

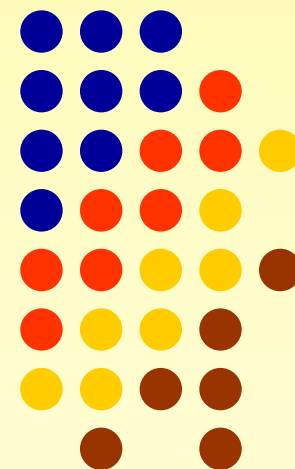
China: Can the Rapid Growth Be Sustained?

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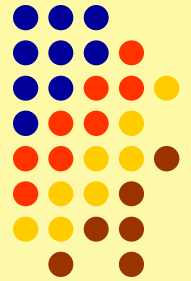
IMF Book Forum: December 14, 2006



Jahangir Aziz
International Monetary Fund

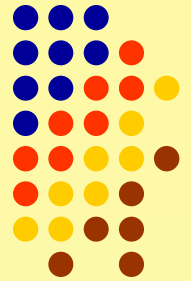


In the last 20 years, China has added ...



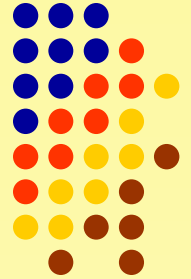
- nearly \$2 trillion to global GDP
- 120 million in employment
- and pulled 300 million people out of poverty

These large numbers are equivalent to ...



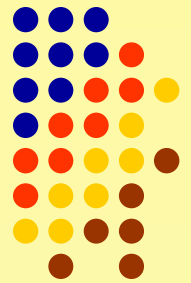
- ... adding a country of the size of Portugal each year to the world economy ...
- ... creating as many new jobs each year as Australia's total labor force ...
- ... and eradicating poverty in Ethiopia, Nigeria, Tanzania, and Zambia combined.

Can This Expansion Be Sustained?

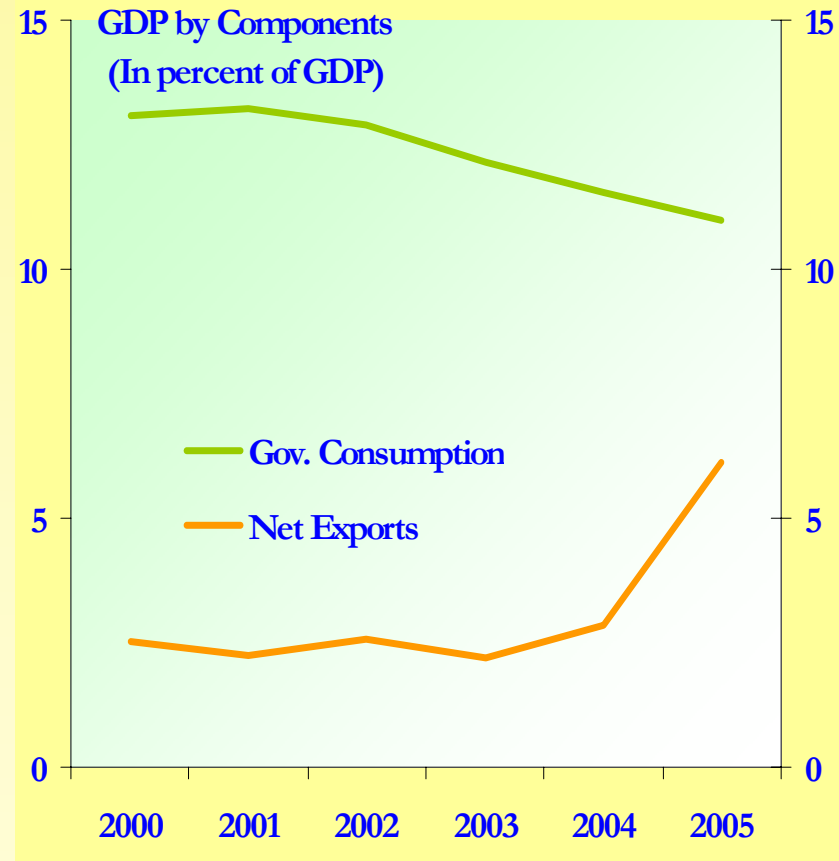
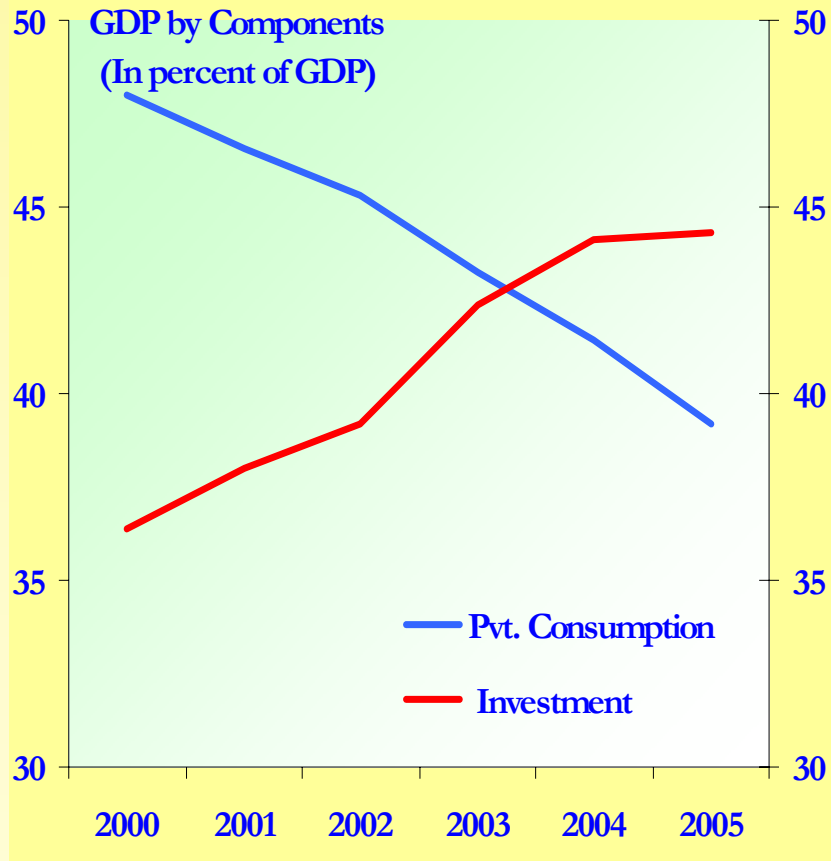
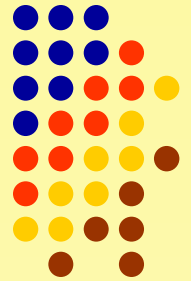


- What's driving recent growth?
- Where are the weaknesses?
- What needs to be done?

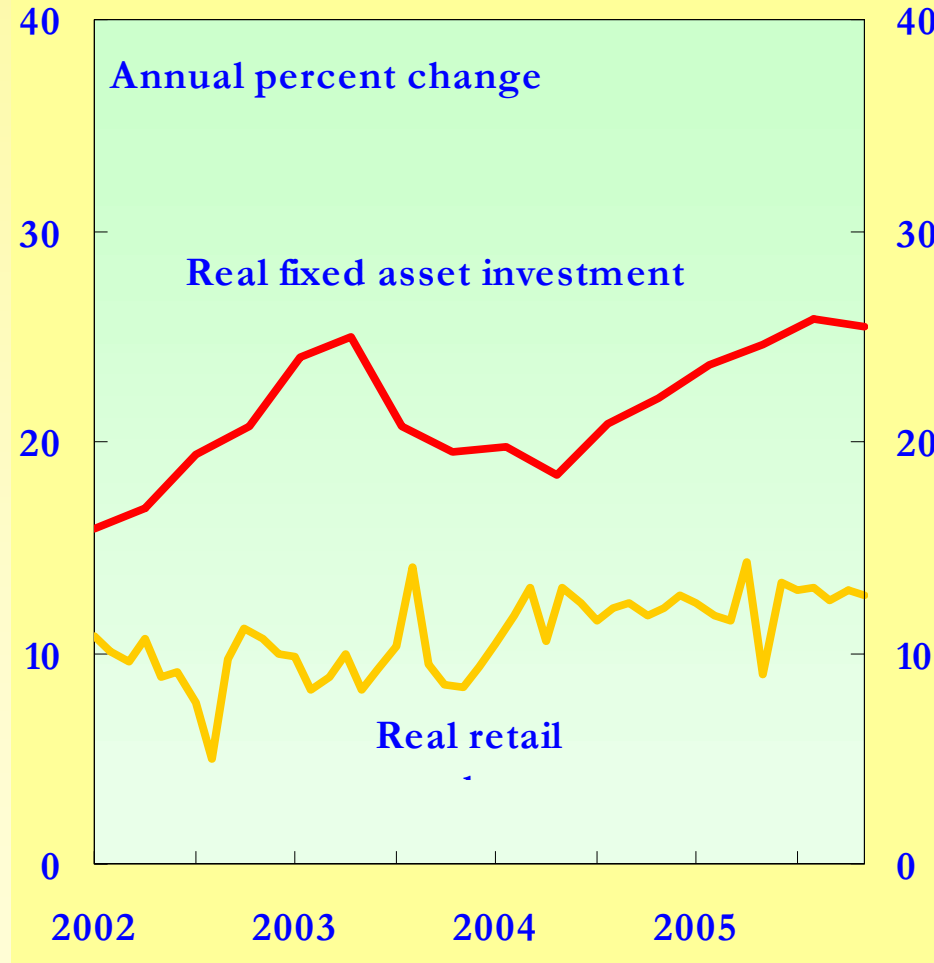
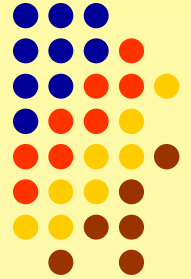
In recent years, growth in China has been driven by...



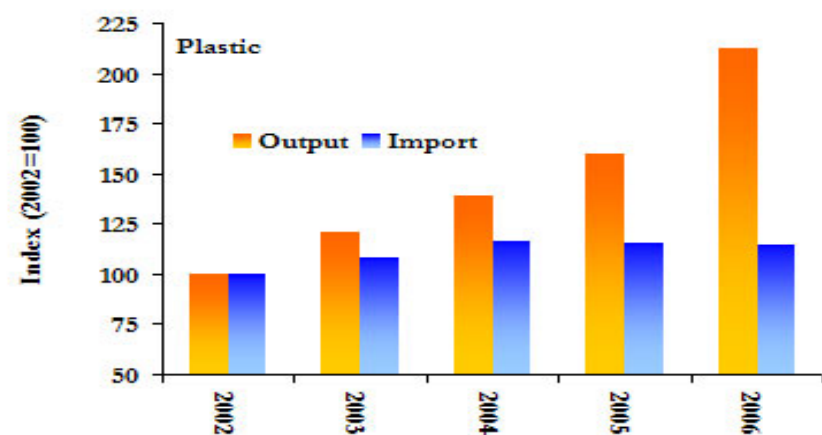
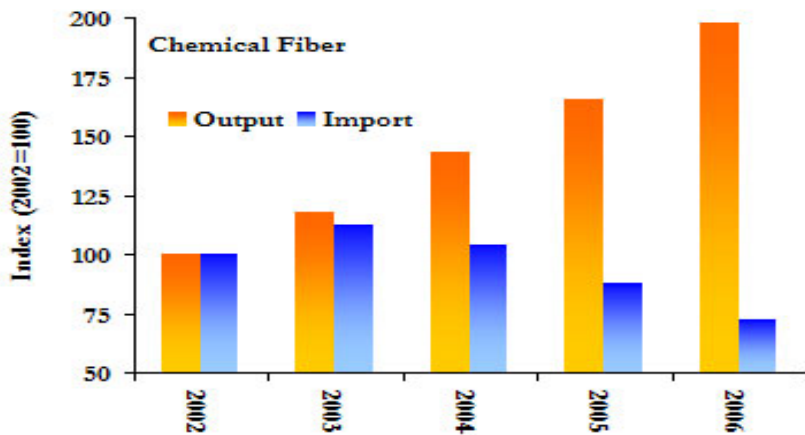
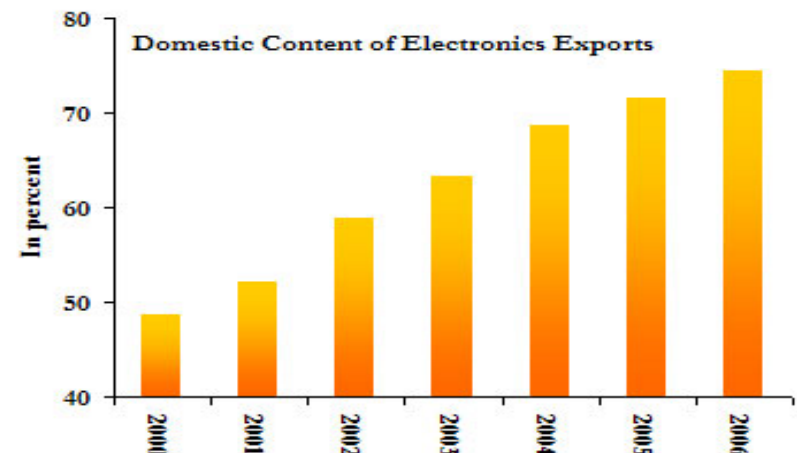
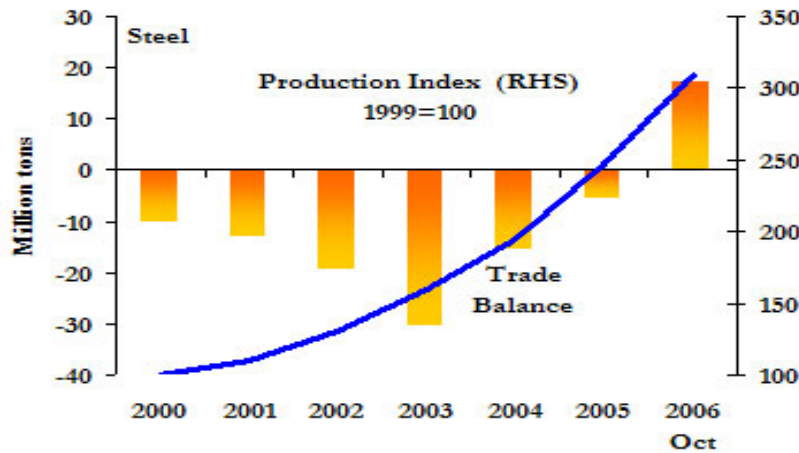
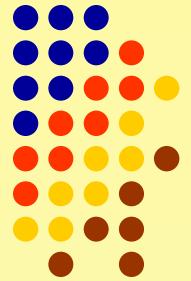
... rapid investment and rising trade surplus.

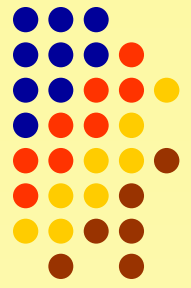


However, as consumption has not grown sufficiently fast ...

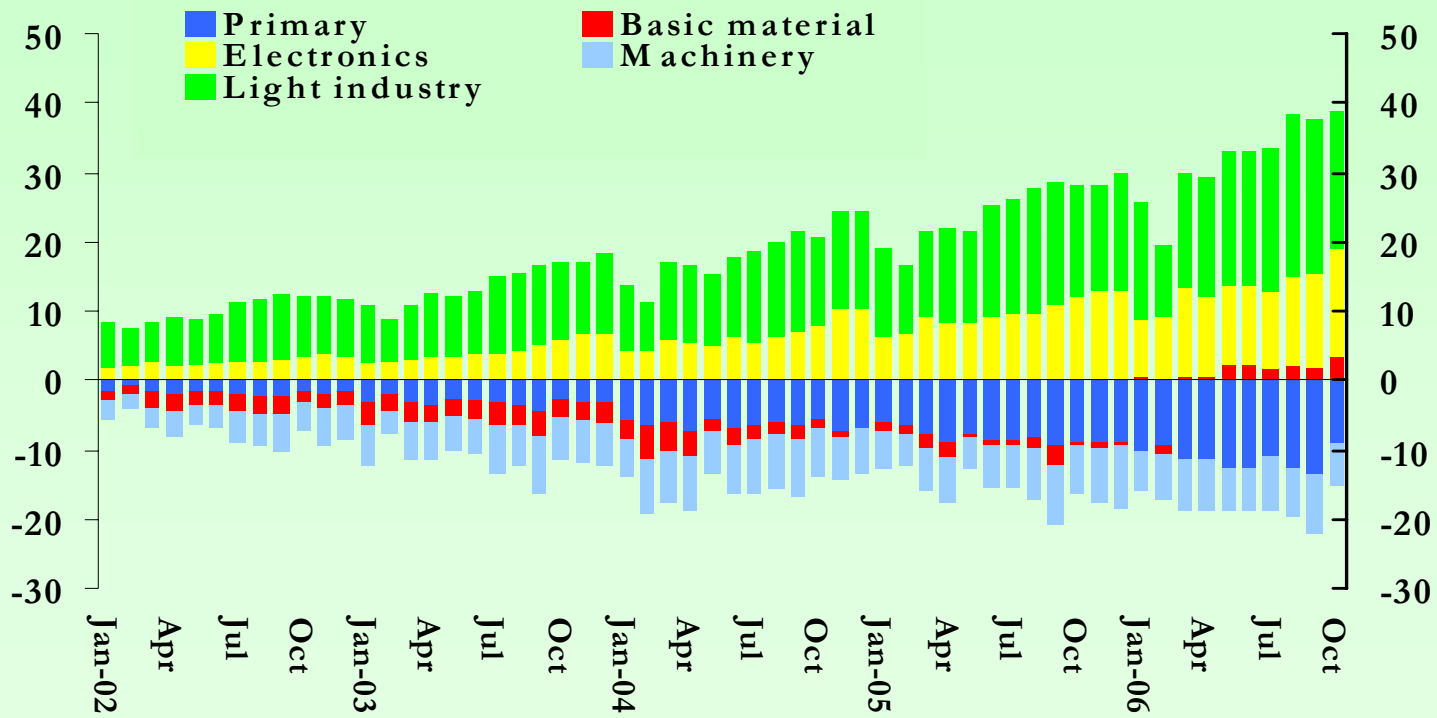


... the capacity created by investment has been absorbed by rising net exports ...

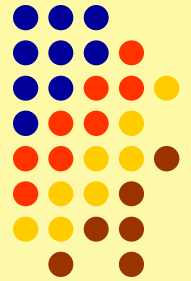




China: Trade Balance (USD Billions)

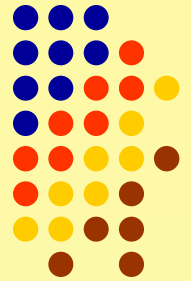


This process could be disrupted due to...



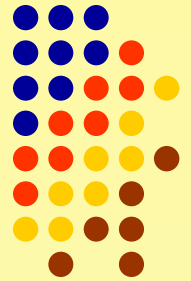
- Falling prices in overcapacity sectors
- Limits to export market growth
- Both leading to potentially large new loan defaults

Thus there is a need to:



**Rebalance growth from investment
and exports to consumption.**

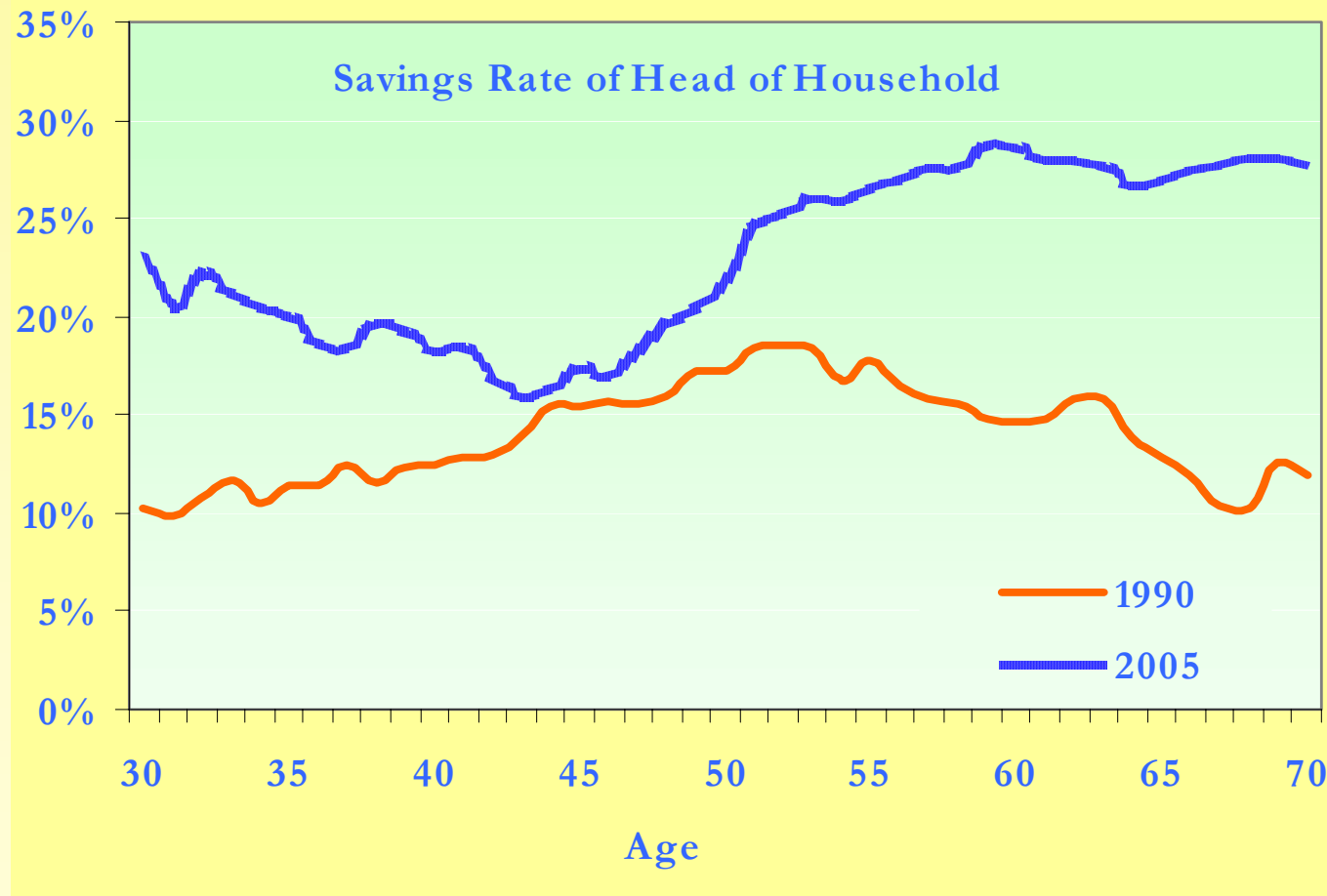
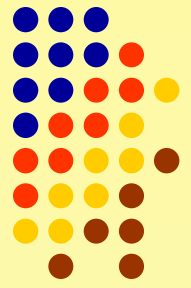
Why is consumption low?



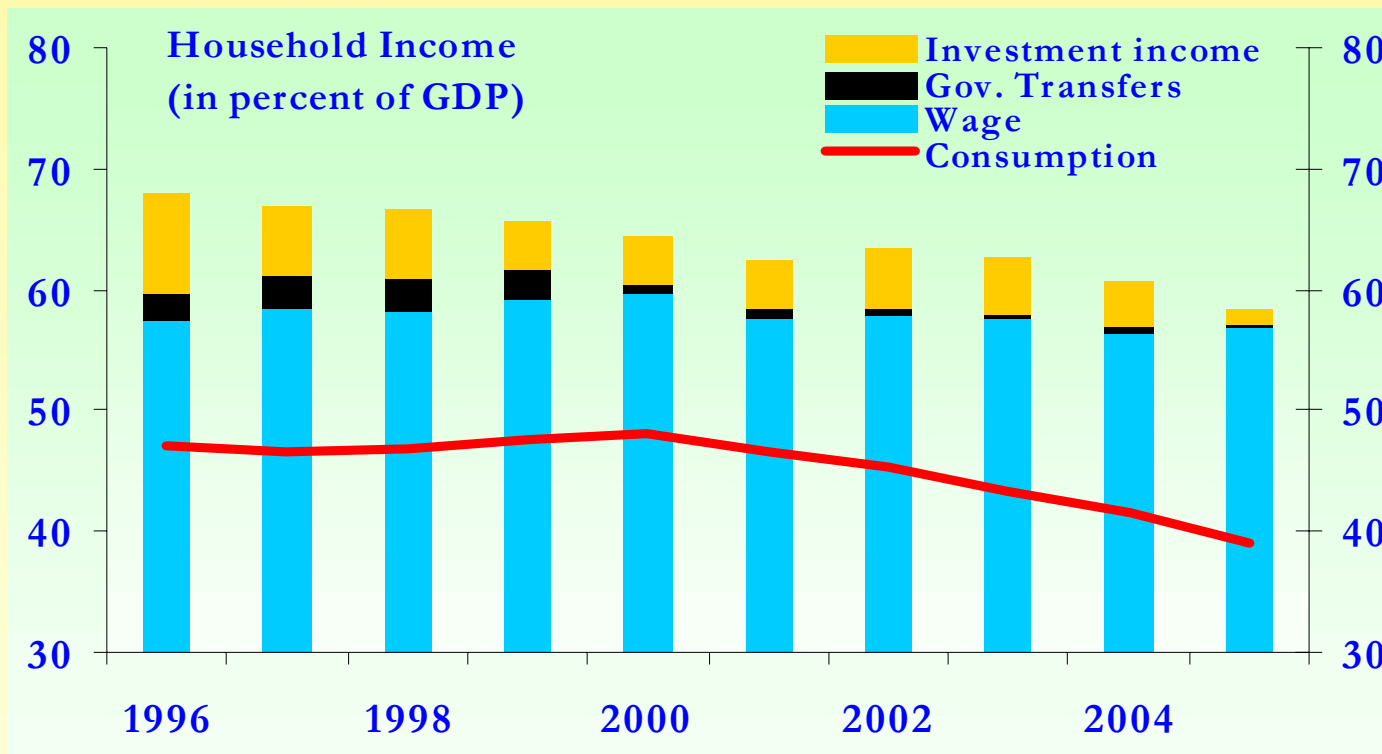
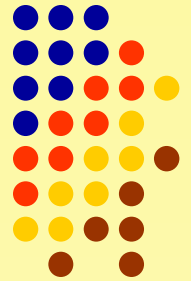
Selected Countries: Consumption, 2004
(In percent of GDP)

	Labor Income	Disposable Income	Income Tax	Personal Consumption	Government provided health and education	Adjusted Consumption
US	57	74	9	70	10	80
UK	56	66	10	65	12	77
Australia	49	58	12	60	11	71
Canada	50	58	12	56	7	63
Korea	44	54	3	51	5	56
France	52	62	8	56	6	62
Germany	51	66	9	57	6	63
Italy	42	67	11	60	12	72
Japan	51	59	8	57	5	62
India	...	84	2	67	4	70
China	56	60	1	41	3	44

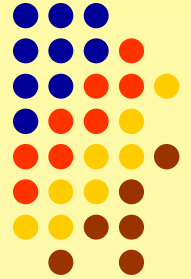
Household savings rate has risen with the rise in uncertainty over state provided pension, health, education ...



... and because household income has fallen as share of national income.

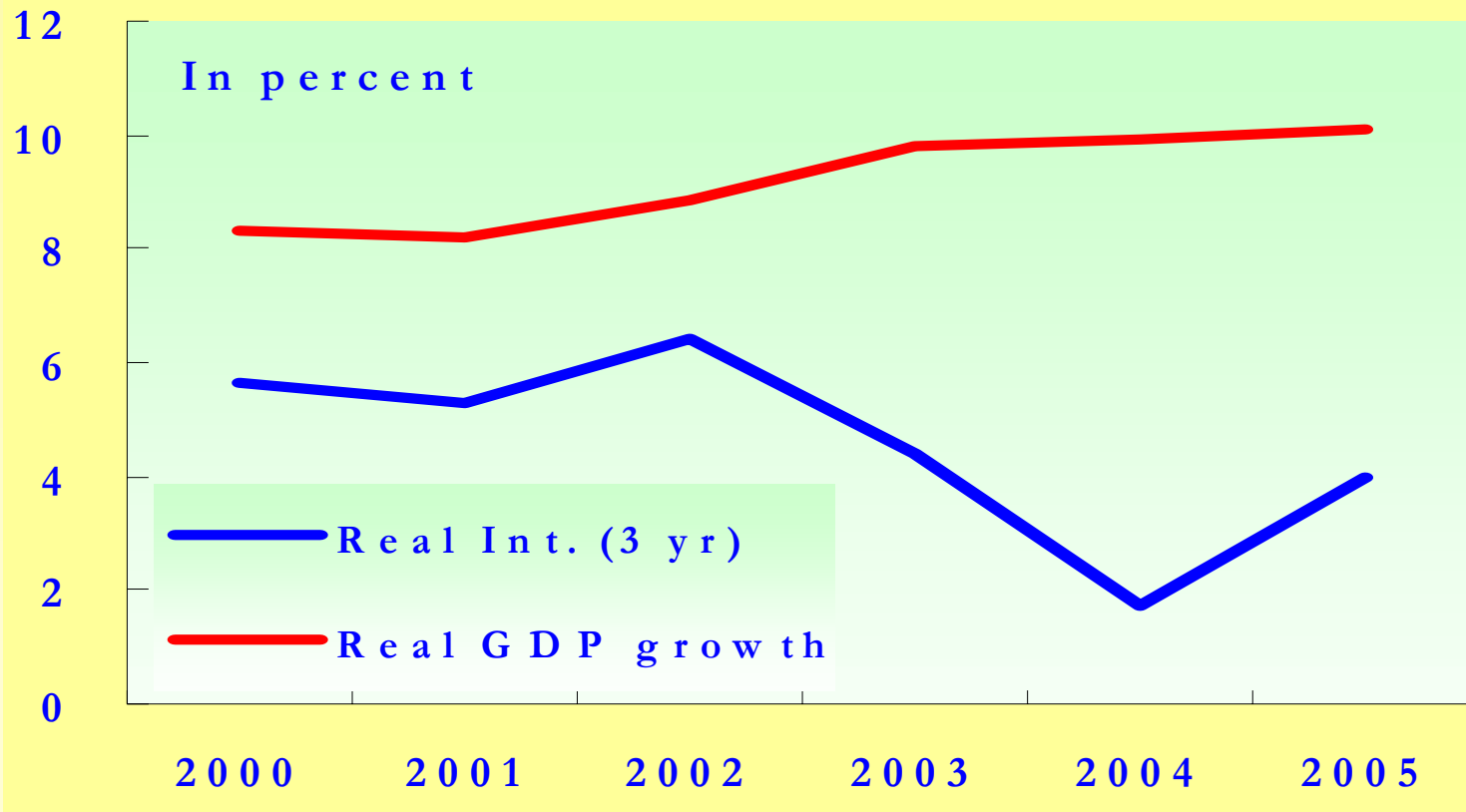
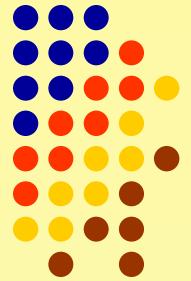


Why is investment high?

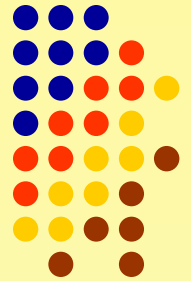


- Profit is high at over 40 percent of GDP
- Much of this profit is retained, especially by the public sector
- Input prices are low, including ...

... cost of capital.

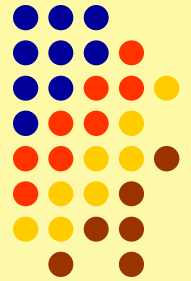


Rebalancing growth is a government priority ...



- Reform pension, education, healthcare systems
- Reform banks and develop capital markets
- Shift public spending towards social areas
- Get state-owned enterprises to pay dividends
- Price utilities, land, etc. to reflect market conditions

In addition, China needs more rapid exchange rate appreciation.



- In the near term, to allow the People's Bank to raise interest rate, without encouraging capital inflows.
- In the medium term, to provide better price signals to investment such that it is not concentrated in the traded sector and to raise household purchasing power.

Recent appreciation is important, but the RMB remains low in real and nominal effective terms.

