The Role of RMB in Stabilizing the Chinese and Global Economy

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Asian Perspectives Global Issues

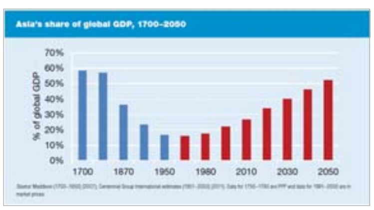
Global Imbalance in Finance and Income

– Reserve Currency Countries (G4) vs. Rest of the World

% Global GDP (2010)	G4 – US, Eurozone, Japan, UK	Rest of the World
Share of Global GDP	54.6%	45.4%
World Population	11.7%	88.3%
Current Acc. deficit (2008)	2.2%	
Excluding Japan	3.1%	
Net Foreign Liability	$3.9 trn (11% of GDP)	
NFA (ex. Japan)	$6.4 trn (20.8% of GDP)	
FX Reserves (ex.gold)	16.1%	83.9%
Stock Market Cap	56.7%	43.3%
Public debt	79.6%	20.4%
Private debt	81.1%	18.9%
Total Debt Market	80.4%	19.6%
Bank Assets	65.4%	34.6%
Total Financial Assets (TFA)	69.2%	30.8%
TFA/GDP (%)	503.2	270.1

Source: IMF Global Financial Stability Report, author calculations

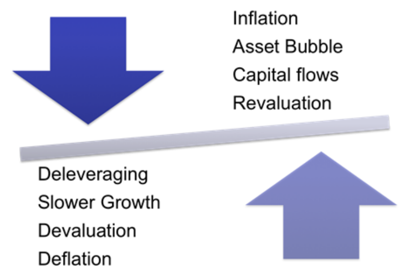
Economic centre of gravity is shifting back to East



Asian Century Scenario by Asian Development Bank

- **Asia's share of global GDP to double to 52%** (US$174 trillion at market exchange rates) in 2050
- With a per capita GDP of US$40,800 (PPP), Asia would have incomes similar to today's Europe
- Asia would have roughly half of total global financial assets

Re-balancing in finance and income: Advanced vs. Emerging Economies



Capital Flows to rise to US$825 Billion in 2010 - IIF

Three Major Global Trends

- **(1) Rising costs of labor and rent in the emerging markets:**
  - **Productivity growth in the tradable sector leads to rising wages and rent/property price in non-tradable sector**
- **(2) Rising costs of real capital in the emerging markets:**
  - **Higher return on capital and rising prices for capital (real interest rate) due to rapid industrialization and urbanization.**
- **(3) Rising costs of resources:**
  - **Rising costs of carbon emission and natural resources due to limited supply of clean energy and raw materials and rising demand from emerging markets.**

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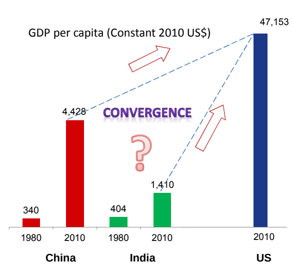
Convergence of Nominal GDP per Capita between Advanced and Emerging Economies



Source: World bank World Development Indicators

Sources of Convergence:

- Productivity catching up
- Structural inflation
- Structural currency appreciation

Convergence of Nominal GDP per capita between China and US (measured in USD)

Speed of convergence in Nominal GDP per capita =

growth of real GDP per capita in China

– growth of real GDP per capital in US

+ inflation in China

– inflation in US

+ RMB appreciation against USD;

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Convergence of Price Levels between China and US (measured in USD)

Speed of convergence in Price Levels =

inflation in China– inflation in US

+ RMB appreciation against USD

= Structural Inflation + Structural Appreciation;

Mainly driven by rising prices of non-tradable in China (wages and rents/property prices).

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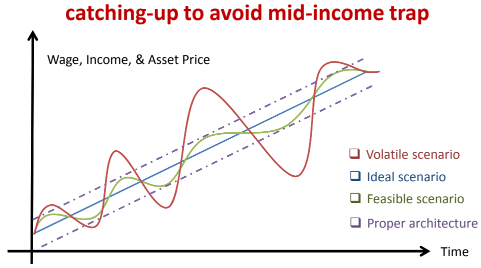
Managing long-term volatility during China's catching-up to avoid mid-income trap



- As wage, income and asset price are converging with those of advanced economies, China needs a proper financial architecture that can help minimise disruptive boom and bust

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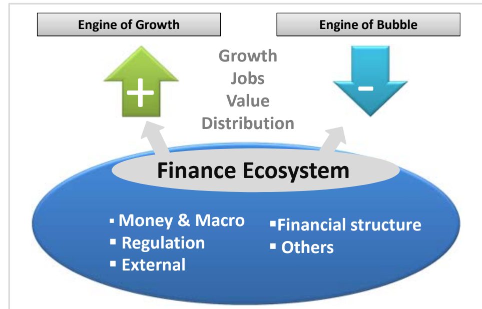
Finance: Engine of growth or bubble?



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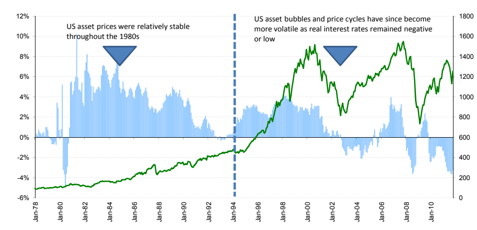
Lessons from the US: bubbles and low real interest rate



Source: Bloomberg

- Negative to low real interest rates, among other factors, have led to increasingly frequent and intense price cycles in the US

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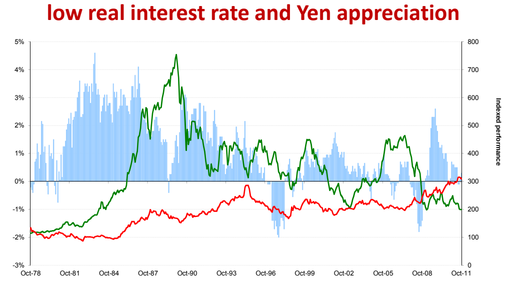
Japan's Lost Decades: low real interest rate and Yen appreciation



Source: Bloomberg

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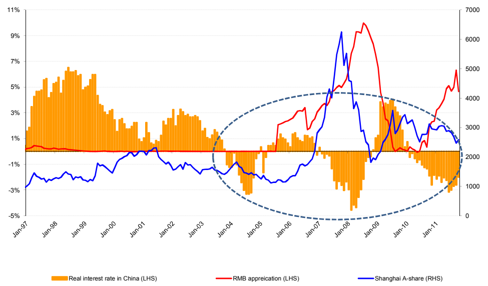
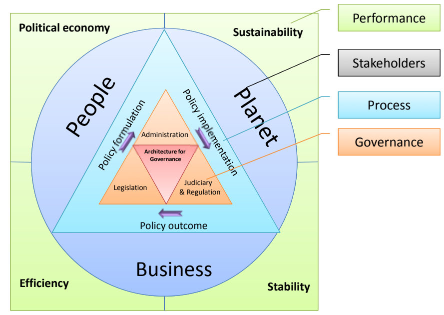
China's market volatility: low real interest rate and RMB appreciation



Source: Bloomberg

A Systemic Inquiry of Governance, Process, & Performance for People, Planet and Business



China's Macro Dilemma

•Because of the difficulties in distinguishing productive investment from unproductive investment, the central bank of China faces a dilemma:

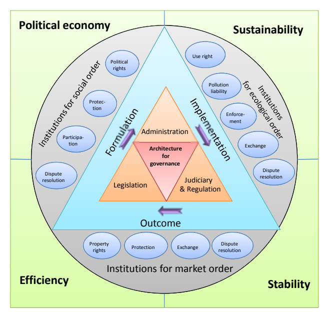
-if it adopts a loose monetary policy, it will have to deal with over-capacity when unproductive investment expands out of control;

-if adopts a tighter monetary policy, it will have to deal with slow growth, weak demand, and current account surplus.

The key is to increase real interest rate (the price of capital)!

Why not? SOEs, local governments, property owners, … all against raising interest rate at the expe P1 e of poor depositors!

Architecture for Governance
顶层设计



How China can stimulate stable growth (Xiao Geng, China Daily, 2012-05-29)

1. More aggressive lowering of the reserve requirement ratio for banks to provide enough liquidity and credit for private enterprises while keeping interest rates in the unofficial markets at lower levels.
2. When lowering RRR, the central bank should also consider raising deposit rates aggressively over a period of time, so that they align more closely with the estimated medium and long-term inflation rate.
3. Stop implementing many temporary and ad hoc administrative restrictions on prices, demand, lending and investment, which include many complicated restrictions on the purchasing of real estate by non-residents.
4. Provide fiscal subsidies on interest payments for specific public projects and disadvantaged groups.
5. Develop a regulatory system for dealing with expected interest-rate gaps between China and the advanced economies such as the US, Europe, and Japan.

Thank You

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P1 The problem is
PC, 5/10/2011