

# China 2016 Economic Outlook Growth, Debt, and China's Changing Financial Landscape

European Chamber of Commerce

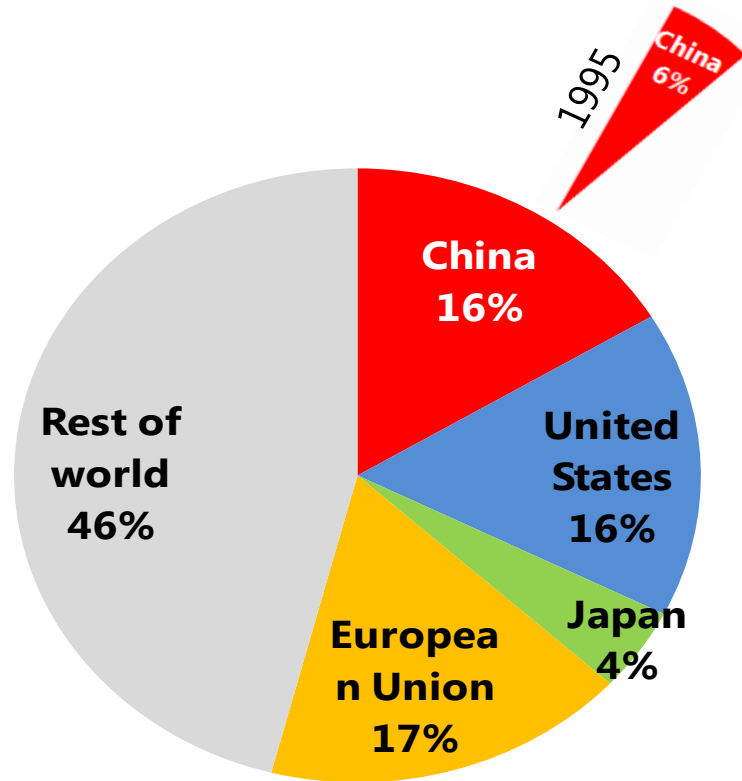
Alfred Schipke  
IMF Senior Resident Representative  
December 2, 2015

# Roadmap

- Setting the stage: all eyes are on China
- Growth, investment, and credit
- Public and corporate debt
- Financial sector development: finding the right balance
  - Banking and shadow banking
  - Equity markets
  - Bond markets
  - P2P platforms
- Reforms
- RMB internationalization

Setting the stage: all eyes are  
on China

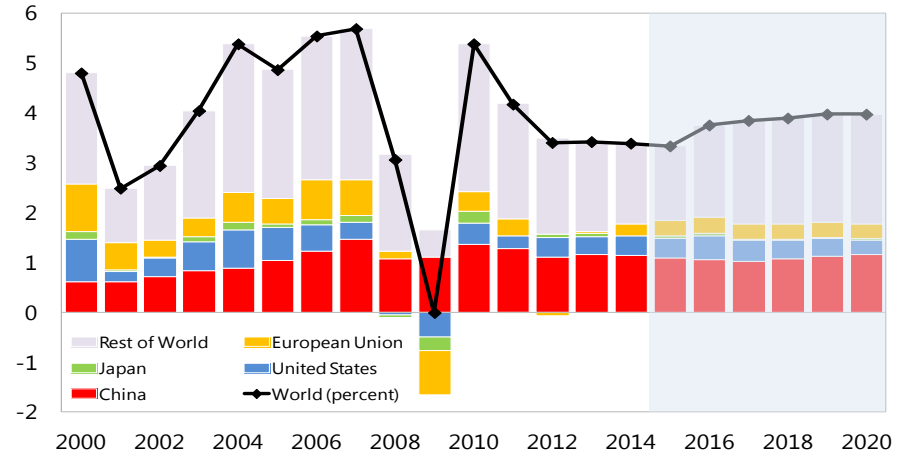
# China's economy contributes 25 percent to global GDP growth



PPP terms, 2014

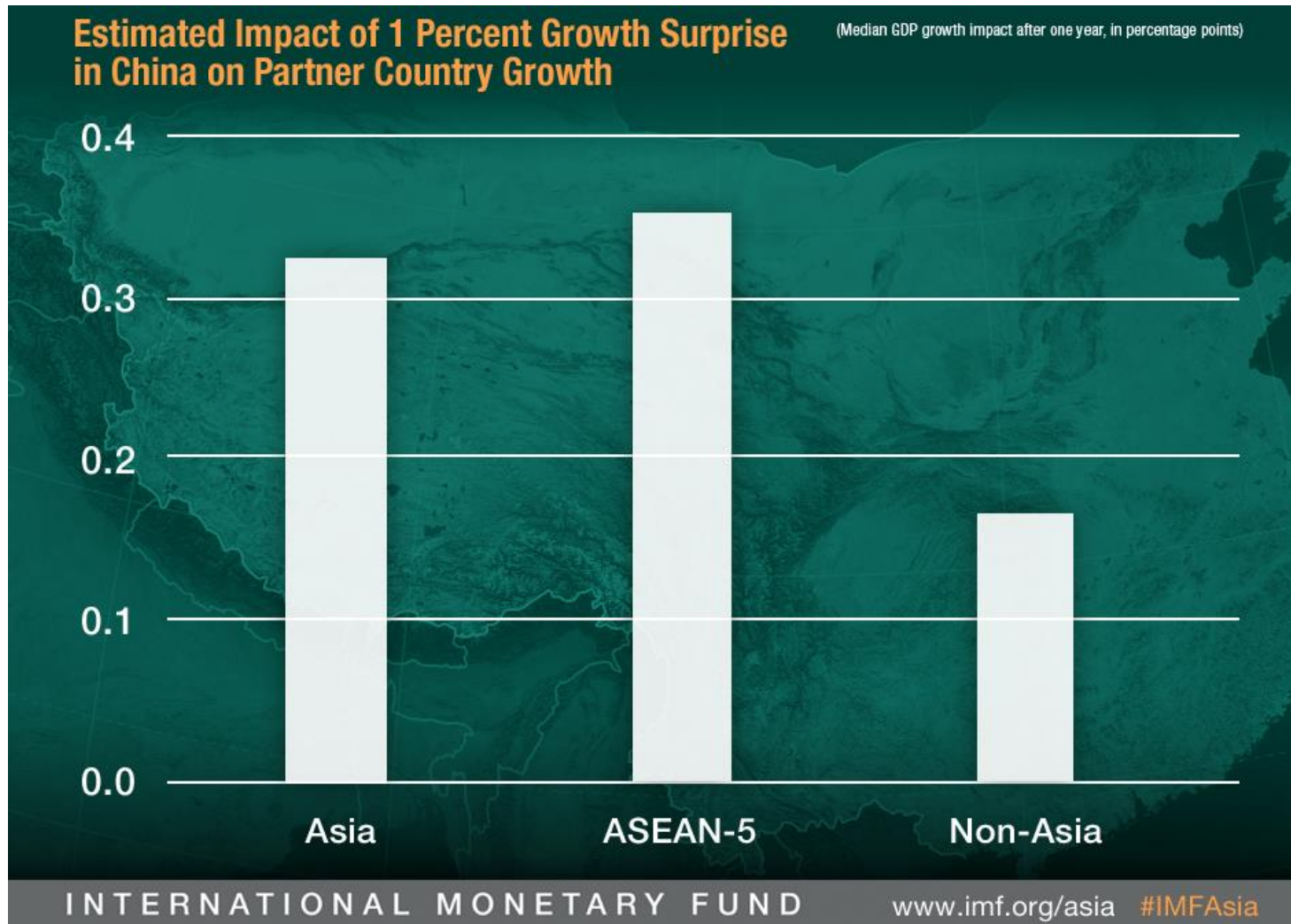
## Contribution to Global Growth

(In percentage points)

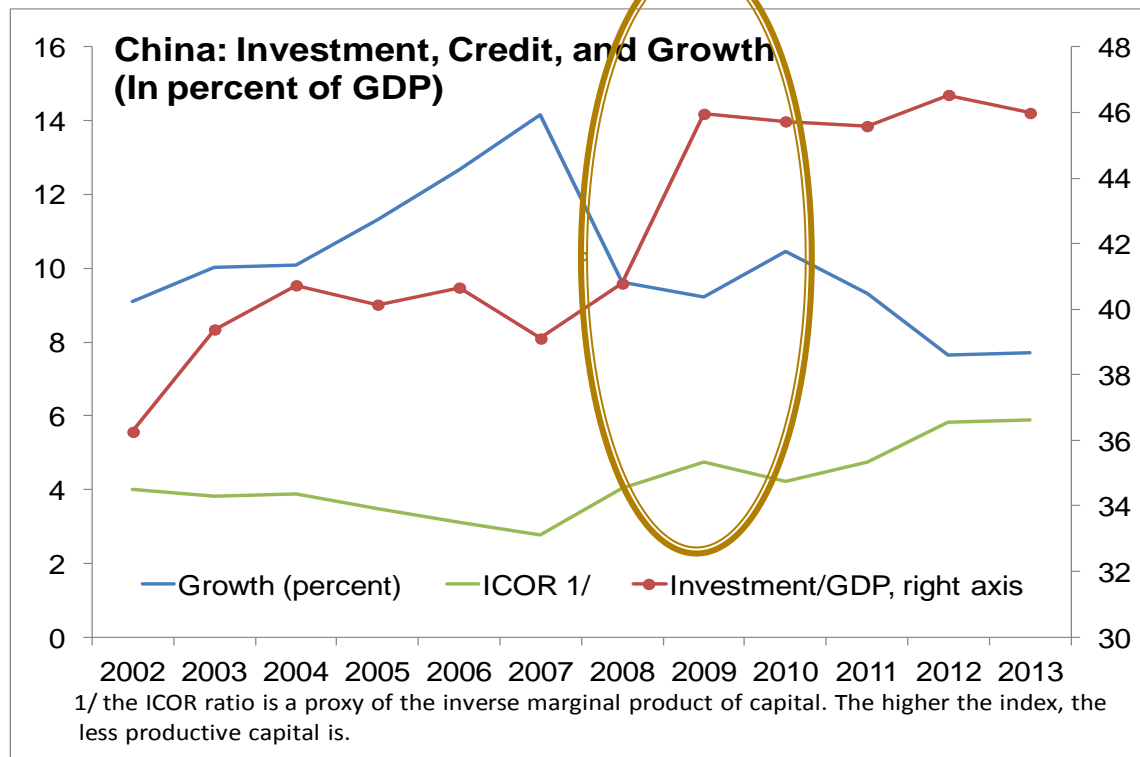


Sources: IMF World Economic Outlook; and IMF staff calculations.

# Spillovers might be even more pronounced going forward



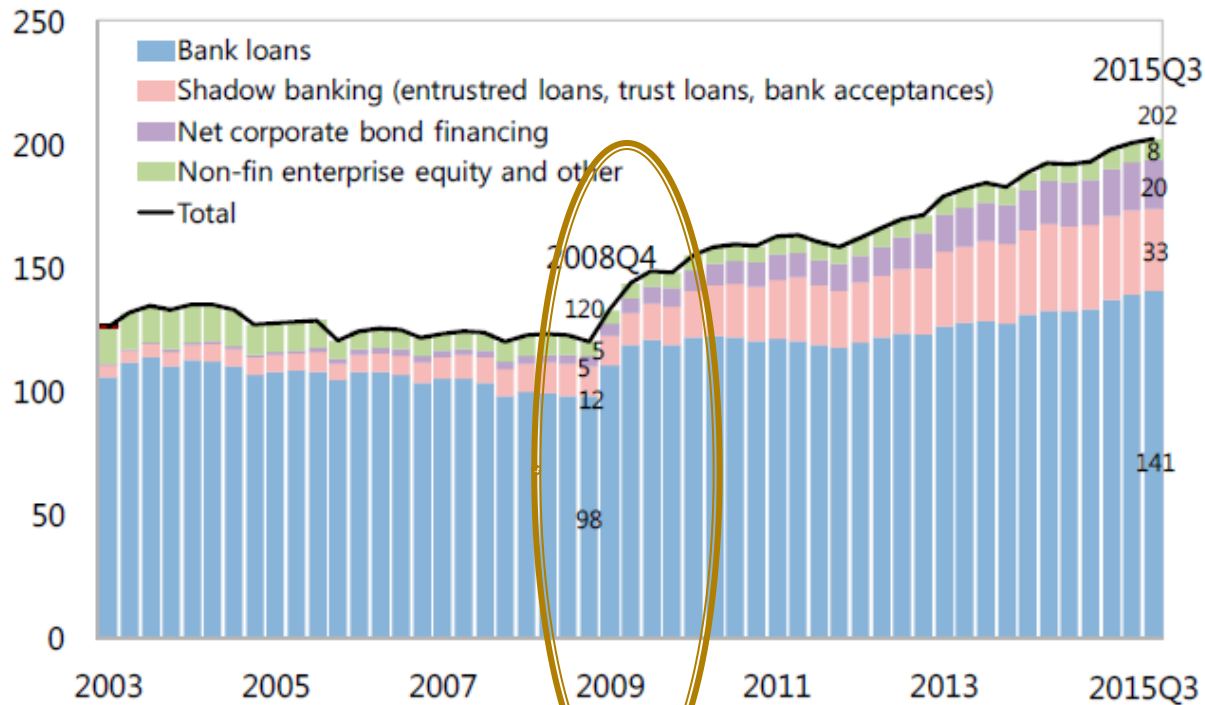
# Signs of diminishing returns



# Surge in credit growth

## Social Financing Stock

(In percent of GDP) <sup>1/</sup>

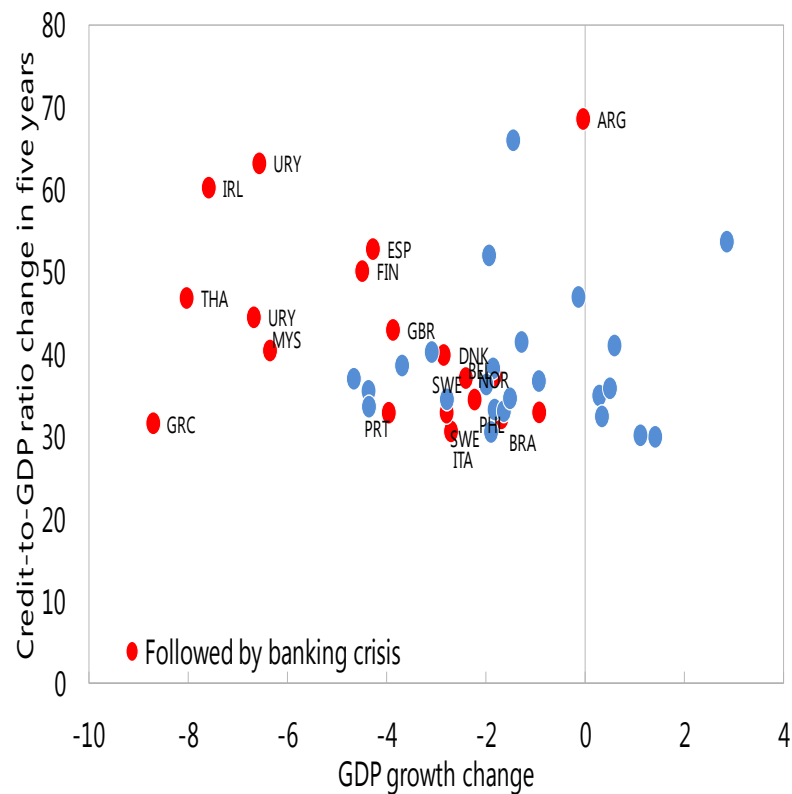


<sup>1/</sup> In percent of 4Q rolling sum of quarterly GDP.

# Risks of high credit growth

## Credit Booms and Change in GDP Growth Rates

(In percentage points)



Source: IMF staff estimates and calculations.

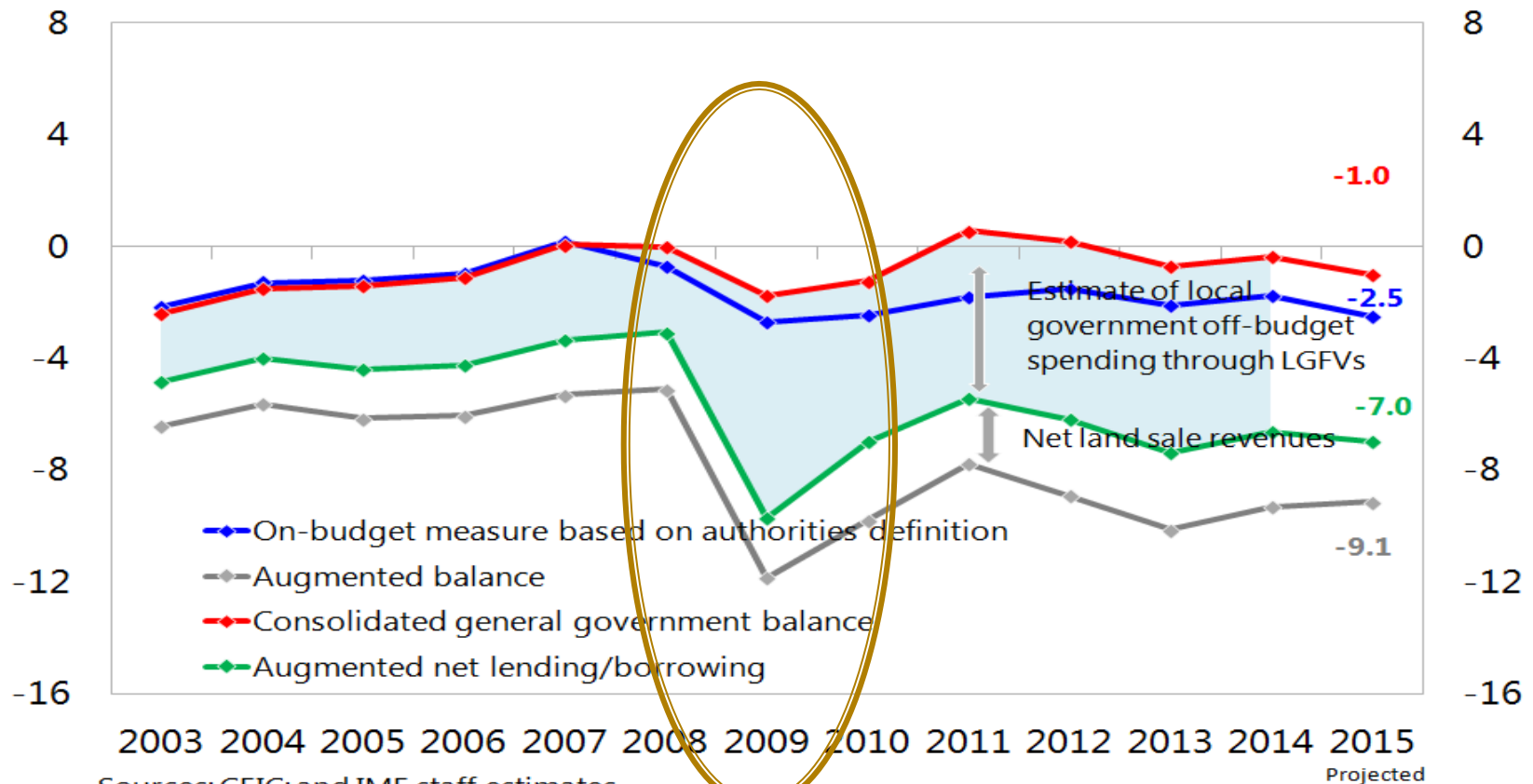


# Local and corporate debt

# Augmented fiscal deficit remains large

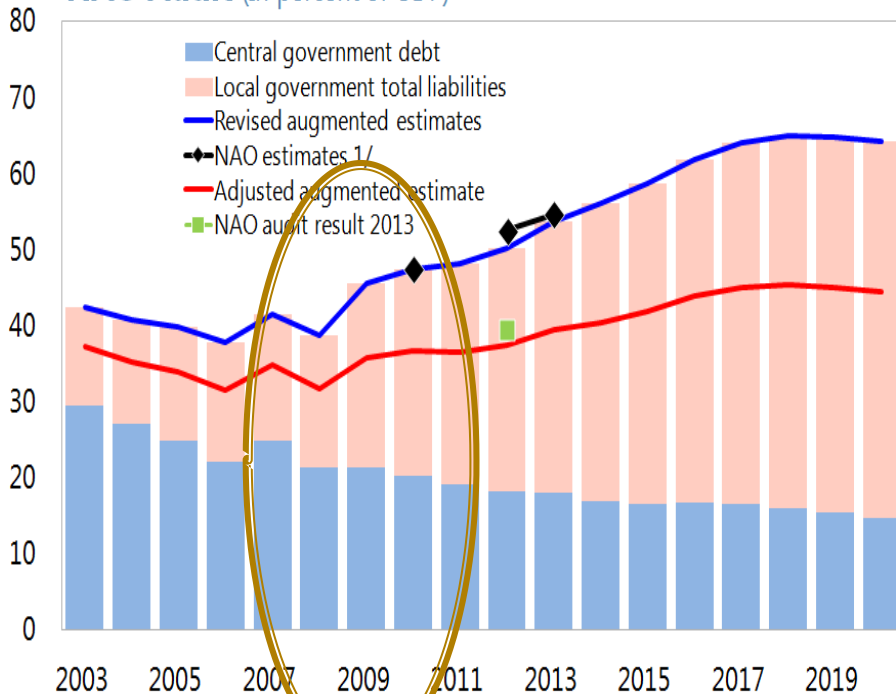
## China: General Government Balance

(In percent of GDP; including state-administered SOE funds and social security)



# Evolving strategy to address local government finances

General Government Debt: Augmented Measure and NAO Audit (In percent of GDP)



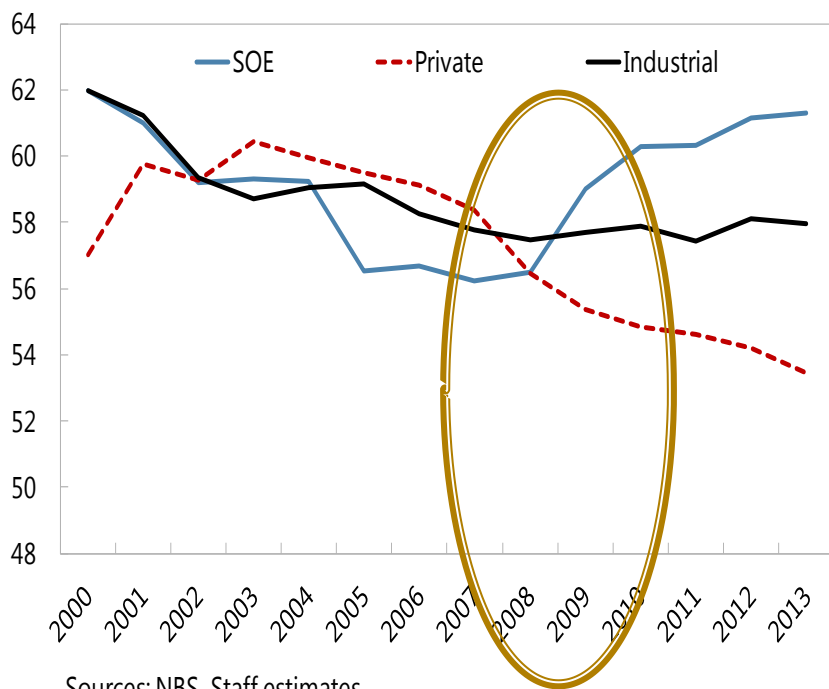
Sources: NAO; and IMF staff estimates.

1/ including explicit government debt, government guaranteed debt, and the liabilities that the government may incur obligations.

- Overall (augmented) debt levels will continue to rise
- Revised budget law to constrain local government borrowing
- Debt swaps
- Implications for banks

# Corporate indebtedness: high and vulnerable to shocks

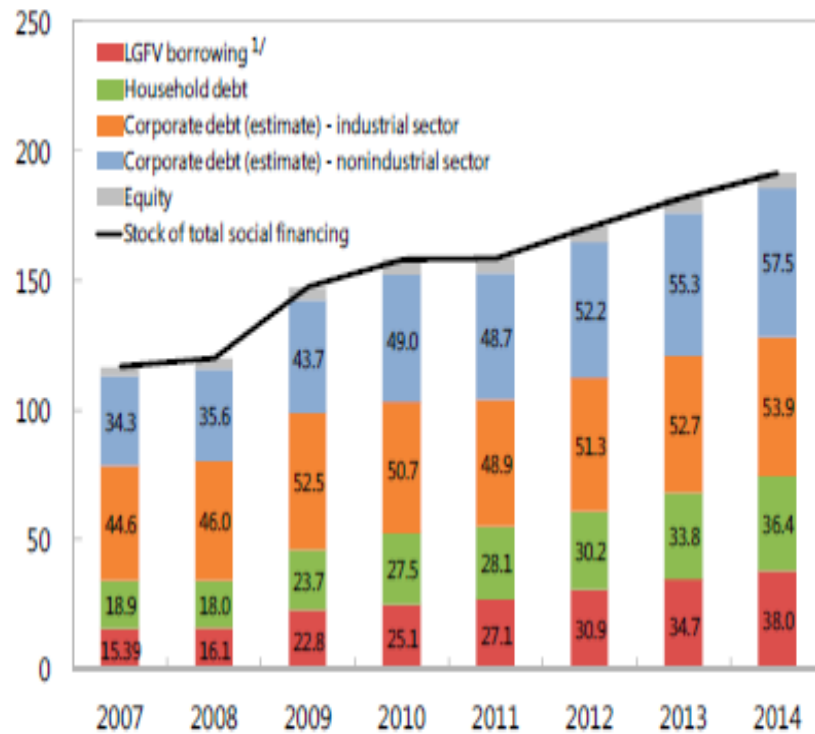
## Leverage by Ownership



Sources: NBS, Staff estimates

## Total Credit by Sectors

(In percent of GDP)



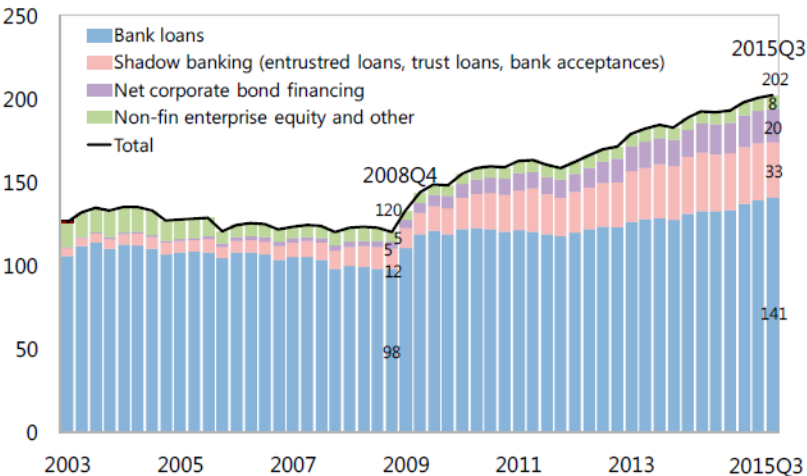
1/ Includes all local government debt except local government bonds.

Financial system: finding the right  
balance between innovation and  
stability

# Investment driven growth model calls for financing (from banking, to shadow banking, to ....)

## Social Financing Stock

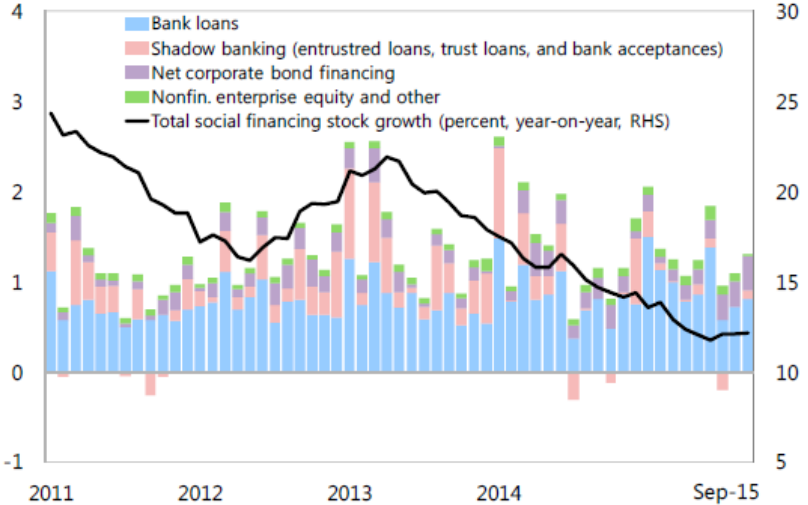
(In percent of GDP) <sup>1/</sup>



1/ In percent of 4Q rolling sum of quarterly GDP.

## Social Financing Flow

(In RMB trillion)



# Equity markets: sharp correction and government response

- 80 percent are retail investors
- Impact on real economic activity (wealth relatively small)
- Lessons: financial oversight, countercyclical macro prudential measures, communication

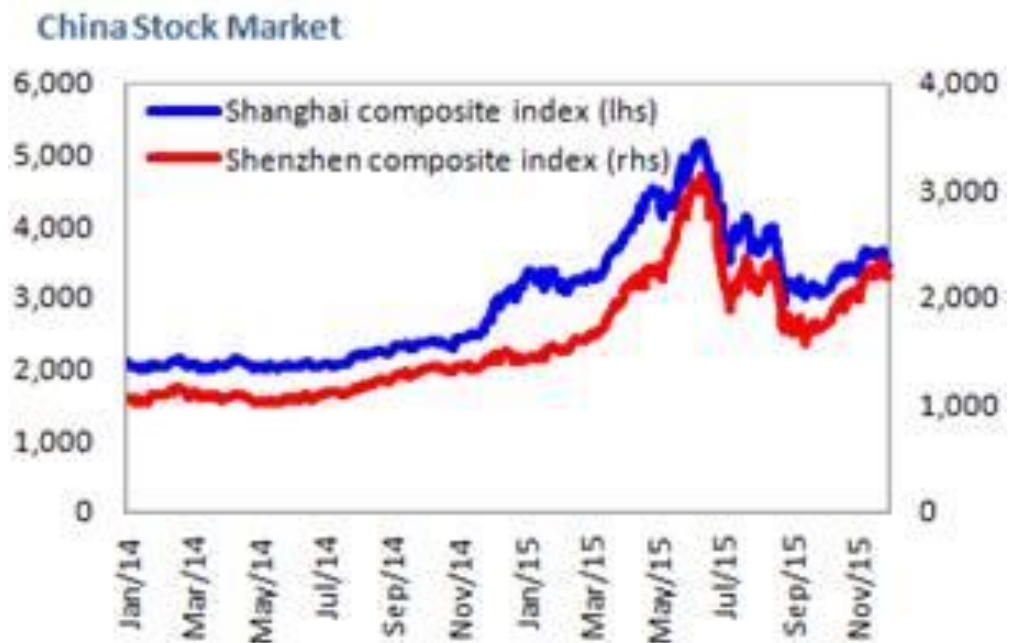
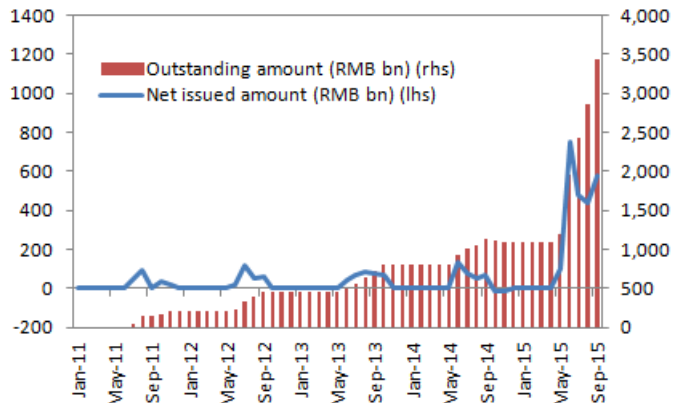


Table 2

	Today's closing	Relative to 2014 trough (Jan 20)	Relative to 2015 peak (Jun 12)	Relative to recent trough (Jul 8)
Shanghai composite index	3445.7	73.0	-33.3	-1.8
Shenzhen composite index	12037.9	60.0	-33.5	9.0
Chinex (high-tech stocks)	2672.6	94.7	-31.5	13.1

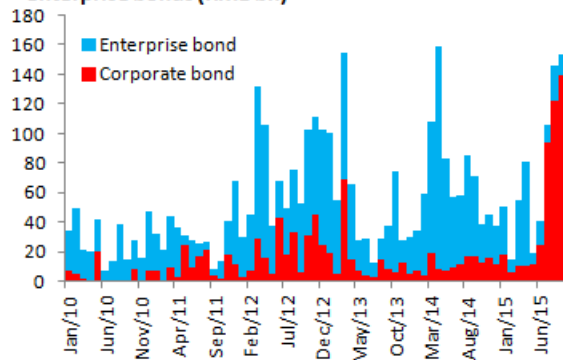
# Bond markets—compressed credit spreads

China: Local government bond issuance



Source: WIND; staff estimates.

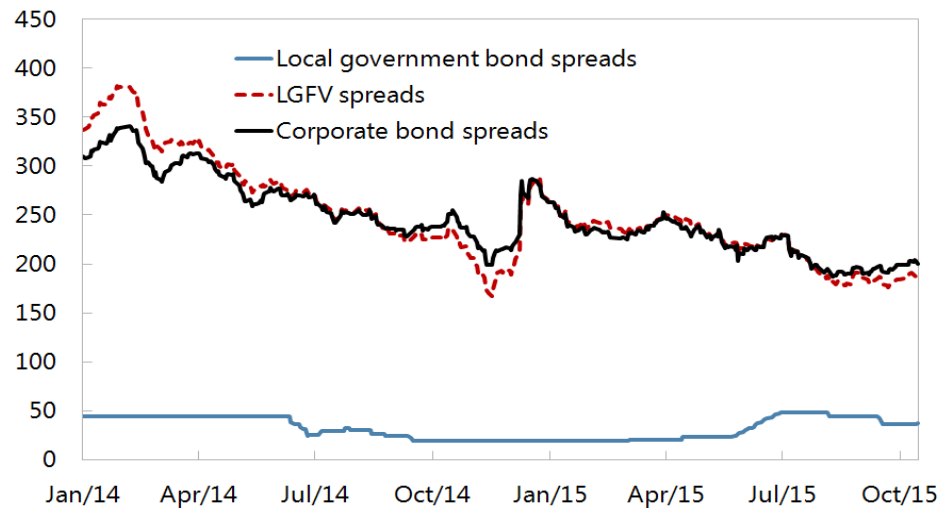
China: Gross issuance of corporate bonds and enterprise bonds (RMB bn)



Source: WIND.

## Bond Spreads over Sovereign Bonds

(5-year bonds; in basis points)

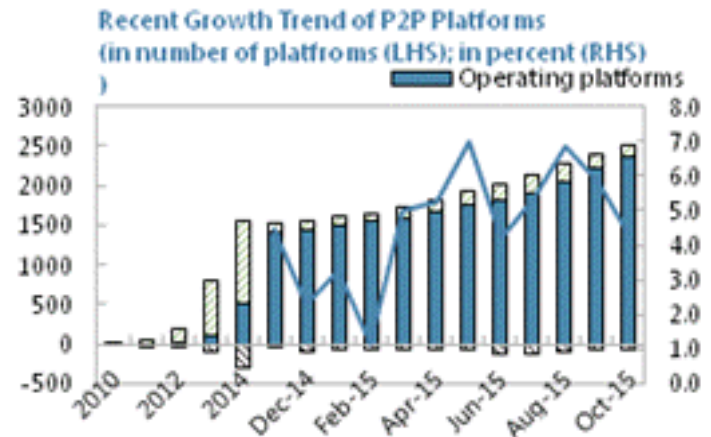


Sources: WIND.



# Example of innovation: P2P platforms

- Advantages:
  - Lower search costs
  - Possibly use of big data
  - Mere platforms: only intermediation



- Microcredit, SME financing
- Risks:
  - Guarantees (75 percent)
  - Moral hazard
  - Fraud
  - Lack of regulation

# Reforms

# Implementation of reforms critical

Financial	Fiscal	External	Structural
Better pricing of risks	Implementation of new budget law framework on local gov'n't finance; tax reforms	Greater exchange rate flexibility	Open-up for competition; level playing field; harden SOE budget constraints
Resolving implicit guarantees; greater tolerance of defaults	Realigning local gov't spending and revenue responsibilities;	Gradual capital account liberalization	Advance in urbanization and hukou reforms

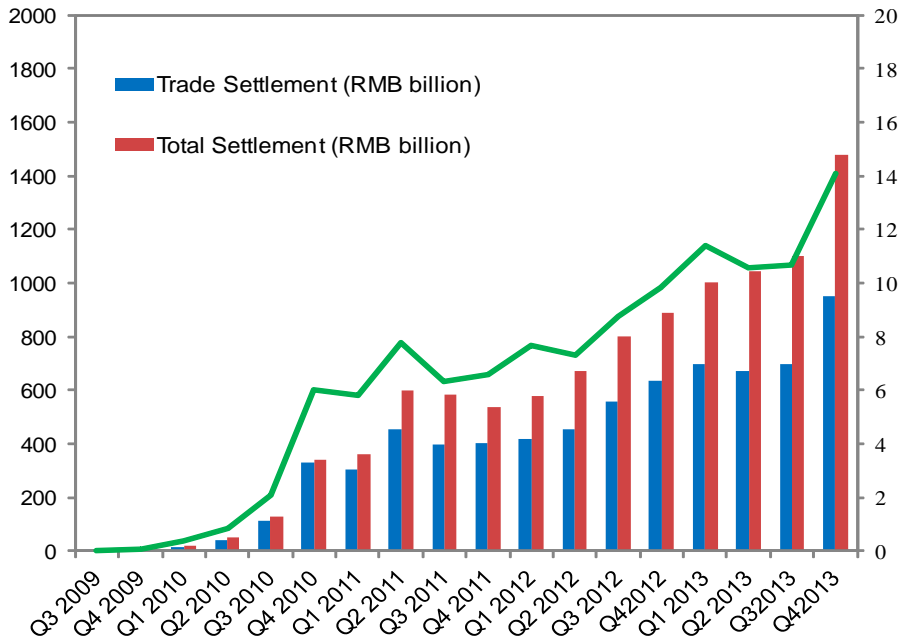
# RMB Internationalization

# Different dimensions

- Medium of exchange
  - Foreign exchange transactions associated with cross-border trade in goods, services, and financial instruments (currency, bonds, equity, etc.)
  - Official foreign exchange intervention
- Store of value
  - Savings/investments vehicles used by private companies and households (banks and capital markets)
  - Reserve currency/swap lines
- Unit of account
  - Global pricing
  - Pegging of currencies
  - SDR

# RMB for international payments increased significantly

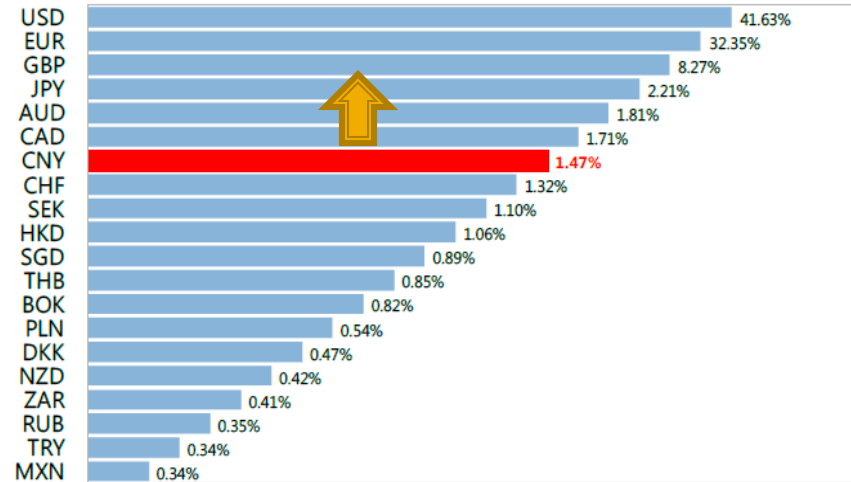
Use of Renminbi in China's cross border transactions



Sources: PBoC, China's Customs, Staff Calculations.

## RMB as World Payments Currency in Value

(May, 2014; customer initiated and institutional payments. Inbound and outbound traffic. Based on value.)



Source: SWIFT watch.

# Sharp rise in offshore RMB deposits and bond issuance, but from low levels

**Table 4. International Banking Liabilities**

(shares in percent of global total) 1/

	2010:Q2		2015:Q2	
	US\$ bn	%	US\$ bn	%
USD	13,064	48.7	14,050	52.8
EUR	8,909	33.2	7,573	28.5
GBP	1,719	6.4	1,538	5.8
JPY	970	3.6	687	2.6
CHF	436	1.6	479	1.8
Other	1,721	6.4	1,814	6.8
			<i>Memo item:</i>	
			RMB 2/	1,139

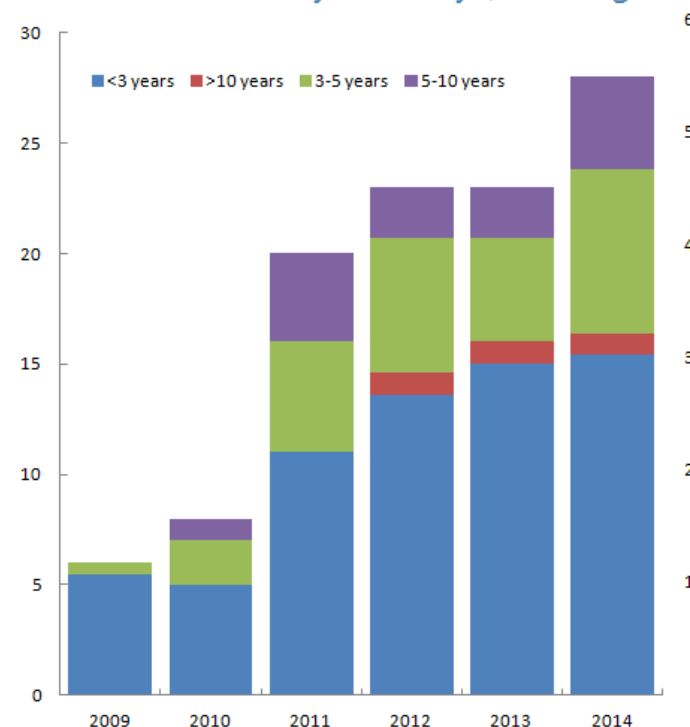
Sources: BIS Locational Banking Statistics; IMF staff calculations based on BIS data; Haver Analytics; and national sources.

1/ Hong Kong SAR, Macao SAR, and Taiwan Province of China are treated as domestic.

2/ Amount for RMB if Hong Kong SAR, Macao SAR, and Taiwan Province of China were treated as international.

## CNH Bonds: New Issuance

(in billions of RMB; by maturity (Sovereign bonds))



Sources: Bloomberg; and IMF staff estimates.

# Official reserves

- Some 38 central banks hold RMB as foreign currency assets
- Swap lines (more than 30)
- Australia's central bank publicly announced a 5 percent RMB target
- In 2014, Britain issued its first RMB bond for RMB reserves

**Table 3. Official Foreign Currency Assets**  
(shares in percent of global total)

	2013			2014			
	SDR bn	%	Reporting countries	SDR bn	%	Reporting countries	
USD	2,701	61.3	127	USD	2,961	63.7	127
EUR	1,041	23.7	109	EUR	978	21.0	108
GBP	187	4.2	108	GBP	190	4.1	109
JPY	147	3.3	87	JPY	160	3.4	88
AUD	98	2.2	79	AUD	98	2.1	78
CAD	87	2.0	84	CAD	92	2.0	85
RMB	29	0.7	27	RMB	51	1.1	38
NZD	11	0.2	27	CHF	11	0.2	69
CHF	10	0.2	73	NZD	11	0.2	29
NOK	9	0.2	45	SEK	9	0.2	40
Other	66	1.9		Other	73	1.9	

Source: IMF staff survey of members.



# RMB appreciation expectations played an important role

- Appreciation expectations most important factor
  - Offshore deposit growth
  - Offshore bond growth
- Caveat: time series is limited
- Going forward: economic reforms and macroeconomic stability will be key determinants of further RMB internationalization

# Decision on Nov 30, RMB inclusion in IMF Special Drawing Rights (SDR)

- SDR is a reserve asset issued by the IMF (1969)
- Currently, value of SDR based on basket of four currencies, starting Oct. 2016, RMB included
- Total stock of SDRs 204 billion (\$309 billion U.S.\$)
- Criteria for inclusion in
  - Exports – Use in trade
  - Freely Usable Currency – Designated by the IMF Board
    - Widely use (bank liabilities, debt securities, reserves)
    - Widely traded (spot market turnover)
  - Weigh in the basket
    - RMB's weight of 10.92% ahead of the Japanese yen (8.33%) and the British pound (8.09%), behind the US dollar (41.73%) and the euro (30.93%).

**Thank you!**

# Large buffers

- Large FX reserves
- Low fiscal debt/low interest rates
- High degree of state control
- High potential growth
- Liquid banking system

# China's recent operational reforms

- Access to China's bond market (assets and derivatives) by central banks, sovereign wealth funds, and international organizations (IMF, WB, BIS, etc.)
- Regular issuance of 3 months government T-bills
- CEFTS quotes of CNY exchange rate

# Exchange rate: change in China's exchange rate mechanism

- Recent change provides the basis for a more market based exchange rate
- Important as China integrates into the global financial system and the world economy
- Depreciation since August 11 does not alter our assessment that exchange rate is broadly in line with medium term fundamentals

