THE BROOKINGS INSTITUTION

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CHINA AND THE GLOBAL ECONOMY: A CONVERSATION WITH YI GANG AND BEN BERNANKE

Washington, D. C.

Thursday, April 14, 2016

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The Chinese Economy: Past, Present, and Future:

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P R O C E E D I N G S

MR. WESSEL: Good afternoon, I am David Wessel, director of the Hutchins Center on Fiscal and Monetary Policy here at Brookings. It is my pleasure to welcome you on behalf of the Hutchins Center and also the John Thornton Center on China. Once upon a time in my career as a journalist a conversation about the global economy was largely a conversation about the U.S. with occasional references to Japan or Western Europe, then came China, economic miracle, lifted millions of people out of poverty but still it was a story about China.

Today, China is the world's largest trading nation, the second largest economy in the world and conversations about the global economy often begin by addressing what's going on in China and the impact that it's having on the rest of the world and its complex transition to a slower and safer rate of growth, to an economy driven not by exports in investment but by consumer domestic demand and by a more market driven financial system so in the past several months, we have all learned just how much news about China's economy and its economic policies ricochet around the world, all of which makes today's event particularly timely.

We're going to start with a panel with my colleague David Dollar, senior fellow here at Brookings, formerly with the World Bank and the U.S. Treasury in Beijing. Eswar Prasad also of Brookings and Cornell University, formerly head of the IMF's China desk. We are very pleased to Xiqing Gao as a professor Tsinghua University and formerly the head of China's investment Corp and really one of the pioneers in bringing securities markets and securities regulations to China and I am very pleased that today's panel will be moderated by Lingling Wei, my former colleague at The Wall Street Journal, a star in our Beijing bureau.

I am going to turn it over to Lingling and I will be back in about 45 minutes with Yi Gang and Ben Bernanke; take it away.

MS. WEI: Thank you very much, David. Thank you everyone. It is an honor for me today to moderate such a great panel. Our mission today is to talk about China's changing economy. As most of you know, China's government has been undertaking a massive task of transforming the Chinese economy so that it can be driven more by domestic consumption and less by exports in manufacturing.

The government recently released a proposal for its new and 13th five year plan which basically will guide the country's social, economic and political development for the next five years, starting this year and through 2020 so my first question is for Mr. Gao, in your view, what are the key messages the leadership is sending through this new five year plan?

MR. GAO: Well the new five year plan looks good and logical and it will accepted by people following the Third Plenum of the party, 18th Party Congress. The problem is that other than any other party congress before, other than all the Third Plenum since the 11th Party Congress, everyone was followed very loyally by our people over the past 30 years but this time, this is two and a half years after the Third Plenum and after the pronouncement of all of the reform agenda and all these things, people were very excited at the time -- I myself was very excited about the agenda and economic reform and political reform for that matter and the Fourth Plenum which is the rule of law premium.

The problem is that as of today, after two and a half years, we are still waiting for many of the measures to come out so the fifth year plan -- the five year plan, as we look at it is still promising and makes all sense. Somehow, we just do not have as much of a confidence in the possibility of it getting implemented in a short period of time and somehow, it gets -- there is this bifurcating development in the past few years, where people see that on one hand, the government has been very encouraging about innovation, about reform, talking about it a lot and especially talking about the part which I would say, as political reform, namely the two lists, we see the negative list and the power list to, sort of speak to streamline the government policy and also their new constant call on the reform of SOEs but on the other hand, so far, we haven't seen too many things being done so far, both on the side of the political reform, namely the two lists. We are still waiting for the lists to come out.

Every government agency is talking to the list but no one seems to be coming out with a real list and also, at the same time, if you are looking at the SASAC) which is in charge of all the state owned enterprises, so far hasn't done much and we keep hearing about the new set of plans for the state enterprises reform and the only thing we have seen so far in the past few years is a re-monopolization of a few industries and that's the negative partbut of course on thepositive side, you can see that in many other ways, especially on a grass root level, on the private enterprises level, that people are taking more initiative and people are trying to push forward and more and more people are coming out and being more vocal about the necessity to reform the state enterprises but we see this huge tension between those people who are saying that state enterprises are what they call the founding -- the power base of the Communist Party on the one hand, therefore the rational is that we should keep the state enterprises.

On the other hand, people are saying look at these state enterprises, they are so inefficient, and they are in many ways corrupting, one way or the other, and they are not working hard anyways with the anti-corruption campaign so why do we keep them still as such a big waste of the resources so we see on both ways and my take of it is that it's probably going to take a few more months or a year or two before we can see the real progress of these state enterprises, going one way or the other and then we will know much better as to whether or not our government is willing and able to pull forward to this reform blueprint as mapped out by theThird Plenary.

MS. WEI: Thank you very much. Professor Gao mentioned -- you pointed out the really interesting trend in China right now. Basically on one hand, expectations were running so high for reforms happening at a faster pace under the current administration than years past but it really hasn't happened yet and in some aspects, we have seen reforms actually getting dialed back so Eswar, in your view, why is this happening? Why are we seeing things -- reality not meeting up with expectations?

MR. PRASAD: So one interesting thing about the new five year plan is that it looks a lot like the old five year plan. Now that's not necessarily a bad thing because many of the problems that China faces are still there and they haven't morphed that much, although the scale and scope of some of the problems have increased quite significantly but I think Mr. Gao has correctly put his finger on what is the key reform that is needed on the real side, which is state enterprise reform. My view is that over the last year, in fact the landscape for those reforms has gotten somewhat more complicated. It's not like there were no reforms last year. In fact, if one looks at what happened last year, we didn't have the depository liberalization, we didn't have the ostensible freeing up of the exchange rates and capital account opening measures, the establishment of the explicit deposit insurance system but virtually every one of these reforms is about financial or capital markets.

The real side of the economy and institutional reforms, including corporate governance, auditing and accounting standards, regulatory frameworks, all of which are necessary to support a market oriented environment, those haven't been as much focused on and this year I think is going to be a complicated environment for the real reforms that China needs, beyond finance. One of the reasons, of course, is the economic growth has slowed down, which it makes it much harder to generate the appetite for reforms to the state enterprises which, as Mr. Gao pointed out, still remain a very important part of the economy.

In addition, I think last year, there were two very well intentioned steps which turned out to be missteps on the stock market and on the currency that I think have enabled the reactionary forces that are opposed to reforms. And then one must almost always think in China's context, or in any context about the political overlay over the economic reforms and with a change in high level positions coming up next year, 2017, I think the jockeying for positions has already begun and I suspect we will begin to see senior level officials either trying to protect their territory or trying to make sure that they do not stir the water or stumble too much by taking aggressive reform measures so I suspect that one of the reasons we got so much in terms of financial market reforms last year was so that there was a very clear framework getting the RMB in the basket, a few boxes have to be take , take all of them in a somewhat uneven and haphazard way but it did get done and you had a very effective advocate, Governor Zhou. Real side reforms lack that framework, they lack the urgency and I think the political and economic environment is going to make it very difficult to see significant progress on those real reforms this year, despite the fact that the five year plan, the state enterprise reform plan which was put out late last year all have exactly the right words and intentions in them but I think it is going to be politically and economically difficult to push forward.

MS. WEI: The government seems to juggling two major tasks at the same time. On one hand, they're trying very hard to prevent near term hard landings through expansionary fiscal and monetary policy. On the other hand, the leadership has repeatedly reiterated its desire to carry on reforms, painful reforms, for example, making sure that zombie firms are allowed to go under.

David, my question for you is how do you think the current effort to prevent hard landing is affecting the reform effort?

MR. DOLLAR: Okay, thank you very much. So I thought I was going to be the pessimist on this panel and at least in the first few moments, I find myself being the optimist, okay, so to answer Lingling's question, or let me put it in this context, I don't disagree with the things that Gao Xiqing and Eswar just said but I would say that if you go back three months or so, all of that was true plus there was a real worry around the world about a hard landing in China. There had been the missteps in the exchange market, there was worry about an unruly devaluation and I think in the last couple of months, at the more macro level, the government has done some things to stabilize the situation.

First, they have done a better job of communicating that they are trying to manage the exchange rate with reference to a basket. That seems to have calmed markets to some extent. The reserve loss was much lower in March than it had been in previous months and then frankly the dovish stance of the Fed is probably helping out there to some extent and then they did marshal some old style stimulus last year. They approved a lot of the investment projects, partly this is related to the five year plan. That seems to be kicking in now and I think we are about to get some better data.

Now I view this as both good news and bad news. The good news is there is a lot of worry about the world economy. The IMF just marked down the forecast for the US, for the global economy, for Japan, actually marked up the forecast for China very modestly to I think 6. 5. There is a sense that the Chinese economy stabilizing and that’s a positive thing in the short run. Now I do think -- like I said, I think there is both good news and bad news because I still worry about the same things that Gao Xiqing and Eswar talked about so I see China as having bought itself an opportunity, a window of opportunity.

They need to move ahead on these reforms. They need to close zombie firms, clean up the financial system. One of my favorite reforms is opening up the service sectors, the competition. If they move ahead on that agenda, then having bought some time is useful and we can get a successful transition in China.

If, on the other hand, after another six or nine months, there is still this pessimistic sense that they are not really doing the hard reforms, then that ability to keep applying stimulus, that’s going to be a diminishing quality over time.

MS. WEI: Thank you. As you mentioned earlier, there was a lot of market turmoil since August of last year. Actually since June/July of last year and among the conversations that we had was foreign ministers and even with foreign rating agencies such as Moody and Standard & Poor's, as you know recently downgraded the credit outlook for China and one of the concerns they often cite is policy uncertainty. They are not afraid of market uncertainty, market volatility but they are very much concerned about the kind of policy uncertainty they have been witnessing since last year so professor Gao, my question for you is why is there so much policy uncertainty in China? Do you think the government has done enough in terms of better communicating its intentions to the public?

MR. GAO: I think the biggest problem, really, is not as much what we call policy and certainty per se but really the age old question of local reform because the market hates -- unpredictability and over the past 30 years the Communist party and the state council have done a great job in maintaining predictability so gradually we have more and more predictability but all of a sudden, last year in July, I personally was involved in quite a few of these, what they call saving the market by violence in the past, both in my capacity as a regulator and then in my capacity as a major state investor but in the past, there was always a contending of various small groups of people at very particular line of things and a very short period of time but this time, it just surprised everyone by having such a large scale, so many people getting involved sort of a true violence in saving the market and then it basically changed the expectations to not only international investors because we already care about those things.

If you actually look at a number, internationally, investments account for less than one percent of the market gap in China but that's why in the first time when it happened last July, when some people came out saying that this is Americans doing it, American hedge funds trying to sabotage our market. I just laughed, I said, "Look, altogether there are like 30 billion dollars," but our market at that time was already quite a few trillion dollars' worth but the problem is that the Chinese investors this time, the first time for a long time because we -- the Chinese investors typically never really expected that much of the predictability per se. They always knew that the government was going to do something but they never knew the government was going to do something like this.

This time, not just the government itself but really 20 some state owned or state controlled securities firms came into the arena, every one of them having their managers, their relatives and all these people coming in. Of course, people say that won't happen but I think that, to me, is not as much of a problem as the other side of the issue, which is that the government, on the very top, I don't think they meant what these people think that they totally want to change the market form.

The big leaders are probably saying -- our biggest concern is maintaining stability, trying to maintain stability. I don't care what you do but then those people there start to -- these are regulators and the regulators and of course, the main regulators who are recorded by saying other than constitution I can change every other law but of course, now he is in jail for some other reason but the thing -- this is the vice chairman of the regulators but the problem is that the fact that these people, these -- he is a very smart person; I have known him for a long time and for him to come out in such a bold fashion to say that he doesn't care about the law is the first time in our history of the past thirty years of reform so I think somewhere, someone up there would have to come out and say okay, forget it, these people -- you cannot run a country like this anymore.

The fact that for quite some years, the government doesn't come out and say this thing, because during my time in the CSRC, we constantly came out and said, "Look, the government does not care about the ways of the sub-market. It's not our responsibility." We only care about wrongdoings in the market but now, for a long time, nobody says that anymore, it sounds like the regulators are taking it upon themselves as to what they call the development of the market, namely what they call the bullish market, which would signify their own achievement and that's totally wrong and I have been quite vocal about it and people keep warning me and say, "Don't say that, you're stepping on the shoes of those -- the feet of those people." And I said, "I don't care." The problem is that -- the fact that many of these private enterprises are coming out and said okay, forget it, I am not investing in America, in Europe or even in Africa, rather than in China. It's a manifestation of that.

MS. WEI: It's really interesting what you said about the responsibility of Chinese regulators. It seems like they have too many goals to protect investors' interests and also, at the same time, trying to get the stock market industry to a certain point so --

MR. GAO: Not too many goals, there are two goals, two conflicting goals.

MS. WEI: Right, right.

MR. GAO: So I keep telling the governor, I said, "Can you not ask the regulator to take care of the market development. It's not their responsibility." Their only responsibility is to try to catch the bad guys, period.

MS. WEI: Right.

MR. GAO: So far nobody comes out and says it so --

MS. WEI: Yeah, we talked about the stock market and I'd like to get your views on the other very important market, the currency because right now, it looks like the yuan has stabilized a little bit but still, it's a big concern for a lot of investors. What is really happening to China's exchange rate policy these days? – it is the Renminbi (RMB), another name for the yuan any more market driven today than prior August 11th last year?

MR. GAO: Connecting to Mr. Gao's thoughts about the stock market, I think there is a fundamental tension in how the Chinese government views markets. On the one hand, it does see them as a useful mechanism for the allocation of resources and of determining prices but on the other hand, it also wants to maintain stability and control because without stability and control, there is a sense among the regulators that they have failed, or among the government that somehow something is going wrong and the market gets out of control. Those are two fundamentally contradictory impulses and I think the tension between them does lead to many stumbles, even when the government has the right intentions and on the currency, my senses of the PBOC certainly has the right intentions although I guess we'll hear more explicitly about this from Mr. Yi Gang shortly.

The difficulty, of course was that the way the August 11 move was implemented created a number of complications both in terms of capital flow, capital outflow dynamics in particular and currency depreciation which made it very difficult to move towards this objective so given where they are right now, I think the right solution would be to stabilize investor expectations and rebuild some market confidence which would require two things. You would need enough macroeconomic stimulus or at least signs that the economy is heading in the right direction in the short term and the second would be to reenergize the reform efforts so that the investors are convinced that the economy is in the right direction the long terms because there are too many good reasons to invest in China.

It is still a relatively fast growing economy. There are many opportunities there so I view this as a problem that is not so much policy uncertainty -- which country doesn't have policy uncertainty, but it's also the capacity of the policies, the fact that we don't have a sense of what the framework is that the government or the central bank is using to think about various issues.

Once you have those frameworks sort of laid out in the minds of investors then it becomes somewhat easier for markets to see the logic of your action because your objectives are clear. So my sense is that we will see the PBOC allowing the currency to float more freely but the wild card in all of this, as we were discussing earlier, is the dollar. The fact that the dollar weakened over the last month and a half or so has certainly given the PBOC a lot more room in terms of easing pressures in the currency and allowing it to use as flexibility a little more but if the dollar were to strengthen further from here, especially if the ECB and EOJ were to intervene aggressively to weaken their own currencies which have been uncomfortably appreciating, that could reenergize the downward pressures on the RMB, but set against that is the fact that the expectations about growth do seem to have stabilized somewhat.

Views about China do tend to swing wildly from one extreme to the other so I think we are swinging quite significantly back in the other direction based on a sliver of positive looking data and you could as easily swing back but I suspect that for the remainder of this year, we are going to see relative stability because there are two important events on the calendar, one is the Chinese leadership of the G-20 Summit, that comes up in early September and then the October 1 accession of the RMB to the SDR basket and my sense is that China would like to go into both of these on a high note so barring something extraordinary happening with the dollar, I think we will see relative stability and I think the PBOC, using whatever opportunity it can to start allowing the currency to float more freely but again, there could be lots of bumps and stumbles along the road.

MS. WEI: All right, you guys all mentioned that in the past few months, the PBOC has gotten a helping hand from the Fed because of the dollar kind of weakening a little bit against the euro and the yen and that helped alleviate pressure, weakling the RMBso that touches upon another question that a lot of people within China have been talking about is should the PBOC and the Fed better communicate with each other or even coordinate their actions? David, what are your thoughts?

MR. DOLLAR: So when I was the US Treasury representative in Beijing, the treasury position organizes the meetings of the Fed presidents and Fed governors to China so I organized quite a few of those meetings and sat in on some of the discussions.

My experience was there is really quite good communication between the Fed and PBOC. In some ways, it's a less politicized relationship than between the US Treasury and the Chinese government; the Fed is independent and my experience in those meetings is that the Fed governors and presidents are genuinely interested in finding out about the Chinese economy, the direction of Chinese policy so I think there is good communication. Of course, it could be better. There had been talk about the two central banks exchanging more staff and there has been a little bit of progress but there could be a lot more. They could do a better job but I think the communication is basically good and I think the notion of they should coordinate, I think that's a bit of an artificial notion. I think Janet Yellen has been very clear that if events in China affect the global economy and affect the United States, either through financial conditions or the real economy, then those are factors that the Fed is looking at and making decisions and if China is not influencing those things, then it's not realistic to think that that is going to change policy.

I think statutorily they have to make policy in order to hit at roughly two percent inflation targets and the US maximizing employment so I think good communication is already there, better communication can certainly help. Any sense of coordination, I think is probably unrealistic.

MS. WEI: You reminded me of a conversation that I recently had with the PBOC official and I posed the same question to him. His response is China and the US seem to have a hard time agreeing on everything, let alone coordinating their actions on monetary policy. So with that, I would like to open the floor up to questions. Anyone? Okay? Do we have a mic?

MR. DOLLAR: And please introduce yourself.

MS. WEI: Yes?

QUESTIONER: My name is Sandra. I am from Tenzan Financial from China Press. My question is about China's banking system because yesterday IMF basically warned of China's banking risk because it's related to China's corporate debts overhaul so I wanted to ask the panel whether they worry about China's banking risk and what is your thought about China's strategy to use this kind of debt to actively swap to basically share the burden among the corporates and the banks? Any suggestions? Thanks.

MS. WEI: Professor Gao, would you like to answer this question?

MR. GAO: This is a legitimate question but it's not, as I said earlier, it's not as big of an issue as the reform itself. If you look at the things we are talking about, you know, zombie companies, SOE reforms, and what we call the government plan to try to reduce overcapacity in the auto and steel industry and coal, cement, glass, you know, all these things and today, if you look at the effort going forward, all these years, and you know, the Chinese government has been quite smart about these things but the problem is that the political struggle between the central government and local government and the competition among the provinces such that at the end of the day, you don't have a strong central government really trying to do it, then it won't happen.

Only yesterday I heard that the effort to reduce coal production and steel production finally resolved in this fashion. Since we cannot really get rid of all the zombie companies so for every province, you have to reduce your capacity by 13.3 percent.

Anyway, I don't care how you cut so at the end of the day, the local government is probably going to cut as much of zombie companies as on better company side because everyone cuts 13.5 percent. To us, that doesn't make sense economically but that what would happen. So when you actually look at the corporate data and also if you travel -- I travel a lot in China, every city you go, you see huge areas, high rises with nobody living in there especially in the third or fourth line cities.

Ordos is the most famous one with 20,000 people with 400,000 apartment buildings. there so, you know, why would people have traveled all the way in a remote place in Mongolia to live there with twice as many people so these are much more on the political side, how the local government, the local officials are being promoted, how they view themselves as being an effective leader. So long as the HR system doesn't change -- was in a party--then so long as these people are always evaluated on their ostensible achievement on the GDP numbers, this will never change.

So as for the corporate debt itself, I am, you know, -- I have been in finance for all these years and I have been constantly looking at it and I never worried as much because CIC had, you know, is the major shareholder of all major banks, all the top four or five major banks. Every time when this thing comes up and we go back again and check on our bank numbers, we say: "Well we don't have as much of a problem" but deep down you know there are many problems but the thing is these problems can be resolved and since the Chinese monetary system is still relatively sort of a sealed off system, so you don't have as much of a problem if you have the resolve to solve it on the other side to, namely, you start addressing root problems rather than just the symptoms.

MS. WEI: Yes, sir?

QUESTIONER: I am Judd Harriet. Could you discuss efforts to deepen capital markets, specifically interest rate liberalization?

MR. PRASAD: Interest rate liberalization, in principle, is done. In practice, however, it's a different matter because whether you have a truly market determined interest rate system depends on whether the banks do have this legacy problem taken off their books and without that, it's hard to see them operating as purely commercial enterprises. Having said that, the legacy problem is really most important for the big banks rather than the smaller ones which have a lesser legacy problem.

There has been also indirect interest rate liberalization, especially of the depositories of the wealth management products even before they formally liberalize the deposit rates, which created some risks of its own, of course, but in principle, interstate liberalization is done but I think all of this really doesn't work very well unless we deal with this problem which is the debt overhang and corporate debt is certainly a big concern.

Like Mr. Gao, I don't -- this is not a stay up at night kind of worry. It's not going to cause the system to come apart but there is going to be a big price to be paid and the question is when is the government going to accept the fiscal costs because ultimately, in one way or the other, that's what it's going to come down to.

I suspect that the problem is not as big as some in the private analyst community have made it out to be but it is going to be perhaps somewhere in the range of 10 to 20 percent of GDP. If you think about the overall bad loans and deal with the fact that you're going to have partial asset recovery, you're going to have some of these loans paid off, the banks to have some degree of provisioning so it's a big cost but a manageable one and here, the government is trying these interesting and innovative strategies.

Now Lingling has a very nice piece in the Wall Street Journal about exactly the issue you spoke about and although I do this with hesitation, in terms of disagreeing with The Wall Street Journal, I think there is a slightly positive angle to this as well. What happened is that basically the government is taking debt that had been given to state enterprises which are in the books of banks and converted them into equity, still in the books of banks and Lingling's piece correctly points out that this puts the squeeze on banks because now the equity has to be marked down, in principle to market value but the somewhat more positive spin on this is that at least it starts dealing with the legacy problem because the difficulty of the legacy problem was that if a US bank had made a loan to a state owned enterprise, even if that state owned enterprise as illiquid or insolvent, your incentive was to continue lending to that state enterprise because otherwise that loan shows up as an (inaudible) on your books. Now it's gone to the equity market.

It is going to be priced right but you don't have an incentive as a bank to lend anymore. So it's a very inefficient way of trying to break that link but here again, I think the government is approaching it with the right intentions of dealing with the legacy problem and trying to get the right price for those assets in the market. Again, is the equity market in China going to give you the right price for the assets? Probably not but conceptually, I wouldn't dismiss it quite as quickly.

MR. DOLLAR: I was just going to add briefly that China remains relatively close to foreign investment and financial services, it's partially open and that's a separate issue from opening the capital account and I think moving on that agenda would tend to make the financial system more robust and it will be tricky but as you deal with some of these problems and bad debts, there will be some possibility to sell those -- sell some of those banks and perhaps attract foreign investors to come in and take over some of those risky situations but there is still tremendous interest in getting into China's domestic market.

MR. GAO: In the past year also, we have repeatedly been hearing from the central government that they are going to let some bank some major institutions to fall. This, we hear from time to time for a long time and in our past 30 year history, we never really had too many companies to really go bankrupt anyways but this time, more and more people started to believe in it because you see so many companies not just being zombie companies, they are dead weight for the whole system (so people start to be gradually prepared for that sort of thing and at the same time, another development in the whole system, which is that last -- September of last year, the Supreme Court came out with a whole line of what they called the explanations of law, which officially, this is the Supreme Court and they recognized a long rate of 24 percent annually. In our history it was always regarded as the usury rate and it was always illegal but now they are saying, "Okay, as long as it's contractual loans, so long as it's below 24 percent, the court will support it. So long as it's within 36 percent, if the parties agree to do that, we won't say that we support them but we won't invalidate it."

So basically what they are saying is that 36 percent annual interest rate, beyond that, it's illegal. This is mind opening for a lot of people and people always say, “Okay, look at the official rate, it’s only six or seven percent and you are never allowed to do more,” but the state banks or the major state enterprises are going to be able to get the six percent interest from the banks and then turn around and loan it to private enterprises, that’s why the rates are so high. It’s a very inefficient system so now that the court recognizes it and the central government knows it -- so you look at the past three years of history, gradually they are opening up so I am sure that this liberalization is going to go forward. We have so far yet to see any reversion on that department yet.

MS. WEI: Okay. Sir? In the back, yes?

QUESTIONER: Thanks for a fascinating presentation. I am Tom Switzer, I am State Department Foreign Service Officer who has been to China several times and is intrigued by this discussion. Dr. Dollar, you made a comment that in the course of your stay in China, there was relatively good communications between American and Chinese officers at the working level but he then went on to comment that there even have been some exchanges between the two countries’ people but they apparently hadn’t worked out that well.

I guess my question is are these all direct government to government exchanges or have you brought in third parties, have they brought in -- like Fulbright and so on and what are your recommendations going forward? Could there not be an increase in exchanges? Thank you.

MR. DOLLAR: My comment was specifically in reference to the Federal Reserve system of the United States and People’s Bank of China and as I said, there were a couple of staff exchanges. I didn’t mean to say that this didn’t go well but I don’t think it has been continued or expanded to my knowledge so our Federal Reserve in the US is interesting in that we employ foreign citizens so actually I think there are some Chinese citizens who happen to be working in our Fed, that’s just part of our normal system but I was expressing the view that certainly when you are talking about say the research department, some of the study parts of central banks seems to me that it would be perfectly sensible to have exchanges of staff.

Of course you are not going to have foreign nationals involved in the operation of the policy setting committee but then as you yourself know, I think throughout the US government, there are lots of other examples. I am just trying to think back. As I said, I was representing treasury. I don’t recall that we had any staff exchanges with China. It seems to me that would actually be a useful thing. There are a lot of things that are done that are not confidential and just in terms of confidence building that would help a lot.

It just seems to happen a lot in a think tank like Brookings and universities or that kind of place. Not too many examples in the government that I can think of.

MR. GAO: I know as a fact that the CSRC over the years had some of their staff members working with SEC, including a young woman who was there for a whole year before she went back so that sort of exchange is established very solid in a person to person context.

MS. WEI: We probably have time for one last question. Yes, sir? The gentleman with glasses, right, you.

QUESTIONER: Sergey Kastiv, Financial News to Moscow, Russia. It might be a question to the wrong audience but anyway. Are the revelations made in the Panama Papers are going to have any ramifications for Chinese economic policy? Thanks.

MR. GAO: What do I think about it? I didn't even get to read it so. In China, we didn't get to read it so.

MS. WEI: Any other burning questions? Yeah, please.

QUESTIONER: -- Grant EJF Capital. I have a question with Mr. Gao. How strong is the capital control now in China and what is your outlook on it? Thank you.

MR. GAO: Capital control means the current accounts, these things, right?

QUESTIONER: Right.

MR. GAO: Okay, I think it's -- I have the feeling that the government now is -- especially from last year on, starting to exert more stringent rules on that but I personally don't think it's going to happen because there are these numbers. If you look at it, there are 15 million overseas Chinese today in the world, 15 million and there are over almost three million Chinese students in foreign countries and last year, there were 120 million Chinese traveling outside of China so what is this sort of cross-border movement? How on earth, our central bankers here, how can you possibly control these things so that's why I am very positive in that regard. I am saying that despite the ostensible control on the capital accounts, there's not going to be that much control anyways so it's not -- many people predicted that after last year they said the Central Bank was going to reclose the door and totally go back on their promise to open the capital account; I don't think that is going to happen.

It won't happen because once you open the door, it's difficult to put it back in, short of a revolution.

MS. WEI: With those last words, we are ending today's session. Thank you very much for your great input.

(Recess)

MR. WESSEL: So on behalf of the John L. Thornton Center on China and the Hutchins Center on Fiscal and Monetary Policy at Brookings, I want to welcome Yi Gang, the deputy governor of the People's Bank of China to Washington and thank him for fitting us into his busy schedule and I also want to thank Ben Bernanke, distinguished senior fellow here at Brookings. Former chairman of the Federal Reserve who is fighting a cold and didn't cancel so we really appreciate that.

I think, Governor Yi, when we listen today to the International Monetary Fund give a rather gloomy outlook for the world economy talking about growth being too slow for too long, rising risks of financial instability, consternation that government policies aren't supportive enough for growth. I wonder, from your perch, what you think could improve the trajectory of the world economy? What should we do to do better?

MR. YI: I think we are here in town for the G-20 meeting. I think the finance ministers and Central Bank governors now are here trying to discuss this million dollar question.

MR. WESSEL: Million RMB question.

MR. YI: Yes, and I think policy coordination is very important, like they did in Shanghai. What I can say here is that from the first quarter data, I can see that China's economy is in the pretty robust in a lot of indicators in terms of transportation, in terms of electricity, in terms of CPI, PPI and other indicators. So that -- I think that China will release its first quarter GDP data very soon and if the U.S. economy -- I would say still within the expectation growth at maybe around the two percent range and the second largest economy in China, I am pretty confident that we are going to have 6.5 to 7 percent growth this year.

If the two largest economies -- economic picture is -- pretty much within the expectation, I would say that we have a solid foundation to continue to fight this weak demand and maybe for the global economy, we can continue to -- through the coordination of the macroeconomic policies and through the reform and structural reforms can restore trade and restore growth.

MR. WESSEL: What do you think the biggest risk to that scenario is?

MR. YI: I think that right now, even some international organization lowered the global growth outlook but historically speaking, if you look at the past decade and the past two decades, we are still around the average of the growth rate so that there is nothing -- panic. And I think on one hand we really have this very solid macroeconomic policy, including fiscal policies and the monetary policy. On the other hand, we also should not exaggerate the risk and overreact, that's another risk.

I would say that the most difficult thing is reform. If you really want to do some reform, it's difficult. People can have quantitative easing, they can have fiscal deficit and try to pump up the economy in the short time and have a quick result -- but compared to the real structural reform, the supply side reform, you have to solve your labor market problem.

You have to solve a lot of property rights and fundamental deep rooted problems. I think -- not reform -- is a risk and overreaction is another risk.

MR. WESSEL: So, Dr. Bernanke, what would be your recipe for having a somewhat better trajectory for the global economy?

MR. BERNANKE: Let me first agree with the governor that we are far better off than we were a few years ago but the growth overall is fairly disappointing for different reasons. And advanced industrial economies, there are still some cases of trying to overcome insufficient demand and trying to hit inflation targets.

In the emerging markets, they are dealing with the combination of some slower growth in China, the clients' commodity prices, the stronger dollar, so there are a whole bunch of factors that are relevant there. I don't -- obviously I don't have any magic formula but I guess a few points I would make: one would be in those countries that are still struggling with aggregate demand efficiency, there should be a better balance between monetary and fiscal policy. Currently, in some countries, the central banks are carrying an awfully large part of the load and --

MR. WESSEL: You mean China and US?

MR. BERNANKE: I am thinking primarily of Europe and Japan as well and a better fiscal monetary balance would be desirable. The structure reform is important and it's a little bit of a mantra and people always say, "Well, structural reform." And that is critical, particularly of course emerging markets like China but I think there has to be smart reform and in particular, in countries where there is deficient demand, some reforms are not so effective, for example, reforms that allow you to fire workers more easily may not be so beneficial when you have high unemployment but what should be the focus should be policies that increase productivity and the incentive to invest so that creates both demand and supply, so to speak.

The other point that I would make and this is something that became increasingly important in these international meetings when I participated in them is financial and banking relationships.

I think that if you think about the United States and its vulnerability to developments abroad, it's less issues of trade and foreign growth than it is the way the financial markets are reflecting uncertainties globally and so I think continued emphasis on cooperation and supervision, financial regulation, particularly with emerging markets who have sometimes taken a second seat to the advanced economies and financial coordination. I think that's an important direction as well.

MR. WESSEL: Governor Yi, I think there is still a lot of worry in global markets and among policy makers that we can have a bad outcome in China and I think one specific part of the worry has to do with the currency, the continued risk that there will be a large devaluation of the RMB. Now markets have been pretty calm lately. You have done a good job at discouraging speculation that a large devaluation is imminent but I think there is still some confusion about precisely how you look at foreign exchange regime. What is it that you want people to understand about how you are managing the currency?

MR. YI: The official statement of our exchange rate is -- it is based on the market of supply and demand and you have seen baskets of currency as reference -- managed floating regime. That has the major three key parts of the statement. One is that it has to have demand and supply driven; it's a market base, that's the first part.

The second part is using a basket of currencies as reference and then the third part is managed floating regime. I think that is still probably the most precise statement that I can say.

Right now, the market activity has been coming down quite a bit. What I want to say is that we have been relatively successful to convey the message. It's -- with basket of currencies as reference but in the basket, the US dollar still has a very large rate which means that if they say the RMB is a stable reference to basket and also it's relatively stable, relative to the US dollar so I think what I want to say is that the market force is still the number one consideration, the number one factor but at this stage, I think the tremendous market volatility in an overshoot scenario is not good for China, it's not good for the rest of the world, especially in the situation when the global demand is weak and I think we want, on one hand, still consider the market supply and demand and on the other hand, we don't want to see overshooting scenarios so that if we look at the current account, if you look at FDI and ODI, I would say that RMB is within the range of more or less equilibrium level so that in terms of fundamental, I have the confidence that we can still have a fairly stable exchange rate.

MR. WESSEL: But isn't there some tension between saying you want the market to set the value of the currency but you also want it to be stable? Aren't those sometimes at war with each other?

MR. YI: Yes, I think so, yes. You have to weigh the benefit and the cost. You see but if you look at the chart, you can see that -- I would say that in the long run, it's still market based. It is the number one factor you have to consider.

MR. WESSEL: Dr. Bernanke, we learned from economists that it's hard, if not impossible, for a country to have an independent monetary policy, an open flow of capital and a fixed exchange rate at the same time and sometimes it looks like China is trying to weigh those three things against each other and have three out of three. What do you think China needs to do to make the exchange rate commitments more credible?

MR. BERNANKE: While first there are market elements, of course, there is an important element of management also, which I think given all the other things going on and Chinese economic policies, it is probably pretty inevitable. The PBOC has been pretty clear that a sharp decline in the value of the RMB is not desirable or likely and making that clear in itself was helpful because it reduced some of the speculation against the RMB so as you point out, China is facing the so called trilemma of trying to simultaneously to have independent monetary policy, free capital flows and at least a partly managed exchanger rate.

I think that what they will be able to do is meet their objectives. In particular, on the capital flow side, the speaker, the last speaker in the previous session was saying that reducing capital freedom is not likely and I agree with that and it's more desirable but there are things that can be done, for example, to increase desirability of investment in China by both domestic investors and foreign investors and the recent opening of the bond market, for example, is one example of a way to bring more cash into the country, further the regulation of basic investments will be another thing so I think the main potential contradiction is between avoiding depreciation and monetary ease and so my recommendation and I've written about this on a Brookings blog, my recommendation to China would be to focus more on what I call targeted fiscal policy, that is to use fiscal policy as a way of achieving the level of demand which doesn't have the negative effects for the currency that monetary policy can have but at the same time, use that fiscal policy to advance the goals of reform so in particular, the -- in order to create a more consumer led economy, you need to improve the social safety net so people would be more willing to spend and not save so much. You need to increase disposable income through tax cuts. You need to reallocate labor from the heavy industry sector to the services sector, which again is a fiscal challenge so I think that getting the monetary fiscal mix right, in order to support the currency objectives is consistent with reform goals and that will be sort of the framework that I would encourage.

MR. WESSEL: Dr. Bernanke has made the point, as has his successor, Janet Yellen that in the United States, there has been a tendency to rely too much on monetary policy and fiscal policy not being helpful enough. Do you ever feel that that's the way it is in China?

MR. YI: In China, fiscal policy is very important. For example, this year we are going to increase our deficit ration to three percent of GDP so that our fiscal deficit for this year will be over two trillion RMB. Three percent relative to GDP.

Last year it was 2.3 percent so I think the proactive or fiscal policy in China is very important. Coming back to your trilemma question, I think the People's Bank of China, we have independent, more or less independent monetary policy because China is a large country, we need monetary policy to decide our domestic interest rate and so on and so forth.

Capital account accomodability you see our capital account is to a large degree convertible but you see, during the situation of crisis or some abnormal situation, we can still have some management on the capital accounts. For the stable exchange rate, we are not having fixed exchange rates and if you look at the past ten years, for example, starting from 2005, you see, 2005, the exchange rate was 8.28 RMB to a dollar, right.

And if you look at the past 11 years, if you look at the REER and NEER, RMB appreciated REER and NEER --

MR. WESSEL: Real effective exchange rate.

MR. YI: Yeah, real effective exchange or nominal effective exchange rate. Appreciate in the order of 30 percent to 40 percent in the past ten years and if you compare to last year and say the year before, actually, this time, RMB appreciated all the way to 6. 05 and now it's 6.50 so that still, you see, to a certain degree, RMB is still floating, right?

That kind of exchange rate adjustment, exchange rate floating is primarily driven by the market force. That helps to balance the economy and to absorb some shocks so that the trinity dilemma, it says that for the independent monetary policy, capital account accomodability and a stable exchange rate, you cannot have three, you can have only two but you can have a combination of the three and theoretically you can prove there is a triangle and what we say is that the overall distance from a point to the edge of the triangle, the sum is equal to two. It is possible, which means that between the three, you can have the combination of the three, make the sum of the three equal to two.

MR. WESSEL: I am going to have to work this out with a little bit of geometry after this is over.

MR. YI: Thant is different form -- in certain variables, the only truth is 0 or 1, right?

MR. WESSEL: I see.

MR. YI: That is just one combination but theoretically there are infinite combinations that we can choose. My job is, we tried to consider optimal or suboptimal combination of the three.

MR. WESSEL: So do you have a little calculator on your desk that helps you make sure that it adds up to two and not to two point one or one point nine?

MR. YI: I already proved that 20 years ago. That's the work that I was doing.

MR. WESSEL: Your academic work, right.

MR. BERNANKE: You only ever make changes of 27 basis points, right? Which is three cubed.

MR. WESSEL: Well I am glad you are putting your academic research to such practical use. You know, one thing that -- if you look at what is going on in the world economy, I would say that there are two things that get the most attention. One is what you are doing at the People's Bank of China and the other is what the Federal Reserve is up to. So the Federal Reserve has begun the process of normalizing interest rates. It is moving a little more slowly than it and a lot of other people had anticipated but they are moving in that direction.

At the same time, we see increasingly easy monetary policy in Europe, in Japan and I am not quite sure what is happening in the U.K. they seem to be frozen at the moment. Does this divergence of monetary policy outside of China and the normalization of rates in the US, do you feel that this is creating difficulties for you in China?

MR. YI: Yes, it is somewhat challenging -- but you see the monetary policy is primarily based on domestic consideration although the important Central Bank should consider the spillover effect. I think --

MR. WESSEL: You mean the Fed? Or are you talking about the People's Bank?

MR. YI: I think the important central bank. You see, the right formula is you make decisions primarily based on the domestic consideration but for the important ones, really, you should consider the spillover effect. I think that the current situation, as you described at the ECB and the Bank of Japan and also the Federal Reserve, and also People's Bank of China. I think we communicate and coordinate fairly well and we understand each other and we have an effective channel of communications. I think so far, we can still manage to make the picture by and large stable.

MR. WESSEL: So do you think the Fed takes into consideration sufficiently, the spillover effects?

MR. YI: That's a question to Ben. I know he has the best capability to answer --

MR. WESSEL: So do you think that some emerging markets, not Governor Yi but as you know Governor Rajan of India and others have said that the Fed is not sufficiently sensitive to the impact that Fed policy has. To what extent do you think there really are big spillovers from what the Fed does to emerging market economies?

MR. BERNANKE: Oh, you're talking to me now? Can I discuss the triangle part first? Well, there are spillovers of course. I think that the Federal Reserve does pay attention to what is happening in the world. The United States is part of the global economy. There is feedback of all different kinds, both real and financial so it's very important for the Fed to pay attention globally. At the same time, the Fed can't make monetary policy for the world. It's in the interest of the world for the US to have stable, non-inflationary growth, that's what the Fed is trying to achieve and what you observe is that other countries are affected by Fed policy to a varying degree according to their own decisions.

I would take an example of a country which has managed pretty well is Mexico, which is right on our border but they've got sound monetary and fiscal policies. They've got a reasonably flexible exchange rate. They've got a strong financial system and they have -- it's in their interest obviously, Mexico's interest to see the US economy growing in a healthy way so it's really responsibility on both sides. I mean the Fed has to think about the global environment and the effects of its decisions for no other reason than that's going to feedback on the US economy but the -- what happens globally does depend an awful lot on the choices that are made by the other economies as well.

MR. WESSEL: There has been concerned expressed outside and inside China, Governor Zhou at his speech at the China Development Forum about the problem of rising leverage in the corporate sector in China. Zombie firms that are kept alive by banks that just keep rolling over the loans because they don't want to recognize the losses.

Two questions, do you see this as a risk to the Chinese economy and if so, what's the solution to this so that you don't end up with some of the problems of debts that we have seen in some western economies?

MR. YI: I do realize that the debt of the corporate sector in China is relatively high, compared to other developing countries. I think the solution is that one thing that you really have to have is the financial discipline to make every enterprise, every unit of the economy to be responsible for themselves, right?

If they bankrupt, they bankrupt and that is the financial discipline is very important. The property rights are very important and the nature of market economies is that the unit of the market has to be responsible for their behavior and for their investment. That is the most important -- if that is not true, then there are a lot of moral hazards, right?

The other thing I want to say is that given the corporate sector's leverage ratio is already relatively high, we have to consider this problem or alleviate this problem in a very gradual manner so that it probably still takes time to make it stable and then maybe decline but it's not realistic to say that you want to have some policy to immediately decrease the leverage ratio, that is not realistic so you really have to do it very carefully and you really have to consider the government leverage ratio and family, household leverage ratio and corporate leverage ratio and the leverage ratio for the economy as a whole and you have to look at this whole picture and try to optimize and find a smooth solution.

MR. WESSEL: How well do you think China is doing in making individual borrowers responsible for their debts?

MR. YI: I think we still have some reform to do to go. For example, we have to strengthen our bankruptcy law and we should speed up the -- simplify and speed up the procedure for the bankruptcy process and that, if you have a good legal environment, that will make people's expectations more stable so that they make the process more efficient.

MR. WESSEL: Dr. Bernanke, are there any lessons that China should learn from our experience from the last decade of credit, too much credit?

MR. BERNANKE: Let me first say that while leverage is very high in China, including not just corporations but regional governments and others as well that there are a couple of ameliorating factors. One is that unlike some emerging markets, China's debt, for the most part is in local currency. There is about a trillion dollars of dollars (inaudible) in nominated corporate debt I believe but most of the debt is in local currency so there isn't the exchange rate risk that other -- some other countries have faced.

Also it's funded mostly by domestic savings and pretty sticky savings as well going through the banking system for example so that means that we don't really see the risk of our capital flight in the same way that you might see in the 90s and the Asia crisis for example. The other factor is that the Chinese government has resources and while I appreciate the point that borrowers should stand on their own two feet so to speak, should there be a systemic problem, I think the China government has the resources necessary to address that and indeed, I think a useful direction would be to stop using banks sort of as an indirect arm of fiscal policy and to separate much more cleanly, fiscal action and credit, which would simplify some of this in the future.

In terms of lessons, I think the main lesson I would suggest is not about the run up to the problem but sort of the response to the problem. I think that one can at least make the case that the US did a pretty good job of cleaning up the banks and getting them back into healthy condition quickly.

We put capital in the banks, we did stress tests and the like and so competing with the view that you should be very gradual, which I also understand is an argument in the market economy for just trying to get the problem fixed, the Japanese took a very long time in the 90s to address their banking problems for example. So to the extent that the problems are severe enough and this may not be the case in China, but to the extent that the problems are severe enough that they erode confidence in the banking system, sometimes a really quick response and rapid recovery is more effective.

MR. WESSEL: So if you could ask Ben Bernanke one question, what would it be?

MR. YI: Of course, it’s the direction of US monetary policy.

MR. WESSEL: Lots of luck with that.

MR. BERNANKE: Well I am not in charge of that anymore as you know.

MR. WESSEL: I thought that you would say that it would be prudent.

MR. BERNANKE: It will certainly be prudent and careful, yes.

MR. WESSEL: And is there a question that you would like to ask Governor Yi before I turn to the audience?

MR. BERNANKE: Well, let’s see, how do you think that this critical growth model reformed, going from the heavy industry, from exports, that kind of model to growth to the model that you are trying to get to, one that has consumer-led, services -- that’s a very tricky transition and how do you see that as going and what do you see as the main barrier to that? What kind of timeframe are we thinking about?

MR. YI: I think it will probably take several years for this transition but what I can say now is the transition is going on right now. For example, last year, our GDP growth rate is 6.9 whereas the consumption and contribution to this incremental is about 66 percent, which is consumption contribution is about two-thirds of the growth and also if you look at the composition of the economy, China used to -- the manufacturing sector for the Chinese economy used to be the largest and in the past several years, the service sector of tertiary industry is much larger and has a much faster growth rate. Last year, the service sector was already beyond 50 percent of GDP so that it's more than 10 percent higher than the manufacturing sector so in terms of the structure of the economy, the service sector has grown as the most rapid sector and also, the service sector is the more labor intensive sector.

The employment in the recent years has been very good in China and consumption is relatively stable but as I said, last year, the contribution of the consumption to GDP growth is about 2/3 so all these indications point to the direction that China already is on the transition from a heavy industry and export oriented economy to a consumer driven economy but still, it takes several years to finish this process.

The difficulty is that as you correctly pointed out, China's saving rate is relatively high, probably one of the highest in the world. And for the very high saving, you have to invest or you -- either abroad or domestic invest, which means that the investment, as a percentage of GDP is relatively high. How do you solve that -- the consumption driven economy, probably the consumption percentage as a percentage of GDP should be much higher but on the same consideration, you have to find out how you deal with the very high savings rate. I think that is a question that we have to figure out.

MR. WESSEL: I think we have time for some questions. Do we have a mic? Anybody want to -- Eswar, you want to take the first question?

MR. PRASAD: Governor Yi, you have spoken about how China wants to move towards a more flexible exchange rate, what do you see as the end game here. What is the monetary policy framework that you think is going to be suitable for China as it adapts to more open capital account, more flexible exchange rate, a different structure of the economy?

MR. YI: Do you mean the monetary policy framework? I think that our monetary policy framework is still in transition and for example, now we still consider the money supply, say M2 is still a forecast target. It's not a mandatory target but still a forecast target. At the same time, we may also think that interest rate is very important. We already somewhat established the preliminary stage of an interest rate corridor or something similar to an interest rate corridor so that I think that if on one hand you still consider the aggregate money supply, on the other hand, you realize that interest rate is very important in the transmission mechanism and also you know that theoretically, the two, actually you have to coordinate between the two.

To answer your question, I think the same dilemma we are facing is also the trilemma problem, the exchange rate problem and the whole economy is in transition like from the investment and the export led model to a consumption led model.

The monetary policy framework in the transition from heavily dependent on the quantitative variable to the more emphasis on the interest price variable and you see, the exchange rate regime is also in the transition. I think my point is that right now, my number one consideration is manage those transition.

Of course, you say if you don't have a final goal, how can you manage the transition. I think the final goal is fairly clear. The final goal is fairly clear except probably there are some dimensions that are more subtle and it's difficult to describe.

MR. WESSEL: Krishna, did you have a question? Stand up so that the mic can find you.

QUESTIONER: Krishna Guha, Evercore Partners. I wanted to ask Gang also about the exchange rate. You have done -- made significant efforts in recent months to communicate more about the exchange rate and I think it's better understood and yet there is still a source of confusion that you talk about the currency with reference to the basket and yet in recent months, we have seen the currency not stable against the CTS basket but continually depreciating on average so can you enlighten us, if you are setting the exchange rate with reference to the basket, why it is that it's not stable against that basket but appears to be trending against the basket, thank you.

MR. YI: That's a good question. I have explained that quite in detail. Just directly to try to answer your question, we considered three major baskets. One is the CFETs basket. The second one is the BIS basket and the third one is the SDR basket. All the three are under our consideration.

We say with reference to a basket. We don't say packed to a basket. That explains itself. The other thing is you mentioned the CFETS basket and I think if you look at the data, you can see that it is a little bit off the basket but the base period of the CFETS basket is the end of 2014 and 2014 was a relatively high point for RMB. As I said, in the last ten years that the NEER and REER of RMB appreciated 30 to 40 percent, in that range whereas the end of 2014 was the high point of this process and it really -- to answer your question, it really depended on the time window you considered.

If you consider the past three years as a moving average as window it's a different conclusion. If you consider the past five year moving average as the time window, you have a different average and that's different so that can answer part of your question. The other part of the question is answered by -- if you cannot explain the situation and you have to explain the situation by the market demand and supply. As I said, my belief is that market supply and demand is the first factor in the process of determining exchange rates and if the market is stable, right, you really have to give the market demand and supply more weight, right, and that's my philosophy and that's my belief.

MR. WESSEL: We got a question here.

QUESTIONER: Thank you. Again, in reference to the exchange rate, I want to see if I understand correctly your position. So there's a lot of nervousness now about the strange rate policy but is it fair to say that, especially with the trilemma specifically, given that it's not desirable to close the capital count for a variety of reasons, having an exchange rate that moves in the direction that the markets wanted to move, not entirely because that's moving too much but in that direction would help the conduct of monetary policy would free up the carrying out of independent monetary policy regardless of whether the sum of the triangle is two or whatever you want so if that is true, why should we be afraid of whenever China -- the RMB devalues. Isn't that -- doesn't that mean that China is doing the exact same thing that every other central bank has done or would do in its place, which is to support a weakening economy with easier monetary policy and the result of that is a weakening exchange rate.

The sequence is different. First the exchange rate and then the easy monetary policy instead of vice versa but isn't that what China is trying to do?

MR. WESSEL: I think that was a yes/no question.

MR. YI: I think if I understand your question correctly, your question is basically we should let the market decide period, right? I think if you look at the literature of exchange rate and you see a lot of overshooting models, you see a lot of multiple equilibrium models. I would say that for China, it's a significant economy and also we have the G-20 and other platform of corporation. I would say that to maintain the relative stability is good for China and good for the rest of the world.

If you look at the major investment predictions on RMB last year and if you look at the prediction for the magnitude of one direction bet of the major financial institution, I think they have very smart economists and they have a base, a model to produce the result. It turns out that if you look at the past year's data and it has been relatively stable and they manage a relatively stable and I can tell you that right now, the pressure has been reduced, significantly reduced.

I would say that the current outcome is better than a free float model.

MR. WESSEL: All right, is there one here in the aisle. Let's take two and why don't you pass this to the women on your left and we'll take both questions.

QUESTIONER: Thank you; I am Jennifer Lee with Hong Kong Phoenix TV. A question for Governor Yi and Dr. Bernanke, it's about China's financial regulators, so due to the market turbulence earlier this year, the talks of how to coordinate the three regulators emerged which include the regulators of security, banks and insurance companies.

We are even here to talk about establishing a super central bank to better coordinate the three regulators so I wonder what is Governor Yi's point of view on that and do you think how the Central Bank can play a role in dealing with the financial instability?

And for Dr. Bernanke, do you think how China can derive their experience from the western countries in terms of structure or coordinate better dealing with financial instability or even when the financial crisis comes?

MR. WESSEL: Thank you. Why don't you pass it to your left and we'll take that question as well.

QUESIONER: I am Jiang Yujuan with the Xinhua News Agency. The IMF has expressed its concerns about some of China's stimulus might hurt the quality of the economic growth and how China can strike a balance between ensuring stable growth and controlling the risk and the second question is about the SDR and Governor Zhou, China is proposing the greater use of the SDR and how do you see this kind of proposal and what is the relevance between the greater use of the SDR and the internationalization of the Chinese yuan, thank you.

MR. BERNANKE: I thought I was getting two questions and I think I got six.

MR. WESSEL: Let's start Ben first. What advice do you have them on structuring their bank regulation other than don't do it the way we do.

MR. BERNANKE: That was going to be my answer, no. Well I mean the United States has a particularly complicated financial system, which is partly a choice and partly it is an accident but we have a trade-off which is that given our complex financial system that we have different specialization so to speak, the SEC specializes in securities markets and the FDIC and the OCC specialize in banking and so on so there are skill sets there but at the same time, it's very important that there be close coordination. The Fed tries to act as a coordinator.

There are counsels of coordinators among bank regulators and then of course, the Dodd-Frank Act created the financial stability oversight council so whether it's the right balance, I don't know then -- the regulates think not, the banks think they are overregulated by too many different points of view.

Another way of looking at that is that you have more eyes, maybe it's better than only a few eyes so there's a tradeoff between having the specialized regulators providing independent points of view versus the coordination and efficiency of working together and I can't be much more general than that. I think that we do try in the United States to have coordination but obviously we failed sometimes.

MR. WESSEL: What is your view on coordinated -- is the coordination adequate in China and what would you do to make it better?

MR. GANG: I can only answer that question in principle. I think in principle, you have to consider first the information. You have to consider the information that is -- there is an efficient transmission of information, an efficient usage of information. Those who have the responsibility, who have accountability, who have the power and should have the information, that's one criteria. The second criteria is you have to design the mechanism to make the responsibility and the power to be symmetric.

If somebody has power but they are not responsible of the consequence, that's not good. That's my answer to your regulatory question. For the SDR question, I think the SDR was created in 1960s. I think still there are some potential usages for SDR, for example in terms of reporting, like BIS reporting in terms of SDR and also there is a potential SDR denominated S-ED market.

There are some benefits and also some costs. If some international organization or some central bank or some private institution finds out that it's more convenient to use SDR, there is a potential broader usage of SDR.

MR. WESSEL: Thank you. I am afraid we are out of time. I would like to ask a favor. This room is going to be set up for another event immediately afterwards so if you could take any papers at your seat and put them in the recycling, we would appreciate that and we would like to clear the room as quickly as possible. Please join me in thanking Governor Yi and Dr. Bernanke.

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CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

Carleton J. Anderson, III

(Signature and Seal on File)

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Expires: November 30, 2016