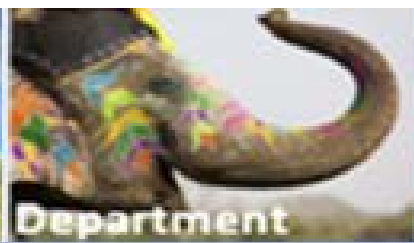
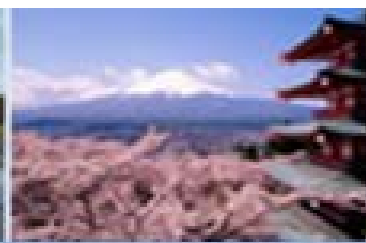
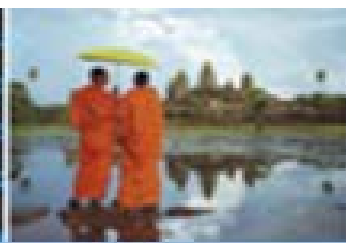
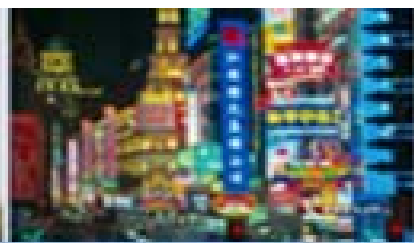




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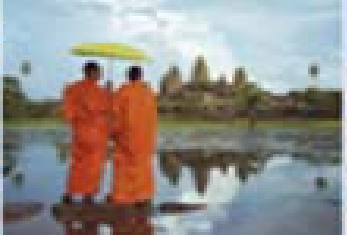
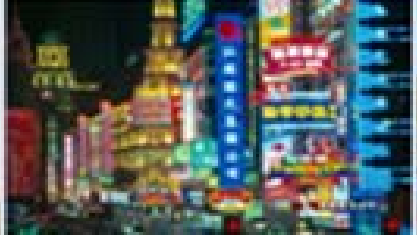


Can China Pilot a Soft Landing?

2017 Article IV Consultation – Analysis, Outlook, and Policy Advice



September 2017

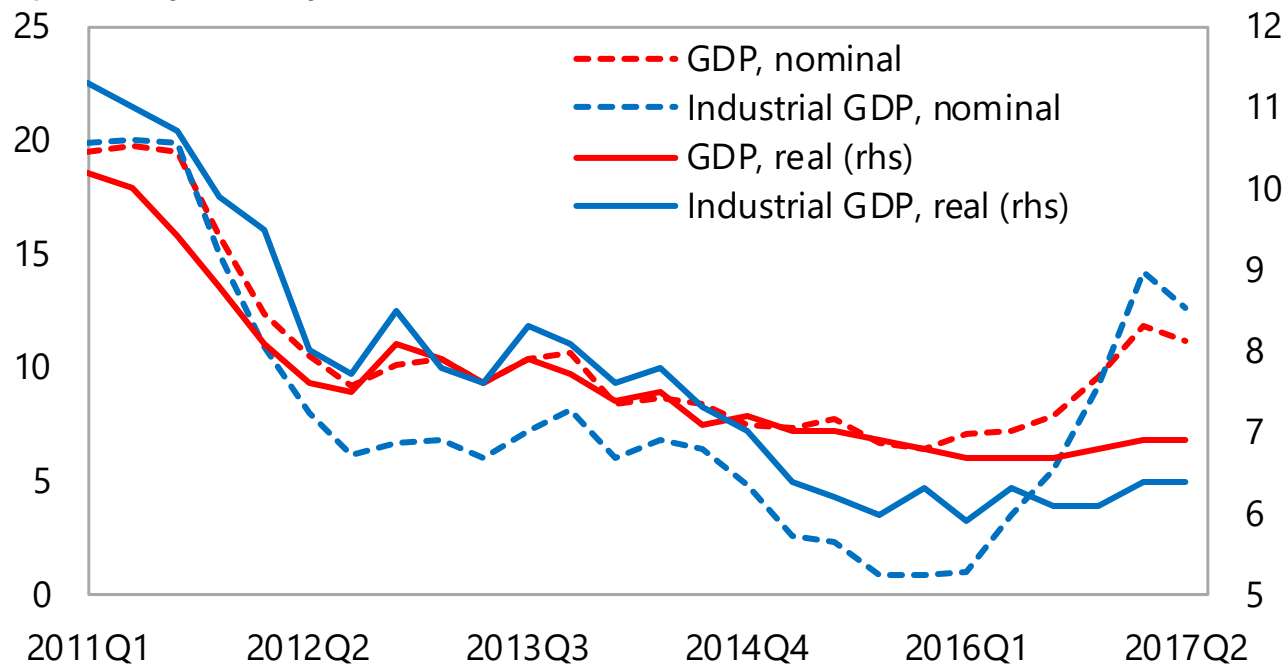


KEY RECENT DEVELOPMENTS

China has had strong growth momentum which...

Real GDP

(In percent, year-on-year)

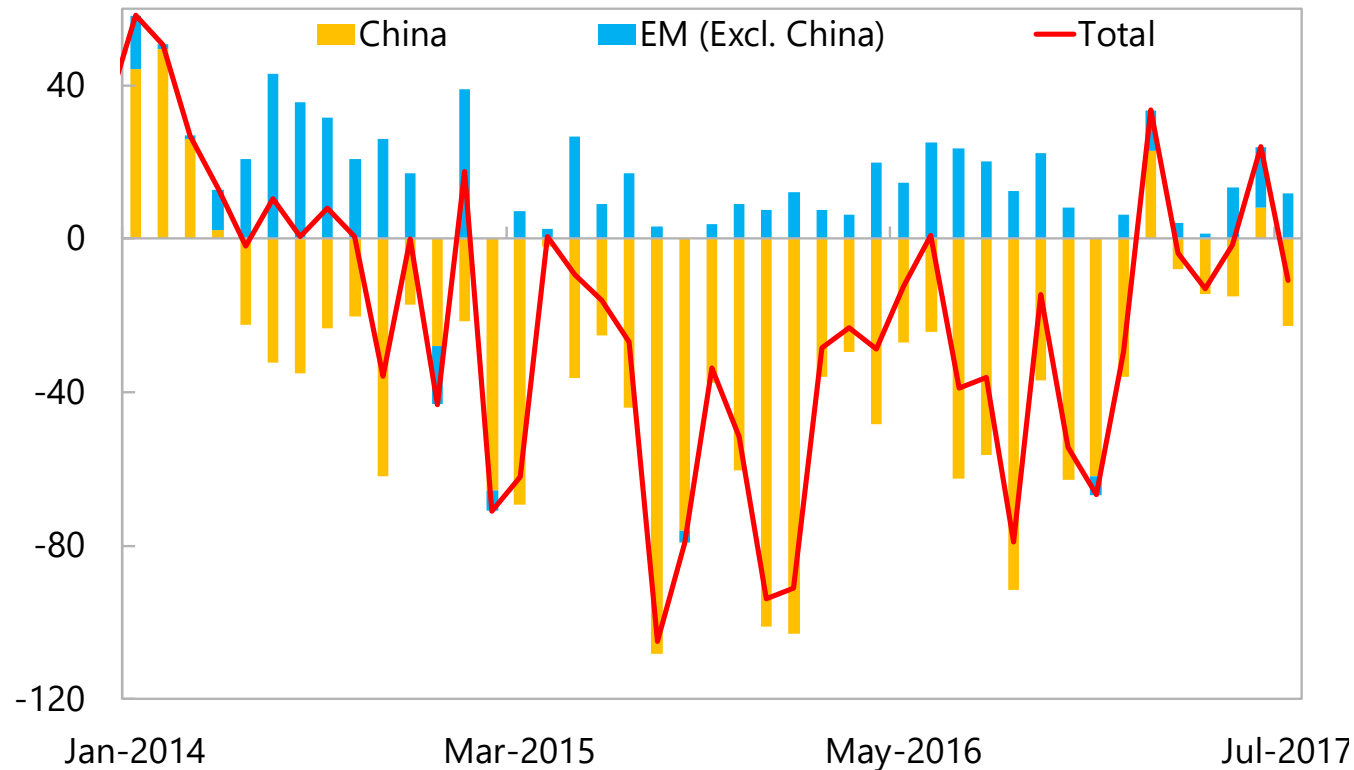


Source: Haver Analytics.

...along with tighter capital controls, helped stabilize the capital account

Capital Outflows Moderate Sharply

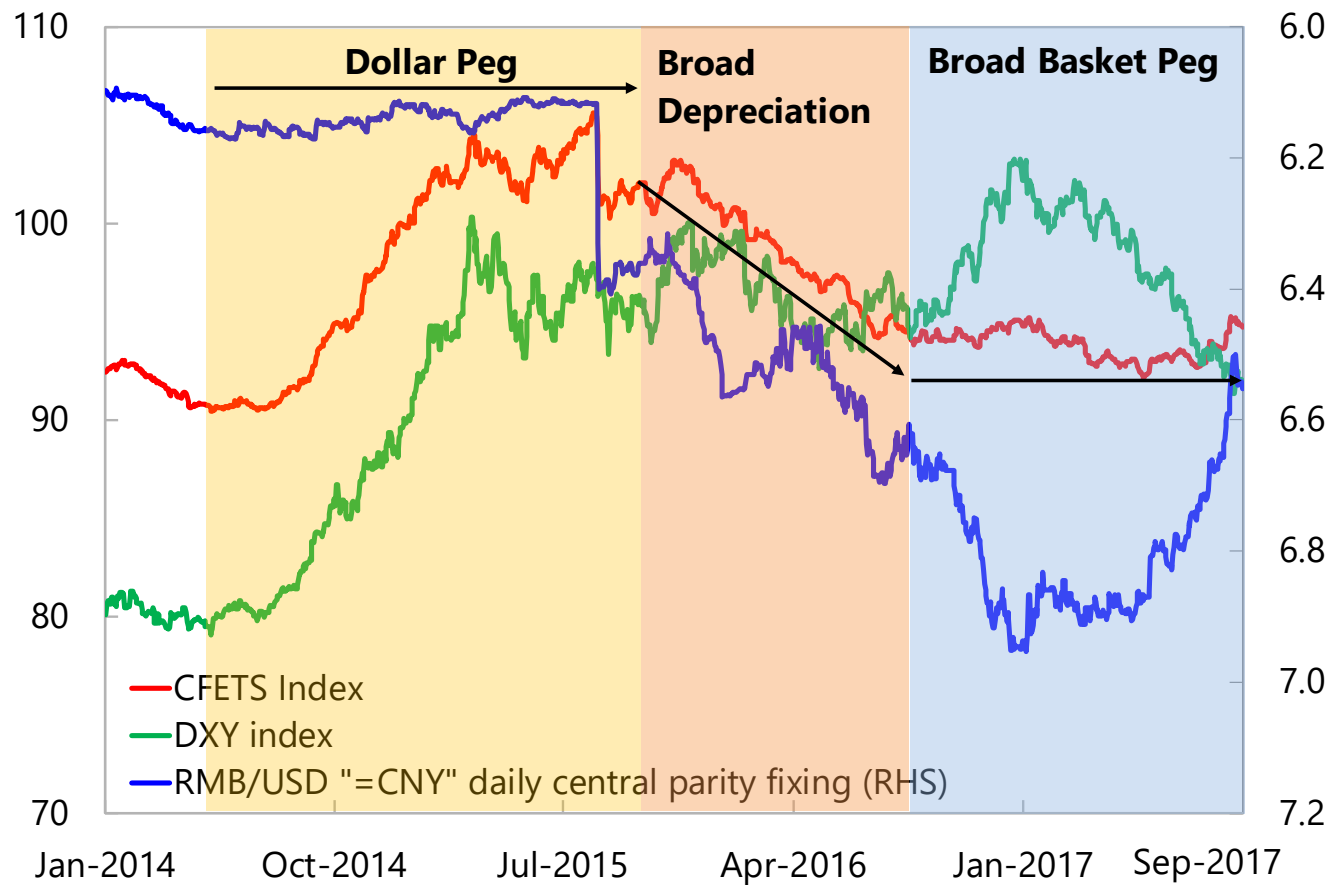
(In US\$ billion)



Sources: Institute of International Finance (IIF); and IMF staff estimates.

...and the exchange rate

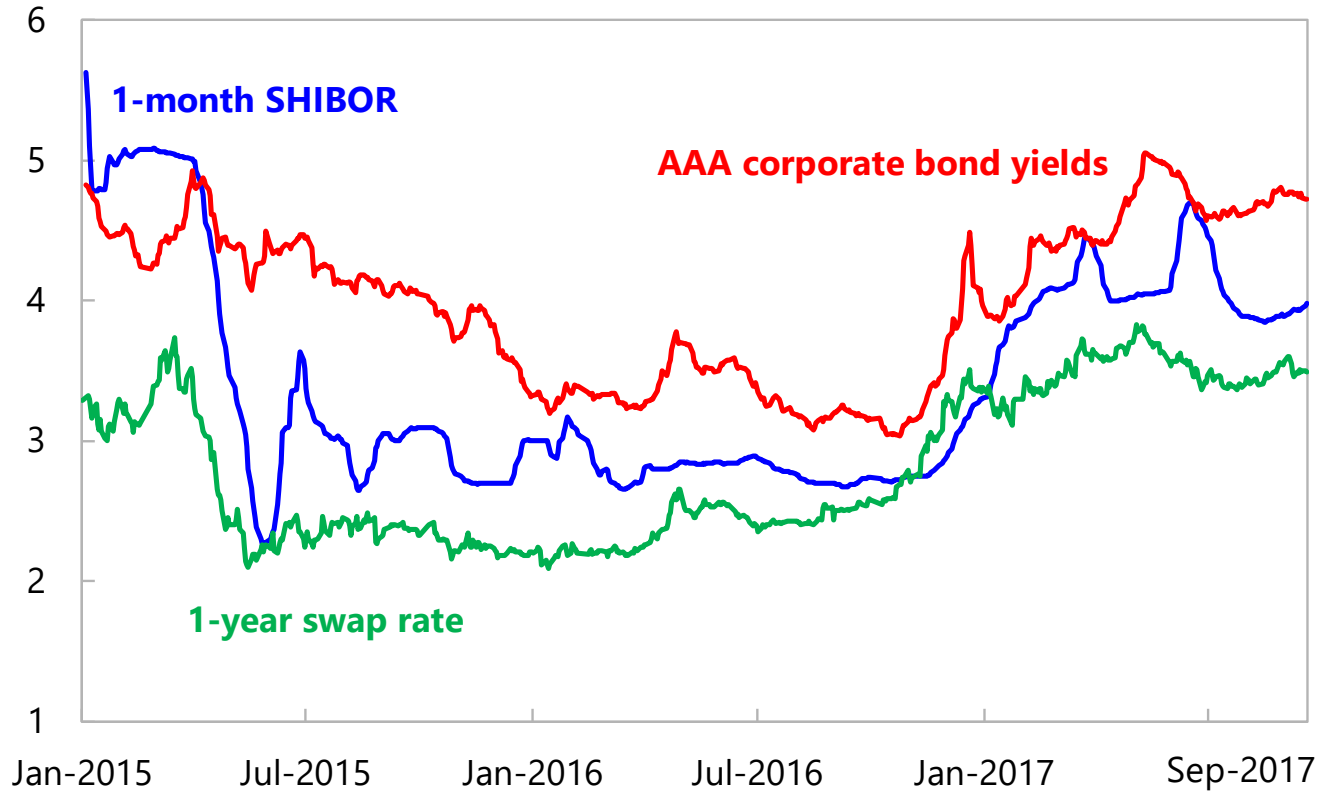
Daily Exchange Rate



Now supervisory actions are tightening financial conditions...

Increase in Interest Rates

(In percent)

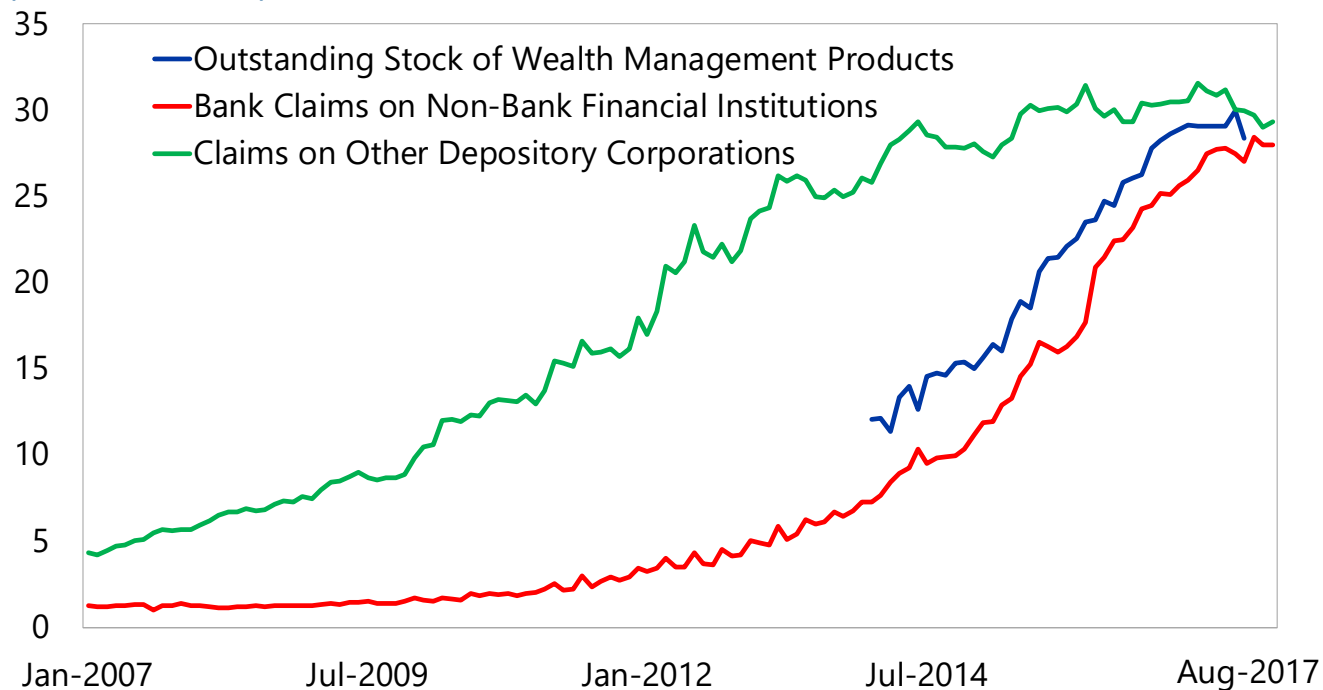


Sources: Bloomberg LP; CEIC Data Company Ltd.; and IMF staff estimates.

...resulting in slower growth in intra-financial sector claims...

Intra-financial Sector Claims

(In RMB trillions)

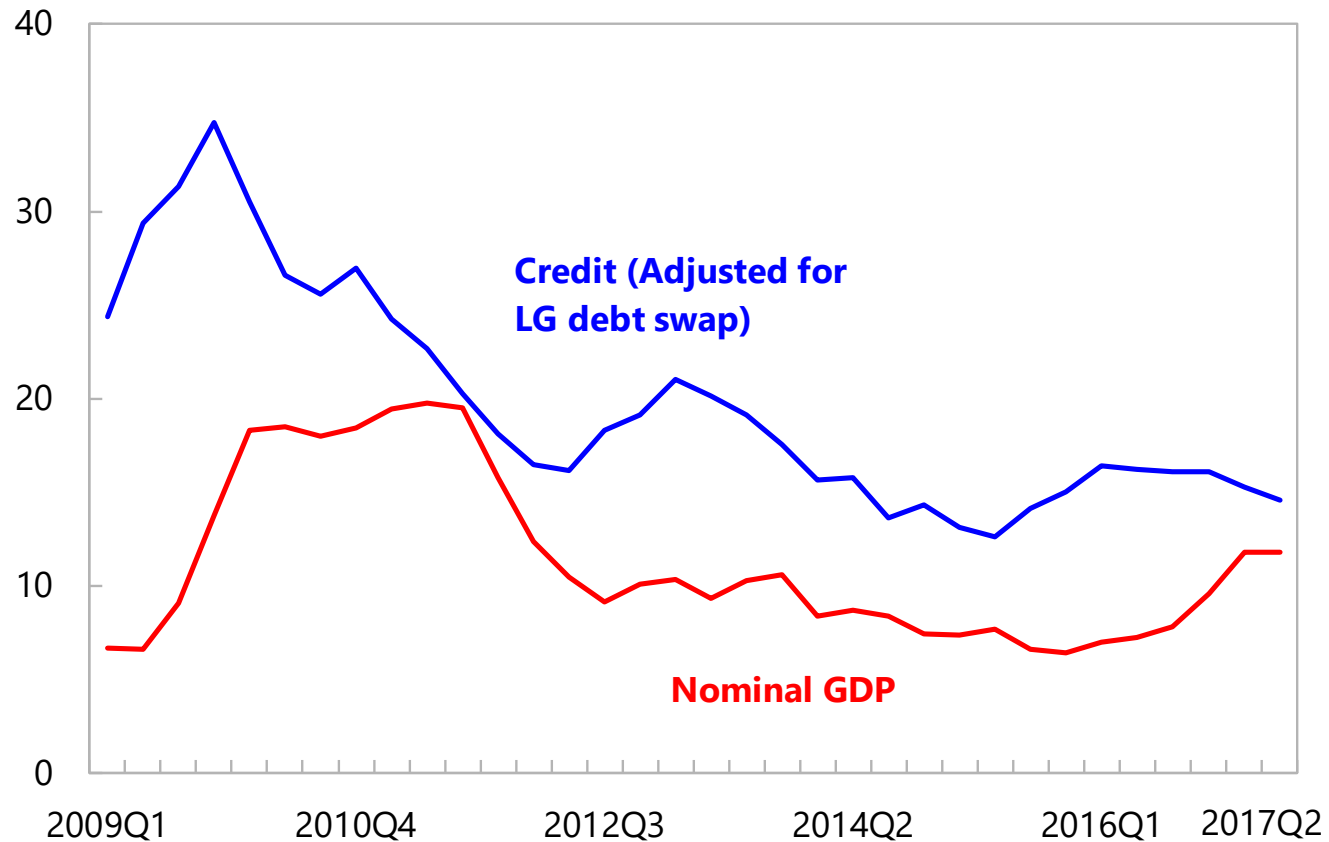


Sources: Haver Analytics.

...and slower growth in credit to the real economy

Credit

(Total Social Financing, in percent, year-on-year)

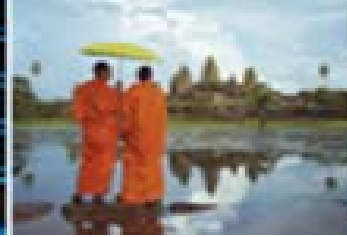
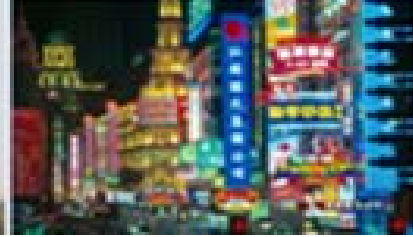




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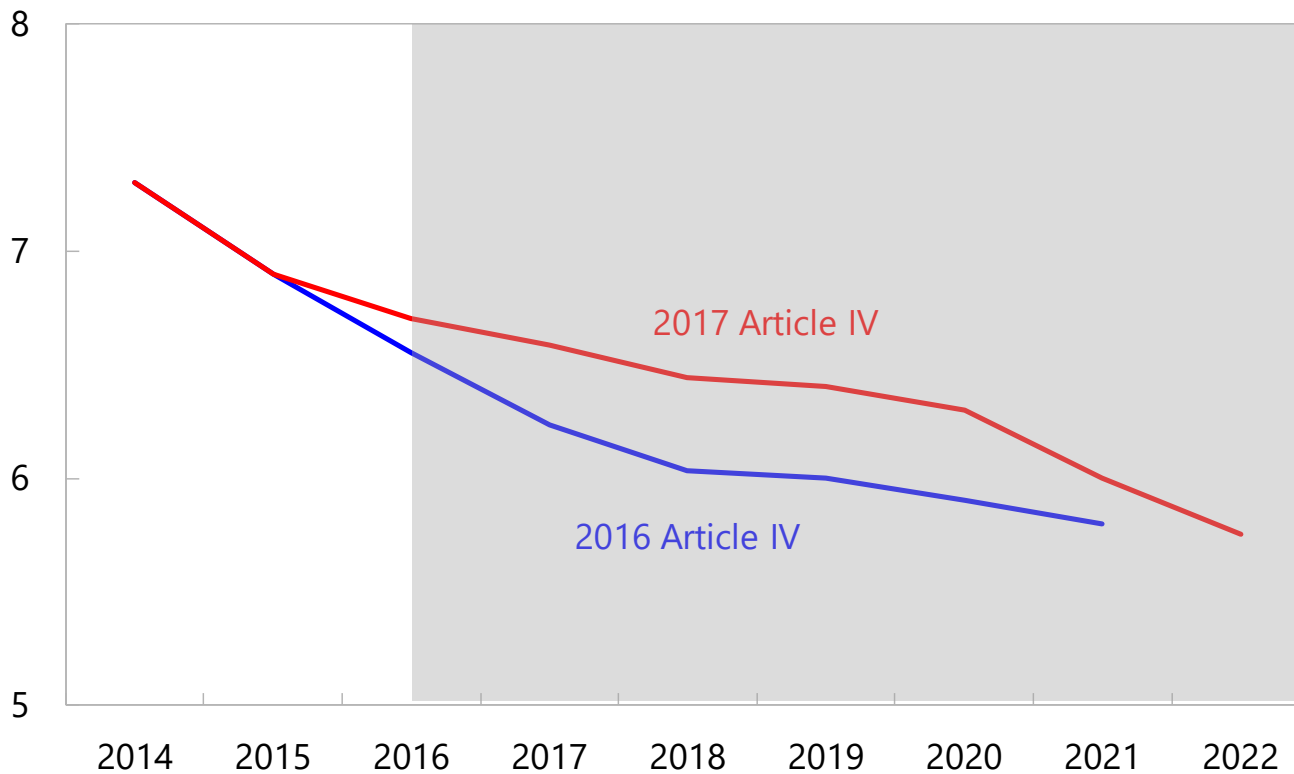


OUTLOOK

The upward revision to growth internalizes the authorities' stated policies...

Real GDP Growth

(In percent)

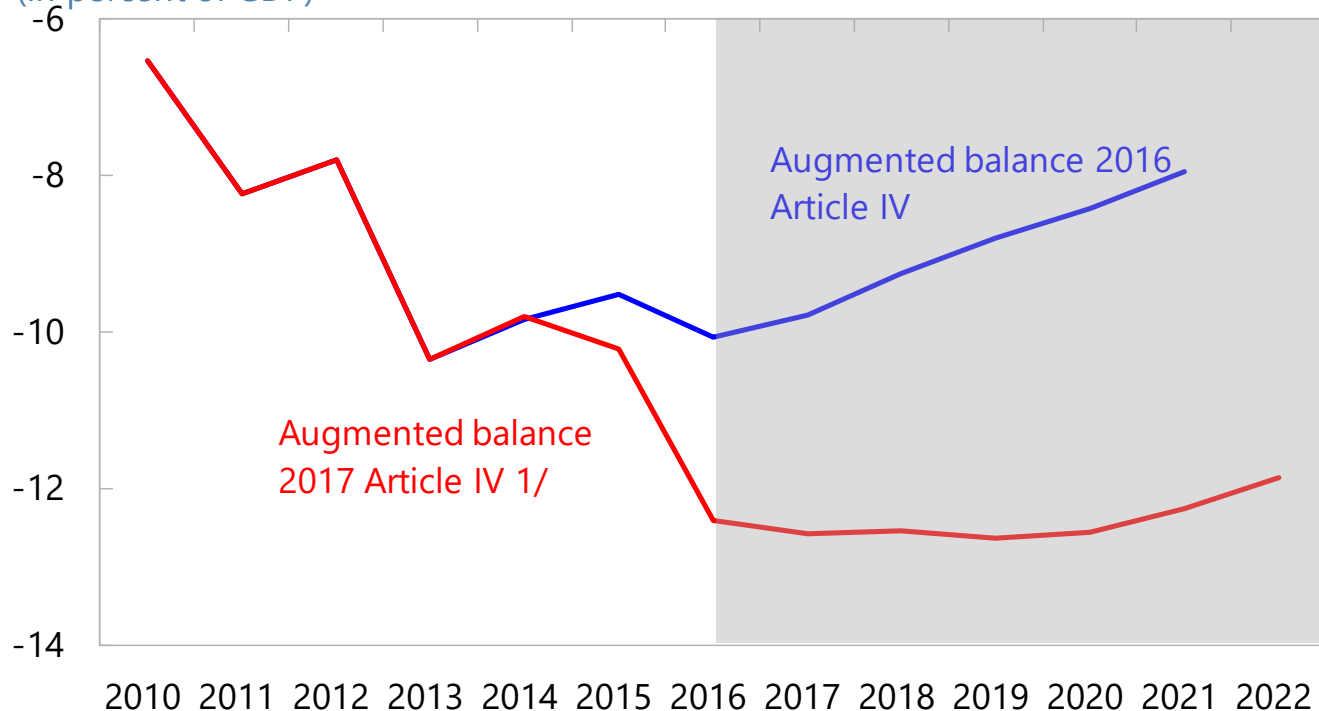


Sources: CEIC Data Company Ltd.; and IMF staff estimates.

...which likely imply slower fiscal consolidation...

Augmented Fiscal Balance

(In percent of GDP)



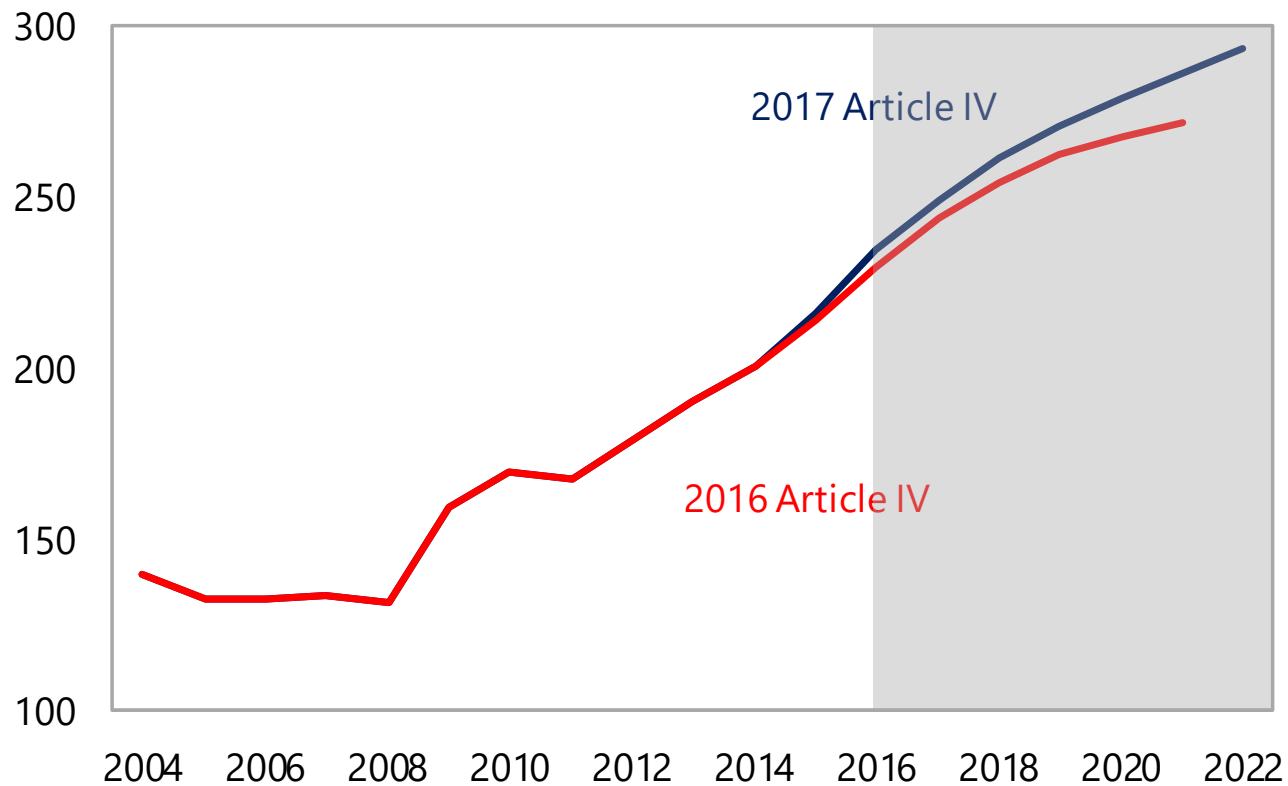
1/ Definition of augmented deficit has been expanded to include government guided funds. This has also resulted in a revision to the historical path back to 2015.

Sources: CEIC Data Company Ltd.; and IMF staff estimates and projections.

...and more rapid debt accumulation

Total Non-Financial Sector Debt

(In percent of GDP)



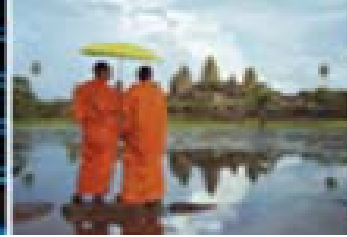
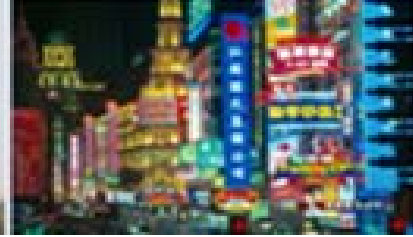
Sources: Haver analytics and IMF staff estimates.



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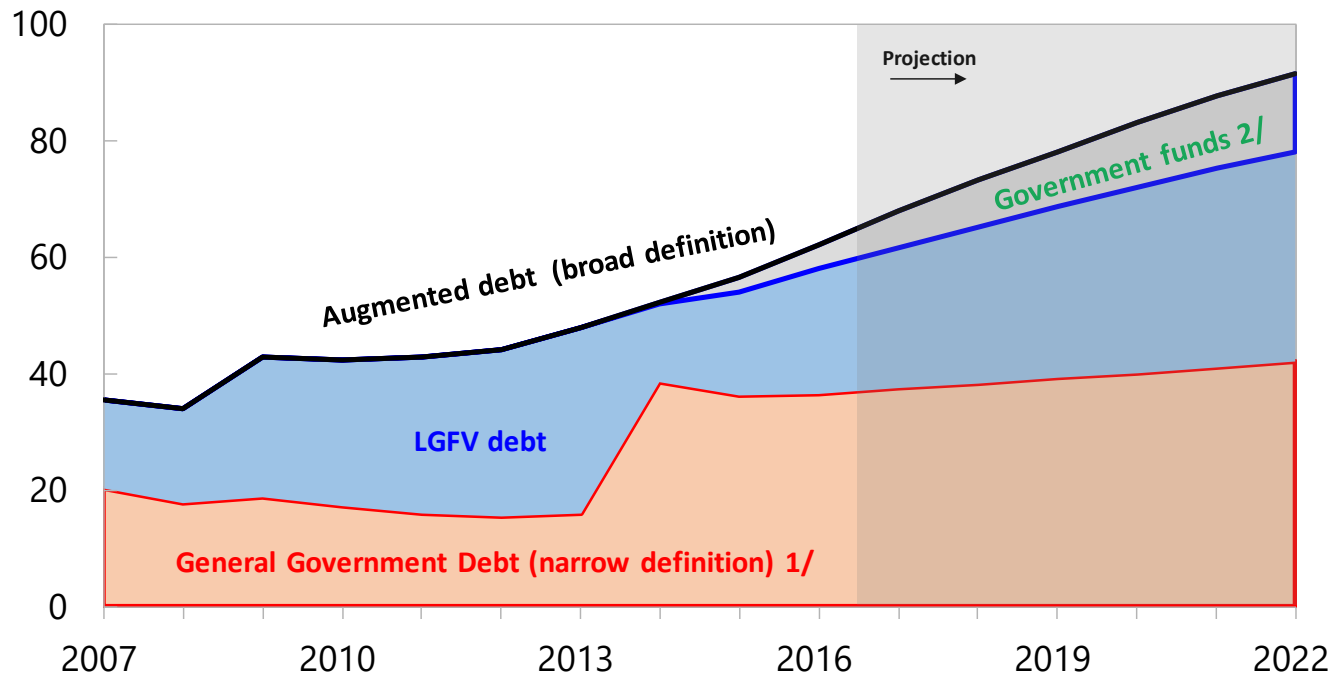


POLICY PRIORITIES

Macro-Policies: Fiscal policy will need to be tightened over time...

Augmented Fiscal Debt

(In percent of GDP)



Source: IMF staff estimates.

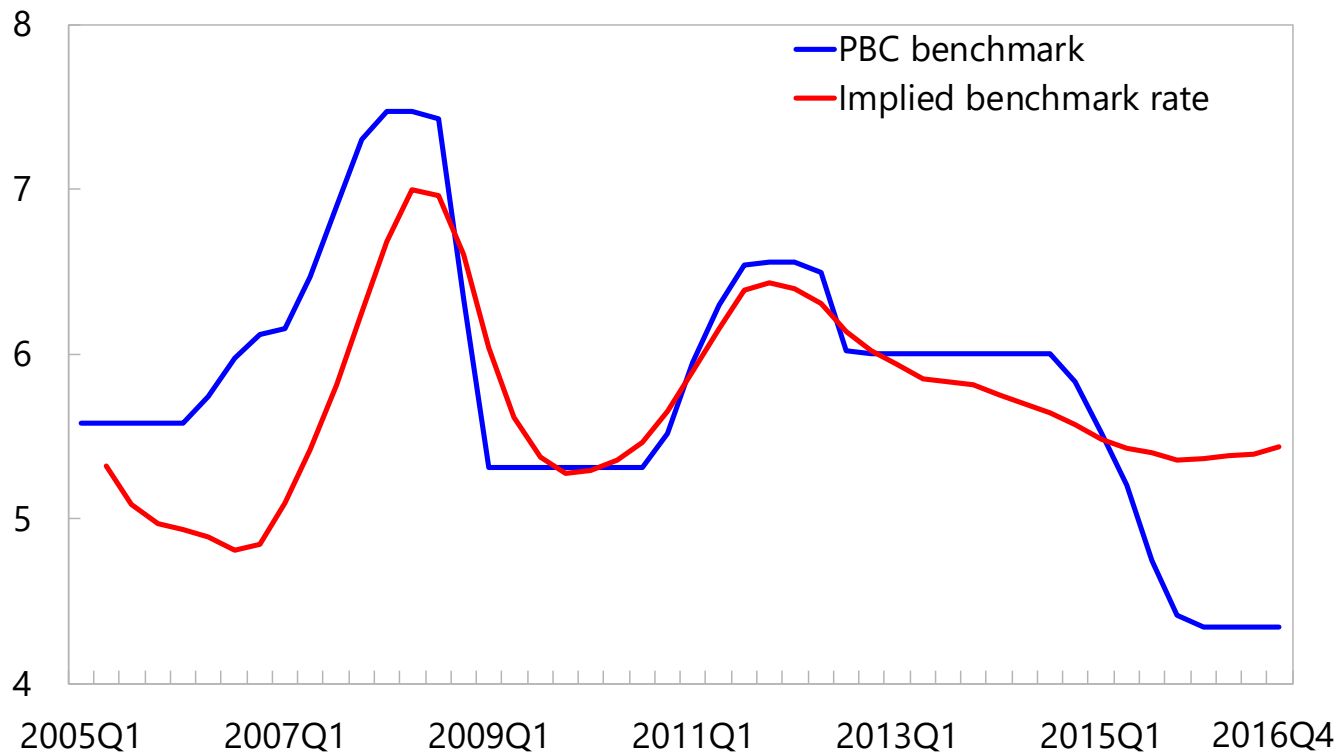
1/ Data through 2015, 2016 estimated, 2017 projection. Large jump in 2014 reflects official recognition of 22 percent of GDP in LGFV debt.

2/ Government guided funds (GGF) and special construction funds (SCF). Social capital portion only.

Macro-Policies: ...as will monetary policy

Central Bank Interest Rates

(In percent)



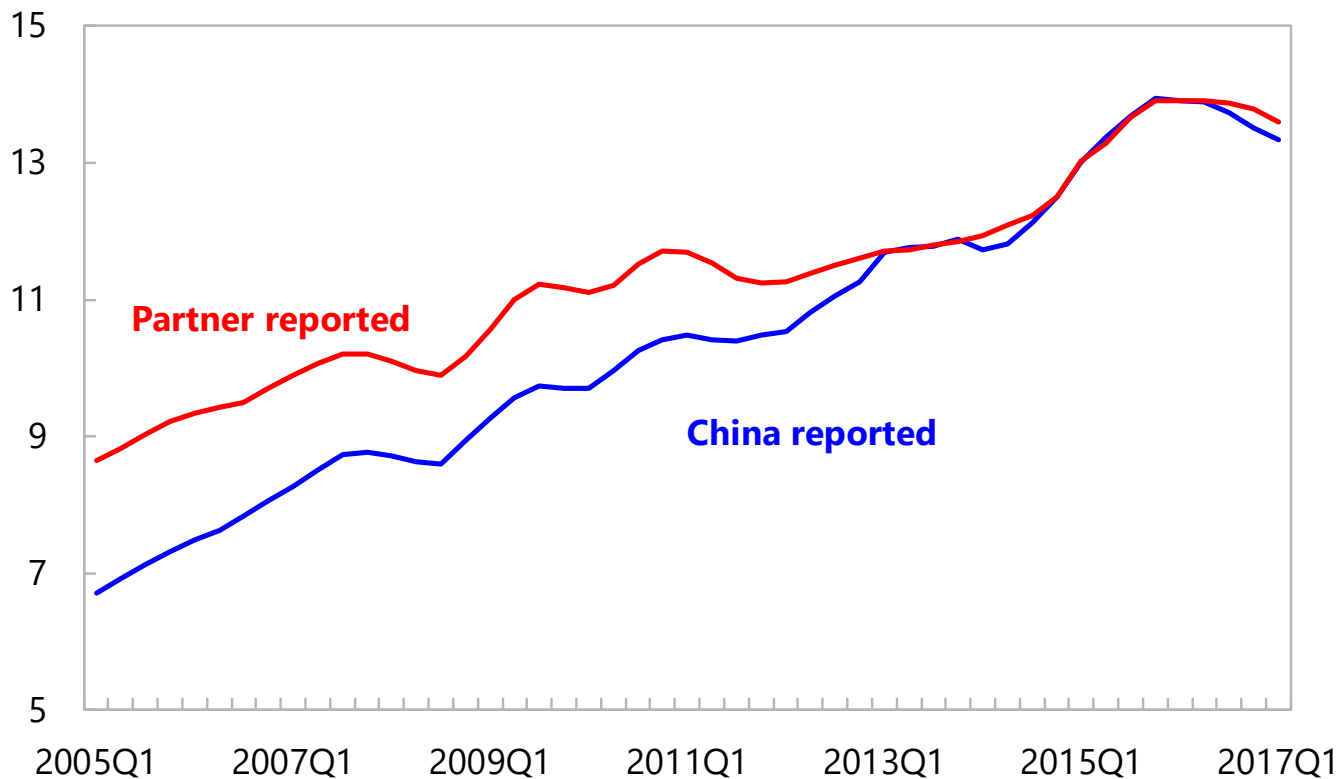
Note: The Taylor rule assumes an inflation target of 3% and a neutral benchmark lending rate of 6%.

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

Macro-Policies: ...while the Exchange Rate should become more flexible

Export Market Share

(In percent)



Sources: Haver Analytics; and IMF staff estimates.

But the deeper challenges to China's transition are structural in nature

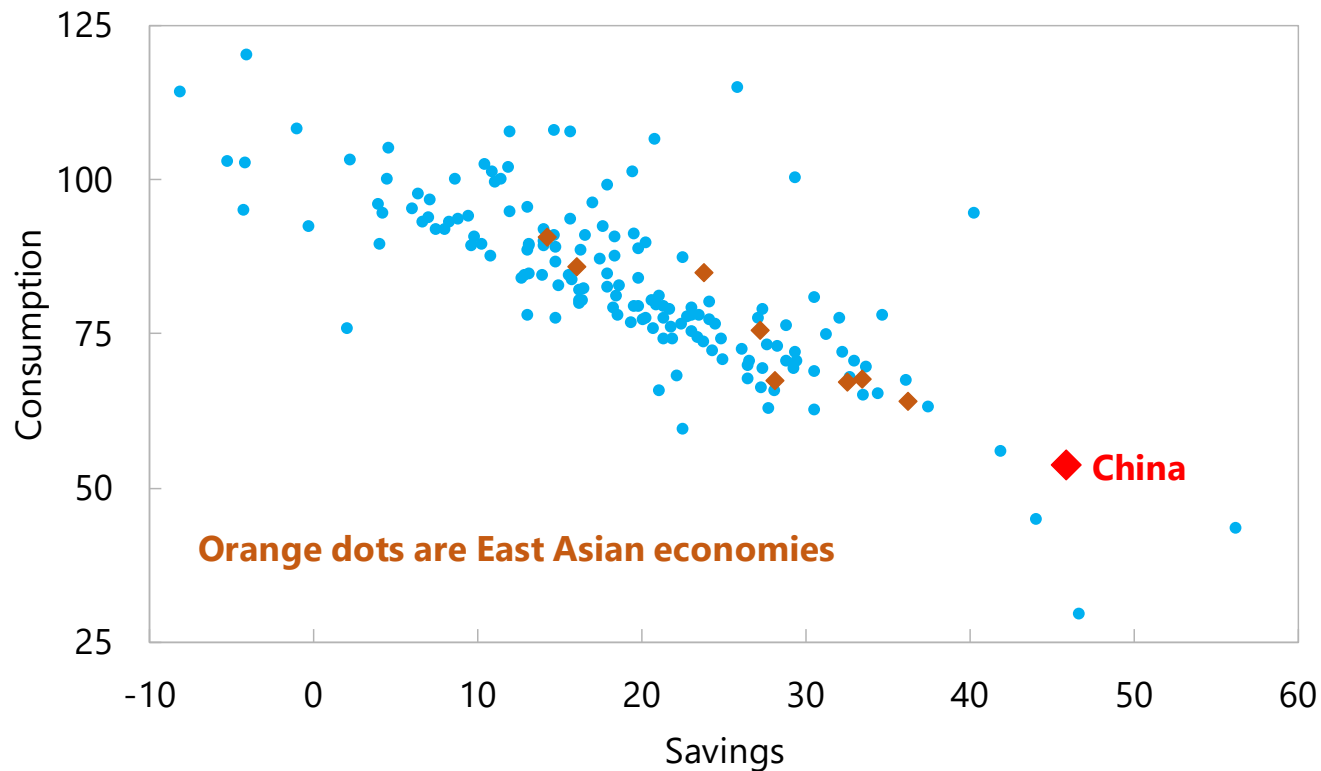
Key Issues:

1. Excessive National Savings
2. Large and Rising SOEs
3. Financial Sector Complexity and Fragility
4. High Corporate Debt
5. Persistent Overcapacity Industries

Structural Policy Issue 1: Much More Needed on Reducing Savings

China is Major Outlier in Savings and Consumption

(In percent of GDP, 155 countries)

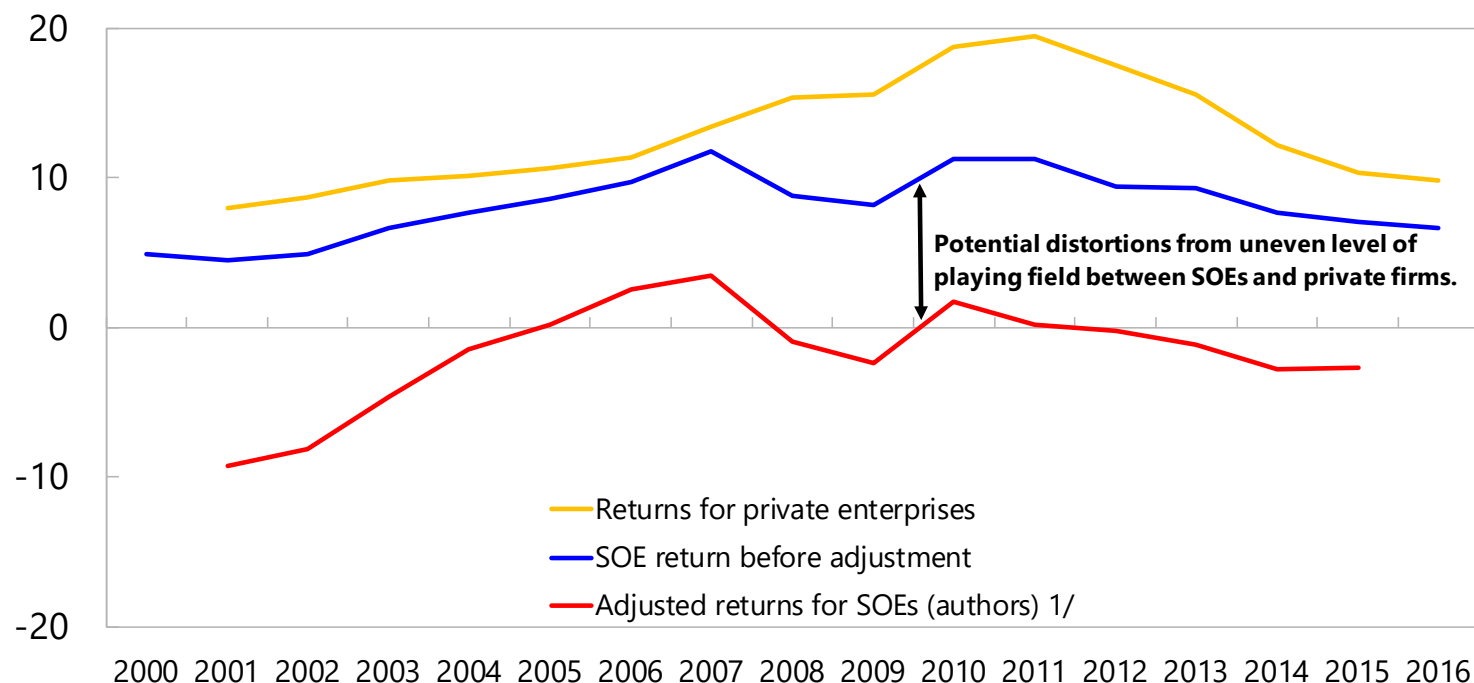


Sources: *World Economic Outlook (WEO)*; and IMF staff estimates.

Structural Policy Issue 2: SOE Drag on the Economy Persists

Weak SOE Return on Equity

(Net return on total owners' equity; in percent)



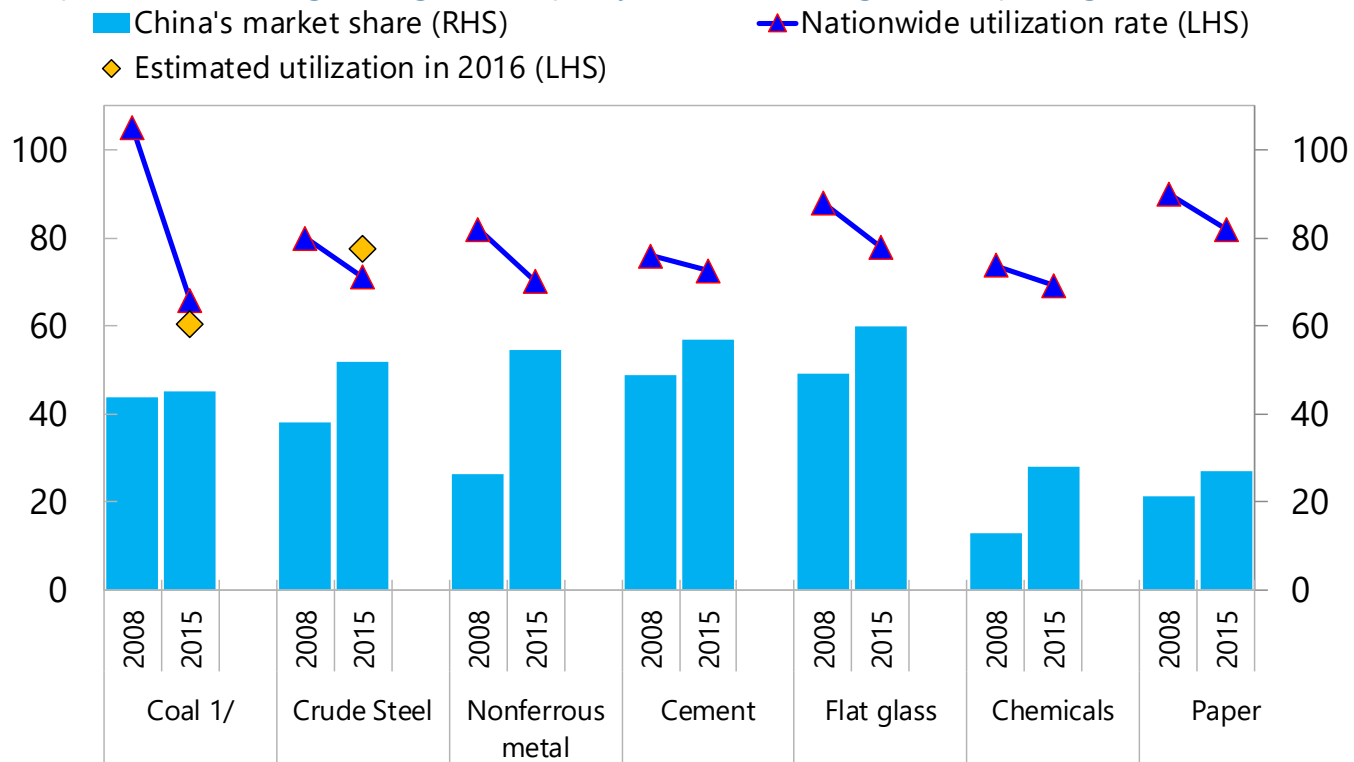
Sources: Statistical Yearbook (2015); Unirule Institute of Economics (2015); and IMF staff estimates.

^{1/} Based on nominal profits of industrial SOEs net of fiscal subsidies, implicit support through the use of land and natural resources, and lower implicit financing cost.

Structural Policy Issue 3: Underlying Drivers of Overcapacity Remain

Key Characteristics of Overcapacity Sectors

(In percent of total legal designated capacity (left-scale) and global output (right-scale))



Sources: European Chamber of Commerce, Goldman Sachs, and IMF staff estimates.

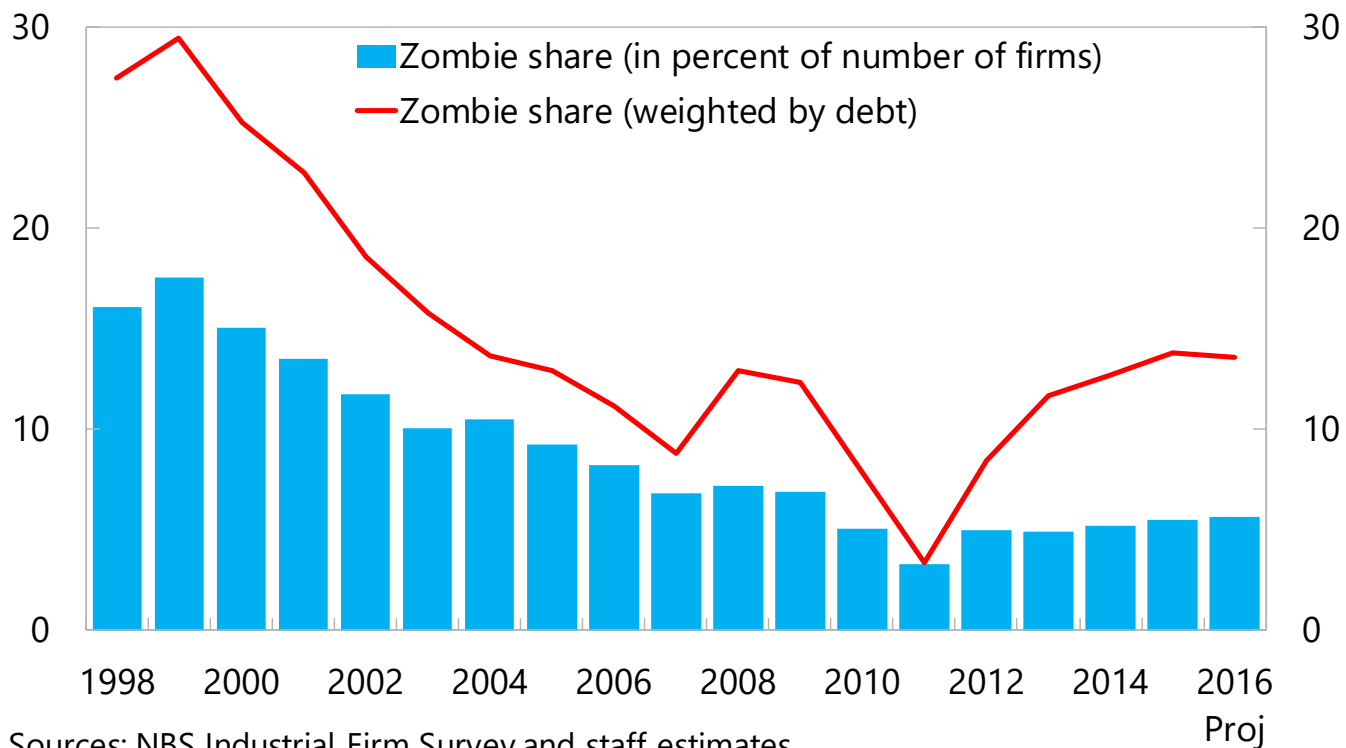
1/ Coal capacity exceed 100 percent because coal mines produced over legal designated capacity level in earlier years.

Coal capacity utilization in 2016 fell because coal production fell sharper than the cut in coal capacity relative to 2015.

Structural Policy Issue 4: Directly Targeting Corporate Debt

Nonviable Zombie Firms are Rising Again 1/

(In percent of total industrial firms, weighted by number of firms and total liabilities)



Sources: NBS Industrial Firm Survey and staff estimates.

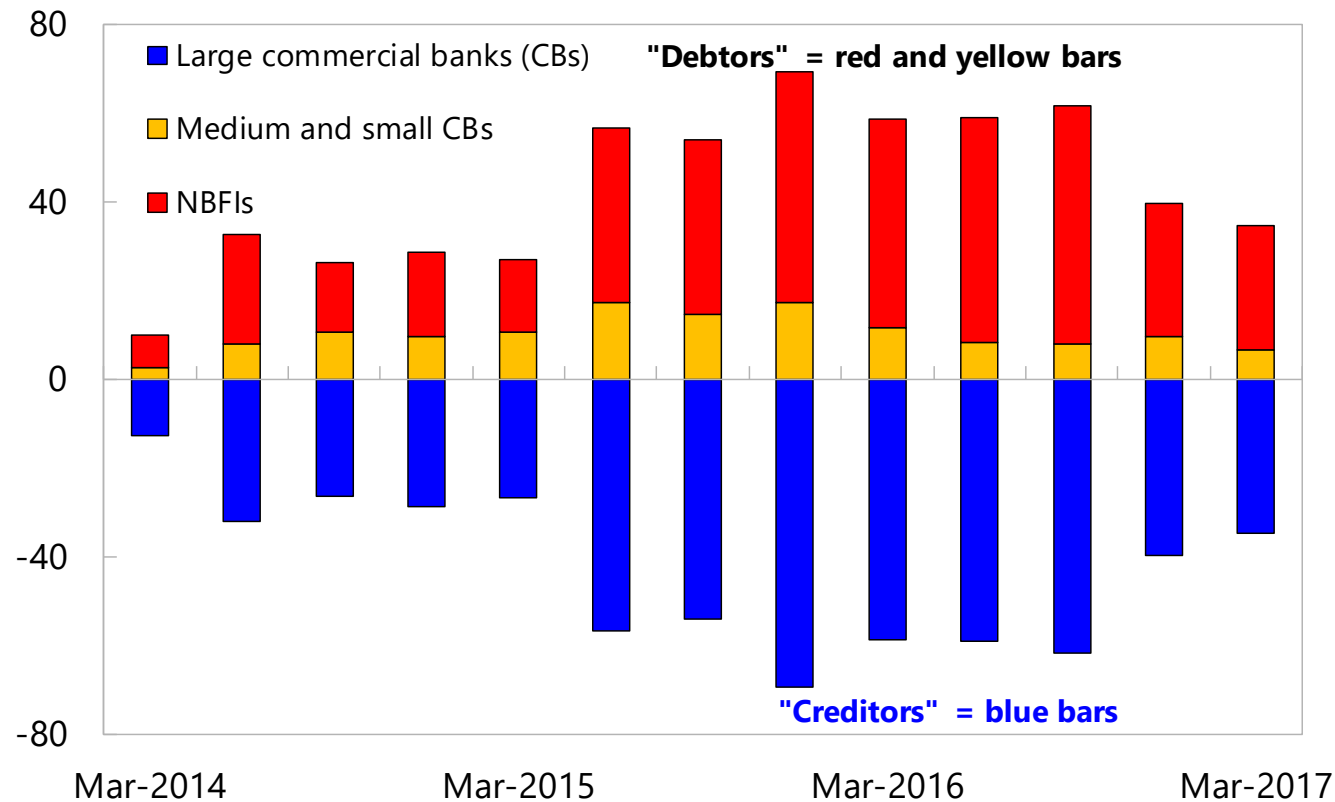
1/ Data for 2010 are missing and based on average of 2009 and 2011. Estimates are average between two definitions of zombies (State Council and Fukurama and Nakamura (2001).

Nonviable zombie firms are those whose liquidation value is greater than their value as a going concern, taking into account potential restructuring.

Structural Policy Issue 5: Reducing Financial Sector Fragility

Large Banks Fund Small Banks, NBFIs in Wholesale Market

(In RMB trillion)



Sources: The People's Bank of China.

Authorities' Views

- **Basic agreement** on needed direction of change.

But they argue:

- They have **more time**, larger buffers (savings, reserves, fiscal), stronger underlying growth momentum (6½-7 without stimulus)
- **Reforms are in train** and more effective (“supply side”, SOEs, financial reform, opening up)
- **Industrial Policy** – different approach

Key Takeaways

- + **Rebalancing** well underway
- + Authorities **focused on financial stability**
- Large stock of **problems**
- ? **Reforms** decisive & fast enough, sustained ?

Policy priorities: structural

- SOEs, banks, LG finances
- Less investment, more consumption
- New sources of growth

Outlook: policy dependent

IMF on China (2017)

Staff Report (July 2017):

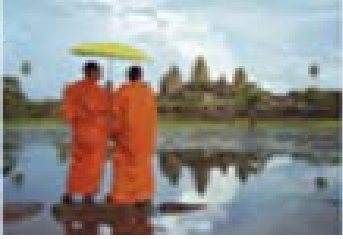
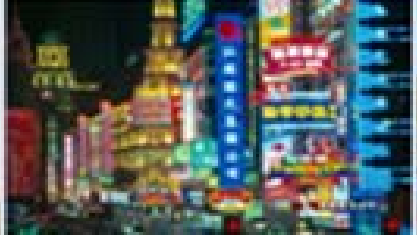
<http://www.imf.org/en/Publications/CR/Issues/2017/08/15/People-s-Republic-of-China-2017-Article-IV-Consultation-Press-Release-Staff-Report-and-45170>

Selected Issues Background Papers (July 2017):

<http://www.imf.org/en/Publications/CR/Issues/2017/08/15/People-s-Republic-of-China-Selected-Issues-45171>

Modernizing China (April 2017, Book Excerpt):

http://www.elibrary.imf.org/staticfiles/misc/pdf/modernizing_china_excerpt_en.pdf



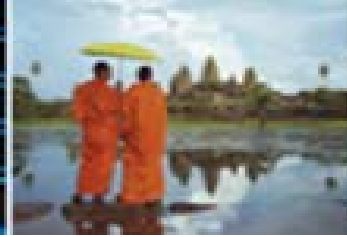
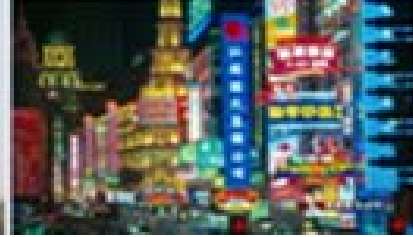
Thank you



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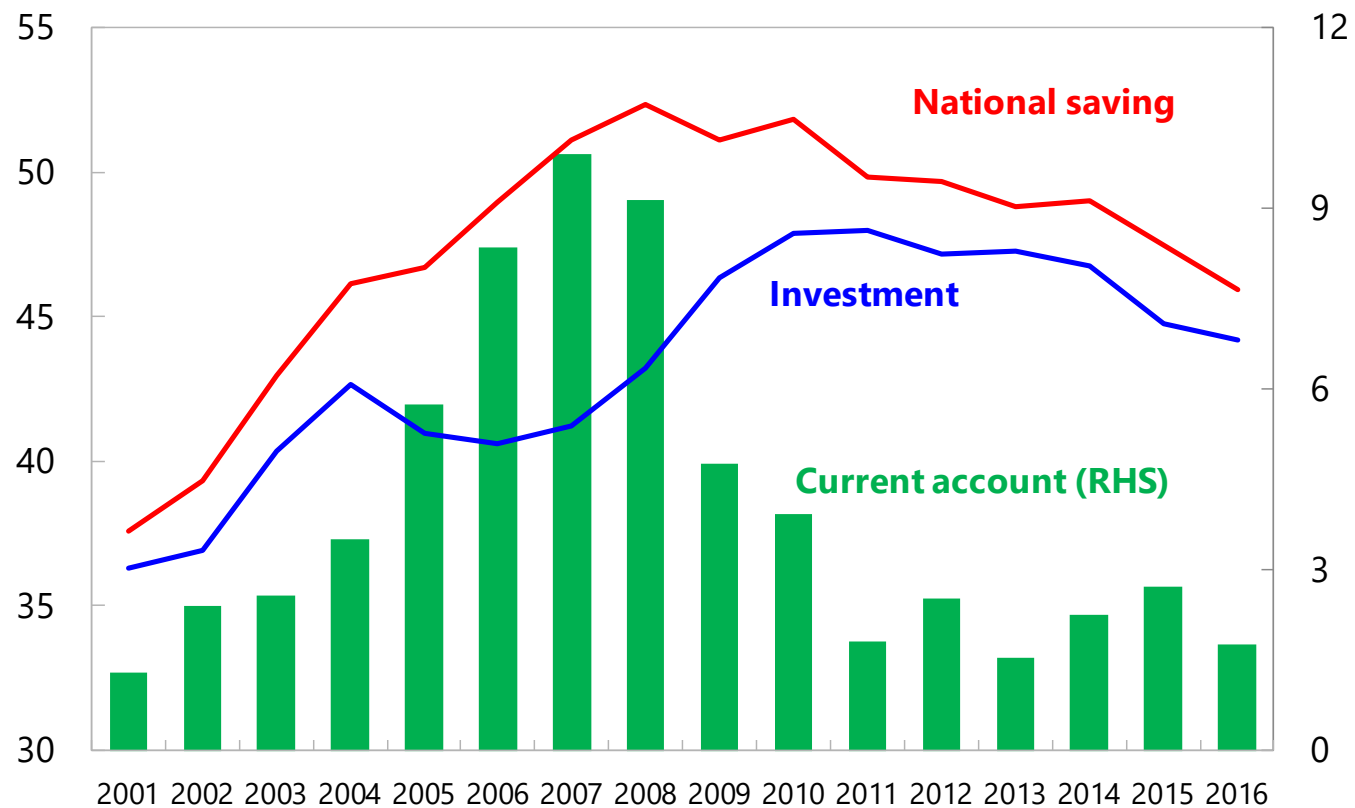


EXTRA SLIDES

China has made progress in rebalancing away from external-led growth...

Investment and Saving

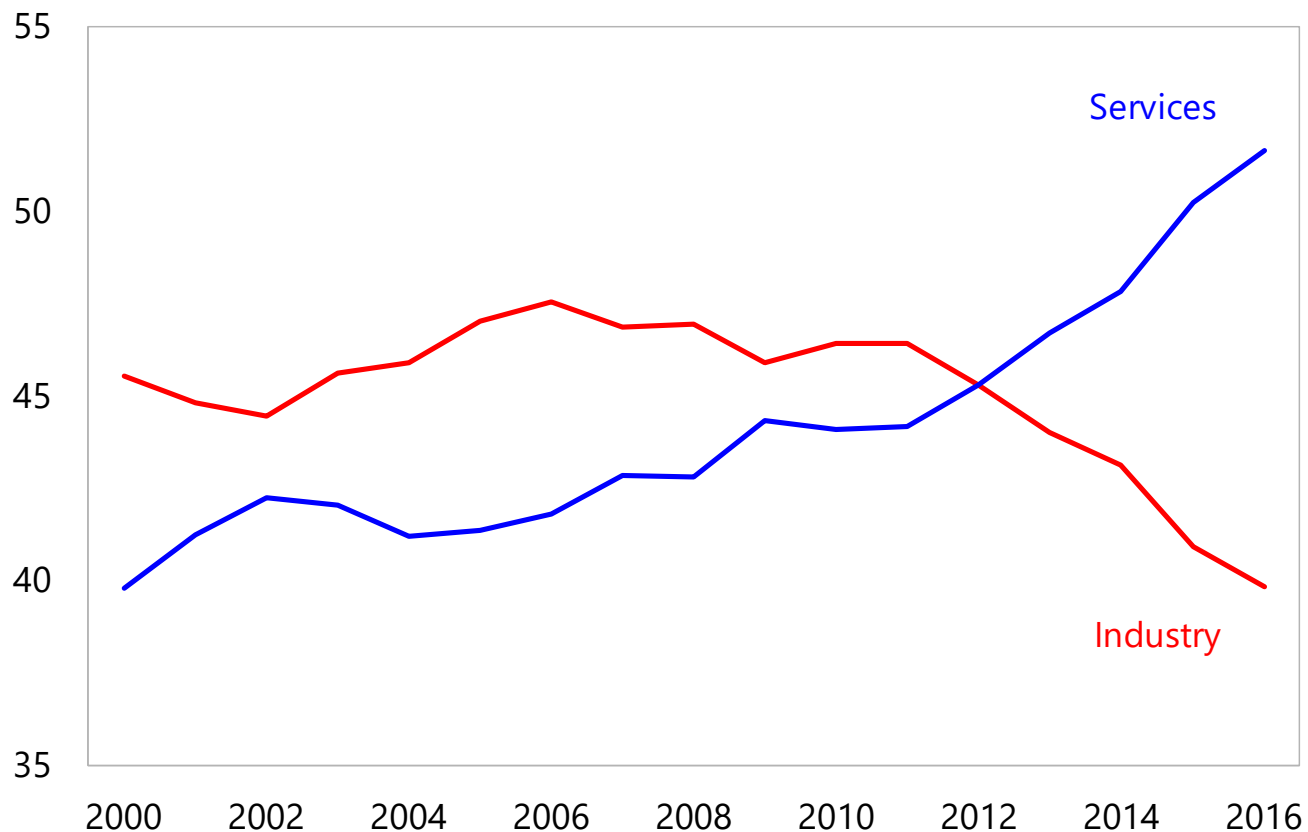
(In percent of GDP)



...and moving toward a more service-dominated economy.

GDP by Production

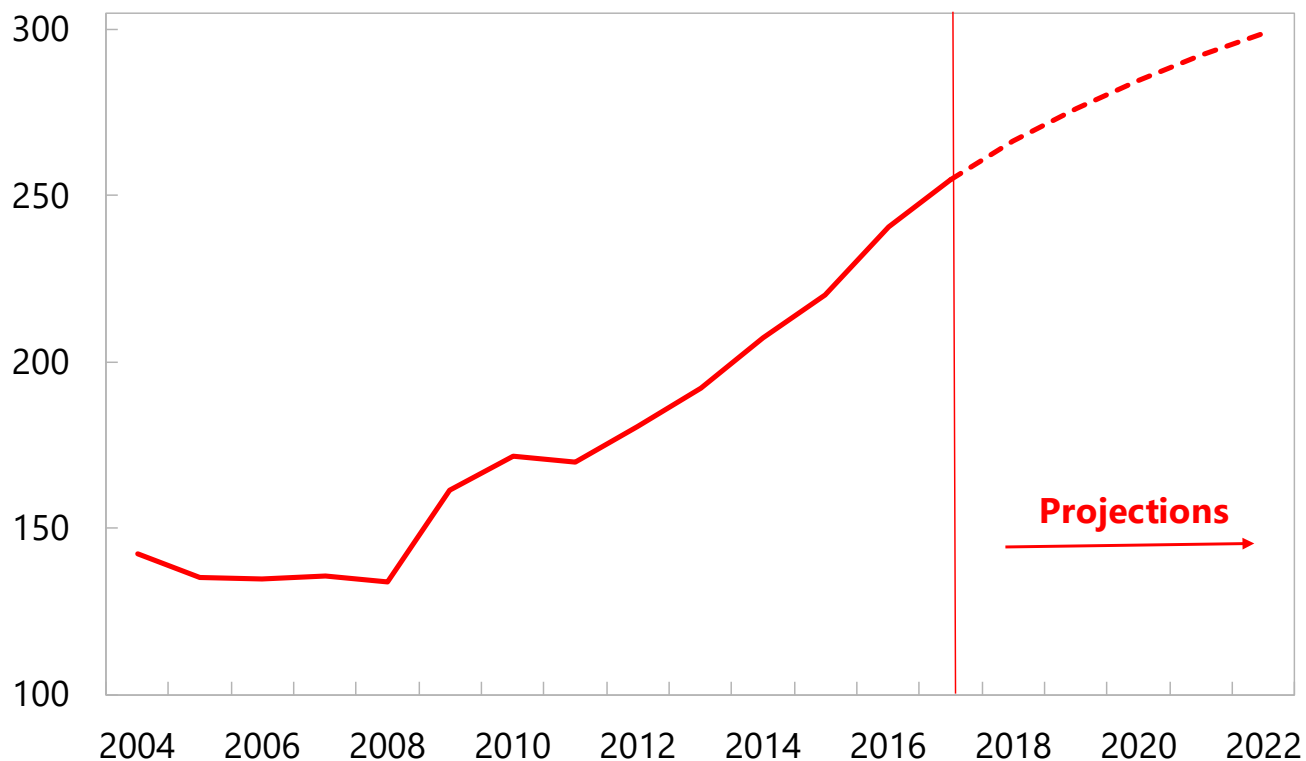
(In percent of nominal GDP)



The core problems remain an excessive reliance on debt...

Non-Financial Sector Debt

(In percent of GDP)

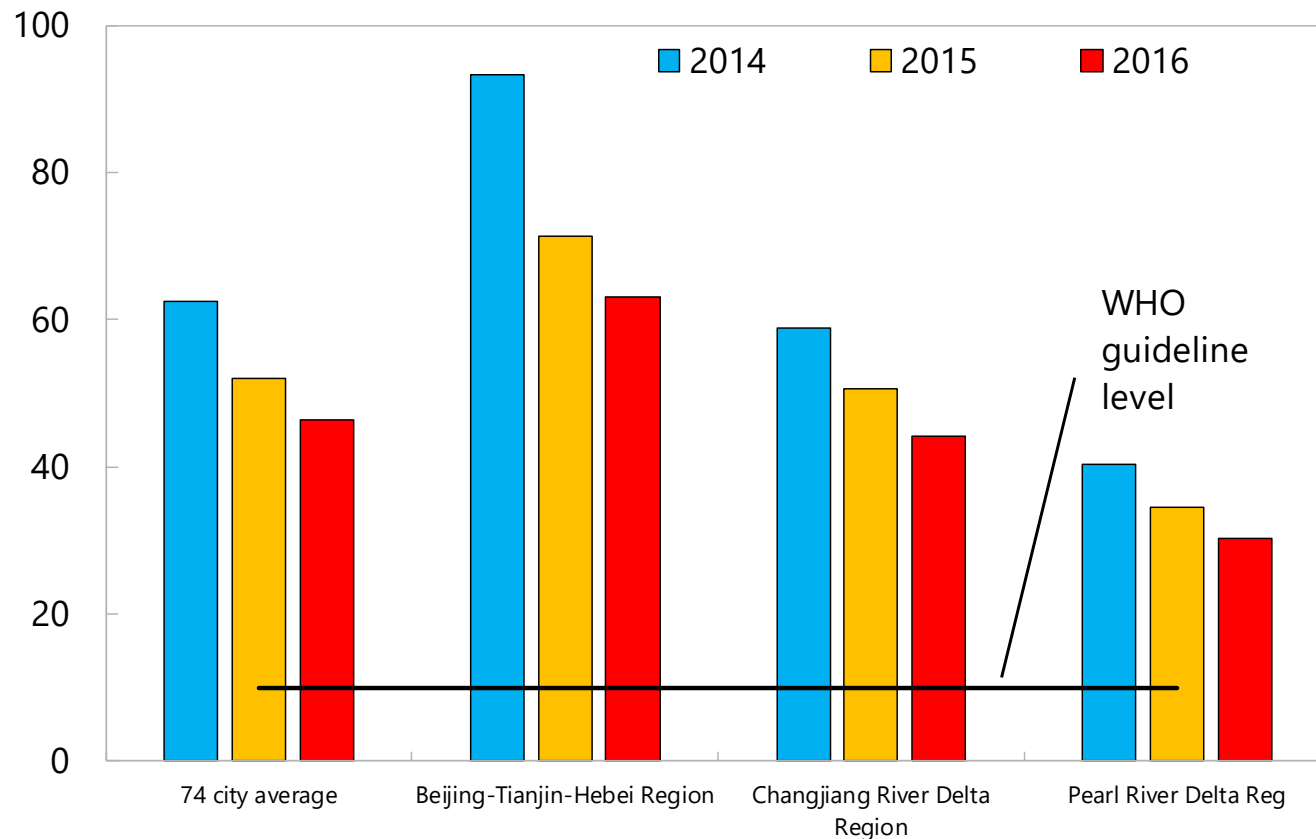


Sources: Haver Analytics; and IMF staff estimates.

...and the high environmental costs to growth

Air Pollution

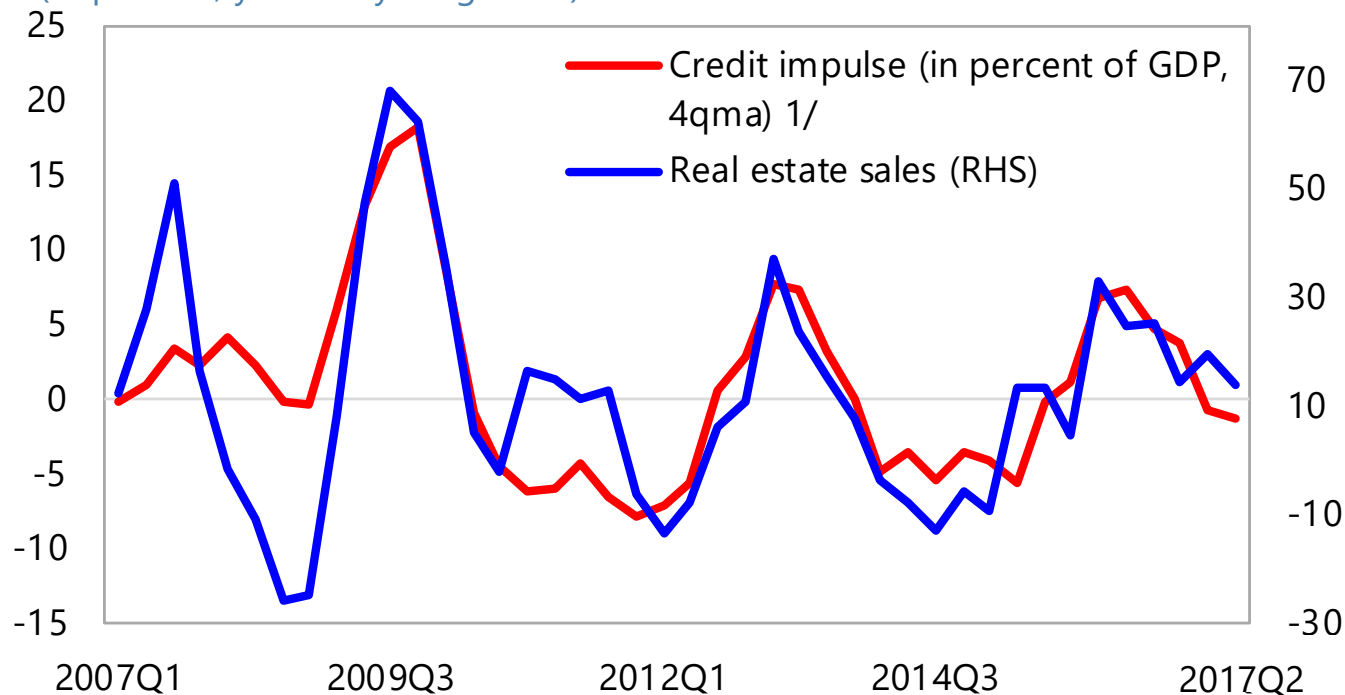
(PM2.5 concentration, in mcg/Cub m)



Initial headwinds for real estate

Credit Impulse and Property Market

(In percent, year-on-year growth)



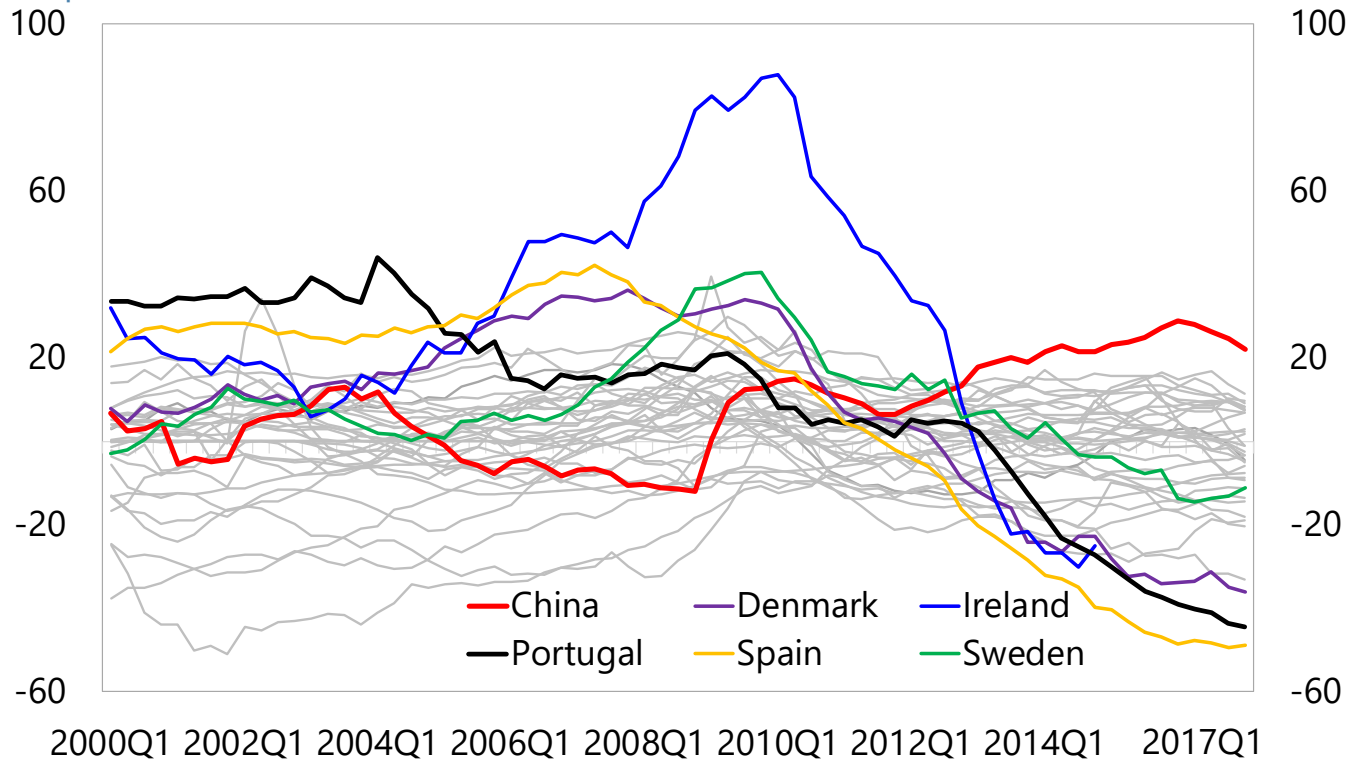
1/ Credit impulse is the change in the flow of adjusted TSF over the last four quarters relative to GDP.

Sources: Haver analytics and IMF staff estimates.

China's credit gap remains large

China's Large Credit Gap

(In percent of GDP)



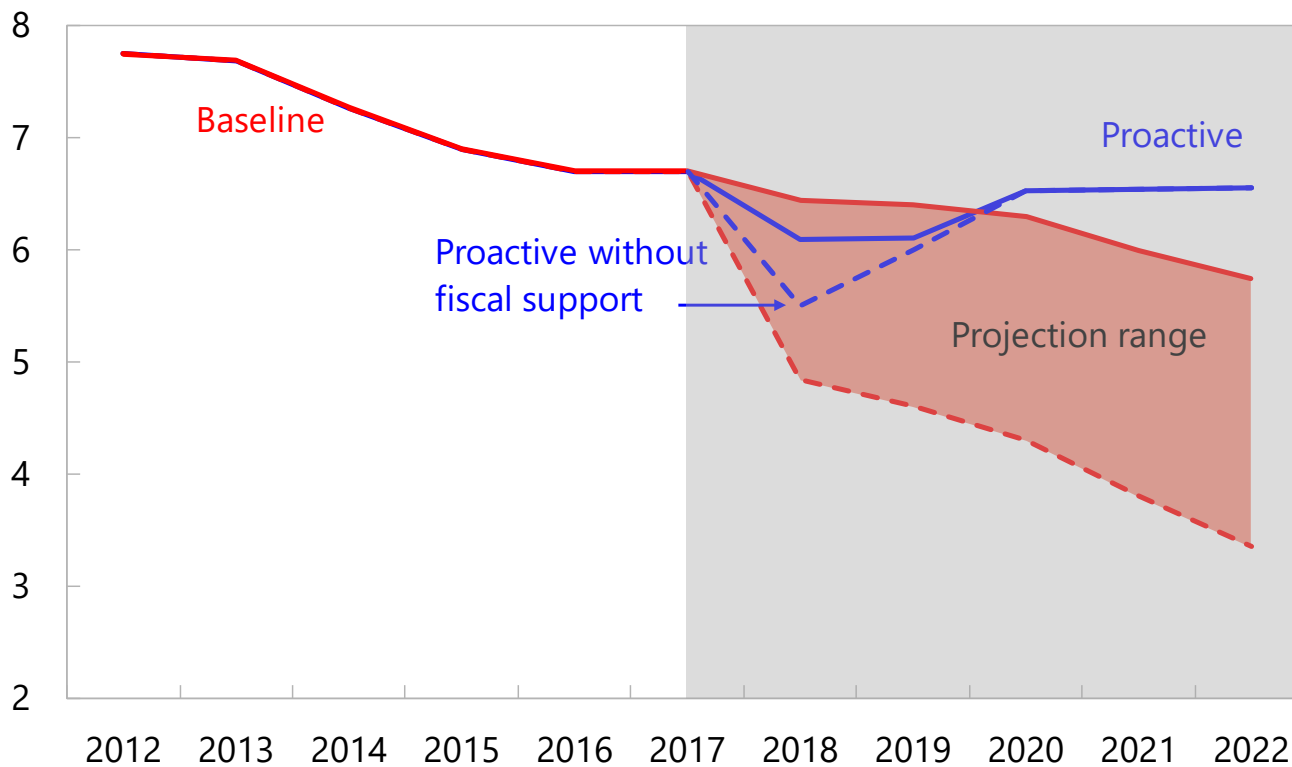
Note: Based on credit to private non-financial sector.

Sources: Bank for International Settlements (BIS); and IMF staff estimates.

Larger downside risks to the baseline

Real GDP Growth Scenarios

(In percent, year-on-year growth)



Sources: CEIC Data Company Ltd.; and IMF staff estimates and projections.