

Adjusting Global Imbalances

China's Role & Implications for
Asian Countries

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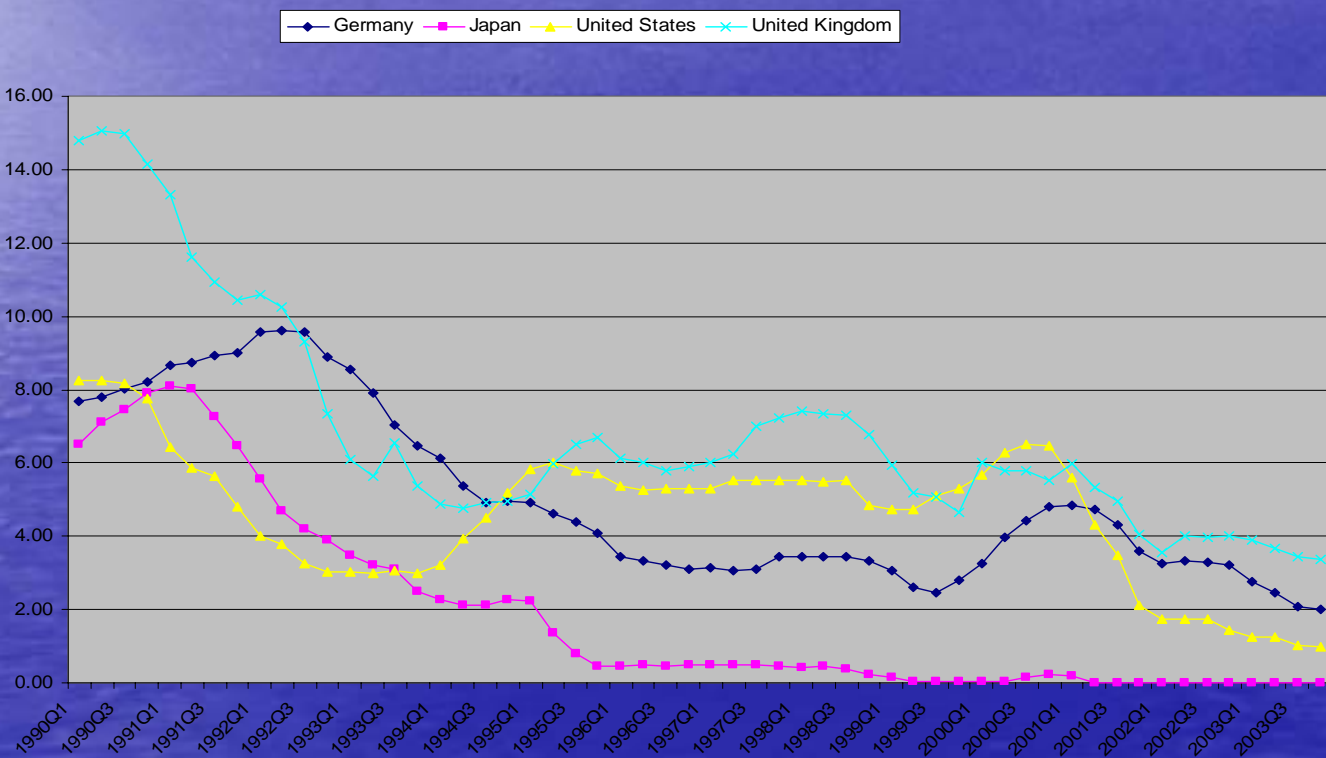
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- Global Imbalances
What are they?
- China—Performance and Policies
- Implications for Asian countries
Trade and FDIs?
Structural reforms?

1. Abnormal Interest Rates

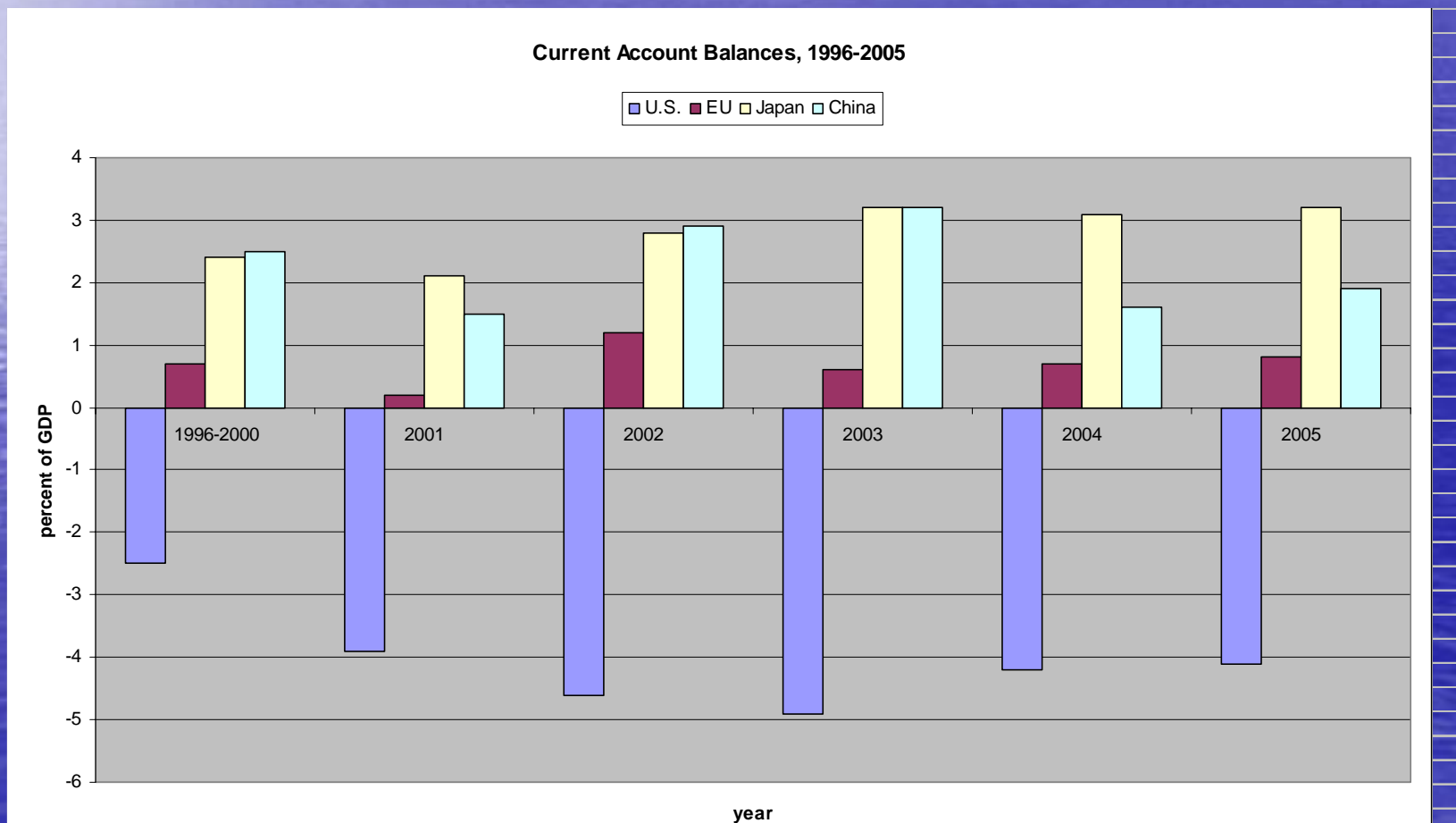
Germany, Japan, U.S. & U.K.

Char 1: Short-Term Interest Rate in Major Countries, 1990-2003

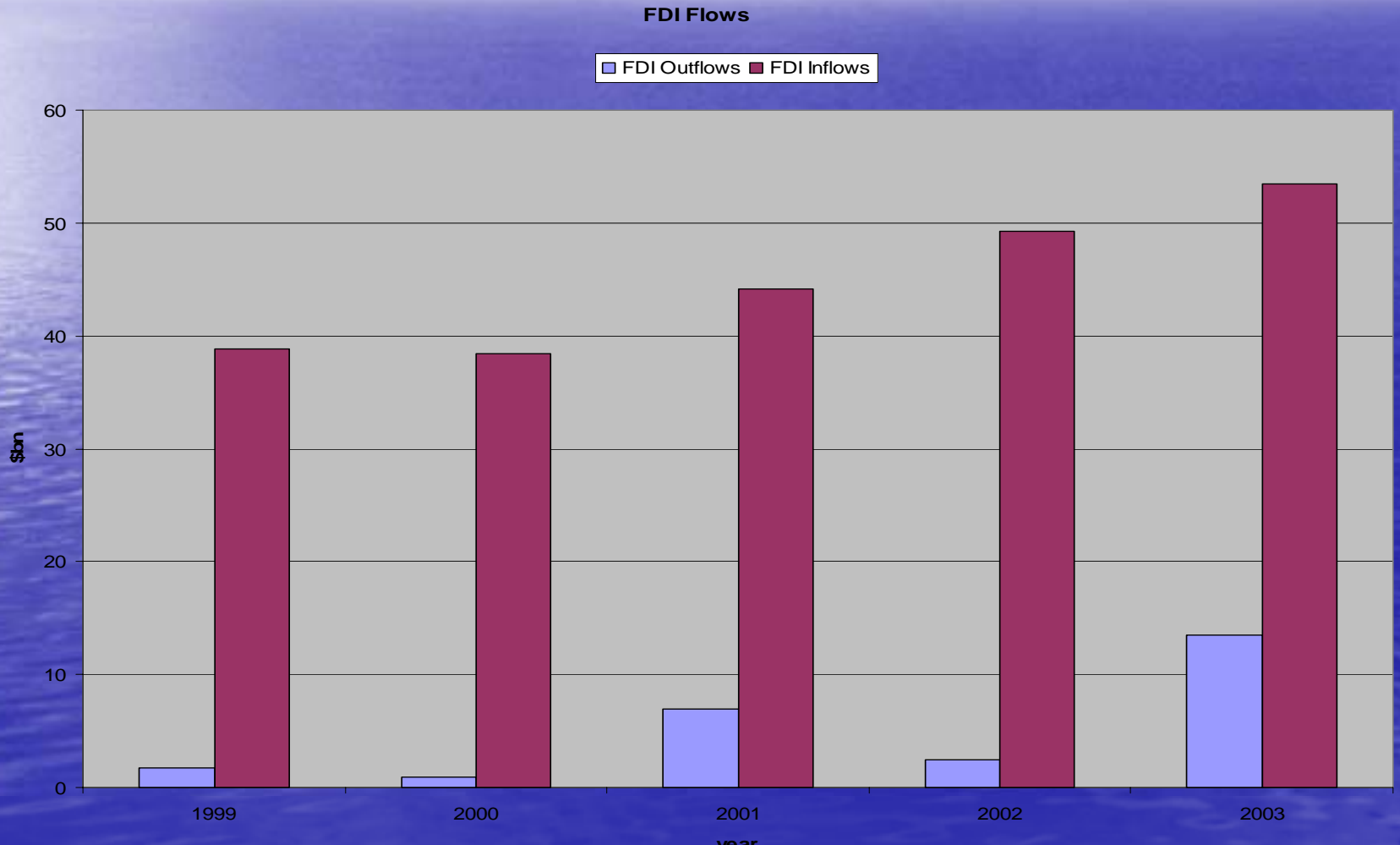


2. Current Account Imbalances 1996-2005

U.S.; EU; Japan; & China

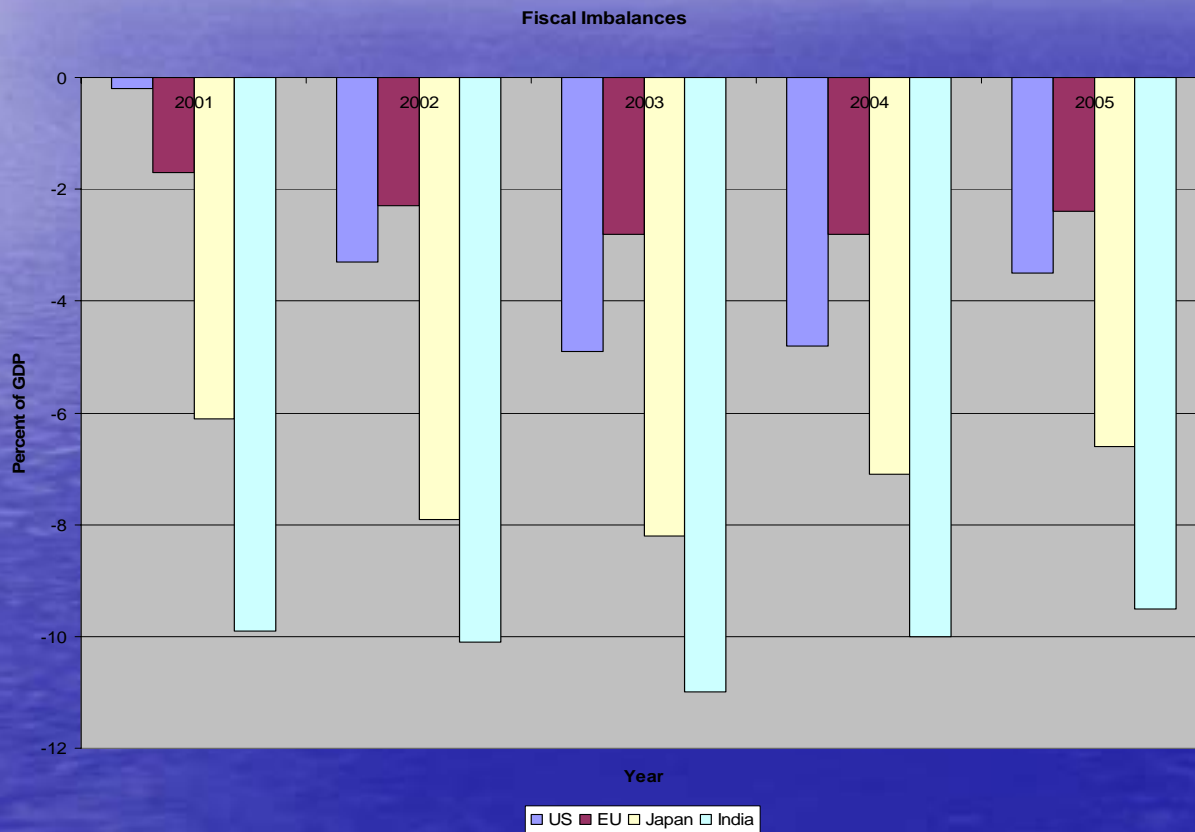


3. China: FDI Flow Imbalances 1999-2003



4. Fiscal Imbalances, 2001-05

U.S.; EU; Japan; & China



China Problems

- Massive Unemployment in 2003
 - Labor Force—760 mn people
 - Rural: 490 people
 - Under-employment: 150-250 mn
- Inflationary Pressures
 - Raw materials
 - Grains

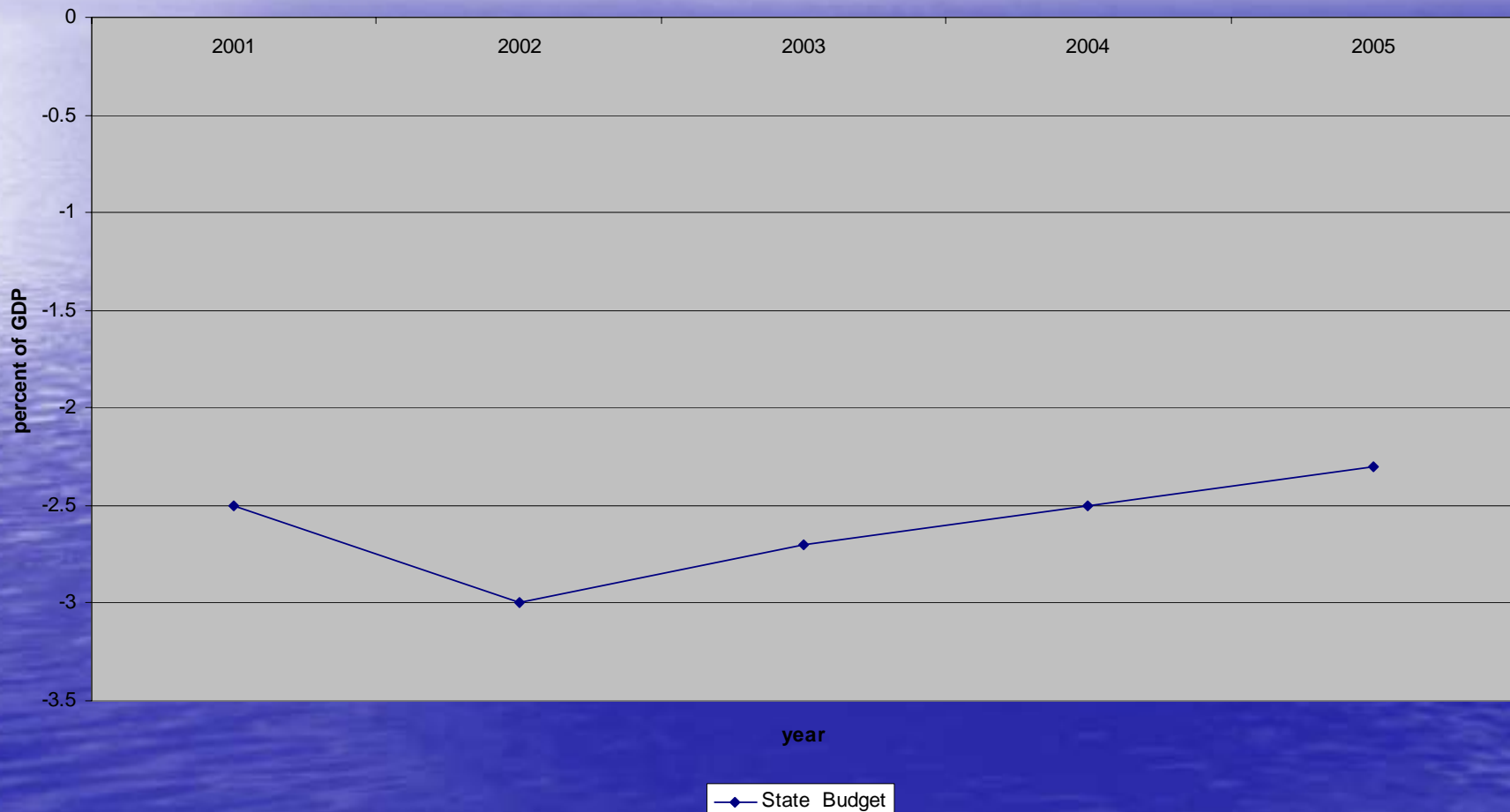
Fiscal Policy

- Gradual tightening in early 2000's
 - key—M-T sustainability
- Expenditure Priority
 - Education, Health, Infrastructure
 - Social safety nets
 - Infrastructure
- Tax reform

China: Fiscal balance, 2001-2005

M-T Fiscal Sustainability

State Budget



Monetary Policy

- Tightening of policy stance in late 2003
- Difficulty in controlling monetary aggregates
 - Increases in NFA
 - Sterilization

China: Changes in Monetary Aggregates and Prices, 1990-2003

M2 & DC Growth and Inflation percent, 1990-2003

—●— Inflation —■— M2 growth —▲— DC growth

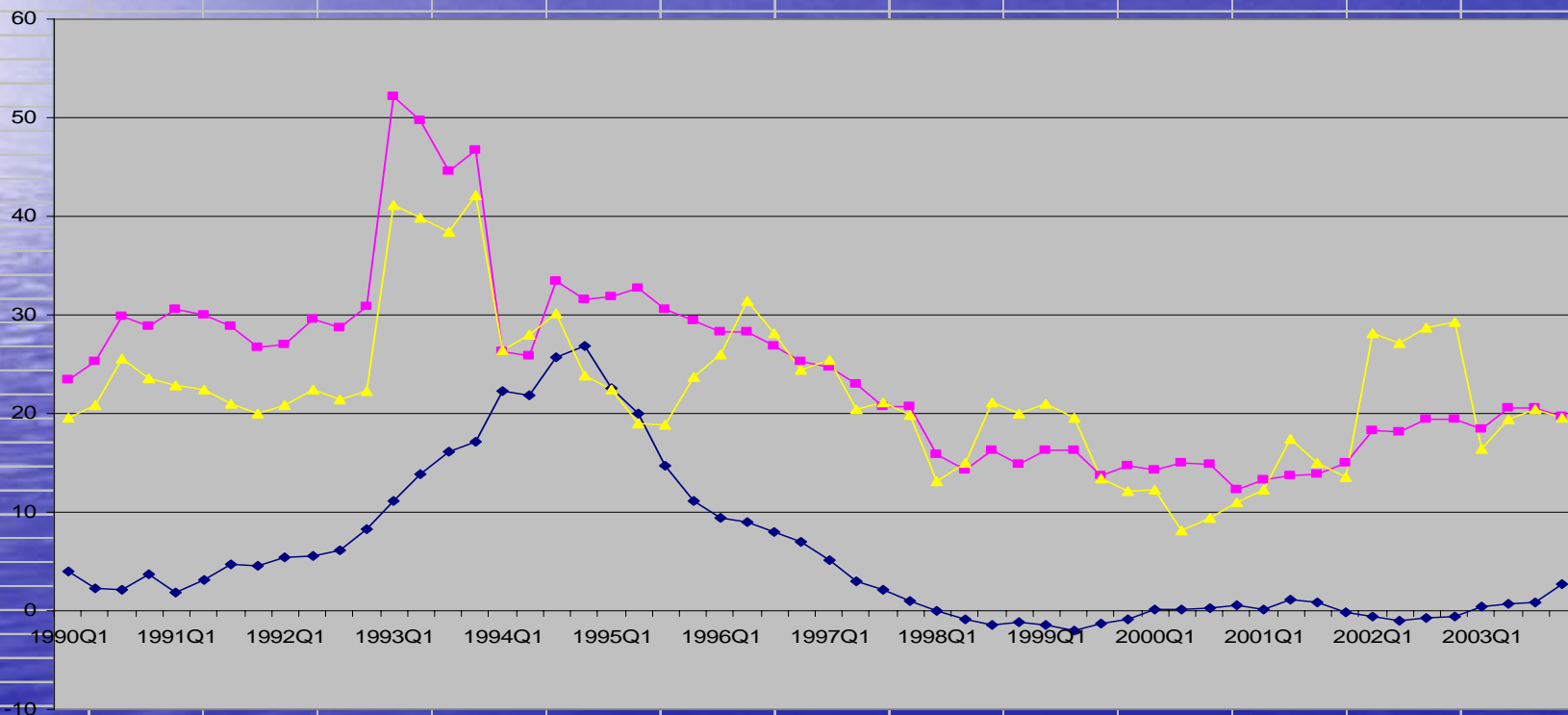
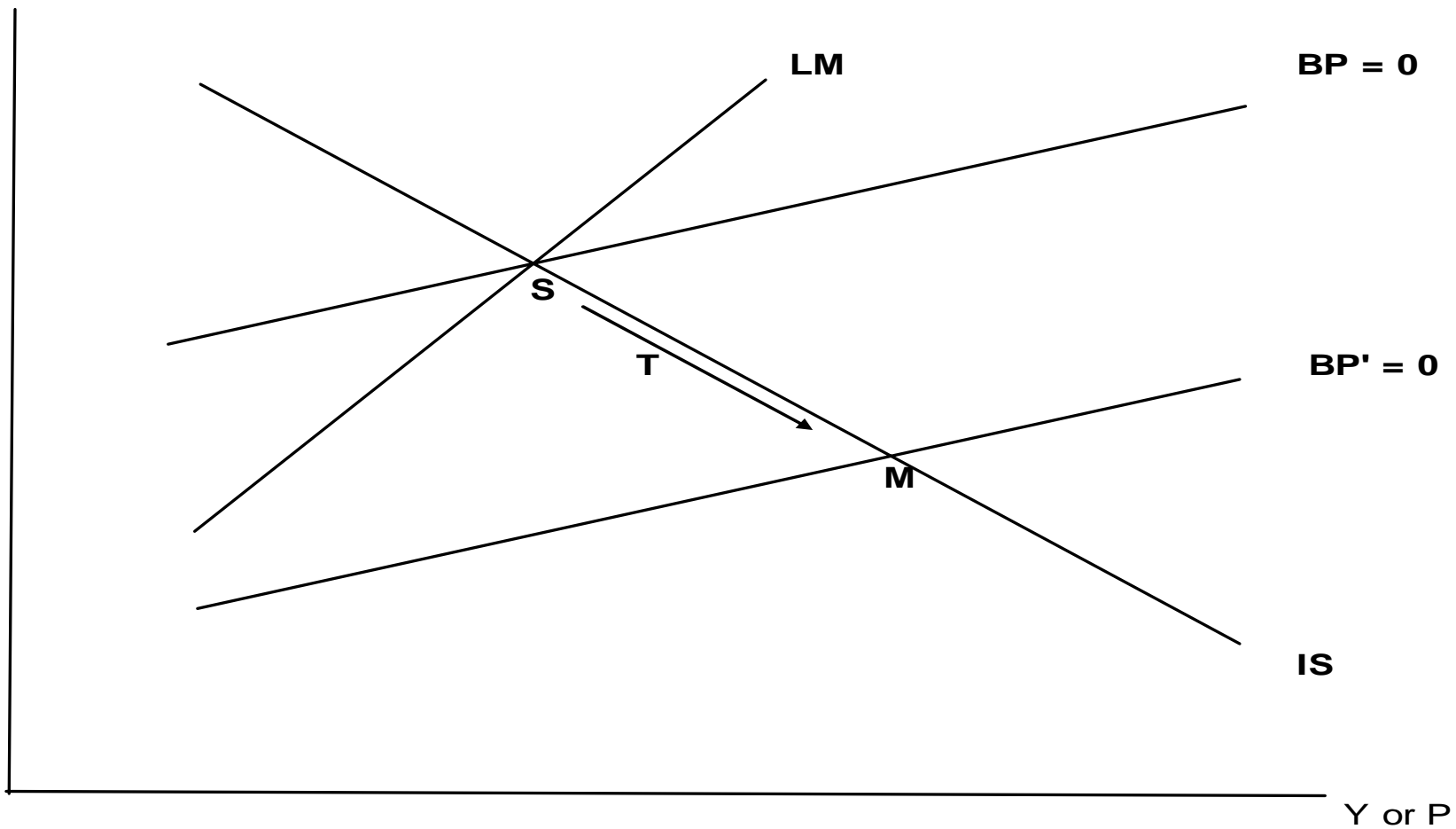


Figure 1: Impact of Speculative Capital Flows



Assumptions: Fixed ER & Partially Effective Capital Controls

2001-2 Rough Equilibrium $BP = 0$
2002-4 Transition to New Equilibrium (Y expanding and P rising)
: ? (with speculative capital inflows) $BP' = 0$

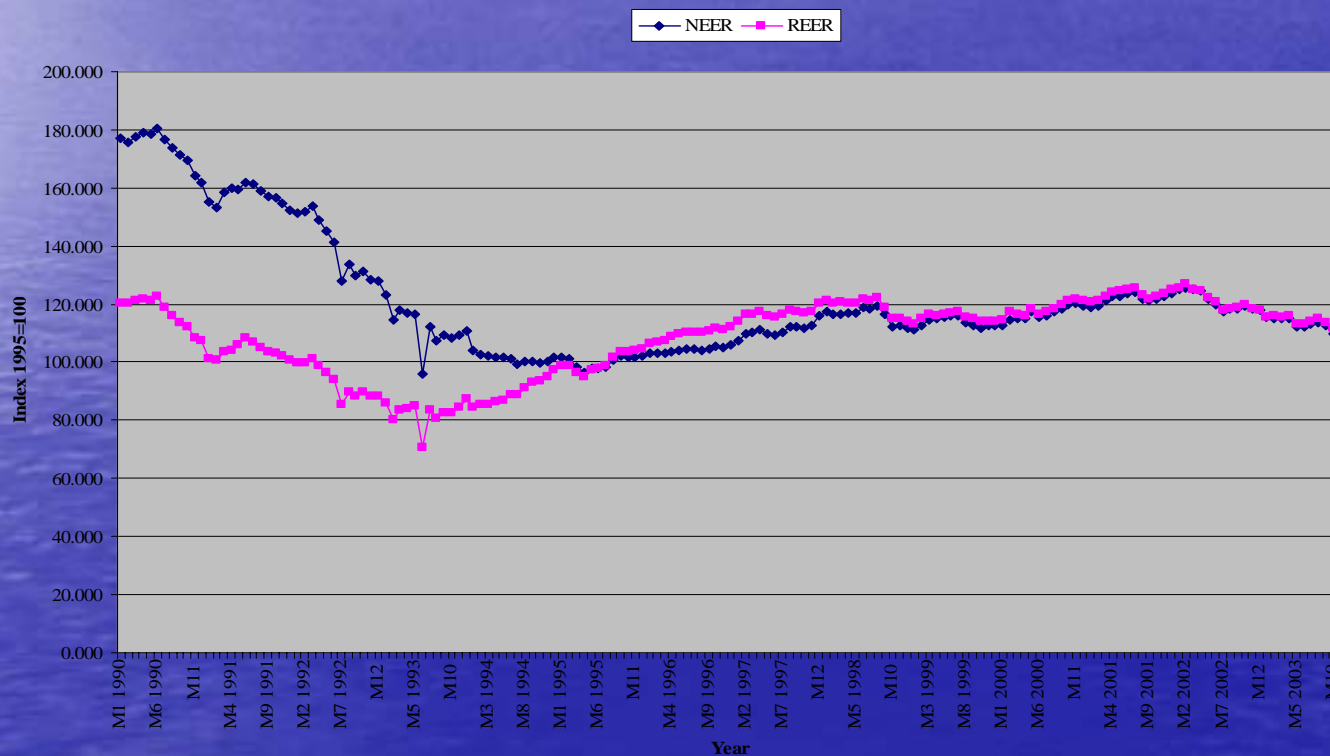
Exchange Rate Policy

- ER level
 - "Stable rate"
- ER system
 - De Facto Peg now
 - Flexible system in future

China: REER & NEER

1990-2004

Chart 5: China REER and NEER, 1990-2004



China: As a Good Citizen of the World

- Contribute to a better global balance?
- Domestic and External balance?
- Expand domestic demand?
 - exchange rate and macro policies?
 - structural reform policies ?

ER: Suggestions from Others

- Level
 - Appreciation
 - No change
 - Depreciation
- System
 - a basket peg
 - a wider band
 - a managed float
 - a free float

Structural Reforms

- Financial Sector Reform
- Fiscal Sector Reform
- State-owned Enterprise (SOE) Reform
- Labor Market Reform

Implications for Emerging Asia

- Soft Landing
 - Macroeconomic Stability
 - Trade flows
- FDI
 - Challenges and opportunities
- Exchange Rate
 - Toward a more flexible system
- Structural reforms
 - Financial, Fiscal, Corporate, ...