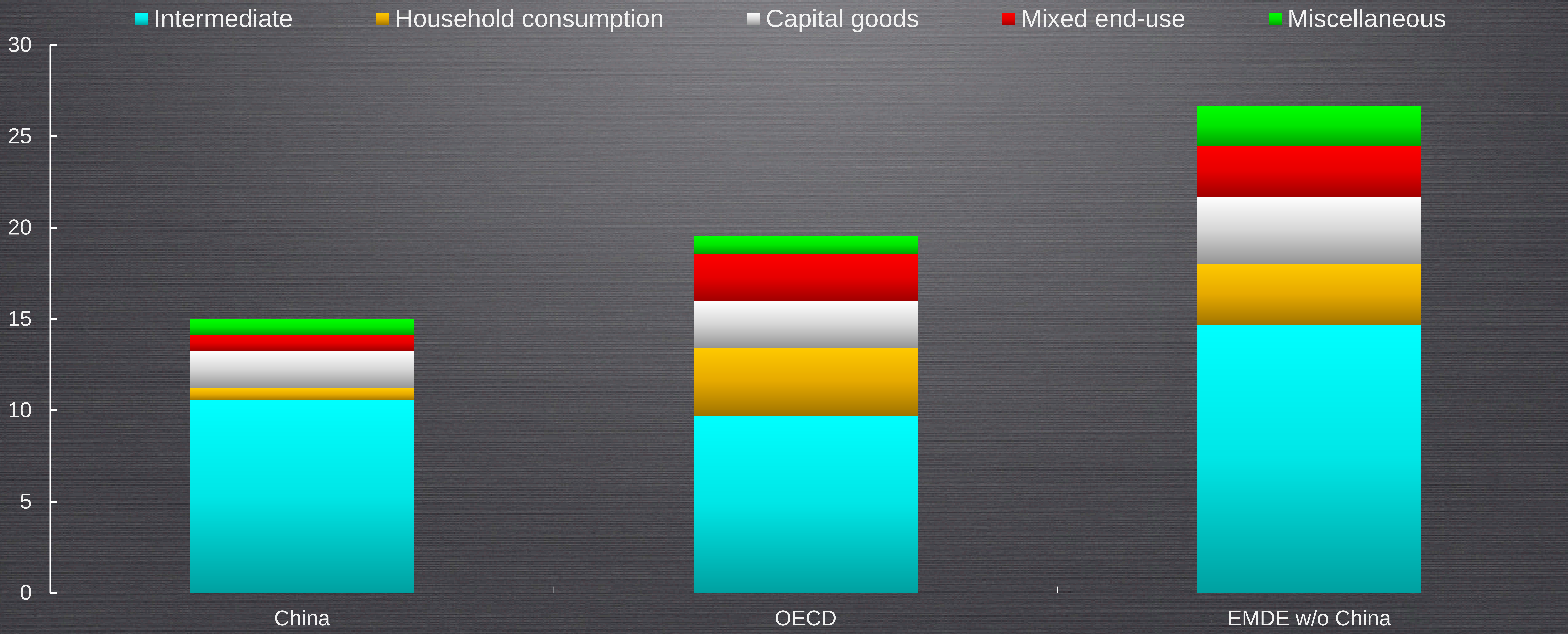
China among most closed in OECD
(OECD's product market regulation (PMR) index)



Source: OECD.
Note: The PMR index assesses degree to which policies promote competition in the product market. Policies assessed include state control of business enterprises; legal and administrative barriers to entrepreneurship; and barriers to international trade and investment.

And has relatively few final consumption imports

China, OECD and EMDEs: Import Breakdowns, 2015
(percent of GDP)



Source: OECD STAN Bilateral Trade Database in goods.

Summary and policy recommendations

Excessive saving is problematic for macroeconomic stability

- Allocating a higher share of income to consumption could both increase welfare and support growth in a less debt-intensive way
- Given home bias and capital account restrictions, high saving translates into excessive domestic investment which is unlikely to be absorbed efficiently
- The fall in inefficient investment, without an increase in consumption, would widen the current account surplus, worsening global imbalances and undermining the multilateral trade system

Better macro-policy mix should play a key role in the transition

- The current fiscal stance uses up limited fiscal space to support unsustainable growth
- A modest removal of monetary policy accommodation is justified by the growth and inflation outlook, and financial stability concerns
- Progress toward a more flexible exchange rate should continue