China Monetary Policy Report Quarter Four , 2013

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Monetary Policy Analysis Group of the People's Bank of China

Executive Summary

In 2013 the Chinese economy maintained stable growth, made progress, and took a turn for the better. The growth of consumption was stable; investment expanded rapidly; the structure of imports and exports was optimized; the agricultural sector faced another bumper-harvest year; growth of industrial output rebounded after stabilizing; and the hike in both consumer prices and employment remained fairly stable. In 2013 GDP reached 56.9 trillion yuan, up 7.7 percent year on year and the consumer price index was up 2.6 percent year on year. The current account surplus as a share of GDP was 2.1 percent.

In accordance with the overall arrangements of the State Council, the PBC followed the principle of making progress while maintaining stability, continued its sound monetary policy, and made innovations in the conduct of macro-economic management. The PBC remained sober-minded, maintained a focus on policy measures, neither loosening nor tightening the supply of money, and when necessary conducted fine-tunings and preemptive adjustments with appropriate strength. The direction and intensity of liquidity operations were adjusted in a flexible manner based on changes in the liquidity situation. A combination of innovations in liquidity-management tools was used when necessary and as appropriate to address fluctuations in the supply of short-term funds caused by various factors. The PBC implemented the State Council's decisions on stepping up financial-sector support to adjust and upgrade the economic structure, adjusted the parameters of the dynamic adjustment mechanism of the differentiated required reserve ratio, strengthened coordination of credit policy and industrial policy, increased central bank lending and discounts for the agricultural sector, and guided financial institutions to beef up support to key sectors and weak links in the economy, such as the agricultural sector, rural areas and farmers, small and micro enterprises, and so forth. The market-based interest-rate reform made new progress, with the lifting of controls on lending interest rates offered by financial institutions, the creation and improvement of a self-regulatory mechanism for market interest-rate pricing by financial institutions, the launch of centralized quotations and release mechanisms for loan prime rates and interbank certificates for deposit. The RMB exchange-rate regime was improved, continuing a self-initiated, controllable, and progressive approach to reform. The use of RMB was expanded in cross-border trade and investment activities, and financial-market innovations and regulations were further enhanced.

In general, the sound monetary policy produced good results. The rapid expansion of money, credit, and all-system financing aggregates, as witnessed in the first several months of the year, was controlled, and overall annual growth was close to the anticipated goals. Credit support to the weak links in the economy was enhanced. The relatively stable monetary and financial environment contributed to sustainable and steady growth in the economy and structural adjustments, to stabilization of inflation in the second half of the year after moving upward in the first half of the year, and to containment of the excessive expansion of the total debt and leverage rate. In 2013, broad money M2 was up 13.6 percent year on year. Outstanding RMB loans were up 14.1 percent year on year, an increase of 8.89 trillion yuan from the beginning of 2013 and 687.9 billion yuan more than the growth registered in 2012. The growth of loans to small and micro enterprises and agro-related loans both exceeded the average growth of total lending, and the amount of new loans to small and micro enterprises and agro-related new loans both exceeded that in 2012. All-system financing aggregates totaled 17.29 trillion yuan, an increase of 1.53 trillion yuan year on year. Lending and deposit interest rates offered by financial institutions were generally stable. In December, the weighted average lending rate offered to non-financial enterprises and other sectors was 7.20 percent. At end-2013, the central parity of the RMB against the US dollar was 6.0969 yuan per dollar, an appreciation of 3.09 percent from end-2012.

In terms of the potential drivers of economic growth, the Chinese economy is likely to continue the momentum of stable economic growth and make progress toward higher-quality growth. In particular, the advance of comprehensive reforms will help release the potentials for growth and will stimulate economic dynamism. But there are many risks and challenges ahead, including those due to the uncertainties in the global economy, the yet-to-be strengthened indigenous growth drivers, the growing reliance on investment and borrowing, the potential risks in the financial sector, and the arduous task of making structural adjustments and transforming the growth pattern. As the price situation is generally stable, continued guidance is needed to manage inflation expectations.

The PBC will follow the overall arrangements of the State Council and implement the decisions adopted at the 18th CPC National Congress and the 3rd Plenary Session of the 18th CPC Central Committee, following the principle of making progress while maintaining stability and continuing reform and innovation. The PBC will continue its sound monetary policy, continue the orientation to maintain aggregates at stable levels and optimize the structure, maintain the stability and continuity of policy, make macro-economic measures more forward looking, targeted, and coordinated, strike a balance among preserving stable economic growth, adjusting the economic structure, promoting reform, and preventing risks, and conduct fine-tunings and preemptive adjustments where appropriate and with a proper intensity in order to continue to provide a stable and opportune monetary and financial environment. A combination of quantitative and price instruments will be used and the macro-prudential policy framework will be improved to keep liquidity at a reasonable volume and to realize opportune growth of money, credit, and all-system financing aggregates. The stock of credit assets will be properly managed and the use of new loans will be optimized to improve the financing and credit structures. The use of monetary policy measures will be combined with deepened reforms, with a focus on higher efficiency in terms of resource allocations and increasing consumer dominance, so as to allow the market to play a decisive role in resource allocations; efforts will be made to further improve the approach to macro-economic management in view of the deepening of and innovations in the financial market and straighten up the transmission mechanism, so as to improve the efficiency of the financial sector and financial services to the real economy. Measures will also be taken to effectively prevent systemic financial risks and to support the sustained and sound development of the economy.

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Part 1 Monetary and Credit Performance

In 2013, liquidity in the banking sector was appropriate, the structure of all-system financing aggregates became more diversified, credit aggregates continued to increase at a relatively rapid pace, and the monetary and financial situations were basically stable.

I. The growth of money supply gradually declined, approaching the annual target

At the end of 2013, outstanding M2 stood at 110.7 trillion yuan, up 13.6 percent year on year, decelerating by 0.2 percentage points from the end of the last year, close to the target set at the beginning of the year. Year-on-year growth of M2 was relatively high from January to May, gradually slowed down beginning in June, and decelerated by 2.5 percentage points at end-2013 from the yearly high. Outstanding narrow money (M1) stood at 33.7 trillion yuan, up 9.3 percent year on year, an acceleration of 2.8 percentage points over end-2012. Currency in circulation M0 stood at 5.9 trillion yuan, up 7.1 percent year on year. The central bank injected 389.9 billion yuan of cash on a net basis in 2013, at par with that in the previous year. Affected by the rapid monetary expansion at the beginning of 2013, M2 may grow at a reduced pace at the beginning of 2014.

At the end of 2013, outstanding base money registered 27.1 trillion yuan, up 7.4 percent year on year and 1.9 trillion yuan more than that at the beginning of the year. The money multiplier stood at 4.08, which was 0.22 higher than that at the end of 2012. The excess reserve ratio of financial institutions was 2.3 percent and that of rural credit cooperatives was 7.3 percent.

II. Deposits in financial institutions increased steadily

At the end of 2013, outstanding deposits of domestic and foreign currencies in all financial institutions posted 107.1 trillion yuan, up 13.5 percent year on year and a deceleration of 0.6 percentage points from end-2012. This was 12.7 trillion yuan more that at the beginning of the year and an acceleration of 1.0 trillion yuan year on year. Outstanding RMB deposits registered 104.4 trillion yuan, up 13.8 percent year on year, an acceleration of 0.4 percentage points over end-2012. This was 12.6 trillion yuan more than that at the beginning of the year and an acceleration of 1.7 trillion yuan year on year. Outstanding deposits in foreign currencies posted USD438.6 billion, up 7.9 percent year on year. This was USD28.4 billion more than that at the beginning of the year and a deceleration of USD103 billion year on year.

Broken down by sectors, the growth of household deposits moderated, while that of the non-financial corporate sector accelerated. At the end of 2013, outstanding household deposits in financial institutions posted 46.1 trillion yuan, up 13.6 percent year on year, a deceleration of 3.1 percentage points from the beginning of the year; this was 5.5 trillion yuan more than that at the beginning of 2013 and represented a deceleration of 216 billion yuan year on year. Outstanding deposits of the non-financial corporate sector registered 36.2 trillion yuan, up 10.4 percent year on year and an acceleration of 2.5 percentage points over end-2012. This was 3.5 trillion yuan more than that at the beginning of the year and represented an acceleration of 756.3 billion yuan year on year. At the end of 2013, outstanding fiscal deposits registered 3.0 trillion yuan, representing an acceleration of 755 billion yuan over that in the previous year.

III. New loans by financial institutions maintained relatively rapid growth

At the end of 2013, outstanding loans in domestic and foreign currencies by all financial institutions registered 76.6 trillion yuan, up 13.9 percent year on year. This was 9.3 trillion yuan more than that at the beginning of the year and an acceleration of 224.9 billion yuan year on year.

New RMB loans increased in a stable and relatively rapid manner. At end-2013, outstanding RMB loans stood at 71.9 trillion yuan, representing year-on-year growth of 14.1 percent, which was at par with the growth rates at the end of June and at the end of September. This was also 8.89 trillion yuan more than that at the beginning of the year and an acceleration of 687.9 billion yuan year on year. Total credit extensions remained at an elevated level.

In terms of the credit structure, RMB loans to the household sector increased relatively rapidly, the growth of loans to the non-financial corporate sector and other sectors was relatively stable, and the share of medium- and long-term loans in total new loans picked up. At the end of 2013, outstanding loans to the household sector registered year-on-year growth of 23.1 percent, an acceleration of 4.5 percentage points over end-2012; this was 3.7 trillion yuan more than that at the beginning of the year and an acceleration of 1.2 trillion yuan year on year. In particular, individual home mortgage loans increased 1.6 trillion yuan from the beginning of the year, representing an acceleration of 720.4 billion yuan year on year. Loans to non-financial enterprises and other sectors grew 11.1 percent year on year, at par with the growth at end-June and end-September; this was also 5.2 trillion yuan more than that at the beginning of 2013, representing a deceleration of 483.5 billion yuan year on year. In terms of loan maturities, compared with the beginning of the year new medium- and long-term loans increased by 4.6 trillion yuan, representing an acceleration of 1.7 trillion yuan year on year. The share of new medium- and long-term RMB loans was 51.6 percent, up 16.5 percentage points over 2012. Short-term loans including bill financing grew in a stable manner, increasing 4.1 trillion yuan from the beginning of the year. Among the different types of financial institutions, loans by Chinese-funded large-sized national banks, Chinese-funded small- and medium-sized national banks, and small-sized rural financial institutions registered larger year-on-year growth.

Table 1 RMB Loans of Financial Institutions in 2013

Unit: 100 million yuan

	2013		2012	
	New Loans	Acceleration	New Loans	Acceleration
Chinese-funded large-sized national banks①	40,995	2,211	38,784	1,323
Chinese-funded small- and medium-sized national banks②	27,798	4,596	23,202	619
Chinese-funded small- and medium-sized local banks③	12,545	-668	13,214	5,884
Small-sized rural financial institutions④	13,324	1,780	11,544	1,532
Foreign-funded financial institutions	386	-391	777	-3

Notes: ① Chinese-funded large-sized banks operating nationwide refer to banks with assets denominated in domestic and foreign currencies equivalent to no less than 2 trillion yuan (according to the amount of total assets in both domestic and foreign currencies at end-2008).
② Chinese-funded small- and medium-sized banks operating nationwide refer to banks operating across provinces with assets of less than 2 trillion yuan denominated in domestic and foreign currencies.
③ Chinese-funded small- and medium-sized local banks refer to banks operating within a single province, each of which has total assets of less than 2 trillion yuan denominated in domestic and foreign currencies.
④ Small-sized rural financial institutions include rural commercial banks, rural cooperative banks, and rural credit cooperatives.
Source: People's Bank of China.

The growth of foreign currency denominated loans slowed down from an elevated level. At end-2013, outstanding foreign-currency loans of financial institutions posted USD776.9 billion, up 13.7 percent year on year and a deceleration of 19.5 and 9.2 percentage points from end-June and end-September respectively. This was USD93.5 billion more than that at the beginning of the year and a deceleration of USD51.7 billion year on year. In terms of the loan structure, trade financing increased by USD21.4 billion, a deceleration of USD71 billion year on year; outward lending and medium- and long-term domestic loans increased by USD55.5 billion, USD3.8 billion more than the increase registered in the previous year.

IV. The amount of all-system financing aggregates increased somewhat and the financing structure was diversified

According to preliminary statistics, in 2013 all-system financing aggregates reached 17.29 trillion yuan, representing an increase of 1.53 trillion yuan year on year. Among this total, all-system financing aggregates amounted to 10.15 trillion yuan in the first half of the year, representing an increase of 2.38 trillion yuan year on year, while all-system financing aggregates in the second half of the year amounted to 7.14 trillion yuan, representing a decrease of 849.7 billion yuan year on year. In terms of the financing structure, all-system financing aggregates in 2013 displayed the following characteristics: First, the share of new RMB loans in all-system financing aggregates posted 51.4 percent, a historic low, and down 0.6 percentage points from the previous year. Second, new foreign currency denominated loans registered a larger deceleration from the previous year, mainly due to the deceleration of 634 billion yuan in the second half of the year. Third, net financing via enterprise bonds decreased from the previous year and equity financing continued to remain at a subdued level. Fourth, entrusted loans and trust loans registered larger year-on-year growth, resulting in a larger share of off-balance-sheet financing activities. In 2013 the combined share of entrusted loans, trust loans, and undiscounted bankers' acceptances in all-system financing aggregates was 29.9 percent, up 7.0 percent from the last year.

Table 2 All-system Financing Aggregates, 2010～2013

Unit: 100 million yuan

	All-system financing aggregates ①	Of which:						
		RMB loans③	Foreign currency denominated loans (RMB equivalent)	Entrusted loans	Trust loans	Undiscounted bankers' acceptances	Enterprise bonds	Financing by domestic non-financial institutions via the domestic stock market
2010	140,191	79,451	4,855	8,748	3,865	23,346	11,063	5,786
2011	128,286	74,715	5,712	12,962	2,034	10,271	13,658	4,377
2012	157,631	82,038	9,163	12,838	12,845	10,499	22,551	2,508
2013②	172,904	88,917	5,848	25,465	18,448	7,751	18,021	2,219

Notes: ① All-system financing aggregates refer to the total value of funds provided by the financial system to the real economy during a certain period of time. It is a flow rather than a stock value.

② Data for the current period are preliminary.

③ Data for RMB loans are the historical numbers released in the past.

Sources: People's Bank of China, National Development and Reform Commission, China Securities Regulatory Commission, China Insurance Regulatory Commission, China Government

Securities Depository Trust & Clearing Co., Ltd., National Association of Financial Market Institutional Investors, and so forth.

V. Deposit and lending rates of financial institutions fluctuated within small margins

In December the weighted average lending rate offered to non-financial institutions and other sectors was 7.20 percent, up 0.42 percentage point from the beginning of the year. In particular, the weighted average interest rate of loans was 7.14 percent, up 0.07 percentage points from the beginning of the year; the weighted average bill financing rate was 7.54 percent, up 1.90 percentage points from the beginning of the year. The hike in bill financing rates was mainly due to the restructuring of assets and liabilities by financial institutions and the reduced size of bill financing, which also pushed up the weighted average lending rate. Home mortgage interest rates rose appreciably. In December, the weighted average home mortgage interest rate was 6.53 percent, up 0.31 percentage points from the beginning of the year.

The shares of loans with interest rates lower than or flat with the benchmark rates declined appreciably, while the share of loans with interest rates higher than the benchmark rates rose. In December, the shares of loans with interest rates lower than or flat with the benchmark rates were 12.48 percent and 24.12 percent respectively, down 1.68 and 1.98 percentage points respectively from the beginning of the year, and the share of loans with interest rates higher than the benchmark rates was 63.40 percent, up 3.66 percentage points from the beginning of the year.

Table 3 Shares of Loans with Rates at Various Ranges of the Benchmark Rate, January through December 2013

Unit:%

Month	Lower than the benchmark	At the benchmark	Higher than the benchmark					
			Sub-total	(1.0，1.1]	(1.1，1.3]	(1.3，1.5]	(1.5，2.0]	Over 2.0
January	10.62	25.08	64.30	19.84	25.23	7.87	8.28	3.07
February	11.69	25.05	63.26	19.57	23.96	7.88	8.83	3.02
March	11.44	23.79	64.77	19.55	24.71	8.15	9.28	3.09
April	10.56	23.53	65.91	18.96	25.52	8.96	9.23	3.24
May	11.89	22.45	65.66	19.65	25.92	8.84	8.46	2.79
June	12.55	24.52	62.93	19.47	24.95	7.95	8.04	2.52
July	10.54	23.32	66.14	19.99	27.07	8.61	7.96	2.51
August	10.23	21.95	67.82	19.70	27.33	9.46	8.60	2.73
September	10.70	23.31	65.99	19.59	26.58	9.33	8.03	2.46
October	9.81	24.23	65.96	19.85	26.26	8.86	8.41	2.58
November	10.41	24.09	65.50	19.13	26.15	8.90	8.45	2.87
December	12.48	24.12	63.40	17.89	24.66	9.64	8.55	2.66

Source: People’s Bank of China.

Due to interest-rate movements on international markets and changes in the supply and demand of foreign currency in China, the deposit and lending rates of foreign currency were generally higher than those at the beginning of the year. In December, the weighted average interest rates of large-value US dollar demand deposits and US dollar deposits with a maturity within 3 months were 0.18 percent and 1.99 percent respectively, up 0.01 and 1.48 percentage points from the beginning of the year. The weighted average interest rates of US dollar loans with a maturity of less than 3 months and 3 months (inclusive) to 6 months were 2.66 percent and 2.82 percent respectively, up 0.64 and 0.86 percentage points from the beginning of the year.

Table 4 Average Interest Rates for Large-value Deposits and Loans Denominated in US Dollars, January through December 2013

Unit: %

Month	Large-value deposits						Loans				
	Demand deposits	Within 3 months	3-6 months (including 3 months)	6-12 months (including 6 months)	1 year	Above 1 year	Within 3 months	3-6 months (including 3 months)	6-12 months (including 6 months)	1 year	Above 1 year
January	0.11	0.90	1.35	1.75	1.90	2.45	1.74	2.04	1.87	2.00	3.25
February	0.12	0.84	1.42	1.75	2.04	2.12	2.18	1.91	1.82	2.14	4.08
March	0.11	0.92	1.57	1.91	2.44	1.54	1.97	2.16	2.07	2.35	3.03
April	0.10	0.82	1.36	2.04	2.36	1.27	1.99	2.13	2.22	2.30	3.26
May	0.12	0.80	1.39	1.89	2.31	1.20	2.00	2.11	2.34	2.38	3.02
June	0.12	1.07	1.69	1.86	2.50	1.14	2.23	2.34	2.40	2.78	3.33
July	0.13	1.14	1.97	2.15	2.57	1.79	2.25	2.58	2.69	2.77	3.13
August	0.12	1.17	1.84	2.05	2.68	2.39	2.29	2.41	2.57	2.63	3.23
September	0.19	1.58	2.37	2.06	3.43	2.22	2.28	2.80	2.63	2.49	3.18
October	0.22	1.63	2.38	2.65	3.18	1.58	2.46	2.60	2.83	2.75	3.36
November	0.17	1.81	2.69	2.91	3.36	1.87	2.52	2.64	2.88	2.91	3.29
December	0.18	1.99	3.19	2.89	2.70	1.96	2.66	2.82	2.88	2.95	3.71

Source: People's Bank of China.

VI. The RMB exchange rate showed an appreciating trend

During 2013 the RMB exchange rate experienced a mild appreciation but moved in both directions, with much stronger flexibility and stable expectations. At the end of 2013 the central parity of the RMB against the US dollar was 6.0969 yuan per dollar, representing an appreciation by 1,886 basis points, or 3.09 percent, over end-2012. From the reform of the RMB exchange-rate regime in 2005 to the end of 2013, the RMB registered a cumulative appreciation by 35.75 percent against the US dollar. According to calculations by the BIS, in 2013 the nominal effective rate of the RMB appreciated by 7.18 percent, and the real effective exchange rate appreciated by 7.89 percent; from the RMB exchange-rate regime reform in 2005 to December 2013, the RMB nominal effective exchange rate appreciated by 32.05 percent and the RMB real effective exchange rate appreciated by 42.21 percent.

Part 2 Monetary Policy Operations

Since the beginning of 2013, in view of the complex and ever-changing domestic and international economic and financial situations and in accordance with the overall arrangements of the CPC Central Committee and the State Council, the PBC followed the principle of making progress while maintaining stability, continued its sound monetary policy, made innovations in macro-economic management, allowed policies to be well-targeted and with appropriate strength, and neither tightened nor relaxed the supply of liquidity in the financial system. Preemptive adjustments and fine-tunings were carried out in a timely and appropriate manner. Efforts were made to improve and optimize the financing and credit structures, to support economic structural adjustments, transformations, and upgrading. The financial reform made some achievements in phases, the market-based interest-rate reform made new progress, and cross-border use of RMB expanded further.

I. Flexible open market operations

In 2013 management of liquidity in the banking system faced a relatively complex situation. On the one hand, this was related to changed policy expectations of the major economies and changes in the direction of capital flows. On the other hand, liquidity in the banking system assumed a larger role in guiding the proper growth of money, credit aggregates, and all-system financial aggregates as financial development and innovations accelerated. In early 2013, when the major developed economies enhanced their QE policies, China's foreign capital inflows increased substantially. As a result, liquidity in the banking system was relatively abundant and there was great pressure for monetary and credit expansions. In May and June, with stronger market expectations of tapering of QE by the U.S. Fed and the downward pressures in the domestic economy, inflows of foreign exchange slowed down. At the same time, due to some short-term factors, such as large cash withdrawals during the holidays and corporate tax payments, there was a temporary decrease in the supply of liquidity. After August and September, as the U.S. Fed delayed exiting the QE and the effects of China's further reform measures on growth gradually unfolded, inflows of foreign exchange again increased significantly. In the meantime, changes in fiscal revenues and expenditures, as well as fluctuations in treasury funds, also added to the complexity in managing liquidity. However, balance-sheet expansion by banks and many other innovative financial products increased the demand for liquidity. Financial institutions, influenced by profit maximization and regulatory arbitrage, used the interbank business and wealth management tools to borrow short-term funds and to lend long-term funds. The asset and liability structures of financial institutions were very sensitive to interest-rate risk exposure, while financial institutions were highly dependent on the money market, thus contributing to the increased volatility on the money market.

Against this background of the complex nature and frequent changes in the direction of fund flow, the PBC strengthened its analysis and monitoring of the banking system's liquidity situation, flexibly managed the direction, intensity, and rhythm of open market operations, and reasonably adjusted liquidity levels in the banking system. In the first half of the year, in view of the changing liquidity situation, the

PBC flexibly carried out open market operations in both directions and maintained liquidity in the banking system at an appropriate volume; in the second half of the year, in view of the increased volatility in liquidity supply and demand, the PBC used a mix of tools, such as repo open market operations and the Short-term Liquidity Operations (SLOs) to smooth out the volatilities in short-term liquidity caused by short-term factors. In the meantime, the PBC decided to roll over part of the matured 3-year central bank bills. In 2013, a total of 765 billion yuan of reverse repo operations was conducted on a cumulative basis, while the volume of repo operations amounted to 2.2 trillion yuan and a total of 536.2 billion yuan of central bank bills was issued.

In view of the changing market situation and the movements in interest rates during different stages, the PBC appropriately managed the elasticity of open market operation interest rates to effectively guide market expectations. Against the background of the complex and volatile external environment, interest rates of open market operations remained generally stable during the first three quarters. During the fourth quarter, in line with the price movements and the changes in the market interest rates, repo open market operation rates rose appreciably, which was conducive to managing inflation expectations and to bringing into play the role of market interest rates to adjust the supply and demand for funds. At end-2013, interest rates of 7-day and 14-day repo operations were 4.1 percent and 4.3 percent respectively.

The PBC conducted state treasury cash management operations in an appropriate manner. In 2013, a total of 430 billion yuan of state treasury funds was deposited in commercial banks in 10 separate operations, including 260 billion yuan in three-month time deposits and 170 billion yuan in six-month time deposits, reaching an outstanding balance of 110 billion at the end of the year.

II. Standing Lending Facility (SLF) operations were conducted in an appropriate manner

Since the beginning of 2013, the PBC has introduced innovative liquidity management tools and actively used the Standing Lending Facility (SLF) to provide liquidity. Prior to the Spring Festival of 2013, the SLF was used to address the liquidity gap in some banks as a result of the massive credit extensions by some banks. In June, the PBC conducted SLF operations with some financial institutions in response to the money -market volatility that was driven by a number of factors. The outstanding SLF posted 416 billion yuan as of end-June. Since September, in view of the changed inflows of foreign exchange, to maintain liquidity on the money market at a reasonable volume the PBC continued to conducted SLFs with financial institutions complying with the requirements for macro-prudential regulation, and at the same time conducted SLFs at a reduced yet appropriate pace according to the specific conditions of the financial institutions for guiding commercial banks to adjust their asset/liability management models. As the rapid growth of financial institutions' loan delivery and interbank business moderated and the maturity mismatch lessened, most of the liquidity provided via the SLFs in June was recovered by the end of the year. At end-2013, outstanding SLFs totaled 100 billion yuan, a decline of 316 billion yuan from end-June; on cumulative terms a total of 2365 billion yuan of SLFs was issued in 2013.

Efforts were made to further strengthen and improve liquidity management in the banking system. In January 2014, the branch offices of the PBC conducted pilot SLF operations in Beijing, Jiangsu, Shandong, Guangdong, Hebei, Shanxi, Zhejiang, Jilin, Henan, and Shenzhen. This was an innovative attempt by the central bank to adjust short-term liquidity, aiming to meet the liquidity requirements of local financial institutions with a legal person status that complied with the requirements for macro-prudential regulation and to improve the central-bank channel for providing normal liquidity to small- and medium-sized financial institutions. By the Spring Festival of 2013, the PBC Headquarters had provided short-term liquidity to large commercial banks via SLF operations, and the PBC branch offices in the pilot areas had provided short-term liquidity to eligible small- and medium-sized financial institutions. These measures helped stabilize market expectations and maintain stable operations on the money market.

Box 1 The Central Bank Lending System Was Improved to Enhance Its Capability to Perform its Duties

To further improve macro-economic management and regulate the positioning of central bank lending, to give full play to the role of the central bank in managing liquidity and guiding financial institutions' credit structural adjustments, and to better perform its functions, the PBC decided to adjust the classification of central bank lending from three categories to four categories, i.e., the central bank liquidity loans were further subdivided into central bank liquidity loans and credit policy support loans, while the central bank financial stability loans and special policy loans remained unchanged.

The reasons behind the aforesaid adjustments were that the central bank liquidity loans had assumed dual functions. Specifically, the PBC Headquarters' liquidity loans issued to deposit-taking financing institutions operating nationwide and the PBC's branch offices' short-term loans issued to local deposit-taking financial institutions with legal person status played the role of providing liquidity, while loans issued to small- and medium-sized financial institutions, including city commercial banks, to expand SMEs loans and consumer loans as well as central bank agro-linked loans to support rural financial institutions to expand loans to the agricultural sector, mainly played the role of promoting credit structural adjustments. After this adjustment, central bank liquidity loans and the Standing Lending Facility (SLF) launched in 2013 were combined to provide liquidity support to financial institutions that complied with the requirements of macro-prudential regulation, while the central bank credit policy support loans included central bank agro-linked loans and small- and medium-sized loans (i.e., the original central bank loans to small- and medium-sized financial institutions).

On the basis of the re-classification, management of central bank loans was further improved. To implement the *Guidelines of the State Council General Office on Stepping up Financial Support for Economic Structural Adjustments, Transformations, and Upgrading* and to support financial institutions to step up credit extensions to small- and micro-sized enterprises, the PBC renamed the central bank small- and medium-sized loans as central bank support small loans. The recipients of the central bank support small loans changed from the original city commercial banks to small-sized city commercial banks (according to the PBC's statistical standards), rural commercial banks, rural cooperative banks, and village and township banks, and their purpose was adjusted from supporting SMEs loans and consumer loans to supporting the aforesaid financial institutions to extend loans to small- and micro-sized enterprises. The lending criteria were specified as two "not less than" indicators of growth of small- and micro-sized loans and incremental loans, i.e., at the end of the last quarter the growth of small- and micro-sized loans should be no lower than the average growth of total loans , and incremental loans should not be l ess than that during the corresponding period of the last year. The management of central bank agro-linked loans remained unchanged.

By adjusting and optimizing the classification system, the recipients and the use of central bank loans will help further strengthen liquidity management over financial institutions and will promote structural adjustments. Tools such as central bank liquidity loans and the Standby Lending Facility (SLF) will combine to play the role of providing liquidity, enriching the toolkit of the central bank in managing liquidity, strengthening the incentives and constraints on financial institutions in their liquidity management, improving the efficiency of monetary policy transmission, and anchoring market expectations. In the meantime, having a separate facility of central bank credit policy loans will help central bank to better use its loans to guide the direction of credit funds, promote credit structural adjustments, and strengthen the role of the central bank in guiding credit support to the agricultural sector and to small businesses. Furhter more, agro-linked central bank loans and the support small loans both cover a wide range of recipients, and each has its own priorities, therefore they have become more targeted.

III. Macro-prudential management was strengthened and the dynamic adjustment of the differentiated reserve requirement continued to play a role in counter-cyclical management

In 2013 the PBC continued to use a dynamic adjustment mechanism of the differentiated reserve requirement as a way to strengthen macro-prudential management. Based on the domestic and global economic and financial developments, the soundness of financial institutions, and the implementation of credit policy, the PBC calibrated the parameters of the differentiated reserve requirement to guide stable and reasonable credit growth and to improve the resilience of financial institutions. At the beginning of the year, the PBC guided rural financial institutions to satisfy seasonal credit demand during the agricultural cycle and to timely extend agricultural loans to support farming activities in the spring season in an effort to meet the credit demands of the agricultural sector, rural areas, and farmers. In the third quarter, the PBC stepped up efforts to adjust the policy parameters in order to further encourage and guide financial institutions to increase credit support to small- and micro-sized enterprises, the agricultural sector, rural areas, and farmers, and less-developed areas in the central and western regions.

IV. A mix of measures was taken to optimize the credit structure and improve the financial sector's efficiency in serving the real economy

The PBC followed the overall arrangements of the Central Economic Work Conference and the State Council to step up financial services to the real economy, continued to use central bank agro-linked loans, central bank discounting , and the reserve requirement ratio to guide credit structural improvements, enhanced coordination between monetary policy and industrial policy and regional development policy, and strengthened the financial sector's capacity to serve the real economy. Financial resources were consolidated to support the development of small- and micro-sized enterprises, and commercial banks were encouraged to issue financial bonds earmarked for lending to small- and micro-sized enterprises. In 2013, 21 commercial banks issued a total of 110 billion yuan of financial bonds earmarked to support small- and micro-sized enterprises. The PBC vigorously promoted financial products and service innovations in the rural areas, and ratcheted up credit inputs to the agricultural sector, rural areas, and farmers so as to promote the development of a modern agricultural industry. Financial institutions were guided to provide credit to ongoing and follow-up national key projects, the modern service sector, science and technology innovations, strategic emerging industries, and other important areas that are critical to social and economic development, improve financial services and step up support job creation and students in need, for better livelihood of the people. The differentiated home mortgage policy was strictly followed. The financial services and the development coordination mechanism played a role in promoting financial services for poverty reduction and development in the contiguous poor areas. Strict controls continued to restrict lending to highly polluting and high energy-consuming industries, and to sectors burdened with overcapacity so as to resolve the overcapacity problem. The pilot program of credit asset securitization was advanced to better manage the stock of credit assets. Assessment of credit policy guidance was improved so assessment work would play a greater role in guiding credit extensions.

Judging by the effectiveness of the above measures, credit structural improvements supported economic structural adjustments, transformations, and upgrading. First, credit support to small- and micro-sized enterprises and to the agricultural sector, rural areas, and farmers maintained a strong momentum. At end-2013, outstanding loans issued by financial institutions to small- and micro-sized enterprises grew 14.2 percent year on year, outpacing the growth of total loans by 0.1 percentage point; new loans to small- and micro-sized enterprises posted 2 trillion, an increase of 357.6 billion yuan year on year. At end-2013, outstanding RMB and foreign currency denominated agro-linked loans increased 18.4 percent year on year, outpacing the growth of total loans by 4.5 percentage points; new agro-linked loans in 2013 registered 3.39 trillion yuan, an increase of 380.6 billion yuan over the previous year. Second, growth of new loans to the service sector accelerated. At end-2013, outstanding medium- and long-term loans to the service sector (the tertiary industry but excluding infrastructure and the real-estate sector) grew 13.7 percent year on year, an acceleration of 11.5 percentage points from end-2012. Third, the growth of loans to some highly-polluting, high energy-consuming industries, and to those sectors burdened with overcapacity slowed down. By end-2013, outstanding medium- and long-term loans to the iron and steel industry had declined 10.7 percent year on year, and those to the construction materials industry had declined 3.3 percent year on year.

V. Advancing the market-based interest-rate reform

In line with the overall arrangements of the State Council, since 2013 the PBC has accelerated the market-based interest-rate reform, fully lifting lending rate controls, establishing and improving the self-regulatory pricing mechanism for market interest rates, and promoting issuances and transactions of interbank certificates of deposits. The market-based interest-rate reform made new strides.

Box 2 The Market-based Interest-rate Reform Made New Strides

In 2013, according to the overall arrangements of the CPC Central Committee and the State Council, the PBC established and improved the market-based interest-rate formation mechanism by relaxing interest -rate controls, strengthening institutional building, and promoting product innovations. The market played a decisive role in resource allocations and the market-based interest-rate reform made new progress.

Controls on lending interest rates were completely removed. Approved by the State Council, starting from July 20, 2013 the PBC removed the floor (0.7 times the benchmark lending rates set by the PBC) for the lending rates of financial institutions, controls on the interest rates for bill discounting, and the ceiling on the lending rates of rural credit cooperatives. Thus, controls on lend ing interest rates were fully liberalized, with the PBC maintain ing caps only on deposit interest rates. The space for financial institutions to independently price their products was further expanded and the role of the market mechanism in interest-rate pricing was significantly enhanced.

A self-regulatory pricing mechanism for market interest rates was established and improved. The self-regulatory pricing mechanism for market interest rates is a market-based self-regulatory coordination mechanism, with participation by the financial institutions, aiming to apply self-regulatory management over interest rates which are independently determined by the financial institutions on the money, credit, and other financial markets, under the precondition that they comply with the relevant interest-rate regulations, so as to maintain market order for fair competition and to promote the healthy development of the financial market. On September 24, 2013, the inaugural meeting of the self-regulatory pricing mechanism for market interest rates was convened. The first batch of panel banks included the Industrial and Commercial Bank of China and nine other banks. There were four specialized working groups under the self-regulatory pricing mechanism, namely the working group on the evaluation of compliance, prudence, and overall strength, the working group on the loan prime rate (LPR), the working group on interbank certificates of deposits, and the working group on the Shibor . These have played an active role in launching the loan prime rate centralized quota and release mechanism and in the issuance of interbank certificates of deposits.

The loan prime rate (LPR) centralized quote and release mechanism was formally operationalized. The LPR is the most preferential lending rate offered by a commercial bank to its prime clients ; other lending rates are generated by adding or subtracting basis points based on the LPR. The authorized agency calculates a weighted average of the quotes provided by the panel banks as the average LPR rate and releases it to the general public. The LPR mechanism represents an expansion of the market-rate base interest -rate quotation from the money market to the credit market, and provides an important reference to financial institutions for the pricing of their credit products. On October 25, the loan prime rate (LPR) centralized and release mechanism formally began operations after a one-month trial run. The first batch of panel banks included nine commercial banks to implement the self-regulatory pricing mechanism. For the time being, the LPR is operating in an overall stable manner and is playing a greater role in the pricing of credit products and derivatives by financial institutions. According to statistical data, by the end of 2013 a cumulative total of more than 30 billion yuan of loans, with rates based on the LPR, had been issued, and the interest-rate swap business based on the LPR was developing on a gradual basis.

The issuance of interbank certificates of deposit was advanced steadily. An interbank certificate of deposit, as a money market instrument, refers to a book-entry certificate of a time deposit issued by a deposit-taking financial institution with a legal person status on the national interbank market. On December 8, 2013, the PBC issued the *Provisional Rules on the Management of Interbank Certificates of Deposit*, which became effective on December 9, 2013. On December 12 and 13, ten financial institutions, including the Bank of China, the China Construction Bank, and the China Development Bank, issued the first batch of interbank certificates of deposit respectively and thereafter consecutively carried out their transactions on the second market, thus initially establishing a two-way quotation and market-making system for interbank certificates of deposit. As they are market-based priced, featuring electronic pricing, standardization, high liquidity, and high transparency, interbank certificates of deposit can provide a more transparent and market-based reference for the pricing of Shibor rates with medium and long ends. Interbank certificates of deposit are of great significance for increasing the benchmarking status of the Shibor with medium and long ends, broadening the funding channels for banking deposit-taking financial institutions, and promoting and regulating the development of interbank business. Interbank certificate s of deposit can also provide experience for the issuance of certificates of deposit to enterprises and individuals, so as to explore an effective way to promote the market-based deposit-rate reform in an orderly manner.

VI. Further improving the RMB exchange-rate regime

The RMB exchange-rate regime reform was further improved in a self-initiated, controllable, and gradual manner. Based on market supply and demand and with reference to a basket of currencies, the flexibility of the RMB exchange rate was enhanced and the exchange rate remained basically stable at an adaptive and equilibrium level. The PBC continued to support direct trading between the RMB and other emerging-market currencies, and on April 10, 2013 direct trading of the RMB with the Australian dollar was launched on the interbank foreign-exchange market. In 2013 the central parity of the RMB against the US dollar peaked at 6.0969 yuan per dollar and reached a trough of 6.2898 yuan per dollar. It appreciated on 126 out of 238 trading days in 2013 and depreciated on the remaining 112 trading days, with the largest intraday appreciation at 0.20 percent (or 126 points) and the sharpest one-day depreciation at 0.15 percent (or 91 points). The RMB exchange rate moved in both directions against the euro, the Japanese yen, and other major international currencies. At end-2013, the central parity of the RMB against the euro registered 8.4189 yuan per euro, a depreciation of 1.20 percent from the end of 2012, and the central parity of the RMB against the Japanese yen stood at 5.7771 yuan per 100 yen, an appreciation of 26.45 percent from the end of 2012. Beginning from the reform of the RMB exchange-rate regime in 2005 to the end of 2013, on a cumulative basis the RMB appreciated 18.95 percent against the euro and 26.46 percent against the Japanese yen. Direct trading between the RMB and foreign currencies on the interbank foreign-exchange market was brisk and market liquidity increased notably.

Table 5 Trading Volume of the RMB against Other Currencies on the Interbank Foreign-Exchange Spot Market in the Third Quarter of 2013

Unit:100 million yuan

Currency	USD	Euro	Japanese Yen	HKD	GBP	Australian Dollar	Canadian Dollar	Malaysian Ringgit	Russian Ruble	Thai Baht
Trading Volume	231646.2	2748.2	12737.4	1455.5	171.6	1496.0	8.5	11.4	54.4	5.4

Source: China Foreign Exchange Trade System.

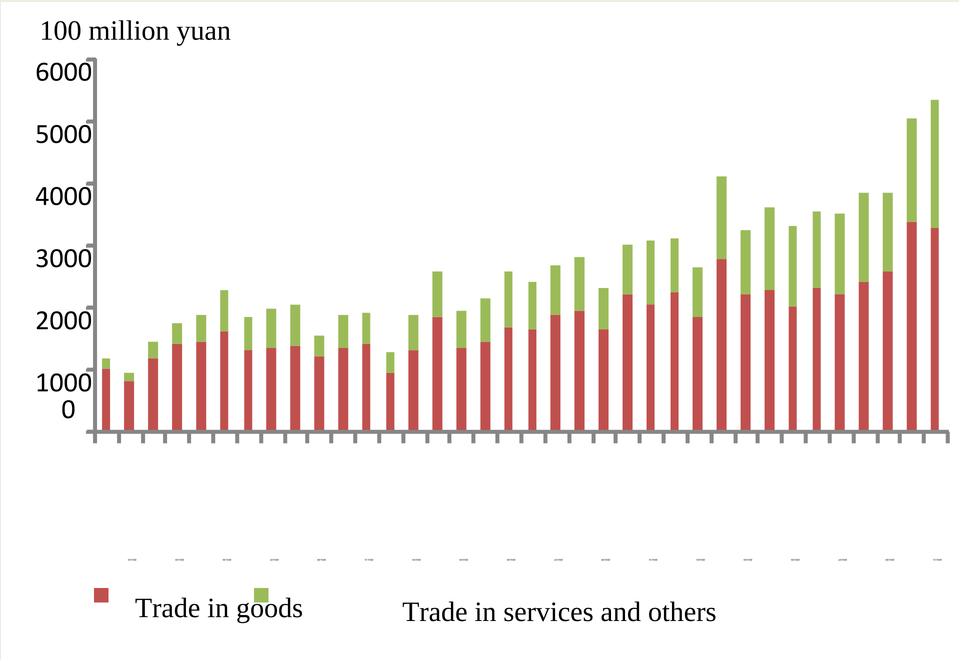
In 2013, based on the local currency swap agreements signed with the PBC, overseas monetary authorities conducted a total of 1.03 trillion yuan of currency swap transactions. These played an active role in promoting bilateral trade and investment.

VII. Promoting steady development of cross-border RMB business

In July 2013, the PBC issued the *Notice on Simplifying the Procedures for Cross-border RMB Business and Improving the Relevant Policies* (PBC Document No.168 [2013]), which straightened out the cross-border RMB business procedures under the current account, streamlined the cross-border clearing business of RMB bank-card accounts, specified that domestic non-financial institutions can conduct overseas RMB loan business and overseas participating banks can carry out the transfer of funds between them, and adjusted the term and ceiling of RMB account financing by overseas banks so as to meet the business demands of banks and enterprises and to further facilitate cross-border trade and investment.

In 2013 the RMB settlement business of cross-border trade and investment maintained stable and orderly growth. According to preliminary statistics, in 2013 the volume of cross-border trade settled in RMB reached 4.63 trillion yuan, up 57 percent year on year. This included 3.02 trillion yuan in settlement of trade in goods and 1.61 trillion yuan in settlement of trade in services and other items under the current account. Actual RMB receipts and payments for cross-border trade registered 1.88 trillion yuan and 2.75 trillion yuan respectively, bringing the receipt payment ratio to 1:1.46. Bank settlement of cross-border RMB direct investments reached 533.74 billion yuan, including 85.61 billion yuan in outward direct investments and 448.13 billion yuan in foreign direct investments, up 180 percent and 76.7 percent from the previous year respectively.

Figure 1 RMB Settlement of Cross-border Trade



Source: People's Bank of China.

In 2013 the PBC signed bilateral local currency swap agreements with five overseas monetary authorities, including the ECB and the Bank of England, with an aggregate amount of 752 billion yuan. Furthermore, the PBC renewed bilateral local currency swap arrangements with three overseas monetary authorities, including the Monetary Authority of Singapore, with an aggregate amount of 403.5 billion yuan. The establishment of bilateral local currency swap lines will help preserve financial stability and facilitate bilateral trade investment between China and other countries and regions.

VIII. Deepening the reform of financial institutions

The pilot scheme of the Rural Financial Business Division of the Agricultural Bank of China (ABC) was advanced. In October 2013, approved by the State Council, 538 county-level sub-branches of the ABC in Jiangsu, Zhejiang, Hunan, Yunnan, Jiangxi, Shanxi, and Guangdong provinces were included in the pilot scheme, and preferential measures, such as the differentiated reserve requirement ratio, supervisory fee reductions or exemptions, and business tax reductions or exemptions, were renewed. After the expansion of the pilot scheme, the proportion of the business volume and profits of the pilot institutions in all the ABC county-level sub-branches rose from 40 percent to about 80 percent, contributing greatly to the development of agricultural sector, rural areas, and farmers, and economic growth in the pilot areas.

The market-based transformation of asset management companies was steadily promoted. China Cinda Asset Management Company was successfully listed on the Hong Kong Exchange in December 2013, the first-ever among the national financial asset management companies. This marked a phased achievement for the joint-stock reform and the market-based transformation of financial asset management companies.

Remarkable achievements were made in reforming the rural credit cooperatives (RCCs). First, the RCCs' capacity for sustainable development was strengthened significantly. Based on the five-category classification, at end-2013 the NPL ratio of the RCCs declined by 0.4 percentage point from end-2012 to reach 4.1 percent; the capital adequacy ratio of the RCCs was 12.5 percent, up 0.7 percentage point from end-2012. In 2013 the total profits of the RCCs amounted to 196.2 billion yuan. Second, the quality of rural financial services improved notably. At end-2013, aggregate outstanding deposits and loans of the RCCs posted 14.3 trillion yuan and 9.2 trillion yuan, accounting for 13.7 percent and 12.7 percent of aggregate outstanding deposits and loans of total financial institutions respectively, up 0.5 and 0.3 percentage points. Outstanding agro-linked loans and lending to rural households by RCCs posted 6.2 trillion yuan and 3 trillion yuan at end-2013 respectively, representing year-on-year growth of 16.4 percent and 14.5 percent. Third, steady progress was made in the property-rights reform of the RCCs. At the end of 2013, there were 1,690 RCCs, 468 rural commercial banks, and 122 rural cooperative banks with legal person status at the county (city) level.

Box 3 The Relationship between Improving the Monetary Policy Measures and Promoting the Financial System Reform

Improving monetary policy measures and promoting financial system reform are complementary. The year 2013 was the 10th anniversary of the reform of large-sized commercial banks and rural credit cooperatives. During the past ten years, under the leadership of the CPC Central Committee and the State Council, the PBC has combined short-term macro-economic management measures with medium- and long-term financial reform. On the one hand, the PBC worked to create a favorable environment for financial reform by implementing monetary policy measures, and, on the other hand, the PBC fully carried out its functions of "on-line repairs" of the financial system and preserving financial stability, improved the monetary policy transmission mechanism, and increased the effectiveness of monetary policy by deepening financial reform, thus achieving a reinforced effect on both fronts.

Efforts were made to seize the favorable opportunity to restructure and reform financial institutions. As a result, the corporate governance of financial institutions continued to improve, financial institutions became more sensitive to indirect macro controls, and the microeconomic foundation of the monetary policy transmission mechanism was further improved. First, the reform of large-sized commercial banks made breakthroughs. After going through the four steps of writing-off actual capital losses, separating and resolving NPLs, injecting foreign exchange capital, and IPOs on the domestic and overseas stock markets, the five large commercial completed their joint-stock reform, became public companies on the Shanghai and Hong Kong stock markets, and gradually developed into modern financial firms with sufficient capital, strict internal governance, safe operations, and good-quality services and high profitability. Second, the reform of the rural credit cooperatives made phased achievements. By linking the redemption of special central bank bills and central bank loans with the actual effectiveness of the reform of the rural credit cooperatives, the PBC guided the rural credit cooperatives to improve their property-rights system, corporate governance, and internal management. The asset quality and operating efficiency of the rural credit cooperatives has been on the rise, and their major role in serving the agricultural sector, rural areas, and farmers has been growing. Third, the reform of policy financial institutions and other financial institutions was steadily promoted. The reform of the China Development Bank made phased achievements, the reform of SINOSURE was gradually implemented, and the reform of the Export-Import Bank of China and the Agricultural Bank of China was accelerated. In the meantime, a number of joint-stock commercial banks, such as the China CITIC Bank and the Bank of Beijing, have gradually established a modern financial enterprise system based on their own efforts and with the support of the local governments. The securities industry and insurance companies also made significant reform and restructuring progress. In recent years, the PBC, jointly with other relevant departments, has been pushing ahead with the establishment of a multi-tiered and market-based risk disposal arrangement, has set up a securities investment protection fund, a futures investor protection fund, and an insurance guarantee fund, has promoted implementation of a third-party depository system for clients' settlement funds in the securities industry, and has conducted in-depth research and repeated experiments on a deposit insurance system. At present, the preparatory work for the establishment of a deposit insurance system is basically in place.

The market-based interest-rate reform and the reform of the RMB exchange-rate regime were advanced, and the price basis for monetary policy transmission was gradually improved. As important prices in the factor market, the interest rate and the exchange rate play essential roles in the efficient allocation of domestic and external financial resources. In recent years, the market-based interest-rate reform was pushed ahead steadily and made significant achievements. For the time being, only the caps on the deposit interest rates are maintained. A self-regulatory pricing mechanism for market interest rates was established and improved, the scope for autonomous pricing of financial institutions was substantially expanded, and microeconomic agents became more sensitive to changes in the interest rates. The RMB exchange-rate regime was advanced in an orderly manner, continuing the self-initiated, controllable, and progressive reform approach. The RMB exchange rate saw both depreciations and appreciations with fluctuations in both directions, and the flexibility of the RMB exchange rate was enhanced, which was conducive to enhancing self-initiated and effective macro-economic management.

Greater efforts were made to develop the financial market, with the share of direct financing rising notably, and the market foundation for monetary policy transmission became more solid. In recent years, the money market, capital market, foreign-exchange market, gold market, futures market, and insurance market are developing soundly amid innovations, a multi-function and all-round financial market system has been initially established, and the breath and depth of the financial market is continuing to expand. Innovations in financial products have been advanced steadily, and financial products have become richer. Subordinated bonds, hybrid bonds, short-term financing bills, medium-term notes, credit asset securitization products, and credit risk-mitigating instruments issued by commercial banks were launched, and a series of innovative instruments and products, such as bond forward transactions, forward interest-rate agreements, and RMB interest-rate swaps, were introduced into the market. The ever-growing financial market provided an improved market foundation for macro-economic management and helped transmit the intentions of monetary policy operations to the real economy via the participating financial institutions, enterprises, and individuals. In the meantime, various market indicators also provided useful information for macro-economic management.

The 3rd Plenum of the 18th CPC National Congress established strategic arrangements for comprehensively deepening the reform, giving the market a decisive role in resource allocations. Going forward, the use of monetary policy measures will be combined with measures for deeper reforms, with a focus on higher efficiency in resource allocations and increasing consumer dominance to deepen the reforms. The market will play a decisive role in the pricing of capital factors such as the interest rate and the exchange rate. Liberalization and opening-up of the financial sector will be expanded, a multi-tiered capital market system will be built, and convertibility of the RMB under the capital account will be accelerated so as to render more options to microeconomic agents. As the environment for macro-economic management becomes a normal state for more marketization and balanced economic growth, efforts will be made to improve the framework for macro-economic management by using a mix of quantitative, price-based, and macro-prudential measures. Efforts will be made to strengthen guidance of market expectations to promote stable and sustainable economic development and to safeguard the bottom line in preventing systemic and regional financial risks.

IX. Deepening the reform of foreign-exchange administration

Efforts were made to promote the reform of foreign-exchange administration to support the healthy development of the real economy. First, reform of foreign-exchange administration in trade was promoted to enhance trade facilitation. Reform of foreign-exchange administration of trade in services was carried out, and the time period for processing receipts and payments of funds for trade in services was shortened. Second, regulation over cross-border guarantees was upgraded so as to improve the policies for investment and financing. The pilot program to allow banks to issue small-value loans to domestic enterprises with overseas guarantees was expanded to the whole country so as to alleviate the difficulties and high costs of financing for SMEs. Third, efforts were made to support the development of cross-border e-commerce and Internet banking, and a pilot program of foreign-exchange payments and receipts for cross-border e-commerce was carried out in five localities.

RMB convertibility under the capital account made steady progress, and the efficiency of cross-border fund allocations was improved. First, building on the earlier pilot scheme, the pilot area for the centralized use of the foreign-exchange capital of multinational companies was further expanded to thirty-two state-owned, private-owned, and foreign-funded enterprises in seven provinces (cities), including Guangdong province, in order to accumulate new experiences for foreign-exchange administration in promoting RMB convertibility under the capital account. Second, administration of foreign debts and the capital market was streamlined and delegated, and a regulatory framework based on registration management by using a statistical monitoring method and focusing on supervision of the participants and ex-post verification, was initially established. Third, the Qualified Foreign Institutional Investor (QFII) scheme, the RMB Qualified Foreign Institutional Investor (RQFII) scheme, and the Qualified Domestic Institutional Investor (QDII) scheme were implemented steadily. By the end of 2013, a total foreign-investment quota of USD49.7 billion was approved under the QFII scheme, an investment quota of 157.5 billion yuan was approved under the RQFII scheme, and USD84.2 billion in an outbound investment quota was approved under the QDII scheme. Explorations were made into expanding the channels for overseas use of domestic funds, research was conducted to promote outbound investments by domestic financial institutions, and a pilot scheme for a qualified domestic limited partnership system to guide the orderly outflow of capital was established.

Efforts were made to continually improve the monitoring of cross-border capital flows so as to promote a balanced position of the BOP account. The *Procedures for Reporting the Balance of Payments* were amended and implemented so as to enhance awareness in the entire society on the reporting of the balance of payments and for further improving the macro-economic decision-making system. When necessary, a contingency plan will be initiated to deal with abnormal cross-border capital flows. Administration of foreign-exchange trade financing was further improved so as to prevent inflows of abnormal cross-border foreign-exchange funds. Utilization of foreign-exchange administration information was strengthened and efforts were made to closely monitor foreign-exchange market developments. In addition, attention was paid to some new issues such as trade arbitrage and false entrepôt trade.

Part 3 Financial Market Analysis

In 2013 China's financial market continued to develop in a sound manner, a number of policy measures for reform and development were pushed ahead steadily, and the financial market played a greater role in promoting economic transformation and structural adjustments. Transactions on the money market registered moderate growth, while market interest rates went up; the amount of bond issuances increased appreciably; the yield curve of bonds on the interbank market showed a flattening and upward trend; and turnover on the stock market increased substantially.

I. Financial market analysis

1. Growth in the volume of trading on the money market moderated and market interest rates went up

The growth of bond repos moderated on the interbank market and the turnover of interbank borrowings declined year on year. In 2013 the turnover of bond repos on the interbank market totaled 158.2 trillion yuan, with an average daily turnover of 632.7 billion yuan, an increase of 11.2 percent year on year and representing a deceleration of 31.9 percentage points from the previous year. The turnover of interbank borrowings reached 35.5 trillion yuan, with an average daily turnover of 142.1 billion yuan, down 24.3 percent year on year. In terms of the maturity structure, overnight products still dominated bond repo and interbank borrowing transactions, accounting for 78.4 percent and 81.5 percent of their respective turnovers in 2013, down 2.3 and 4.8 percentage points from the previous year. The total turnover of government securities repos on the stock exchange soared 68.2 percent year on year to reach 66 trillion yuan.

In terms of financing among financial institutions, the flow of funds revealed the following characteristics: first, although domestically-funded large banks remained net fund providers, the amount of their net lending declined notably. In 2013 net interbank lending of domestically-funded large banks amounted to 47 trillion yuan, 15.4 trillion yuan less than that in the previous year, mainly due to larger decreases in the second and third quarters. Second, borrowings by small- and medium-sized banks declined substantially year on year. In 2013, net borrowings by small- and medium-sized banks posted 12.7 trillion yuan, a decline of 12.1 trillion yuan from the previous year. In particular, on the interbank lending market small- and medium-sized banks changed from net fund borrowers in the previous year to net fund lenders in this year and, together with the large banks, they provided funding to other borrowers. Third, the demand for financing of securities firms and fund management companies increased by 3.2 trillion yuan year on year, the demand for financing by insurance companies was stable, while that of other financial institutions and vehicles declined substantially compared with the previous year.

Table 6 Fund Flows among Financial Institutions in 2013

Unit: 100 million yuan

	Repo		Interbank borrowing	
	2013	2012	2013	2012
Domestically-funded large banks ①	-439,669	-550,748	-30,650	-73,486
Domestically-funded small- and medium-sized banks ②	152,761	242,558	-25,633	5,112
Securities and fund management companies	158,905	130,067	38,354	34,889
Insurance companies	55,543	53,270	25	0
Foreign-funded financial institutions	12,679	20,734	1,598	9,972
Other financial institutions and vehicles	59,780	104,120	16,307	23,513

Notes: ① Domestically-funded large banks include the Industrial and Commercial Bank of China, the Agricultural Bank of China, the Bank of China, the China Construction Bank, the China Development Bank, the Bank of Communications, and the Postal Savings Bank of China.

② Domestically-funded small- and medium-sized banks include the China Merchants Bank and sixteen other medium-sized banks, small-sized city commercial banks, rural commercial banks, rural cooperative banks, and village and township banks.

③ Other financial institutions and vehicles include urban credit cooperatives, rural credit cooperatives, finance companies, trust and investment companies, financial leasing companies, asset management companies, social security funds, investment companies, corporate annuities, and other investment vehicles, among which some financial institutions and vehicles did not participate in the interbank funding market.

④ A negative sign indicates net lending and a positive sign indicates net borrowing.

Source: China Foreign Exchange Trade System.

During the first five months of 2013 interest rates on the money market were generally stable. In June interest rates initially rose rapidly but then fell. Thereafter, they performed stably. Interest rates edged up in the fourth quarter. In December, the weighted average interest rate of bond-pledged repo and interbank borrowings posted 4.28 percent and 4.16 percent respectively. At end-2013, overnight and 7-day Shibor rates posted 3.15 percent and 5.25 percent respectively, down 72 and 67 basis points from end-2012, and 3-month and 1-year Shibor rates were 5.56 percent and 4.96 percent respectively, up 166 and 56 basis points over end-2012.

Box 4 Several Perspectives on the Changes in Market Interest Rates

Since 2013 interest rates on the financial market have witnessed an overall increase and heightened volatility, thus attracting widespread public attention. It is noteworthy that the aforesaid phenomenon occurred in the context of accelerated financial innovations, rapid development in debt financing, continuous advancement in the market-based interest-rate reform, and volatile international capital flows against the background of the opening-up environment. Efforts should be made to carry out an objective analysis of the relationship among these various factors and to look into the inherent mechanism for the heightened volatility in market interest rates.

As the market-based interest rate is the price of funds, its change is the outcome of the interactions between supply and demand for liquidity. In June 2013, the money market saw a large fluctuation in interest rates, which was related to a number of factors, such as rumors in the market, concentrated payments of corporate taxes, increased demand for liquidity during the Dragon Boat Festival holidays, developments in the foreign- exchange market, and the semi-annual evaluation of the commercial banks. From a broader and overall perspective, it reflected the conflict between excessive liquidity demand and appropriate liquidity supply. In the first five months of 2013, the average monthly growth of M2 registered 15.7 percent, surpassing the target envisioned at the beginning of the year. All-system financing aggregates hit several record-highs and saw an acceleration of 3.12 trillion yuan in the first five months of 2013 compared with the same period of the last year. Interbank business expanded rapidly and by end-May 2013 it had increased by more than 50 percent year on year. Within the interbank business, a considerable part is the proxy of bank loans, while financing and outstanding debts expanded rapidly and structural problems, such as maturity mismatches, became more prominent. Furthermore, in the first half of the year, the Chinese economy also faced downward pressures and its economic development was out of sync with its financial development. The central government soberly assessed the complex situation, choosing not to stimulate the economy by loosening monetary policy but allowing policies to be well-targeted and with appropriate strength and maintaining a sound monetary policy stance. Due to the firm implementation of appropriate overall liquidity, the rapid increase in money, credit, and all-system financing aggregates that had been seen in the first several months of 2013 was contained and closely corresponded to the annual target. In the second half of the year, the initial acceleration of the inflation rate that had been seen in the first half of the year was gradually stabilized, playing an active role in containing the rapid increase in the overall debt level and leverage rate. In the second half of the year, issues such as the rapid loan growth of financial institutions, the accelerated expansion of interbank business, and the maturity mismatches, were resolved to varying extents.

Heightened volatilities in market interest rates were also related to the strengthened role of the central bank in adjusting the overall liquidity supply. It has become normal practice for monetary policy to guide and adjust money and credit aggregates. The reasons why this has been reflected more in the changes in market rates since 2013 are related to the deepening of the market and the accelerated financial innovations. Many people have wondered why the market encountered the problem of so-called “tight money” against the background of the huge outstanding M2. In fact, asset expansion and financial innovations, such as the off-balance-sheet business of commercial banks, either directly or indirectly required the liquidity support of the banking system (base money). As the various financing activities became more active, they would consume more liquidity in the banking system, leading to an increased demand for liquidity (base money). As the liability structure and maturity structure became more complicated, financial institutions became more sensitive to changes in liquidity. Similarly, as financial innovation accelerated and financial products became more complicated, we had to rely more on the overall liquidity supply tool to control all-system financing aggregates and monetary conditions. When overall liquidity supply plays a role in adjusting and restraining the rapid growth of financing, it is reflected in changes in market interest rates as the price of liquidity, and the co-movements of prices and the quantity of liquidity will increase. This means that market interest rates are more responsive to the economic situation and changes in liquidity demand and supply. The financial market needs to tolerate reasonable interest-rate movements to allow the interest rate to play a role in guiding resource allocations and the adjustment of behavior of economic agents.

In addition, the market-based interest-rate reform, economic and structural factors, and the spillover effects in an open macro-economic environment merit closer attention. The market-based interest-rate reform is a process of regulated interest rates moving to a rediscovery of equilibrium interest rates. Judging from international experiences, at the initial stage of this process, the benchmark market rates tend to rise and fluctuations in the interest rates may heighten. This actually indicates that the interest rate is playing a more important role in reflecting market demand and supply, and it is helping the price tool to play a more decisive role in resource allocations. In addition, the sectors with soft-budget constraints have a strong demand for funds and are relatively less sensitive to changes in interest rates. Their massive amount of financing also pushed up the costs of financing for the entire society. Furthermore, links among various economies have become closer in the open global economy. Due to the expected tapering of the QE by the U.S. Fed, increases in U.S. treasury bond yields have pushed up long-term rates throughout the world, and by end-2013 U.S. 10-year treasury bond yields had risen by 126 basis points over the end of the last year, thus having some influence on interest rates in the Chinese market.

Overall, market interest rates have become more sensitive to changes in fundamentals, which is the result of the combined effects of various factors. The different parties need to gradually adapt to the new situations. At the same time, the mechanism needs to be gradually improved. In the next stage, the PBC will further improve its monetary policies by using a mix of quantitative, price, and macro-prudential measures, and will strike a better balance between liquidity management and interest-rate movements to adjust and guide market expectations. It is also worth noting that financial issues are often a concentrated reflection of economic problems. Continuous efforts should be made to accelerate structural adjustments and reforms, to control the rapid debt expansion arising from the soft-budget constraints, and to improve the financial eco-system so as to increase the effectiveness of macro-economic management.

Trading of RMB interest-rate swaps was less brisk, and there were fewer bond forwards and forward interest-rate agreement transactions. In 2013, the total notional principal of RMB interest-rate swaps amounted to 2.7 trillion yuan, a decrease of 6.0 percent year on year. In terms of the maturity structure, RMB interest rates with a maturity of one year or less traded most briskly, and their aggregate nominal principal amounted to 2.1 trillion yuan, accounting for 75.6 percent of the total. The base rates of the floating end of the RMB interest-rate swaps mainly included the 7-day fixing repo rate and the Shibor, with their nominal principal accounting for 65.4 percent and 33.2 percent of the total respectively.

Table 7 Transactions of Interest-rate Derivatives, 2008～2013

	Interest-rate swaps		Bond forwards		Forward-rate agreements	
	Number of deals (lots)	Amount of notional principal (100 million yuan)	Transactions (lots)	Amount (100 million yuan)	Transactions (lots)	Amount of notional principal (100 million yuan)
2008	4,040	4,121.5	1,327	5,005.5	137	113.6
2009	4,044	4,616.4	1,599	6,556.4	27	60.0
2010	11,643	15,003.4	967	3,183.4	20	33.5
2011	20,202	26,759.6	436	1,030.1	3	3.0
2012	20,945	29,021.4	56	166.1	3	2.0
2013	24,409	27,277.8	1	1.0	1	0.5

Source: China Foreign Exchange Trade System.

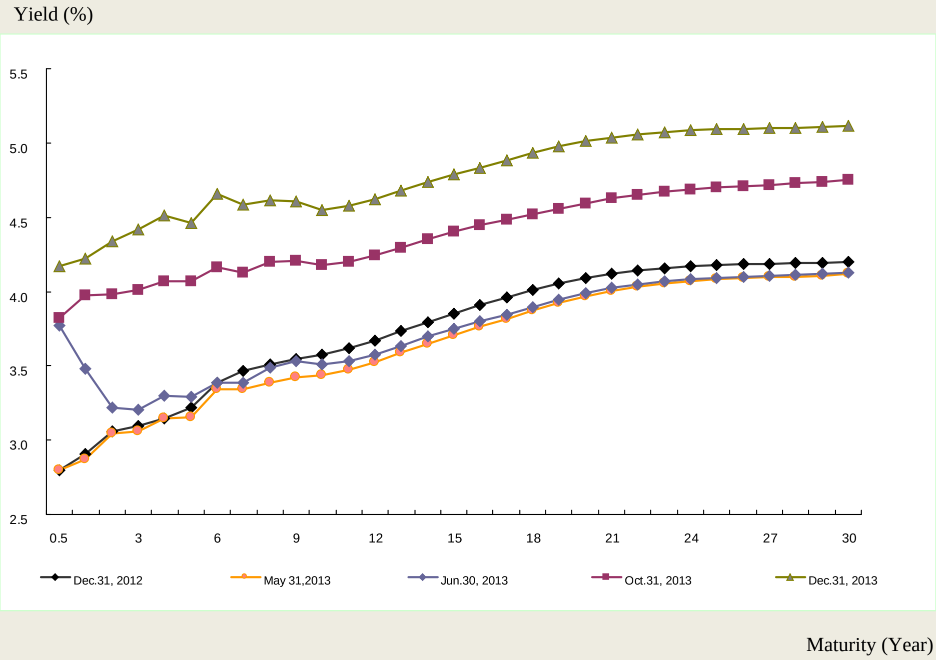
2. Bond transactions saw a year-on-year decline whereas bond issuances continued to increase

The turnover of spot bond transactions on the interbank market declined year on year. In 2013 a total of 41.6 trillion yuan of bonds was traded, with a daily average of 166.4 billion yuan, down 44.9 percent year on year. In terms of trading entities, domestically-funded large banks, insurance companies, foreign-funded financial institutions, and other financial institutions and vehicles were mainly net purchasers on the spot bond market, with net purchases of 274.7 billion yuan, 114.3 billion yuan, 172.8 billion yuan, and 290.3 billion yuan respectively; domestically-funded small- and medium-sized banks, and securities companies and fund management companies were mainly net bond sellers, with net amounts of 684.8 billion yuan and 167.3 billion yuan respectively. A total of 80.4 billion yuan of government securities was traded on the stock exchanges in 2013, 8.3 billion yuan less than that during the previous year.

In 2013 the China Bond Composite Index (net price) declined from 100.69 points at the beginning of the year to 96.07 points at year-end, or down 4.59 percent, while the China Bond Composite Index (full price) declined from 111.63 points to 107.47 points, or down 3.73 percent. The government securities index on the stock exchanges rose 2.71 percent, from 135.84 points early in the year to 139.52 points at year-end.

In 2013 the yield curve of government securities on the interbank market showed a generally flattening and upward trend, and their movements could be divided into the following two phases. In the first five months, the yield curve of government securities moved downward amid fluctuations. In the second phase, from June to December, the yield curve of government securities continued to move up and showed a notable flattening trend. In late June, the yield curve of government securities at short ends rose rapidly, while that at long ends remained stable or even fell for a while. Since late October, the yield curve of government securities continued to move up. At end-December, the yields of 1-year, 3-year, 5-year, 7-year, and 10-year government securities were 131, 132, 124, 112, and 98 basis points higher respectively than those at end-2012.

Figure 2 Yield Curve of Government Securities on the Interbank Bond Market



Source: China Government Securities Depository Trust and Clearing Co., Ltd.

Bond issuances continued to grow, and the methods for issuing bonds were more innovative. In 2013, a total of 8.86 trillion yuan of bonds (including central bank bills) was issued, 887.9 billion yuan more than that during the previous year. At the end of 2013, the outstanding balance of all sorts of domestic bonds posted about 30 trillion yuan, up 12.3 percent year on year. The pre-issuance (trial) of the treasury bond business was launched to increase the efficiency of the pricing of government bond issuances. Financial bonds were allowed to be issued across different markets so as to further promote inter-linkages in the exchange market and the over-the-counter market, and the first batch of such financial bonds, with a face value of 12 billion yuan, offered by the China Development Bank was successfully issued on the Shanghai Stock Exchange on December 27, 2013.

Table 8 Issuances of Major Bonds in 2013

Type of bonds	Issuance (100 million yuan)	Year-on-year growth (100 million yuan)
Government securities①	20,230	4,076
Central bank bills	5,362	5,362
Financial bonds②	26,310	108
Of which: Financial bonds issued by the China Development Bank and policy financial bonds	19,811	-1,604
Corporate debenture bonds③	36,699	-667
Of which：Debt-financing instruments of non-financial enterprises	28,688	2,120
Enterprise bonds	6,252	-1,747
Corporate bonds	1,395	-1,155
Total	88,601	8,879

Notes: ① Including municipal bonds issued by the Ministry of Finance on behalf of local governments.
② Including financial bonds issued by the China Development Bank, policy financial bonds, ordinary bonds issued by commercial banks, subordinated bonds issued by commercial banks, hybrid bonds issued by commercial banks, bonds issued by securities firms, and so forth.
③ Including debt-financing instruments issued by non-financial enterprises, enterprise bonds, corporate bonds, convertible bonds, bonds with detachable warrants, and privately placed SME bonds.
Sources: People's Bank of China, National Development and Reform Commission, China Securities Regulatory Commission, China Government Securities Depository Trust and Clearing Co., Ltd.

The issuance rates of government securities of all maturities edged up. The interest rate of 30-year government bonds issued in December was 5.05 percent, up 93 basis points from that of those of the same maturity issued in August 2012; the interest rate of 5-year government securities issued in December was 4.13 percent, up 118 basis points from that of those of the same maturity issued in November 2012. The Shibor played a greater role in bond pricing. In 2013 the issuance amount of floating-rate bonds based on the Shibor on the primary bond market was 179.3 billion yuan, accounting for 59 percent of the issuance volume of all floating-rate bonds; 371 fixed-rate enterprise bonds were all based on the Shibor, with a gross issuance volume of 471.5 billion yuan. In addition, a total of 445.3 billion yuan of short-term fixed-rate financing bills based on the Shibor was issued, accounting for 54 percent of the total.

3. Bill financing traded briskly, and bill financing rates moved up

The growth of bill acceptances moderated. In 2013 commercial bills issued by enterprises totaled 20.3 trillion yuan, representing year-on-year growth of 13.3 percent; the total volume of outstanding commercial bills at end-2013 posted 9.0 trillion yuan, representing year-on-year growth of 8.3 percent. From January to August, the outstanding balance of accepted drafts grew continuously, reaching a historic high of 9.6 trillion yuan by end-August. Beginning in September, the growth of bill acceptances slowed down and the outstanding balance of accepted drafts fell appreciably. By end-2013, outstanding bankers' discounted bills had increased 700 billion yuan from the beginning of the year. In terms of issuing entities, outstanding bankers' acceptances were mainly issued by enterprises in the manufacturing, wholesale, and retail industries, with small- and medium-sized enterprises issuing about two-thirds of the total. The steady growth of bill acceptances provided greater support to the real sector, in particular to small- and micro-sized enterprises.

Bill financing traded briskly and interest rates on the bill market in general moved up. In 2013 the cumulative amount of commercial bills discounted by financial institutions posted 45.7 trillion yuan, representing year-on-year growth of 44.3 percent. By end-2013, the outstanding balance of discounted commercial bills had declined 4.1 percent year on year to 2.0 trillion yuan. In the first half of the year, the outstanding balance of discounted commercial bills grew appreciably amid fluctuations, reaching a yearly high of 2.4 trillion yuan at end-May. In the second half of the year, as financial institutions strengthened adjustments in their credit aggregates and structure and properly managed the stock of bill financing, the amount of outstanding bill financing declined by 89.6 billion yuan from the beginning of the year. Affected by a number of factors, such as money-market interest-rate movements and changes in the supply and demand for bill financing, from January to May interest rates on the bill market were generally stable; beginning in June, volatilities on the bill market increased and interest rates moved up.

4. Turnover on the stock markets increased substantially

At end-2013, the Shanghai Stock Exchange Composite Index and the Shenzhen Component Index closed at 2,116 points and 1,058 points respectively, shedding 6.8 percent and gaining 20 percent respectively. The Growth Enterprise Board (GEB) (Chinext Price Index) of the Shenzhen Stock Exchange closed at 1,304 points, gaining 82.7 percent from the end of the last year. The weighted average P/E ratio on the A-share market on the Shanghai Stock Exchange declined from 12.3 times at end-2012 to 11 times at end-2013, while that on the Shenzhen Stock Exchange rose from 22.2 times to 28 times.

The volume of trading on the stock markets increased significantly year on year. In 2013 turnover on the Shanghai and Shenzhen stock exchanges totaled 46.8 trillion yuan, up 48.8 percent year on year, and the daily turnover averaged 196.7 billion yuan, up 52.3 percent year on year. Among the total, the volume of transactions on the GEM Board amounted to 5.1 trillion yuan, representing an increase of 119.6 percent year on year. At end-2013 the combined market capitalization of the Shanghai and Shenzhen exchanges posted 20 trillion yuan, up 9.9 percent year on year; the market capitalization on the GEM Board amounted to 821.9 billion yuan, a hike of 146.4 percent year on year.

The amount of equity financing on the stock market was basically flat compared with the previous year. In 2013 a total of 386.7 billion yuan was raised by enterprises and financial institutions on the domestic and overseas stock markets by way of IPOs, additional offerings, rights issuances, and warrant exercises, representing an increase of 500 million yuan year on year. Among this total, 280.3 billion yuan was raised on the A-share market, 32.5 billion yuan less than that which was raised on the A-share market during the previous year.

5. The share of investment-linked assets among total insurance assets increased

In 2013 total premium income in the insurance industry amounted to 1.7 trillion yuan, representing year-on-year growth of 11.2 percent, and total claim and benefit payments amounted to 621.3 billion yuan, representing year-on-year growth of 31.7 percent. Specifically, total claim and benefit payments in the property-insurance sector increased 22.1 percent, while those in the life-insurance sector increased 46 percent.

Total assets of the insurance industry grew at a moderate rate, and the proportion of investment-linked assets went up. At end-2013, total assets of the insurance industry posted 8.3 trillion yuan, an increase of 12.7 percent year on year, a deceleration of 9.6 percentage points from the end of the last year. In particular, bank deposits decreased 3.4 percent year on year, and investment-linked assets increased 20.3 percent year on year, accounting for 65.4 percent of the total assets and representing an acceleration of 4.1 percentage points year on year.

Table 9 Use of Insurance Funds, End-2013

	Outstanding balance (100 million yuan)	As a share of total assets (%)

	End-2013	End-2012	End-2013	End-2012
Total assets	82887	73546	100.0	100.0
Of which: Bank deposits	22641	23446	27.3	31.9
Investments	54232	45097	65.4	61.3

Source: China Insurance Regulatory Commission.

6. Swap transactions on the foreign-exchange market increased rapidly

In 2013 the turnover of spot RMB/foreign-exchange transactions totaled USD4.1 trillion, representing a year-on-year increase of 21.4 percent. The turnover of RMB/foreign-exchange transactions totaled USD3.4 trillion, representing a year-on-year increase of 35 percent. Among this total, overnight RMB/USD swap transactions amounted to USD1.8 trillion, accounting for 52.2 percent of the total swap transactions; the turnover on the RMB forward market totaled USD32.37 billion, a decrease of 62.6 percent year on year. The turnover of foreign currency pair transactions amounted to USD64.23 billion, a decrease of 25.1 percent year on year. In particular, USD/EURO transactions accounted for the bulk of the total turnover, or 44.2 percent, up 15.1 percentage points year on year.

The number of participants on the foreign-exchange market expanded further. At end-2013, there were 405 members on the foreign-exchange spot market, 88 members on the foreign-exchange forward market, 87 members on the foreign-exchange swap market, 80 members on the currency swap market, and 33 members on the foreign-exchange options market. In addition, there were 31 market-makers on the spot market and 27 market-makers on the forward and swap markets.

7. The price of gold declined amid fluctuations

The price of gold declined amid fluctuations. In 2013 the price of gold on the international market reached a peak of USD1693.75 per ounce and a trough of USD1180.1 per ounce. At end-2013 it closed at USD1201.5 per ounce, down USD462.5 per ounce, or 27.8 percent, from the end of the last year. The movement of domestic gold prices kept pace with the movement of gold prices on the international market. During the year, the highest price (AU9999) on the Shanghai Gold Exchange was 340.8 yuan per gram, and the lowest price was 236.36 yuan per gram. At end-2013, the price of gold on the domestic market closed at 236.46 per gram, down 98.04 yuan per gram or 29.3 percent, from the end of the last year. The weighted price averaged 278.6 yuan per gram for the whole year, down 17.8 percent year on year.

The volume of transactions on the Shanghai Gold Exchange increased considerably, hitting a historic high. In 2013 the trading volume of gold was 11,614 tons, an increase of 82.9 percent year on year, and the turnover posted 3,213.4 billion yuan, an increase of 49.4 percent year on year. The trading volume of silver was 430,501 tons, an increase of 106.0 percent year on year, and the turnover posted 1983.5 billion yuan, an increase of 46.1 percent year on year. The trading volume of platinum was 90 tons, an increase of 41.2 percent year on year, and the turnover posted 27.4 billion yuan, an increase of 30.1 percent year on year.

II. Institutional building in the financial market

1. Promoting the sound development and opening-up of the bond market

The investment channel of Qualified Foreign Institutional Investors (QFIIs) was expanded, the investment behavior of the QFIIs was regulated, and those QFIIs that had obtained licenses from the CSRC and investment quotas from the SAFE were allowed to apply to the PBC to enter the interbank bond market. The transaction and clearing business on the interbank bond market was regulated, and it was specified that all bond transactions should be conducted via the National Interbank Funding System. The payment versus delivery requirement on bond transactions on the interbank bond market was further strengthened. On December 31, 2013, the Shanghai Clearing House was authorized to issue the *Rules on the Centralized Clearing Business of RMB Interest-Rate Swaps*, which is conducive to the gradual establishment of an overall framework for centralized clearing of over-the-counter financial derivatives.

2. Steadily promoting financial innovation and development of the gold market

Efforts were made to promote innovations in the gold market based on market demand. Products such as gold forwards and swaps were launched on the interbank gold price enquiry market to provide diversified risk management tools for market participants. Infrastructural and institutional building in the gold market was strengthened. The 2.5 generation version of the trading system was successfully launched on the Shanghai Gold Exchange and its efficiency and safety were further improved. In addition, Friday night trading was launched to further extend the trading hours.

3. Infrastructural building of the foreign-exchange market was strengthened

The *Guidelines on the Management of Market-makers on the Interbank Foreign-Exchange Market* were amended to further increase liquidity on the foreign-exchange market and to improve the price discovery mechanism. The *Notice of State Administration of Foreign Exchange on Adjusting Management of RMB/Foreign-Exchange Derivatives* was issued to improve the functioning of RMB/foreign-exchange derivatives on the domestic market and to help market players manage their exchange-rate risks. Efforts were made to promote the building of a trading platform on the interbank foreign-exchange market and to regulate net clearing business price enquiry transactions on the interbank foreign-exchange market.

4. Institutional building of the securities market was improved

The reform of IPOs was formally launched. On November 30, 2013, the CSRC issued the *Opinions on Further Promoting the Reform of IPOs*. The *Opinions* further highlighted the principle of information disclosure-based regulation and increased the intensity of information disclosure and verification so as to protect the rights of small- and medium-sized investors to information, participation, supervision, and claims. Efforts were made to gradually rationalize the issuance, pricing, and placement of new stocks according to market principles, to strengthen market discipline, and to urge market participants to carry out their responsibilities. At the end of 2013, the issuance of new stocks gradually resumed.

Continued efforts were made to promote the building of a multi-tiered capital market. On June 20, the Executive Meeting of the State Council decided to expand the pilot scheme of National Equities Exchange and Quotations for small- and medium-sized enterprises to the entire country. On December 14, the State Council issued the *Decision on Issues Concerning the National Equities Exchange and Quotations*, specifying the positioning and functions of the National Equities Exchange and Quotations(NEEQ), the Graduate NEEQ arrangement, simplification of the administrative approval system, proper investor management and coordinated supervision, and so forth. The launch of an equity transfer system will give fuller play to the role of the capital market in supporting economic transformation and upgrading and represents a new achievement in the building of a multi-tiered capital market.

Efforts were made to further protect the legitimate rights and interests of small- and medium-sized investors. On December 25, the State Council issued the *Opinions on Further Strengthening Protection of the Legitimate Rights and Interests of Small- and Medium-sized Investors in the Capital Market*, which put forward some 80 policy measures, mainly in nine areas such as improving the investor suitability rules, optimizing the investment return mechanism, and protecting the right to know of small- and medium-sized investors.

Efforts were made to steadily push ahead with reform and innovation in the capital market. On September 6, treasury bond futures were formally listed and traded on the stock exchanges. The launch of treasury bond futures will help improve the issuing system for treasury bonds, guide the optimization of resource allocations, and increase the capacity of the financial sector to serve the real sector. On November 30, the State Council issued the *Guidelines on the Pilot Scheme of Preferred Stocks*. The launch of preferred stocks will help expand the re-capitalization channel of enterprises, accelerate the development of direct financing, promote M&As and restructuring of enterprises, and provide diversified investment channels for investors so as to promote the stable development of the capital market.

5. Institutional building of the insurance market was improved

The market-based reform of the insurance industry was advanced. The reform of the ordinary life insurance premium rate was formally launched. On the front end, constraints on the premium rate of insurance products were lifted and heretofore will be determined by the insurance companies and the market; on the rear end, the premium rate of statutory reserves will influence and guide the reasonable pricing of front-end premium rates so as to strengthen the statutory reserves and solvency supervision. The reform of the use of insurance funds was further advanced, the capacity building of insurance companies in investment management was strengthened, and insurance asset management companies were allowed to engage in asset management business and management of publicly-placed funds. The reform of market access and exit mechanisms was deepened, the proportion of investment by a single stockholder in an insurance company was properly relaxed, and administrative rules for the management of M&As of insurance companies were formulated.

Efforts were made for the insurance industry to better serve the whole society and the real economy. After formal implementation of the *Regulation on Agricultural Insurance* on March 1, 2013, the relevant departments further specified the management of the operation, provision, and premium rates of agricultural insurance and regulated the provision, management, use, and supervision of agricultural insurance catastrophic risk reserves. Efforts were made to specify management, and market access and exit of urban and rural residents' major illness insurance to promote the healthy development of the insurance business for major illnesses. New standards for life insurance disability evaluation criteria were developed, and the scope of payments for accident insurance disability claims was significantly expanded. A pilot scheme was carried out to impose compulsory liability insurance on those industries with high environmental risks. A preferential deferred tax policy for corporate annuities and occupational annuities was unveiled to promote the building of a multi-tiered pension insurance system.

Supervision of the insurance industry was strengthened. The framework for a second-generation solvency regulatory system was published, laying a foundation for improving the modern solvency regulatory system to be compatible with the Chinese environment. Supervision of the insurance intermediary market was strengthened, and the market access threshold for insurance intermediaries was increased. Efforts were made to guide development of the scale of specialized insurance intermediaries, the management of insurance salesmen, brokers, and public loss assessors was strengthened, and basic service standards for specialized insurance intermediaries were regulated. The handling of insurance consumer complaints was regulated to better protect the interests and benefits of clients.

Part 4 Macro-economic Analysis

I. Global economic and financial developments

In 2013 the world economy experienced a slow and zigzag recovery. The growth momentum in the U.S. continued to strengthen, while policy risks remained. The euro zone stepped out of recession, but the recovery was not solidly grounded. Although Japan waged a powerful rebound as a result of the policy stimulus, Japan still faced long-run challenges. In some emerging-market economies, as growth slowed down and financial markets fluctuated, risks became more acute.

1. Economic development in the major economies

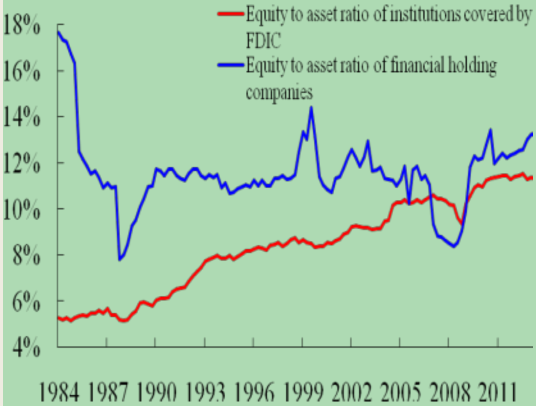
The economic growth momentum continued to strengthen in the U.S. GDP growth recorded 1.9 percent for the entire year of 2013, accelerating quarter by quarter during the first three quarters. The real GDP growth was 4.1 percent quarter on quarter (annualized) during the third quarter, the highest since the first quarter of 2012. The property market continued to recover. Stock indices hit record highs. Driven by the property-market recovery and the wealth effects from the bullish stock market, private consumption grew rapidly. The Purchasing Managers Index (PMI), compiled by the Institute for Supply Management (ISM), was above the threshold of 50 throughout the year except during May. The trade deficit narrowed substantially, recording USD471.5 billion for the whole year, a year-on-year decline of 11.8 percent. The unemployment rate dropped from 7.9 percent in January to 6.7 percent in December, the lowest level since November 2008. Inflation remained low throughout the year. On December 18, the Federal Reserve raised the projection for economic growth in 2014 from 2.9–3.1 percent to 2.8–3.2 percent.

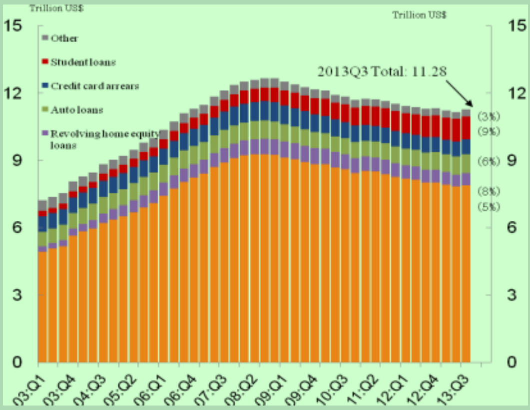
Box 5 Observations on the Recent U.S. Economic Situation

In the recent two years, among the major advanced economies the recovery momentum has been relatively good in the U.S. Average quarter-on-quarter GDP growth posted 2.2 percent in the period from 2012 to the third quarter of 2013, and unemployment rate fell from 8.5 percent in December 2011 to 6.6 percent in January 2014. The Federal Reserve's announcement of a scaling back of the quantitative easing monetary policy at end-2013 can also be attributed to the economic recovery. From a supply and demand perspective, when both supply and demand improve, economic growth will accelerate while the price level will remain relatively stable or will even drop. In the U.S., favorable factors on both the supply and demand sides are conducive to an economic recovery.

Since the outbreak of the crisis, while the Federal Reserve cut the interest rate on several occasions and launched the quantitative easing, the U.S. government took measures that aimed to improve demand and supply. On the demand side, one measure was tax cut and tax relief in a total amount of USD530 billion to boost consumption, including USD400 billion of tax relief for individual taxpayers and benefits in the amount of USD100 billion for low-income people, the unemployed, and the retired, and USD30 billion of tax incentives to businesses. The second measure was to increase government spending by USD380 billion, including USD150 billion for medical care, USD100 billion for education, and USD100 billion for infrastructure investment. On the supply side, businesses were encouraged to invest in and expand production capacity and to promote the development of small and medium-sized enterprises (SMEs). Due to the depreciation privilege policy, businesses can claim 50 percent of depreciation on real estate or equipment purchases during the same period. From 2009 to 2010, seventeen tax relief programs were launched to encourage and reward small enterprises to hire more, in addition to measures to facilitate small businesses to get loans from the Small Business Administration. Second, protection of intellectual property rights was enhanced as a priority measure to promote innovation. The Department of Justice and the Department of Homeland Security reinforced a crackdown on copyright infringements involving digital and electronic works and theft of commercial secrets, and strengthened international cooperation in combating the manufacturing and selling of non-authorized patented drugs.

The debt level of the U.S. private sector experienced significant changes. At the beginning of a deleveraging period, a shrinking household balance sheet usually depresses consumption and investment expenditures and puts a drag on economic growth. However, with debt level declining, a recovery of credit lending will support an expansion of aggregate demand and lay a foundation for a future boom. After the outbreak of the financial crisis, on the one hand the U.S. government helped alleviate the debt burdens of the private sector with USD700 billion in the Troubled Asset Relief Program (TARP) and massive tax cut measures, while on the other hand, financial institutions, households, and the corporate sector underwent self-adjustments through defaults and bankruptcies. About 140 and 157 banks claimed bankruptcy in 2009 and 2010; business bankruptcy cases also increased considerably, reaching 420,000 in the second quarter of 2010; 2.63 percent of residential home mortgages were in default in 2010, up by 1.5 percentage points from end-2007; in March 2010 there were 367,000 home foreclosures, an increase of 70 percent from end-2007. Affected by the aforesaid factors, the debt ratios in various sectors declined. In the financial sector, the equity-to-asset ratio of financial holding companies and institutions insured by the Federal Deposit Insurance Corporation (FDIC) remained at relatively high levels since 1984 (Figure 3). In the household sector, total U.S. consumer debt dropped to USD11.3 trillion in the third quarter of 2013, from a peak of USD12.7 trillion in the third quarter of 2008 (Figure 4). In the corporate sector, the ratio of private-sector lending by the banking sector to GDP fell from 213.9 percent in 2007 to 192.4 percent in 2012.





Source: CEIC.

Source: Federal Reserve.

Figure 3 Equity-to-Asset Ratio in the Financial Sector

Figure 4 Total Debt of the Household Sector and Changes in its Composition

In addition, the self-repairing capability of the U.S. economy, the newly emerging growth points supported by a sophisticated market system, the recently observed improvement in energy supply, the increase in the equipment investment ratio, and the recovery and expansion of capacity are all conducive to supply gains and to bolstering the economic recovery.

Of course, it deserves noting that the outlook for an economic recovery is also overshadowed by uncertainties. The labor participation ratio was at its lowest level since 1980, and the drop in the unemployment rate was also related to the continued decline in the labor participation rate. The tapering of the quantitative easing (QE) and the government debt issue will not only influence economic recovery prospects, but will also generate relatively big spillover effects globally. Moreover, there may be large fluctuations on the U.S. financial market as the QE is being scaled back, which will have a major effect on economic and financial stability in the U.S. and in the world at large. These issues should be closely watched and analyzed with respect to a possible recovery path in the U.S. and its spillover effects.

The e conomy in the euro zone recovered tepidly. Beginning in 2013, with the European sovereign debt crisis in a relatively quiet period, the euro zone once again was on a recovery trajectory. The euro-zone ZEW indicator of economic sentiment, which measures consumer and business confidence, edged up gradually since April, reaching 100 in December, the highest level since August 2011. The price level in the euro zone remained low throughout the year. In December, the Harmonized Index of Consumer Prices (HICP) grew by only 0.8 percent year on year. However, the unemployment rate was still elevated, remaining at 12.0 percent since Q4. On December 5, the European Central Bank (ECB) announced it would keep the ECB macro-economic projection for real GDP growth in 2013 unchanged at -0.4 percent, and in September it raised the projection for 2014 from 1.0 percent to 1.5 percent.

Growth in Japan moderated after rebounding strongly. Due to substantial yen depreciation and a massive fiscal stimulus, economic growth in the first two quarters of 2013 rebounded sharply, before declining markedly in the third quarter, with real quarter-on-quarter GDP growth (annualized) posting at 1.1 percent. The year-on-year core CPI became positive beginning in June, and it reached 1.3 percent in December, hitting a new high unseen in the past five years. Due to a stable labor market, the unemployment rate remained at about 4.0 percent for the whole year. Affected by rising import costs and other factors, the trade deficit recorded 11.47 trillion Japanese yen in 2013, representing year-on-year growth of 65.3 percent, a new historic high.

Table 10 Macro-economic and Financial Indices in the Major Economies

Country	Index	2012Q4			2013Q1			2013Q2			2013Q3			2013Q4		
		Oct.	Nov.	Dec.	Jan.	Oct.	Nov.	Dec.	Jan.	Oct.	Nov.	Dec.	Jan.	Oct.	Nov.	Dec.
United States	Real GDP Growth Rate (annualized quarterly rate, 5)	0.1			1.1			2.5			4.1			3.2（primary estimate）		
	Unemployment Rate （%）	7.8	7.8	7.9	7.9	7.7	7.5	7.5	7.5	7.5	7.3	7.2	7.2	7.2	7.0	6.7
	CPI（YOY，%）	2.2	1.8	1.7	1.7	2.0	2.2	1.8	1.7	1.7	2.0	2.2	1.8	1.7	1.7	2.0
	DJ Industrial Average (closing number)	13096	13025	13104	13861	14054	14579	14840	15116	14910	15500	14810	15192	15237	16086	16577
Euro zone	Real GDP Growth Rate (annualized quarterly rate, 5)	-0.5			-0.2			0.3			0.1					
	Unemployment Rate （%）	11.7	11.8	11.9	12.0	12.0	12.0	12.1	12.1	12.1	12.1	12.1	12.1	12.0	12.0	12.0
	HICP（YOY, %）	2.5	2.2	2.2	2.0	1.8	1.7	1.2	1.4	1.6	1.6	1.3	1.1	0.7	0.9	0.8
	EURO STOXX 50 (closing number)	2525	2551	2569	2641	2647	2698	2725	2662	2605	2699	2671	2789	2774	2901	2919
Japan	Real GDP Growth Rate (annualized quarterly rate, 5)	0.6			4.5			3.6			1.1					
	Unemployment Rate （%）	4.2	4.2	4.3	4.2	4.3	4.1	4.1	4.1	3.9	3.8	4.1	4.0	4.0	4.0	3.7
	Core CPI (YOY, %)	0.0	-0.1	-0.2	-0.2	-0.3	-0.5	-0.4	0.0	0.4	0.7	0.8	0.7	0.9	1.2	1.3
	NIKKEI225 (closing number)	8928	9446	10395	11139	11559	12398	13861	13775	13677	13668	13389	14456	14328	15662	16291

Sources: Statistical Bureaus and Central Banks of the Relevant Economies.

Growth in several emerging-market economies slowed down with heightened risks . Affected by weak external demand, financial-market stress as a result of the spillover from the U.S. monetary policy, and internal problems, in 2013 some emerging-market economies experienced a deteriorating balance of payments , a drawdown of foreign-exchange reserves, grave fiscal and debt conditions , and slowing economic growth . When the Federal Reserve signaled the tapering of QE in May, international capital flows reversed, causing large volatilities in the financial markets of several emerging-market economies. In general, the fundamentals in the emerging-market economies were relatively weak. Considering the QE tapering and other uncertain factors, short-term risks in some economies might increase.

2. Developments in global financial markets

Since the beginning of 2013, affected by such factors as tepid global recovery and expectations of policy changes in the major advanced economies, global financial markets fluctuated violently. The stock markets in some advanced economies rallied, breaking several historic records. The financial markets in some emerging-market economies fluctuated for a period of time, and exchange rates depreciated substantially.

The euro appreciated slightly against the US dollar, whereas the Japanese yen and the currencies in most emerging-market economies continued to depreciate against the US dollar. As of end-2013, the exchange rate of the USD/EUR closed at 1.3745 dollar per euro, an appreciation of 4.2 percent from end-2012, and the exchange rate of the JPY/USD closed at 105.30 yen per dollar, a depreciation of 17.6 percent from end-2012. Most of the emerging-market currencies depreciated. Among them, the Indonesia rupiah and the Argentinean peso depreciated by over 20 percent since the end of the previous year, whereas the Indian rupee, the Brazilian real, and the South African rand depreciated by over 10 percent.

The USD Libor fluctuated at a subdued level. On December 31, the 1-year USD Libor was 0.5831 percent, a decline of 26 basis points from the end of the last year. The Euribor remained low due to the ECB interest-rate cut and other factors. As of December 31, the 1-year Euribor registered at 0.5560 percent, an increase of 1 basis point from the end of the last year.

Government bond yields in the U.S. and Germany rose, whereas yields decreased appreciably in Japan, and yields in some of the emerging-market economies rose considerably. At end-2013, 10-year government bond yield in the U.S. and Germany closed at 3.04 percent and 2.11 percent respectively, up 126 and 73 basis points compared with end-2012. The 10-year government bond yield in Japan closed at 0.736 percent, down 6 basis points from the end of the last year. In the emerging-market economies, the 10-year government bond yields continued to rise, in particular in Brazil, Turkey, Indonesia, South Africa, and Russia, increasing 403, 372, 327, 153, and 86 basis points respectively from the end of the previous year.

The stock indices in the major advanced economies rallied, but they fluctuated wildly in some of the emerging-market economies. At end-2013, the Dow Jones Industrial Average Index, the STOXX50 Index, and the Nikkei 225 Index closed at 16577, 2919, and 16291 points respectively, up 26.5 percent, 13.3 percent, and 56.7 percent from the end of the last year. The stock market indices in most of the emerging-market economies fluctuated even more violently. From June to September, the stock-market indices in Indonesia, Turkey, and India fluctuated by 20.4 percent, 23.0 percent, and 15.3 percent respectively.

3. Monetary policies in the major economies

The major advanced economies maintained their quantitative easing policies. In its

December statement, the Federal Open Market Committee (FOMC) announced that it would scale back the asset purchase program to USD75 billion per month, and the purchase of mortgage-backed securities and long-term government bonds would be cut by USD5 billion respectively. The Federal Reserve also adjusted its forward guidance, claiming that even if the unemployment rate dropped to below 6.5 percent, so long as inflationary expectations remained below 2 percent, it might still be appropriate for the Federal Fund Rate to be kept at the current low level for a relatively long period of time. In May the ECB cut the minimum bid rate on the main refinancing operations by 25 basis points and slashed the rate on the marginal lending facility from 1.5 percent to 1 percent. In November, the ECB cut the minimum bid rate on the main refinancing operations by another 25 basis points to 0.25 percent and the rate on the lending facility by 25 basis points to 0.75 percent. On several occasions, the ECB emphasized that it might maintain an easy monetary stance for a long time in order to promote an economic recovery in the euro zone. The Bank of Japan (BOJ) issued a joint statement with the Japanese government on January 22, deciding to introduce an inflation target of 2 percent and to launch an asset purchase program in the amount of 13 trillion yen per month starting from 2014 and with no time limit until the inflation target is met. In early April, the BOJ decided to implement a "quantitative and qualitative monetary easing" and shifted the operational target of monetary policy from the unsecured overnight call rate to the monetary base, with a target of doubling the monetary base, the purchase of long-term Japanese Government Bonds (JGB), and the average remaining maturity of JGB purchases so as to achieve the 2 percent inflation target within two years. Throughout the year, the Bank of England maintained the Bank Rate at 0.5 percent and the size of asset purchases at 375 billion pounds, and on August 7 it launched the "forward guidance monetary policy," announcing that it had no intention of raising interest rates until the unemployment rate drops to below 7 percent.

At the beginning of 2013, facing downward pressures, the monetary policy pursued by the emerging markets tilted toward an easing stance. In the second and third quarters, their monetary policies began to diverge, with some countries tightening monetary stance in response to inflationary pressures, capital outflows, and pressures for a depreciation of the local currency, and other countries continuing to ease the monetary policy in order to boost the economy. Among them, the Reserve Bank of India (RBI) lowered the benchmark interest rate on three occasions in the first half of the year to 7.25 percent, and then raised it on September 20 and October 28 to 7.75 percent in response to inflationary pressures. From June, The Bank of Indonesia raised the benchmark interest rate to 7.5 percent on five occasions. The Central Bank of Brazil increased the benchmark interest rate to 10.0 percent on a total of six occasions during the year. The Central Bank of Thailand cut the policy rate to 2.25 percent on two occasions by 25 basis points respectively in order to boost the economy. The Central Bank of Hungary cut the benchmark interest rate to 3.0 percent on 12 occasions by a total of 275 basis points. The Central Bank of Brazil lowered the benchmark interest rate to 4.5 percent on two occasions, each by 25 basis points, hitting the lowest level since April 2011.

4. World economic outlook and major risks

In its *World Economic Outlook* released in January 2014, the International Monetary Fund (IMF) revised upward the projection for global growth in 2013 and 2014 by 0.1

percentage points respectively, to 3 percent and 3.7 percent. The projections for growth in the U.S. were 1.9 percent and 2.8 percent respectively, an increase of 0.3 and 0.2 percentage point from the previous forecast; the projections for growth in the euro zone were -0.4 percent and 1.0 percent respectively, at a par with the projections in October; the projections for growth in Japan were 1.7 percent for the two years, representing a downward and an upward adjustment of 0.3 and 0.5 percentage points respectively from the previous projections; growth in the emerging-market economies and the developing countries in 2013 was projected to be 4.7 percent, representing an upward adjustment of 0.2 percentage point from the previous projection, and growth in 2014 was projected to be 5.1 percent, the same as the previous projection. Looking ahead to 2014, the pace of the global recovery is expected to accelerate because of declining uncertainties regarding the U.S. fiscal policy outlook as bipartisan politics entered a peaceful period following ferocious gam es, reduced risks in trade and investment protectionism with breakthrough progress in the WTO Doha Round negotiations, and lower geopolitical risks as tensions in the Middle East eased. However, the world economy still faces the following risks:

First, great uncertainties in terms the pace of the QE tapering and its impact. The direction of cross-border capital flows, exchange-rate markets, asset prices, and commodity prices need to be followed.

Second, the economic recovery outlook in the euro zone remains unclear. Exports are expected to become a driving force for economic growth. However, the euro zone as a whole must address long-term structural issues, such as the building of a firewall, risk controls, deleveraging of the banking sector, the building of a fiscal union, structural imbalances within the euro zone, and a high unemployment rate. It remains uncertain whether the ECB will take new measures to inject liquidity into the market after the conclusion of the second round of the Long-term Refinancing Operations (LTRO).

Third, the internal drivers in Japan are insufficiently strong. The 5.5-trillion-yen stimulus package to be launched by the Japanese government might increase the debt burdens for the short run. There are great uncertainties in terms of whether the effects of the short-term fiscal and monetary policy incentives can be sustained. The temporary fiscal stimulus measures may partially offset the negative effects of the increase in the consumption tax starting from April 2014. However, if the corporate sector fails to substantially raise wage levels, personal consumption may be contained. If the negative impact of the consumption tax increase on the economy is greater than expected, the BOJ might once again scale up its monetary easing, which in turn will affect the global foreign-exchange market.

Fourth, some emerging-market economies may face capital outflow risks. On the one hand, external demand in the emerging-market economies might improve, but the potential for a negative shock from the QE tapering by the U.S. Federal Reserve still looms large. On the other hand, the fundamentals in some emerging-market economies will not secure substantive improvements in the near term. The room for their fiscal and monetary policies is narrowing, and some long-term structural problems hampering economic development will not be solved in the short run. Due to internal and external factors, the economies with weak fundamentals and current account deficits are more vulnerable to potential shocks.

II. Analysis of China’s macro-economic performance

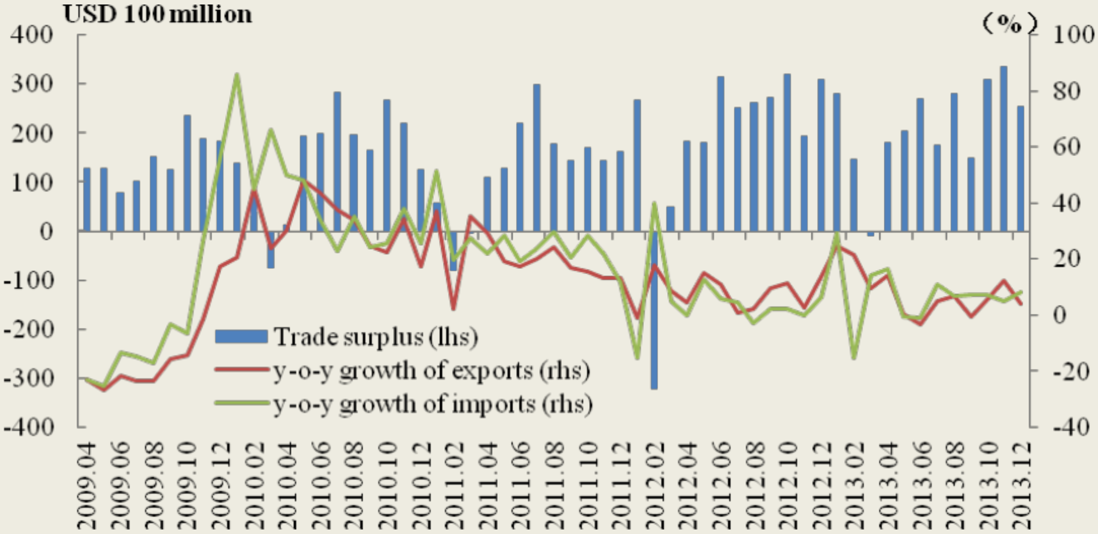
In 2013 the Chinese economy remained stable and headed for the better. The outlook for the agricultural sector was good, and the growth of industrial production stabilized and picked up. Investment and consumption grew steadily. The inflation and employment situations were basically stable. GDP totaled 56.9 trillion yuan in 2013, up 7.7 percent year on year, the same as that in the last year. In 2013 the CPI rose by 2.6 percent year on year, flat with that in the previous year. The trade surplus registered USD259.75 billion.

1. Consumer demand registered steady growth, investment growth was stable though slightly down, and the structure of exports and imports was improved

Household income continued to grow and growth of consumption demand was stable. In 2013, per capita disposable income of urban households posted 26,955 yuan, representing year-on-year growth of 9.7 percent and price-adjusted real growth of 7 percent. The per capita net income of rural households registered 8,896 yuan, up 12.4 percent in nominal terms and 9.3 percent in real terms. The PBC survey of urban depositors in the fourth quarter revealed that the household income index had rebounded by 0.4 percentage point from the previous quarter to reach 50.3 percent. Retail sales of consumer goods totaled 23.4 trillion yuan in 2013, representing year-on-year growth of 13.1 percent, or 11.5 percent in real terms. Retail sales in urban areas registered 20.2 trillion yuan, up 12.9 percent year on year, whereas retail sales in rural areas grew 14.6 percent year on year to reach 3.2 trillion yuan.

Fixed-asset investment growth was stable but slightly slower; and private investments accounted for a higher share. Throughout the year, fixed-asset investments (excluding investments by rural households) totaled 43.7 trillion yuan, up 19.6 percent in nominal terms and 19.2 percent in real terms year on year. Among this total, investments by the private sector registered 27.5 trillion yuan, increasing by 23.1 percent over the last year. Private investments accounted for 63 percent of total investments, which was 1.8 percentage points higher than that in 2012. In terms of the regional distribution, growth of fixed-asset investments in the central and western regions continued to outpace those in the eastern region; year-on-year growth in the eastern, central, and western regions registered 17.9 percent, 22.8 percent, and 23.0 percent respectively. In terms of the sectoral distribution, fixed-asset investments in the primary, secondary, and tertiary industries grew 32.5 percent, 17.4 percent, and 21.0 percent year on year respectively.

Imports and exports registered higher growth and their structures improved. In 2013 total imports and exports gained 7.6 percent year on year to reach USD4.2 trillion, with exports rising 7.9 percent year on year to reach USD2.2 trillion and growth at a par with that in 2012; imports rose 7.3 percent to reach USD2.0 trillion, with the growth rate three percentage points higher than that in the last year. The trade surplus was USD259.75 billion. In terms of the regional distribution, the shares of the traditional markets, including Europe, the United States, and Japan declined, while the emerging markets, such as the ASEAN countries, became new growth engines. In 2013 bilateral trade volume with Europe, the United States, and Japan accounted for 33.5 percent of total trade, down 1.7 percentage points from the last year; the trade volume with the ASEAN countries, South Africa, and the five Central Asian countries grew 10.9 percent, 8.6 percent, and 9.4 percent year on year respectively. The share of private enterprises in exports and imports went up, whereas the dependence on foreign-funded enterprises was reduced. In 2013, the volume of imports and exports by private enterprises rose 20.6 percent, accounting for 33.3 percent of total imports and exports, which was 3.6 percentage points higher than that in the last year. Meanwhile, imports and exports by foreign-funded enterprises grew 1.3 percent, holding a 46.1 percent share, down 2.9 percentage points compared with the last year. In terms of the product structure, exports of machinery and electronic products and labor-intensive products grew steadily, and imports of consumer goods and some resource products experienced rapid growth. The capacity for the independent development of external trade was enhanced as the share of general trade increased and that of processing trade decreased. In 2013 utilized foreign direct investments registered USD117.59 billion. Domestic investors invested directly in 5,090 overseas enterprises in 156 countries and regions, realizing cumulative total non-financial direct investments of USD90.17 billion.



Sources: General Administration of Customs, People's Bank of China.

Figure 5 Import and Export Growth and the Trade Balance

2. The outlook for the agricultural sector was good and the growth of industrial output stabilized before rebounding

For the first time, the share of the tertiary industry exceeded that of the secondary industry. In 2013 the value-added of the primary, secondary, and tertiary industries was 5.7 trillion yuan, 25.0 trillion yuan, and 26.2 trillion yuan respectively, up 4.0 percent, 7.8 percent, and 8.3 percent; and the three industries accounted for 10.0 percent, 43.9 percent, and 46.1 percent of total GDP respectively.

A bumper harvest was once again achieved. In 2013 the output of grain rose by 2.1 percent to reach 601.94 million tons. The total output of meat (including pork, beef, mutton, and poultry) rose by 1.8 percent year on year to reach 83.73 million tons, among which the output of pork totaled 54.93 million tons, up 2.8 percent year on year.

The growth of industrial output was stable. In 2013 the value-added of statistically large enterprises calculated with comparable prices grew 9.7 percent year on year, and the quarterly growth rates were 9.5 percent, 9.1 percent, 10.1 percent, and 10.0 percent respectively. The profits of statistically large enterprises increased by 12.2 percent to reach 6.3 trillion yuan, representing a growth acceleration of 6.9 percentage points compared with the last year. Among this total, profits from main businesses registered

6.2 trillion yuan, up 4.0 percent from the last year. In terms of industrial products, 97.8 percent were sold, which was 0.2 percentage point lower than that in the last year. The survey of 5,000 industrial enterprises conducted by the PBC in the fourth quarter revealed a slight improvement in business performance. The business index posted 58.1 percent, up 1.8 percentage points from the previous quarter, and the profitability index posted 57.6 percent, up 2.5 percentage points from the previous quarter.

3. Growth of consumer prices was basically stable

In 2013, affected by the changing domestic-growth situation, the major price indices registered low readings before stabilizing in the later months, indicating a generally stable trend throughout the year. In the first half of the year, growth of consumer prices was basically stable, whereas producer prices declined further. In the second half, as economic growth rebounded growth of consumer prices went up at a more rapid pace and producer prices saw a reduced rate of decline.

Growth of consumer prices was the same as that in the last year. In 2013 the CPI rose 2.6 percent year on year, with the quarterly growth rates at 2.4 percent, 2.4 percent, 2.8 percent, and 2.9 percent. In terms of food and non-food items, the growth of food prices went down slightly, whereas the growth of non-food prices remained basically stable. Food prices rose by 4.7 percent in 2013, a deceleration of 0.1 percentage point from those in the last year. The prices of non-food items went up by 1.6 percent, which was the same as those in the last year. In terms of consumer goods and services, the growth of prices of consumer goods decreased whereas the growth of prices of services accelerated. In 2013 the prices of consumer goods grew 2.5 percent year on year, a deceleration of 0.4 percentage points from the last year; the prices of services increased by 2.9 percent, an acceleration of 0.9 percentage point from the last year.

Producer prices declined by a slightly larger margin. In 2013 ex-factory prices of industrial products fell 1.9 percent, which was 0.2 percentage point more than the decline in the last year; and the quarterly rates of decline were 1.7 percent, 2.7 percent, 1.7 percent, and 1.4 percent in the four quarters respectively. Producer purchasing prices declined by 2.0 percent year on year, which was 0.2 percentage point more than the decline in the last year; and the quarterly rate of decline was 1.9 percent, 2.8 percent, 1.8 percent, and 1.5 percent. The Corporate Goods Price Index (CGPI) fell by 1.2 percent year on year, declining by 1.3 percent, 2.1 percent, 0.7 percent, and 0.5 percent in each of the four quarters. The prices of agricultural products rose more rapidly than the prices of agricultural capital goods. In 2013 the prices of agricultural products rose by 3.2 percent, whereas the prices of agricultural capital goods went up by 1.4 percent.

Affected by factors such as the overall decline in commodity prices, the prices of imports continued to decrease. In the four quarters of 2013, the average prices of Brent Crude oil futures on the Intercontinental Exchange changed 2.3 percent, -8.2 percent, 6.1 percent, and -0.3 percent quarter on quarter, a cumulative decrease of 0.7 percent. Average LME spot copper prices changed 0.3 percent, -9.9 percent, -1.0 percent, and 1.1 percent in each quarter, representing a cumulative decline of 9.5 percent. Average LME spot aluminum prices changed 0.3 percent, -8.4 percent, -2.9 percent, and -0.7 percent, a cumulative decline of 11.5 percent. In 2013 import prices declined by 1.8 percent, with the quarterly rate of decline at 1.8 percent, 2.9 percent, 1.1 percent, and 1.5 percent, respectively. Export prices went down by 0.6 percent year on year, and the rate of decline in each quarter was 0.1 percent, 0.6 percent, 1.2 percent, and 0.7 percent, respectively.

The GDP deflator edged downward to some extent. In 2013 the GDP deflator (the ratio of nominal GDP to real GDP) was 1.7 percent, which was 0.3 percentage point lower than that in the last year.

The resource products pricing reform continued to make progress. First, the pricing mechanism for refined oil was further improved and quality-based pricing for fuel upgrading was implemented. Second, drawing on the experiences from the pilot programs of the pricing-mechanism reform of natural gas in Guangdong and Guangxi provinces, plans for adjusting the prices of natural gas were launched. Third, a tiered electricity pricing system for households and related mechanisms and regulations were further improved. Fourth, guidelines for speeding up the implementation of a tiered water-pricing system for urban households were issued, requiring in principle that by the end of 2015 cities should implement tiered water rates for households and qualified towns should also actively promote tiered water rates for households.

4. Growth of fiscal revenue slowed down, whereas the structure of fiscal expenditures improved

In 2013 fiscal revenue posted 12.9 trillion yuan, up 10.1 percent, which was 2.8 percentage points slower than that in the last year. Fiscal expenditures reached 14.0 trillion yuan, rising by 10.9 percent, which was 4.4 percentage points slower than that in the last year. Fiscal expenditures exceeded fiscal revenue by 1,060.1 billion yuan.

In terms of the structure of fiscal revenue, tax revenue registered 11.0 trillion yuan, up 9.8 percent, which was 2.3 percentage points lower than that in the last year. Growth of revenue slowed obviously, reflecting mainly the influences of the moderation in economic growth, the structural tax reductions, the slowing down of general trade import growth, and so forth. In terms of the categories of taxes, revenue from the domestic value-added tax, domestic consumption tax, business tax, corporate income tax, and personal income tax rose by 9.0 percent, 4.5 percent, 9.3 percent, 14.0 percent, and 12.2 percent, whereas the value-added tax on imported goods and the consumption tax declined by 5.4 percent.

As for the structure of fiscal expenditures in 2013, larger shares were taken by education, social security and employment, and agriculture, forestry, and water conservation, which accounted for 15.7 percent, 10.3 percent, and 9.5 percent of fiscal expenditures, respectively. Important expenditures for improving people's livelihood were given priority, with urban and rural community affairs, social security and employment, and energy conservation and environmental protection growing the fastest, up 21.9 percent, 14.6 percent, and 14.2 percent, compared with the last year.

5. The employment situation was generally stable

As of the end of 2013, 769.77 million people were on the payroll, 2.73 million more than at the end of 2012. Among this total, 382.40 million were urban employees, representing 11.38 million more than those in the last year.

A statistical analysis in the fourth quarter conducted by the China Human Resources

Market Information Monitoring Center on public employment service agencies in 104 cities revealed that overall labor supply and demand was in balance, with supply falling slightly short of demand, and the ratio of job seekers to job vacancies was 1.10, up 0.02 from the previous quarter and the same period of the last year. Broken down by industries, demand for labor in education, mining, finance, real estate, and so forth showed more substantial growth, whereas demand for labor in manufacturing, hotel and catering services, household services and other service industries fell slightly. Compared with the same period of the last year, young people accounted for a larger share of the job seekers; whereas the shares taken by people who had lost their jobs and by people who came from rural areas or other cities declined. Regarding labor demand, 57.6 percent of the demand included explicit requirements for skills or titles; professionals with a medium-to-high level of skills and senior professionals were still in short supply.

6. Twin surplus in the balance of payments

Both the current account and the capital and financial account of the balance of payments remained in surplus. According to preliminary statistics released by the State Administration of Foreign Exchange, in 2013 the current account surplus was USD188.6 billion, accounting for 2.1 percent of GDP, down 0.2 percentage point from that in the last year, but still within the internationally recognized range of sustainability. The surplus in the capital and financial account was USD242.7 billion, whereas during the last year the capital and financial account had experienced a deficit of USD16.8 billion. Reserve assets grew by USD431.4 billion.

The total external debt continued to grow. By the end of September 2013, the outstanding external debt posted USD822.9 billion, up 11.7 percent year on year. Among this total, the stock of registered external debt posted USD496.1 billion, rising 11.4 percent compared with the last year and accounting for 60.3 percent of the total; and outstanding short-term external debt posted USD632.9 billion, increasing 17 percent year on year and accounting for 76.9 percent of the total.

7. Sector analysis

Profits of industrial enterprises grew rapidly. In 2013, among the 41 industries, 31 made more profits in their main businesses compared with the last year, 9 made fewer profits than in the last year, and one industry reduced the size of its loss compared with the last year. Total profits of 35 industries rose compared with the last year, of which five industries accounted for 55.3 percent, i.e., electricity, heat generation and distribution, the automotive industry, non-metallic mineral product manufacturing, computer communications, and other electronic equipment manufacturing. Nevertheless, profits in several industries declined year on year due to sluggish demand and product price cuts.

(1) The real-estate sector

In 2013 the turnover of nationwide sales of commercial housing went down month by month, but it was still higher than that during the last year. The number of cities seeing a month-on-month housing price increase grew substantially, and changes in housing prices varied to a large extent among the various cities. Growth of investment in the real-estate sector remained stable and growth of real-estate loans rebounded.

Growth of sales of commercial real estate declined month by month. In 2013 nationwide sold floor area of commercial real estate was 1.31 billion square meters, up 17.3 percent year on year. The growth rate was narrowing month by month, but the overall growth rate was still 15.5 percentage points higher than that during the last year. The sales value of commercial real estate went up 26.3 percent year on year to reach 8.1 trillion yuan, an acceleration of 16.3 percentage points from the last year. Among the total, the sold floor area and the turnover of commercial residential housing accounted for 88.6 percent and 83.1 percent respectively of the total sold area and of the turnover of commercial housing. Since June 2013, growth of sales of office buildings outpaced that of commercial residential housing.

More cities reported year-on-year increases in housing prices compared with the beginning of the year. In December 2013, out of 70 large and medium-sized cities, the prices of newly-built commercial residential housing increased year on year in 69 cities, 16 more than in January, with the largest margin of increase at 21.9 percent and the lowest margin of increase at -2.8 percent; the prices of pre-owned residential housing increased year on year in 69 cities, 33 more than in January, with the largest margin of increase at 19.7 percent and the lowest margin of increase at -7.2 percent.

Growth of investments in real-estate development was stable. In 2013 investments in real-estate development totaled 8,601.3 billion yuan, up 19.8 percent year on year and representing an acceleration of 3.6 percentage points from the last year. In particular, investments in residential housing were 5,895.1 billion yuan, accounting for 68.5 percent of total investments in real-estate development. The growth rate of investments in residential housing was 19.4 percent year on year, an acceleration of 8 percentage points from the last year. The floor area of newly-built housing rose 13.5 percent year on year to reach 2.01 billion square meters, while that in 2012 had declined 7.3 percent year on year. The floor area of housing under construction grew 16.1 percent to reach 6.66 billion square meters, representing an acceleration of growth of 2.9 percentage points from the last year. The floor area of completed housing climbed 2.0 percent year on year to reach 1.01 billion square meters, representing a deceleration of growth by 5.3 percentage points.

Growth of real-estate loans accelerated. By the end of 2013, outstanding real-estate loans of major financial institutions (including foreign-funded financial institutions) posted 14.6 trillion yuan, an increase of 19.1 percent year on year and up 6.3 percentage points over the last year. Outstanding real-estate loans accounted for 21 percent of total outstanding loans, which was 1.2 percentage points higher than that at the end of the last year. Among the total, outstanding mortgage loans rose 21 percent year on year to reach 9 trillion yuan, 8.1 percentage points higher than at the end of the last year; outstanding housing development loans gained 16.3 percent year on year to reach 3.5 trillion yuan, representing an acceleration of growth by of 6.1 percentage points over the end of the previous year; outstanding land development loans rose 9.8 percent year on year to reach 1.1 trillion yuan, 3.8 percentage points lower than that at the end of the last year. In 2013 new real-estate loans reached 2.3 trillion yuan, which was 998.7 billion yuan more than in the last year. New real-estate loans accounted for 28.1 percent of total new loans, which was 10.7 percentage points higher than that at the end of last year.

Credit support for welfare housing was further reinforced. At of the end of 2013, outstanding loans for welfare housing rose 26.7 percent year on year to reach 726.0

billion yuan, with the growth rate 10.9 percentage points higher than that of residential real-estate development loans and accounting for 27.7 percent of total residential real-estate development loans. In addition, the pilot program of using housing provident fund loans to support the construction of affordable housing projects was steadily promoted. At the end of 2013, based on the construction progress, a total of 63.4 billion yuan of such loans had been disbursed to 301 projects in 75 cities under the affordable housing program and a total of 14.2 billion yuan of the principal had been repaid.

(2) The health-service sector

The health-service sector is an emerging industry and an important part of the modern service sector. It serves the purpose of protecting and promoting the physical and psychological health of the public, and it covers a variety of services, such as medical services, health management, health insurance, and related services and it involves a long industry chain, including supporting industries such as pharmaceuticals, medical apparatus and instruments, health-care products, health-care food, and fitness products. As the income and consumption level of Chinese households increase and the elderly population continues to grow, demand for health services is expanding day by day, thus it is necessary to promote more rapid development of a diversified and multi-layered health-service sector. This is needed in the endeavours to deepen medical-system reform, to improve the people's livelihood, and to enhance the health of the public,. Furthermore, it is also an important measure to further expand domestic demand, promote employment, and advance the transformation of the economic development pattern.

After implementation of the new round of reform of the pharmaceutical and health-care systems, nationwide coverage of medical insurance was basically achieved and a basic medical and health-care system was established, creating favorable conditions for accelerating the development of the health-service sector. At the end of 2012, 535.89 million people participated in urban basic medical insurance; 2,566 counties (cities and districts) started the new rural cooperative medical system, with a participation rate of 98.1 percent. As more and more people were paying attention to their health problems and related demands rise, the health-service sector developed rapidly, with an enhanced capacity and efficiency and the volume of related supporting industries expanded. In 2012 sales volume in the pharmaceutical industry, sports goods manufacturing, health-food manufacturing and domestic beauty aids, and industries manufacturing health electronic appliances registered 1,662.8 billion yuan, 101.7 billion yuan, 85.7 billion yuan, and 27.1 billion yuan respectively, up 20.9 percent, 13.1 percent, 41.8 percent, and 12.8 percent year on year.

Nevertheless, the health-service sector is still at an initial stage of development and it falls short of the people's demand for health services and the requirements for balanced economic and social development. First, the sources of investments in medical care are not diversified, and service capacity and efficiency need to be further enhanced. Currently, private hospitals face many challenges in terms of becoming medical insurance–designated hospitals, recruiting qualifying physicians, acquiring pharmaceuticals and medical devices, which hinders the efficient utilization of medical services. By the end of November 2013, there were 13,441 public hospitals and 11,029 private hospitals, with the latter accounting for 45.1 percent of the total number of hospitals. From January through November 2013, public hospitals treated

2.17 billion person-times, and private hospitals treated 0.24 billion person-times, the latter accounting for only 10.0 percent of the total. Second, medical resources and services, such as commercial health insurance and elderly care, lag behind the demand arising from economic and social development. In 2012 beds per thousand people in medical institutions totaled 4.24, and medical practitioners (including assistants) totaled only 1.94 per thousand people. The premiums for commercial health insurance accounted for only 7.9 percent of the total premiums for life insurance, whereas the share in mature insurance markets commonly totals about 30 percent. As of the end of 2013, about 132 million people aged 65 years old or older. However, by the end of 2012, there were only 44,304 elderly-care institutions nationwide, consisting of 4,165 thousand beds and representing 21.5 beds per thousand elderly people, much lower than the goal of "providing 35–40 beds in elderly-care institutions for every thousand elderly people." Third, supporting policies for the health-service sector are neither systematic nor complete in such areas as market access, land use, finance and taxation, investment and financing, and so forth. Moreover, laws and administrative regulations related to health services require further improvement, and the service quality and the market monitoring mechanisms are in need of further strengthening.

More measures should be put in place to develop the health-service sector. The initiative and creativity of the society should be fully mobilized, market access should be expanded, and the market should play its role to a fuller extent to gradually establish a diversified and well-structured health-service system that covers the entire life cycle. Measures should be adopted to encourage innovation in business models, more rapidly develop health and elderly-care services, diversify commercial health insurance products, improve financial, taxation, and pricing policies, improve policies to guide investment and financing, improve legal standards and supervision of the health-service sector, and build a large force of health-care service professionals .

Part 5 Monetary Policy Stance to Be Adopted in the Next Stage

I. Outlook for the Chinese economy

Despite the complex environment, various constraints, and multiple challenges, given the potential drivers for economic growth and other factors the Chinese economy is likely to continue its momentum of stable economic growth and progres s toward higher quality growth. First of all, the potential and space for economic development remain fairly large. The various parties are keen to promote development and there are endogenous drivers for expansion, economic development complementarities among the eastern, central, and western regions, and fairly comfortable space for maneuver. In particular, after many years of rapid development, the accumulation of human capital, improvements in infrastructure, and the development of capacity for industrial support will help increase the efficiency of industrial activities and reduce transaction costs. Second, progress in the comprehensive reform will stimulate the dynamism of the economy and release the growth potential. The year 2014 will be the first year of implementation of the decisions adopted at the 3rd Plenum of the 18th CPC National Congress and of the comprehensive deepening of reform. At the Central Economic Work Conference, decisions were made to adopt forceful measures to promote reform and innovations and to work actively and in a self-initiated manner to transform the economic development model and to adjust the economic structure in order to bring about proactive growth and to play an active role in international competition. The rolling-out of the reform measures will better enable the market to play a decisive role in resource allocations, improve the efficiency of output factors, and lay a more solid foundation for sustainable and long-term economic development. At the moment, a group of new technology industries and new business models are being developed with a strong momentum. Industries and enterprises that have initiated upgrading, transformation, and innovation have become very resilient and have displayed dynamic growth. As a result of higher incomes and technological progress, tourism, consumption of information, and other new consumption models are driving the upgrading of the structure of consumption. In the external environment, the stronger recovery in the U.S, the more stable recovery in the global economy, and the projections by many institutions of higher worldwide growth in 2014 will provide a stable environment for external demand that will contribute to the steady performance of the Chinese economy. The surveys conducted by the PBC in Q4 show that the business confidence index was up 3.1 percentage points quarter on quarter and 5.5 percentage points year on year. The bankers confidence index, urban depositors future income confidence index, and future employment expectation index all moved up from the previous quarter, by 10.3 percentage points, 1.3 percentage points, and 1.4 percentage points respectively.

However, there are many risks and challenges. In the domestic environment, the endogenous growth drivers are yet to be strengthened and potential risks in the real economy and financial sector still require attention. In recent years, a dual-driver growth pattern has emerged in China, i.e., supported by both external demand and domestic investment. In particular, in recent years the construction and development model financed by massive locality-led borrowing has been strengthened. While this has contributed to stable GDP growth, the potential risks in terms of economic performance are also on the increase. At this stage, the basis for stable economic growth is yet to be strengthened; dependence on investment and borrowing has become stronger; growth driven by high investment and the excessive concentration of investment in the real-estate sector are likely to push up the debt level and squeeze out other participants, especially small and medium enterprises, and exacerbate financing difficulties and increase the financing costs of other players. Structural problems may also affect the outcome of aggregate policies. In terms of the international situation, new drivers for strong growth of the global economy have not yet clearly emerged; the euro area remains relatively weak economically, with still-lingering potential risks; the emerging economies are undergoing a growth model transformation and their weaknesses have not been eliminated; as the U.S. Fed eral Reserve tapers the QE policy, long-term interest rates may go up further, and, as a result, the emerging economies will face shocks from capital outflows and changing financing costs; uncertainties remain in the global economy and international competition in terms of exports may become even fiercer. In general, given the complexities and uncertainties in the external and internal environments, it is necessary to further advance structural adjustments and transformation of the growth pattern and to make new breakthroughs at the difficult and key junctures in the adjustment and transformation.

The price situation is generally stable, but uncertainties remain. Price movements are mainly determined by the domestic and global situations as well as by changes in aggregate demand. The relative stability in the domestic and external economies, the stable monetary environment, sufficient industrial capacity, and the impact of the base factor which is relatively flat with that of last year will all contribute to the continued stability of the CPI. However, it is worth noting that the potential upward pressures of agricultural produce and the service sector, the on-going housing price hikes, in particular the large increase in housing prices in first-tier cities, may spill over to related fields and amplify cost pressures. The negative increase in the PPI is related to the excessive capacity in the process of structural adjustments and to the changes in the factor prices in the major economies and price movements of primary commodities. As the recovery of the global economy progresses, PPI changes in the major economies may affect domestic prices. According to the urban depositors' survey conducted by the PBC in Q4, 2013, the household future price expectation index was 72.2 percent, up 1.7 percentage points quarter on quarter. Price movement trends need to be closely watched.

II. Monetary policy during the next stage

The PBC will follow the strategic arrangements of the State Council, implement the decisions of the 18th CPC National Congress, the 3rd Plenum of the 18th CPC Central Committee, and the Central Economic Work Conference, follow the principle of making progress while maintaining stability, and continue reform and innovation. The PBC will continue the sound monetary policy and the stance of keeping aggregates at stable levels and optimizing the structure, maintain the stability and continuity of policy, make macro-economic measures more forward-looking, targeted, and coordinated, strike a balance among preserving stable economic growth, adjusting the economic structure, and promoting reform and preventing risks, and conduct fine-tuning and preemptive adjustments where appropriate and with the proper intensity in order to continue to provide a stable and opportune monetary and financial environment. Moreover, measures will be taken to improve the efficiency of financial resource allocations, and improve and optimize the financing and credit structures. The use of monetary policy measures will be combined with deeper reforms, with a focus on higher efficiency in resource allocations and increasing consumer dominance in deepening the reforms, to allow the market to play a decisive role in resource allocations, to make further improvements in the approach to macro-economic management in view of the deepening of and innovations in the financial market, to straighten up the transmission mechanism, and to improve the efficiency of the financial sector and services to the real economy.

First, a combination of quantitative, price, and other monetary policy instruments will be used and the macro-prudential policy framework will be improved to keep liquidity at a reasonable volume and to realize proper growth of money, credit, and all-system financing aggregates. Against a background of market deepening and rapid progress in financial innovations, adjustment and guidance of overall liquidity supply will become ever-more important. In view of the BOP account situation and the supply and demand of liquidity, a mix of instruments, including open market operations, the deposit reserve requirement ratio, central bank lending, central bank discounts, the Standing Lending Facility, Short-term Liquidity Operations, and so forth, will be used to manage and adjust liquidity in the banking system. Communications with the market and the general public will be enhanced to stabilize expectations and to promote stable movements of market interest rates. Moreover, financial institutions will be guided to enhance liquidity and asset and liability management, to make good arrangements for liquidity at various time-points, to properly manage asset and liability aggregates and their maturity structures, and to improve the quality of liquidity risk management. The macro-prudential policy will continue to play a role in counter-cyclical adjustment. The various parameters will be adjusted when necessary based on changes in economic performance, the soundness of financial institutions, and implementation of the credit policy to guide financial institutions to support real sector development in a more focused way.

Second, the stock of credit assets will be revitalized and the use of new loans will be optimized to support structural adjustments and transformations. Financial resources will be consolidated to support the development of small and micro enterprises, and financial institutions will be guided to increase credit to the agricultural sector, rural areas, and farmers, to further develop consumer financing to support the upgrading of consumption and to beef up support to key ongoing and follow-up projects, advanced manufacturing industry with a good market outlook, strategic emerging industries, the modern IT industry and information consumption, the modern service industry, and the transformation and upgrading of traditional industries. Financial services will be further improved to contribute to better livelihood of the people, to support job creation, poverty reduction, students in need of loans, to support the regional development policies, and to provide financial support and services for balanced regional development. Lending to energy-consuming, highly polluting industries and those with excess capacities will be strictly controlled to facilitate resolution of the problem of overcapacity. A green credit mechanism will be established and improved to provide better financial services for energy conservation, environmental protection, a circular economy, and treatment of air pollution. The differentiated housing mortgage policies will be properly implemented to support the construction of welfare housing and common commercial housing projects with apartments with modest floor plans and purchases by first-time home buyers of common commercial housing, and to contain purchases for speculative investment purposes. Financial institutions will be guided to adopt differentiated approaches to gradually adjust and revitalize the stock of credit assets based on their different circumstances. They will be encouraged to make innovations in terms of organization, mechanisms, products, and service models, to improve performance evaluations and incentive mechanisms, to evaluate the performance of the banking business in a scientific and reasonable way, to optimize the financial organizational system, and to further improve financial services.

Third, the market-based interest-rate reform and the RMB exchange-rate regime reform will be furthered to improve the efficiency of allocation of financial resources and to improve the monetary policy framework. The self-regulatory market interest-rate pricing mechanism will be improved to build the capacity of financial institutions for independent pricing. The issuing and trading of interbank certificates of deposit will continue while there will be explorations into issuing certificates of deposit to corporate and individual customers and to gradually increase the range of liability products for market pricing. Efforts will be made to develop the Shibor and Loan Prime Rate and to build a fairly complete market interest-rate system. The central bank interest-rate adjustment framework will be improved to strengthen price-based adjustments and the transmission mechanism. The RMB exchange-rate regime will be further improved to allow market demand and supply to play a greater role, to enhance the two-way flexibility of the RMB exchange rate, to keep the exchange rate basically stable at an adaptive and equilibrium level, and to promote a balanced position of the BOP account. Development of the foreign-exchange market will be accelerated to facilitate innovations in exchange-rate risk management. Measures will be taken to support the use of RMB in cross-border trade and investment activities, and more channels will be made available for the inflows and outflows of RMB funds. Direct trading of the RMB against other currencies will be promoted to provide better services for RMB settlements of cross-border trade activities. The impact of the changing international situation on capital flows will be carefully watched and effective monitoring of cross-border capital will be strengthened.

Fourth, there will be continued efforts to promote the sound development of financial markets, to beef up support for direct financing, and to expand available direct financing channels for small- and micro-sized enterprises. Measures will be taken to advance financial market innovations, build stronger risk management awareness, emphasize the role of market mechanisms, strengthen development of market infrastructure, and enhance market regulation, in order to promote the sound development of the financial market. The diversity of financial markets, financial products, investor bases, and financing intermediaries will be further promoted to increase the share of direct financing. More efforts will be made to promote the sound development of the interbank bond market by improving the bond issuance pricing mechanism, facilitating bond product innovation and diversity, raising bond market information disclosure standards, strengthening market discipline and risk-sharing mechanisms, improving transparency in the bond market, opening up to external players, and tapping the role of the corporate debenture bond inter-ministerial coordination mechanism to promote regulatory coordination. With respect to the gold market, there will be greater diversity of participants, while product innovation will be encouraged and risk monitoring, early warning, and prevention will be enhanced to promote steady and sound market development.

Fifth, reform of financial institutions will be deepened. Reform of large commercial banks will be furthered so as to continue to improve corporate governance and promote a modern financial enterprise system, accelerate the transformation of the growth pattern and profit model, and build a capacity for innovation and international competitiveness. The pilot reform program by the Rural Financial Business Division of the Agricultural Bank of China will be advanced to comprehensively improve financial services to the agricultural sector, rural customers, and farmers. The reform of the Export-Import Bank of China and the Agricultural Development Bank of China will be accelerated by clearly defining their policy functions, following the principle of focusing on policy-based business and prudently developing proprietary business, requiring separate book-keeping and management of policy-based and proprietary business, establishing a sound regulatory capital requirement mechanism, and improving the governance structure and the fiscal and financial support policy for the purpose of developing soundly operating policy financial institutions with Chinese characteristics and creating a policy environment to support good services to real economy. To adapt to the needs of economic development and reform of the financial system, reform of the China Development Bank will be deepened to further define its strategic role and its direction of development, and to provide a proper solution to the questions of bond credits, funding sources, and so forth. The development of private financial institutions will be supported to increase the supply of competitive financial resources for the real sector. The switch to commercial operations of asset management companies will be facilitated. The pilot program of cross-sector operations will be advanced actively and prudently.

Sixth, effective measures will be adopted to mitigate systemic financial risks and to preserve stability in the financial system. Macro-prudential regulation will be enhanced to guide financial institutions to operate on a sound basis and to encourage them to strengthen internal controls, liquidity and risk management. While supporting financial innovations, monitoring and prevention of potential risks in the wealth management, bill, and interbank business will be enhanced. Continued monitoring of local government debt and debt service capacity will be strengthened and explorations will be made into the use of market mechanisms to resolve the problem of local government indebtedness. The systemic financial risk early-warning and assessment mechanisms will be improved to strengthen monitoring of credit default risks of local government financing platforms, industries with excess capacity, and lending to the real-estate industry to prevent the spread to the financial system of the risks in some regions, industries, and enterprises and those arising from financing activities outside of the formal financial system. The role of the inter-ministerial coordination mechanism for financial regulation will be tapped to strengthen risk monitoring and regulatory coordination in cross-sectoral and cross-market financial products, to promote balanced development of various financial markets and products, and to establish a comprehensive financial statistical system and information-sharing mechanism. A crisis management and risk resolution framework will be established and the creation of a deposit insurance scheme will be promoted. A comprehensive set of measures will be enacted to preserve financial stability and to safeguard the bottom line in terms of preventing systemic and regional financial risks.