China Monetary Policy Report
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Monetary Policy Analysis Group of

the People's Bank of China

Executive Summary

Since the beginning of 2008 China has withstood the severe test of a range of serious challenges in its social and economic development, overcoming the negative impacts of the devastating natural catastrophes and the adverse international economic and financial environment, and maintaining a stable and relatively rapid economic growth momentum. In the first three quarters of 2008, the Gross Domestic Product (GDP) grew 9.9 percent year on year to 20.2 trillion yuan and the Consumer Price Index (CPI) rose 7.0 percent year on year. Among this total, the GDP in the third quarter grew 9.0 percent and the CPI rose 5.3 percent year on year.

Since the beginning of July, in accordance with the overall arrangements of the Central Committee of the Communist Party of China (CPC) and the State Council, and in light of the worsening international financial crisis and the easing of domestic inflationary pressures, the People’s Bank of China (PBC), taking all factors into account, strengthened the monitoring and analysis of economic and financial developments and timely adjusted macro financial-management measures. The PBC reduced the intensity of its open market sterilization operations, cut the reserve requirement ratios on a consecutive basis two times and the benchmark deposit and lending rates three times, eliminated the credit ceiling requirement on commercial banks, and guided commercial banks to expand credit aggregates. In the meantime, the PBC worked to encourage growth in some sectors while discouraging growth in other sectors, and guided incremental credit resources to tilt toward the key sectors and weak links in the economy. In general, the effects of the monetary policy gradually unfolded. Money and credit aggregates grew steadily, the banking system had abundant liquidity, and the financial system operated in a sound manner.

At end-September 2008, broad money M2 had increased 15.3 percent year on year, a deceleration of 3.2 percentage points from the same period of the last year. Loans were growing in a stable manner. At end-September, outstanding RMB loans stood at 29.6 trillion yuan, representing year-on-year growth of 14.5 percent. Loan issuances were evenly distributed in the first, second, and third quarters, with new loans registering 1.33 trillion yuan, 1.12 trillion yuan, and 1.03 trillion yuan respectively. New RMB loans in the first three quarters totaled 3.5 trillion yuan, representing an acceleration of 120.1 billion yuan year on year and a historical high for the same period of time. The overall payment capacity of enterprises remained at a rational level. At end-September, RMB deposits of enterprises grew 13.9 percent year on year. RMB lending rates fell marginally. In September the weighted average interest rate of 1-year loans of financial institutions declined by 0.09 percentage points from June. The RMB exchange rate remained stable. At end-September, the central parity of the RMB against the U.S. dollar was 6.8183 yuan per dollar.

At present, the international financial market is encountering violent turbulences, which have taken a heavy toll on the world economy, and their negative impact on China's economy has surfaced and may become even more intensive with the passage of time. The growth of exports is expected to slow down further. Corporate profits and fiscal revenues are expected to slide to varying extents. Downward pressures on the economy have increased and macroeconomic management is expected to face a more complex situation. However, China is still in the process of rapid industrialization, urbanization, and industrial upgrading, and still enjoys many advantages, such as its vast domestic market, relatively abundant liquidity, a better-trained labor force, a sound and safe financial system, and heightened awareness and improved capability of enterprises to deal with the changing market. Therefore, China has a strong ability and resilience to prevent potential risks.

In line with the overall strategy of the CPC Central Committee and the State Council and the scientific approach to development, the PBC will carry out a moderately loose monetary policy, adjusting monetary policy operations in response to the changing situation, guaranteeing steady growth of money and credit and sufficient liquidity in the financial system, promoting stable and relatively rapid economic growth, supporting the expansion of domestic demand, safeguarding the stability of the RMB exchange rate and the financial system, and guiding the financial system to play a greater role in bolstering economic growth. First, in line with the changing situation, the PBC will adopt plans to safeguard sound financial and economic operations and will enhance international coordination and cooperation in a bid to deal with the potential impact of the financial crisis. Second, the PBC will provide liquidity support to financial institutions in a timely manner to insure that they have sufficient liquidity. Third, the PBC will promote the stable growth of money and credit aggregates and will beef up support to bank lending for economic growth. Fourth, the PBC will improve window guidance and credit policy guidance and will optimize the credit structure. Fifth, the PBC will guide the bond market to play a greater role in fund-raising and will broaden the financing channels of enterprises. Sixth, the PBC will closely monitor international capital flows and will deepen the reform of the foreign exchange management system.

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Part 1 Monetary and Credit Performance

In the third quarter of 2008 the national economy maintained steady and a relatively rapid growth momentum, along with a continuous deceleration of the consumer price index. Money and credit operated in a sound manner, and the financial system was sound and safe.

I. Stable growth of money supply

At end-September, the outstanding balance of broad money M2 amounted to 45.3 trillion yuan, an increase of 15.3 percent year on year, down 3.2 percentage points from the growth during the same period of 2007. The outstanding balance of narrow money M1 reached 15.6 trillion yuan, an increase of 9.4 percent year on year, down 12.6 percentage points from the growth during the same period of 2007. Cash in circulation M0 grew 9.3 percent year on year to 3.2 trillion yuan, down 3.7 percentage points from the growth during the same period of 2007. Net cash injections in the first three quarters of 2008 totaled 135 billion yuan, 60.8 billion yuan less than that recorded during the same period of 2007.

In the first three quarters of 2008, due to a high base period in the previous year and the moderation of growth of deposits associated with purchases of foreign exchange by financial institutions, the growth of M2 faced a downward trend amid small fluctuations. In the first half of 2007, with the buoyant capital market, enterprises and institutions put a large amount of funds in demand deposits, so the growth of M1 accelerated. However, 2008 witnessed a reverse situation and the growth of M1 decelerated rapidly.

II. Deposits of financial institutions tilted toward time deposits

At end-September, outstanding deposits of all financial institutions (including foreign-funded financial institutions) denominated in both RMB and foreign currencies increased 18.2 percent to 46.7 trillion yuan, 2.2 percentage points higher than the growth during the same period in 2007, representing an increase of 6.6 trillion yuan from the beginning of the year or an acceleration of 1.9 trillion yuan year on year. In particular, outstanding RMB deposits rose 18.8 percent to 45.5 trillion yuan, 2 percentage points higher than the growth during the same period in 2007, representing an increase of 6.6 trillion yuan from the beginning of the year and an acceleration of 1.8 trillion yuan year on year. Outstanding foreign currency deposits rose 9.4 percent to 174.2 billion yuan, 10.2 percentage points higher than the growth during the same period in 2007, representing an increase of 13.4 billion yuan from the beginning of the year and an acceleration of 15.5 billion yuan year on year.

Broken down by sectors and maturities, household RMB deposits grew rapidly, the growth of non-financial institutions' time deposits moderated, and fiscal deposits increased steadily. Household and corporate deposits continued to accelerate. At end-September, outstanding household RMB deposits grew 21.1 percent to 20.8 trillion yuan, 14.1 percentage points higher than the growth during the same period in 2007, representing a growth of 3.3 trillion yuan from the beginning of the year or an acceleration of 2.5 trillion yuan year on year and featuring more growth in time deposits. Outstanding non-financial corporate deposits stood at 21 trillion yuan, an increase of 15.1 percent year on year, 9.9 percentage points lower than the growth during the same period in 2007, representing an increase of 2.2 trillion yuan from the beginning of the year or a deceleration of 695.1 billion yuan year on year, among which corporate time deposits accelerated by 593 billion yuan year on year and the overall affordability of enterprises remained at a rational level. At end-September, outstanding fiscal deposits stood at 2.8 trillion yuan, representing year-on-year growth of 28.7 percent or an increase of 1 trillion yuan from the beginning of the year, a deceleration of 41.5 billion yuan year on year.

III. Loans issued by financial institutions grew steadily

Outstanding loans of all financial institutions in both RMB and foreign currencies stood at 31.5 trillion yuan at end-September, representing growth of 14.7 percent year on year, 2.6 percentage points lower than the growth during the same period in 2007 and representing an increase of 3.7 trillion yuan, or an acceleration of 120.8 billion yuan year on year. In particular, outstanding RMB loans grew by 14.5 percent to 29.6 trillion yuan, 0.4 percentage points higher than the growth at end-June and 2.7 percentage points lower than the growth during the first half of 2007 or a growth of 3.5 trillion yuan from the beginning of the year, representing an acceleration of 120.1 billion yuan year on year. Broken down by institutions, loans of policy banks and joint-stock commercial banks registered a larger acceleration for the first three quarters of 2008. Broken down by periods, loans of policy banks and joint-stock commercial banks were distributed evenly in each quarter, and newly issued loans in the first three quarters totaled 1.33 trillion yuan, 1.12 trillion yuan, and 1.03 trillion yuan respectively, reversing the situation in the previous years when the first half of the year, the first quarter in particular, witnessed a larger increase in newly issued loans. Outstanding foreign currency loans stood at US$269.2 billion at end-September, representing year-on-year growth of 30.9 percent, 3.6 percentage points higher than growth during the same period in 2007 or an increase of US$49.2 billion from the beginning of the year, representing an acceleration of US$12.2 billion. In the second half of 2008, foreign currency loans reversed the previous growth momentum and began to decline. Foreign currency loans decreased by US$6.1 billion on a net basis in the third quarter of the year, resulting from such factors as the weakened expectation of an RMB appreciation, and falling external demand, etc.

Table 1:RMB loans of financial institutions in the first three quarters of 2008

Unit: 100 million yuan

	The first three quarters of 2008		The first three quarters of 2007	
	New loans	Acceleration year on year	New loans	Acceleration year on year
Policy banks	3792	437	3354	1184
State-owned commercial banks	12610	-47	12657	1448
Joint-stock commercial banks	7483	813	6671	1140
City commercial banks	2929	180	2749	387
Rural financial institutions	5431	-251	5682	1214
Foreign-funded financial institutions	850	-264	1114	510

Note: Rural financial institutions include rural cooperative banks, rural commercial banks, and rural credit cooperatives.

Source: The People's Bank of China.

In terms of loan destinations, the growth of household loans moderated somewhat, whereas lending to non-financial institutions and other sectors grew steadily. Outstanding household loans at end-September grew 14.9 percent year on year, 15.4 percentage points lower than the growth during the same period in 2007 and representing an increase of 621 billion yuan from the beginning of the year or a deceleration of 435.9 billion yuan year on year. In particular, outstanding household consumption-based loans grew 368.1 billion yuan from the beginning of the year, representing a deceleration of 319.2 billion yuan and a continuing deceleration in the first half of the year. Outstanding household business-oriented loans grew by 252.9 billion yuan, representing a deceleration of 116.7 billion yuan year on year. Outstanding loans issued to non-financial institutions and other sectors at end-September grew 14.4 percent year on year, with the growth on par with the same period in 2007, an increase of 2.9 trillion yuan from the beginning of the year or an acceleration of 556 billion yuan year on year. In particular, short-term loans decelerated by 4.4 billion yuan year on year, paper financing accelerated by 308.1 billion yuan year on year, and medium- and long-term loans accelerated by 239.2 billion yuan year on year.

The bulk of RMB medium- and long-term loans went to the infrastructure sector, the real estate sector, and the manufacturing sector.[1] In the first three quarters of 2008, new RMB medium- and long-term loans of major financial institutions (including state-owned commercial banks, policy banks, joint-stock commercial banks, and city commercial banks) to the infrastructure sector (transportation, warehousing and postal services, gas, water conservation, environmental protection, and public facility management) and the manufacturing sector stood at 763.4 billion yuan and 213.9 billion yuan respectively, accounting for 43.6 percent and 12.2 percent of all new

[1] According to the National Bureau of Statistics standard definitions of sectors, commercial individual housing loans are not included in real estate loans.

medium- and long-term RMB loans, 12.4 percentage points and 4.2 percentage points higher than the growth during the same period in 2007 respectively. New long-term loans to the real estate sector amounted to 209.7 billion yuan, accounting for 12 percent of all new long-term loans, as opposed to 15 percent in 2007.

In September 2008 the Department of Financial Statistics and Analysis of the PBC conducted an ad-hoc survey on the use of corporate loans by enterprises of various sizes. The results of the survey show that as of end-August 2008, outstanding loans of all financial institutions to small- and medium-sized enterprises stood at 11.4 trillion yuan, an increase of 12.5 percent year on year, accounting for 53.4 percent of all outstanding corporate loans or 38.9 percent of all outstanding loans, down 0.6 percentage points from that recorded at end-2007 and end-August 2007 respectively. Broken down by industries, loans to small-sized enterprises were concentrated in the manufacturing sector (30.2 percent), the wholesale and retail sector (22.2 percent), the real estate sector (8.9 percent), and the agricultural, forestry, and animal husbandry and fishing sector (7.6 percent), with a combined proportion of nearly 70 percent. Loans to medium-sized enterprises were concentrated in the manufacturing sector (28.4 percent), the real estate sector (15.1 percent), the wholesale and retail sector (10.9 percent), water conservation, environmental protection, and public facility sectors (10.4 percent), with a combined proportion of nearly 65 percent. In response to the financing difficulties of small and medium-sized enterprises, the PBC took a range of measures, such as cutting the reserve requirement ratio for small and medium-sized financial institutions and enhancing window guidance, actively guiding and encouraging financial institutions to strengthen credit support to small and medium-sized enterprises, and helping to maintain sound and rapid development of the national economy. All these measures have achieved the initial desired results. The financial institutions will, on the basis of risk controls, continue to strengthen the stock and incremental assets adjustment, establish a long-term effective mechanism to render credit support to small and medium-sized enterprises, and strive to ensure that loans to small and medium-sized enterprises increase more rapidly than other loans.

IV. Base money grew at a stable pace

At end-September 2008, the outstanding balance of base money increased 33.4 percent to 11.7 trillion yuan, representing an increase of 1.6 trillion yuan from the beginning of the year and an acceleration of 0.1 percentage points over the growth during the same period in 2007. Meanwhile, the money multiplier rose slightly from end-June and the expansion capacity of aggregate money remained stable. The excess reserve ratio of financial institutions rose to 2.07 percent at end-September, up 0.12 percentage points from end-June. In particular, the excess reverse ratio of the four state-owned commercial banks, joint-stock commercial banks, and rural credit cooperatives was 1.68 percent, 2.04 percent, and 3.83 percent respectively, and overall liquidity in the financial system was abundant.

V. Lending rates of financial institutions remained stable and edged down

In the third quarter, lending rates of all maturities of financial institutions remained stable and edged down. In July and August, as expectations of an interest-rate hike weakened, lending rates remained generally stable. In September, the PBC cut the benchmark lending rates and lending rates declined marginally. The weighted average interest rate of loans with maturities from six months to one year was 8.38 percent, down 0.31 percentage points from August and down 0.09 percentage points from June. The proportion of loans that applied upward floating rates increased marginally from June to 47.26 percent in September.

Table 2:Average lending rates of financial institutions in the first three quarters of 2008

Unit ： percent

Maturities	1 month	2 months	3 months	4 months	5 months	6 months	7 months	8 months	9 months
Within 6 months	7.06	7.09	7.32	7.47	7.66	7.28	7.31	7.31	7.12
6 months to 1 year	8.33	8.40	8.72	9.15	9.72	8.47	8.58	8.69	8.38
1 to 3 years	7.98	7.99	8.69	9.72	11.99	8.41	8.43	8.47	8.20
3 to 5 years	7.68	7.82	7.98	8.08	7.77	8.04	7.95	8.00	7.91
5 to 10 years	7.66	7.63	7.72	7.74	7.70	7.78	7.73	7.78	7.84
Over 10 years	7.20	7.14	7.27	7.24	7.33	7.37	7.37	7.29	7.41

Source: The People's Bank of China.

Table 3:Shares of loans with rates floating at various ranges in the first three quarters of 2008

Unit: Percent

	Floating downward	At benchmark	Floating upward					
	[0.9， 1]	1	Sum	(1， 1.1)	(1.1， 1.3)	（1.3，1.5]	（1.5， 2）	Above 2.0
January	25.93	29.77	44.30	16.13	14.76	6.06	6.50	0.85
February	26.51	30.04	43.45	15.46	14.22	5.92	6.91	0.94
March	25.46	37.92	36.62	18.77	13.84	2.79	1.11	0.12
April	14.87	21.72	63.42	12.89	15.95	24.40	9.19	0.99

May	10.49	15.87	73.64	8.80	17.49	22.65	7.04	17.66
June	21.60	32.81	45.58	16.40	14.24	6.13	7.66	1.15
July	21.54	30.93	47.53	16.76	15.02	6.37	7.36	2.01
August	18.92	30.46	50.62	17.81	15.79	7.31	8.07	1.64
September	21.59	31.15	47.26	16.35	14.95	6.88	7.37	1.72

Note：The floating range of the interest rate for urban and rural credit cooperatives was [0.9，2.3].

Source: The People's Bank of China.

Affected by movements in domestic fund demand and supply and interest rates on the international market, interest rates of domestic large-value foreign currency deposits and foreign currency loans displayed a declining trend. In September, the weighted average interest rate of 1-year large-value foreign currency deposits was 5.22 percent, down 1.74 percentage points from June; the interest rate of 1-year foreign currency loans was 5.58 percent, down 0.76 percentage points from June.

VI. The RMB exchange rate remained stable

The fundamental role of market demand and supply continued to function well and, in general, the RMB exchange rate appreciated. At end-September, the central parity of the RMB against the U.S. dollar was 6.8183 yuan per U.S. dollar, appreciating by 7.13 percent from the end of 2007; the central parity of the RMB against the euro was 9.9997 yuan per euro, appreciating by 6.67 percent from the end of 2007; and the central parity of the RMB against the Japanese yen was 6.4296 yuan per 100 yen, depreciating by 0.36 percent from the end of 2007. From the exchange rate regime reform on July 21, 2005 to end-September 2008, the RMB accumulatively appreciated by 21.39 percent, 0.14 percent, and 13.63 percent against the U.S. dollar, the euro, and the Japanese yen respectively. Throughout the third quarter, the RMB exchange rate against the U.S dollar was relatively stable, basically in a range between 6.81 yuan per U.S. dollar and 6.85 yuan per U.S. dollar.

Part 2 Monetary Policy Conduct

Since the third quarter of 2008 when the international financial turbulence worsened and uncertainties grew, problems in China's domestic economy became more acute. Against this background, the PBC adjusted monetary policy in a timely and targeted manner, flexibly used policy tools such as open market operations, interest rates, and the reserve requirement ratio, and followed the principle of differentiated treatment for different sectors, guiding new lending to priority and weak sectors such as the agricultural sector, small- and medium-sized enterprises, and the disaster-hit regions. At the same time, the PBC continued to promote the reform of financial institutions, maintained a basically stable RMB exchange rate, improved foreign exchange management, and maintained an aggregate equilibrium.

I. Open market operations were adjusted as necessary to ensure liquidity supply

Since the third quarter of the year, the PBC has appropriately controlled the pace and intensity of open market operations and has continued to improve the proactiveness and flexibility of liquidity management. First, measures were taken to optimize the combination of operational tools and maturity structure. The PBC temporarily halted the issuance of 3-year central bank bills, reduced the frequency of issuance of 1-year and 3-month central bank bills, and expanded the variety of short-term repo transactions in order to ensure liquidity supply. In the third quarter, the accumulated issuance of central bank bills totaled 981 billion yuan and repo operations reached 600 billion yuan; by the end of September, outstanding central bank bills amounted to 4.67 trillion yuan and outstanding repo amounted to 297.6 billion yuan. Second, the interest rates of central bank bills showed a moderately lower trend. To coordinate with the lowered benchmark deposit and lending rates and the reserve requirement ratio, the central bank bills issuance rate showed a downward trend, guiding market expectations and letting the market interest rate balance the supply and demand of liquidity. Third, the PBC carried out treasury cash management when appropriate. In order to strengthen coordination of monetary and fiscal policy and to improve the efficiency of the use of treasury funds, the PBC and the Ministry of Finance deposited 30 billion yuan in 3-month time deposits in commercial banks on July 30 and October 30, 2008 respectively.

II. The reserve requirement ratio was lowered twice

Facing the growing international financial turbulence, the PBC lowered the reserve requirement ratio by 1.5 percentage points in two steps in September and October. Starting from September 25, the reserve requirement ratio was lowered by 1 percentage point for depository financial institutions, with the temporary exception of the Industrial and Commercial Bank of China, the Agricultural Bank of China, the Bank of China, the China Construction Bank, the Bank of Communications, and the Postal Savings Bank of China. In particular, the reserve requirement ratio for financial institutions incorporated in the areas worst hit by the Wenchuan earthquake was cut by 2 percentage points. On October 15, the reserve requirement ratio for deposit-taking financial institutions was cut on average by 0.5 percentage point. These policy moves will help ensure liquidity supply and beef up the financial strength of financial institutions in lending to priority and weak sectors of the economy. In addition, in accordance with the standards for differentiated reserve requirement ratios, the requirement ratios for different institutions were adjusted. All financial institutions that met certain requirements, such as the capital adequacy ratio, were allowed to follow the normal reserve requirement ratio; thusnotably fewer institutions were required to meet the higher ratio.

III. The benchmark deposit and lending rates were lowered three times

In order to brace China for the potential impact of the international financial crisis, the PBC lowered the benchmark deposit and lending rates three times, on September 16, October 9, and October 30 respectively, and lowered the floor interest rate for commercial residential mortgages on October 27, sending signals of securing economic growth and stabilizing market expectations. The 1-year deposit rate was cut cumulatively by 0.54 percentage point, from 4.14 percent to 3.60 percent; the 1-year lending rate was shaved cumulatively by 0.81 percentage point, from 7.47 percent to 6.66 percent.

IV. Window guidance and credit policy guidance was strengthened

Given the changing overall situation, the PBC removed the commercial banks' credit ceilings and guided financial institutions to make lending based on effective demand in the real economy and at an appropriately balanced pace. In line with the principle of differentiated treatment of different sectors, the PBC guided commercial banks to optimize the credit structure while expanding aggregate credit in an effort to strengthen credit support to priority and weak sectors in the economy, such as agriculture, rural areas, and farmers, small- and medium-sized enterprises, and reconstruction in the disaster-hit regions. Lower reserve requirement ratios were applied to financial institutions in rural areas to support their lending to the agricultural sector. At present, the reserve requirement ratio for RCCs with a higher proportion of agricultural-related loans and relatively fewer assets is 6.5 to 7.5 percentage points lower than that for the large national commercial banks. Guidance was also provided for financial institutions to set up credit approval procedures that reflect the characteristics of small- and medium-sized enterprises in order to explore long-term solutions to providing financial support to these enterprises. Comprehensive measures were taken to reinforce financial support to financial institutions in the disaster-hit regions so as to beef up their lending capacity. These measures included lower reserve requirement ratios, financial support to trial reform programs, and early withdrawals of special deposits, etc.

Box 1:Further improving the proactiveness of monetary policy

Monetary policy operations have to be adapted to the ever-changing domestic and international macroeconomic conditions in order to smooth out short-term macroeconomic fluctuations. Most importantly, it takes time for monetary policy to take effect, as monetary policy operations have to go through complicated transmission links before they can affect macro-variables such as prices and output. This means that monetary policy must be "proactive," i.e., when making decisions, policy makers need to take into account the time-lags of policy measures, make forecasts about the future direction of the economy, and take proactive actions.

The PBC has been committed to improving the proactiveness of monetary policy operations and has paid close attention to monitoring, analysis, and research of economic and financial developments. As a result, the new developments and new issues in the economy were foreseen and identified in a timely manner; targeted ex ante adjustments and fine-tuning measures were taken in response to the changing economic conditions. In recent years, PBC policy making has taken into consideration the development of the domestic and international situations and progress has been made to increase policy flexibility against possible shocks and the proactiveness and effectiveness of macroeconomic adjustments, making positive contributions to economic and financial stability.

In the latter half of 2002, China's economy entered a new round of booming. When the economy was plagued with uncertainties brought about by the SARS epidemic and the war in Iraq in early 2003, and faced increasing liquidity due to the purchase of foreign exchange and the mounting credit expansion pressures, in April the PBC decided to adjust monetary policy operations, intensify fine-tuning, and started to issue central bank bills to withdraw liquidity. In September, the PBC raised the reserve requirement ratio from 6 percent to 7 percent. These measures achieved favorable outcomes. In 2003, the GDP grew at 10 percent, compared to 9.1 percent in 2002, and the CPI remained stable at 1.2 percent.

In 2007 signs of overheating became apparent and inflationary pressures increased, with the GDP in the first half of the year growing by 12.2 percent from 11.6 percent in 2006 and the CPI growing by 3.2 percent from 1.5 percent in 2006. During this period, the monetary policy stance changed from “sound” to “moderately tight,” and later on to “tight.” Starting from the third quarter of 2007 and all the way through to the fourth quarter, monetary policy was tightened. In the whole year, the reserve requirement ratio was raised on ten occasions by 5.5 percentage points and the 1-year deposit rate and lending rate were raised on six occasions by 1.62 percentage points to 4.14 percent and by 1.35 percentage points to 7.47 percent respectively. These measures effectively reined in inflation, with the CPI reaching its peak in February 2008 and thereafter continually heading downward.

In 2008 the domestic and international situations began to change gradually. China was hit by serious natural disasters such as the Wenchuan earthquake; the U.S. sub-prime mortgage crisis evolved into a once-in-a-century international financial crisis. Facing these developments, China’s macroeconomic policy stance changed from “preventing overheating and inflation” to “safeguarding growth and controlling inflation,” and further on to “flexible and prudent.” Monetary policy was adjusted accordingly starting from July 2008. First, sterilization through open market operations was reduced, with the issuance of 3-year central bank bills halted and the frequency of 1-year and 3-month issuances lowered, leading to lower issuing rates of central bank bills and ensuring liquidity supply in the market. Second, the PBC cut the benchmark interest rates three times and the reserve requirement ratio two times in September and October, sending signals of securing economic growth and stabilizing market expectations. Third, credit limits on commercial bank lending were removed. Fourth, the PBC continued differentiated treatments to different sectors, encouraging financial institutions to increase lending to the disaster-hit regions, the agricultural sector, and small- and medium-sized enterprises. Fifth, the PBC lowered the floor interest rates on residential mortgages, lending support to households willing to purchase their first ordinary homes or to upgrade to bigger ordinary homes. Generally, the adjustment of monetary policy gradually took effect, with money and credit supply growing in a stable manner, ample liquidity in the banking system, and the financial sector operating smoothly and soundly. The credit structure has been improved and lending to the disaster-hit region, the agricultural sector, and small- and medium-sized enterprises has expanded gradually. In the first three quarters of 2008, new lending to the earthquake-hit areas of Sichuan and Gansu provinces reached 214.1 billion yuan, up by 56.6 billion yuan year on year and up by 48.4 billion yuan compared to the total during the previous year. Agricultural-related lending increased by 318.8 billion yuan and was 12.9 billion yuan more than that during the same period of the previous year. Some financial institutions have set up departments specializing in lending to small- and medium-sized enterprises and have begun trial programs. Some of these programs have generated positive results and there are plans for them to expand.

At present, the international financial market remains in turmoil with the serious fallout on the global economy. The negative impacts on China's economy are felt and intensifying. Against this background, it is imperative to fully and thoroughly implement the principles of the 17th CPC National Congress and the 3rd Plenary Session of the 17th CPC National Congress, which included thoroughly implementing the scientific approach to development and maintaining flexible and prudent macroeconomic policies in order to effectively brace for the severe impact of the international financial crisis. In the next stage, the PBC will implement a moderately loose monetary policy, improve thepro-activeness, focus, and flexibility of financial management, and initiate monetary policy operations in accordance with the changing situation and with a proper priority, pace, and intensity, putting emphasis on maintaining monetary and financial stability and promoting sound and rapid economic development.

V. Reform of financial institutions was promoted steadily

Progress continued to be made in the shareholding reform of state-owned commercial banks. After the shareholding reform, the Industrial and Commercial Bank of China, the Bank of China, the China Construction Bank, and the Bank of Communications continued to improve corporate governance, business transformation, and profitability. By the end of September 2008, their capital adequacy ratios reached 12.6 percent, 13.9 percent, 12.1 percent, and 13.8 percent, their NPL ratios were 2.4 percent, 2.6 percent, 2.2 percent and 1.8 percent, and their profits before taxes were 120.6 billion yuan, 80.3 billion yuan, 108.7 billion yuan and 29.6 billion yuan respectively, with all measures better than those in the previous year. The sub-prime mortgage-related assets of these four banks constituted a very small proportion of their total assets and provisions have been made according to prudential regulation.

The shareholding reform of the Agricultural Bank of China formally began. In late October 2008, the State Council basically approved the *Guidelines for the Shareholding Reform of the Agricultural Bank of China*, signaling the launch of the reform. According to the guidelines, the reform will focus on establishing a modern financial enterprise system based on servicing agriculture, rural areas, and farmers as its main direction, steadily carrying out the reform and transforming the bank into a modern commercial bank featuring adequate capital, good governance, strict internal controls, safe operations, good services, excellent performance, and strong innovativeness and international competitiveness. Bank operations will meet the financial needs of social and economic development in the rural areas, further strengthen its market position and responsibilities that concentrate on the agricultural sector, maintain and develop business units and operations in the rural regions, establish a county-level management system, and increase credit support to the agricultural sector. The bank will continue to deepen internal reforms, strengthen management, transform operational mechanisms, and establish good corporate governance and a risk-control system in order to serve the reform and development of the rural areas.

The reform of policy banks has been promoted steadily. The guidelines and a detailed implementation plan for the reform of the State Development Bank have been approved and the commercial-based reform of the bank has been advanced at a steady pace. At present, preparations for the shareholding reform are underway. The Agriculture Development Bank of China stepped up efforts to deepen internal reform, strengthen risk management and the internal control mechanism, and steadily develop new business-lines, thus creating conditions for a comprehensive reform. At present, the PBC, together with other government agencies, is deliberating issues related to the reform and development of the Agriculture Development Bank of China.

The reform of the RCCs also underwent important progress and produced good results. The RCCs witnessed notable improvement in their asset quality and profitability. At end-September, according to the four-category loan classification system, the outstanding NPLs and NPL ratio of the RCCs stood at 303.4 billion yuan and 8.2 percent respectively, down by 211.3 billion yuan and 28.7 percentage points. The profitability of the RCCs went up year by year since it turned positive for the first time in the past decade in 2004. For the first 9 months of 2008, realized profits increased by 14.3 billion yuan from the previous year to 49.8 billion yuan. With more solid financial strength, the RCCs stepped up financial services in the rural areas. By end-September, the outstanding loans of the RCCs reached 3.7 trillion yuan, accounting for 12.4 percent of the total credit of financial institutions, up from 10.6 percent at the beginning of the reform. Their outstanding agricultural loans increased to 1.7 trillion yuan, making up 46 percent of their total loans and 94 percent of the total agricultural credit of financial institutions, up from 40 percent and 81 percent respectively at the beginning of the reform. The reform of the property rights regime advanced smoothly and corporate governance took shape. By end-September, 20 rural commercial banks, 144 rural cooperative banks, and 1,851 rural credit cooperatives with a unified legal entity at the county (city) level had been established nationwide. Some of the RCCs have accumulated positive experiences in clarifying property rights and improving governance.

VI. Reform of the foreign exchange management system was accelerated

Efforts have been made to accelerate the foreign exchange management system reform and to strengthen monitoring, analysis, and management of cross-border capital flows so as to promote a BOP equilibrium. First, in order to help financial institutions deal with the current financial market turbulence, measures were adopted to guide them to strike an appropriate balance in the safety, liquidity, and profitability of their investment. Second, the newly revised *Regulations on the Foreign Exchange System of the People's Republic of China*, was released in an attempt to further strengthen foreign exchange management according to the laws and regulations and to promote balanced management of capital inflows and outflows. Third, a network verification system was established for the surrender of foreign exchange from exports, and trade-related credits were registered and managed so as to strengthen monitoring and data collection of short-term foreign debt and to prevent irregular foreign exchange flows under the trade accounts. Fourth, a foreign direct investment information system was implemented to step up management of the surrendering of foreign exchange from foreign-funded enterprises. Fifth, small currency exchange outlets were set up on a trial basis to facilitate exchange of foreign currencies for individuals. Sixth, non-resident purchases of foreign exchange were included in the individual foreign exchange purchase and surrender system to strengthen verification of the authenticity of foreign exchange purchases by non-residents.

Part 3 Financial Market Analysis

Since the third quarter of 2008 the financial market has continued to perform in a sound and stable manner, featuring good performance of bond issuances, brisk activities on the money market and the bond market, and a downward shift of the bond yield curve. The institutional building of the financial market continued to improve.

In the first three quarters, corporate bond financing in the financing structure of the domestic non-financial sector (including households, enterprises, and the public sector) grew at a rapid pace, playing a larger role in allocating social funds, and the share of equity financing and government securities financing declined. Affected by the drastic fluctuations in the stock market, equity financing decreased by 47.9 billion yuan on a year-on-year basis. The redemption of government securities at maturity accelerated by 80.5 billion yuan from the increase in the previous year, and the amount of net financing in this category declined year on year.

Table 4:Financing by domestic non-financial sectors in the first three quarters of 2008

	Volume of financing (RMB 100 million yuan)		As a percentage of total financing （%）	
	First three Quarters of 2008	First three Quarters of 2007	First three Quarters of 2008	First three Quarters of 2007
Financing by the domestic non-financial sectors	43223	41700	100.0	100.0
Bank loans	37089	35881	85.8	86.0
Equities 1	2876	3356	6.7	8.1
Government securities 2	642	1392	1.5	3.3
Enterprise bonds 3	2616	1071	6.1	2.6

Notes: 1.Equity financing does not include financing by financial institutions on the stock market.

2. Government securities financing does not include special government securities.

3. Enterprise bonds include bonds issued by enterprises, short-term financing bills, medium-term bills, and corporate bonds.

Source: The People's Bank of China.

I. An overview of financial market analysis

1. Brisk transactions on the money market were accompanied by a slight decrease in interest rates

Transactions on the money market were active, and the average daily transactions on the bond repo market and the inter-bank borrowing market grew at a rapid pace. In the first three quarters of 2008 the turnover of bond repos on the inter-bank market registered 40.6 trillion yuan, with the daily turnover averaging 216 billion yuan and a year-on-year growth of 27.9 percent. The turnover of inter-bank borrowing reached 11.3 trillion yuan, with the daily turnover averaging 60.3 billion yuan and a growth of 77.9 percent year on year. Most of the transactions on the repo and borrowing markets were overnight products, accounting for 59.3 percent and 69.8 percent respectively. The turnover of government bond repos on the stock exchanges increased 22.3 percent year on year to 1.6 trillion yuan. Lenders on the market were diversified. In particular, state-owned commercial banks reduced their lending whereas other commercial banks increased their supply of funds; and funds borrowed by foreign financial institutions decreased from the previous year.

Table 5: Fund flows among financial institutions in the first three quarters of 2008

Unit: 100 million yuan

	Repo		Inter-bank borrowing	
	First three quarters of 2008	First three quarters of 2007	First three quarters of 2008	First three quarters of 2007
State-owned commercial banks	-73725	-97167	23300	3431
Other commercial banks	14296	5497	-30951	-17431
Other financial institutions	36063	64494	577	8466
Of which：Securities and fund management companies	6304	10794	2877	5513
Insurance companies	13739	19832	—	—
Foreign financial institutions	23504	27176	7069	5534

Note: A negative sign indicates a net fund outflow; a positive sign indicates a net fund inflow.

Source: The People's Bank of China.

Since the beginning of 2008, the money market interest rate displayed a slightly inverse V-shaped pattern. Affected by such factors as strong expectations of inflation, themarket interest rate went up. In the third quarter, with the inflation expectations weakened and the central bank appropriately handling the strength and pace of macroeconomic management, the market interest rate was relatively stable and declined marginally. In September, the weighted average interest rates of pledged bond repo and inter-bank borrowing were 2.90 percent and 2.89 percent respectively, and both saw a decrease of 0.18 percentage points from June.

The short-end Shibor fluctuated downward, with the fluctuations moderating from the previous quarter. At end-September, the Shibor with maturities of one week and two weeks were 3.2467 percent and 3.3071 percent respectively, both decreasing by 5 basis points from June, and the fluctuations narrowed by 112 and 106 basis points respectively from that in the second quarter of the year. Due to expectations of interest rate cuts, the medium- and long-end Shibor fell modestly. At end-September, the 3-month and 1-year Shibor stood at 4.3047 percent and 4.6720 percent respectively, down 18 and 4 basis points respectively from June.

Interest rate swap transactions continued to grow, bond forward transactions increased notably, and the turnover of forward interest rate agreements declined. In the first three quarters of 2008, 890 interest rate swaps were conducted based on the Shibor, with a turnover of 74.82 billion yuan, accounting for 21 percent of all interest rate swaps. All forward interest rate agreements were based on the 3-month Shibor.

Table 6: Transactions of interest rate derivatives

	Bond forward		Interest rate swap		Interest rate forward	
	Transactions	Amount(100 million yuan)	Transactions	Notional principal amount (100 million yuan)	Transactions	Notional principal amount (100 million yuan)
2005	108	177.99	—	—	—	—
2006	398	664.46	103	355.7	—	—
2007	1238	2518.09	1978	2186.9	14	10.5
Q1, 2008	441	1512.72	591	837.16	24	14.1
Q2, 2008	313	1208.32	944	1265.93	44	34.5
Q3, 2008	371	1524.00	1263	1343.00	11	24.0

Source: China Foreign Exchange Trading System.

2. Transactions on the bond market were active and bond issue rates fell after climbing

Due to factors such as funds flowing back into the banking system, spot bond trading was active on the inter-bank market. The turnover in the first three quarters of 2008 totaled 26.4 trillion yuan, with the average daily turnover hitting a historic high of 140.2

billion yuan, representing year-on-year growth of 1.5 times. The turnover of government bond spot trading on the stock exchanges registered 124 billion yuan, 31.5 billion yuan more than that during the same period of the previous year. On the inter-bank spot bond market, except for commercial banks that sold 1.3 trillion yuan on a net basis, other financial institutions were net purchasers, with the net purchases of state-owned commercial banks and other financial institutions standing at 448.2 billion yuan and 639.4 billion yuan respectively.

In the first three quarters of 2008, both the inter-bank bond index and the stock exchange bond index displayed an overall upward trend. The inter-bank bond index climbed 7.0 percent from 114.8 points at the beginning of the year to 122.9 points at end-September; the stock exchange T-bond index increased 5.0 percent from 110.8 points at the beginning of the year to 116.3 points at end-September. In particular, both the inter-bank bond index and the stock exchange bond index rose rapidly in the third quarter, with the increase reaching 5.3 percent and 2.6 percent respectively.

In the first three quarters, the yield curve of government securities on the inter-bank market moved down and was flattened particularly downward in the third quarter. This is mainly due to the weakening expectations from the introduction of tight policies under the policy effects and market changes both at home and abroad, which resulted in a continued decrease in the yields of bonds, in particular medium and long-term bonds.

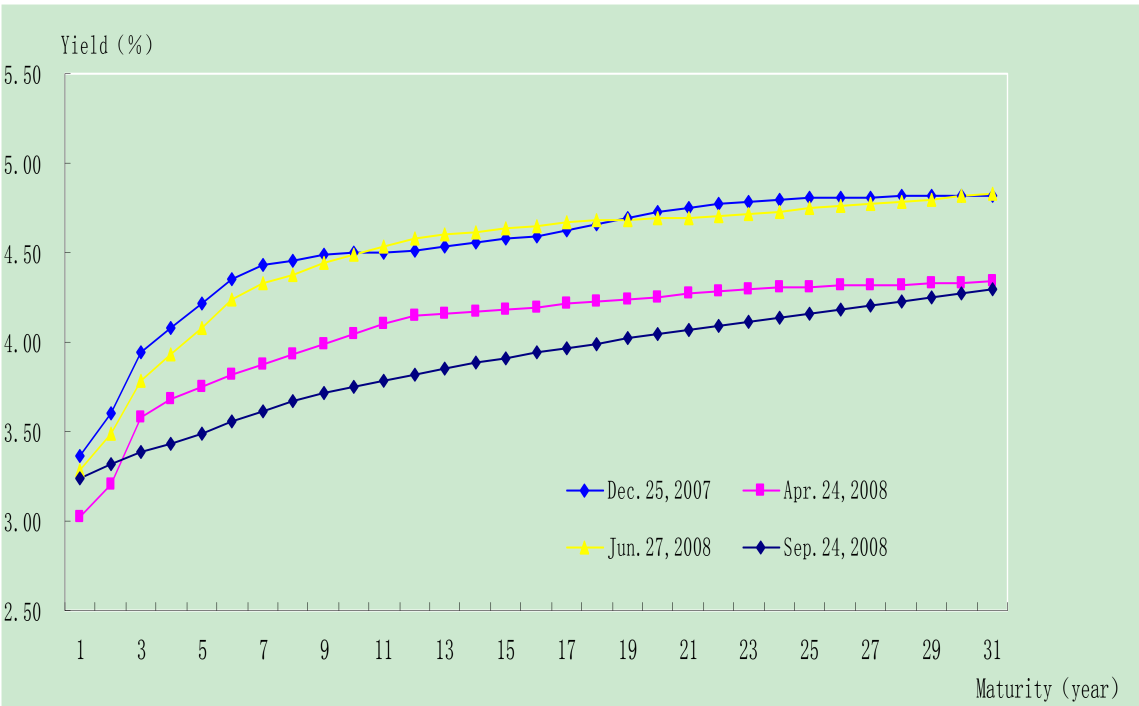

Figure 1: Yield curves of government securities on the inter-bank bond market in the first three quarters of 2008

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

The issuance of bonds was stable, with the issue rates declining after climbing. In the first three quarters, a total of 1.96 trillion yuan of bonds (excluding central bank bills and special government securities) was issued, 192.9 billion yuan more than that issued in the same period of the last year. Among this total, the issuance of enterprise bonds increased rapidly, with the financing channels obviously expanding; the issuance of government securities was flat with that recorded the previous year; and the issuance of policy financial bonds decreased. In terms of their maturity structure, the proportion of issuance of bonds with a maturity of less than 5 years was 64.4 percent, up 2.1 percentage points year on year, among which the proportion of issuance of bonds with a maturity of less than 1 year was 6.2 percentage points lower than that during the same period of the last year. The issuance of financial bonds by commercial banks increased steadily. Since the beginning of 2008, a number of commercial banks have supplemented their capital by issuing subordinated bonds, with the issuance of subordinated bonds reaching 53.2 billion yuan, 15.55 billion yuan more than the total issuance in 2007. At end-September, outstanding bonds deposited with the China Government Securities Depository Trust & Clearing Co. Ltd. totaled 14.5 trillion yuan, a year-on-year increase of 26 percent, down 3.5 percentage points compared with the growth recorded a year earlier.

Table 7: Issuances of major bonds in the first three quarters of 2008

Types of bonds	Issuances (100 million yuan)	Year-on-year growth(%)
Government securities	6228	0.9
Policy financial bonds	7099	-2.9
Bank subordinated bonds and hybrid capital bonds	532	74.1
Bank ordinary bonds	250	−35. 3
Enterprise bonds	5281	58.6
Asset-backed securities	165	277. 3

Source: The People's Bank of China.

The Shibor played a greater role in the pricing of bonds. In the first three quarters, all fixed-rate enterprise bonds were issued based on the Shibor rates. A total of 128 short-term financing bills was issued based on the Shibor rates, amounting to 146.82 billion yuan and accounting for 50 percent of the total issuance. Fourteen medium-term bills based on the Shibor rates were issued, amounting to 36.1 billion yuan and accounting for 49 percent of the total issuance. Three floating-rate bonds based on the

Shibor were issued, namely policy financial bonds, commercial bank subordinated bonds, and enterprise bonds, totaling 12.2 billion yuan.

3. Growth of paper financing grew rapidly

In the third quarter of 2008, the acceptance of commercial bills maintained relatively rapid growth and paper financing transactions were active. In the first three quarters, a total of 5.1 trillion yuan of commercial bills was issued by the corporate sector, up 14.9 percent year on year. Discounted bills totaled 9.5 trillion yuan, up 18.5 percent year on year. Rediscounted bills totaled 9.33 billion yuan, flat with that during the same period of the last year. At end-September, outstanding commercial bill acceptances amounted to 3.1 trillion yuan, up 19.0 percent year on year. Outstanding bankers' acceptances totaled more than 3 trillion yuan, up 19.2 percent year on year. Outstanding paper financing stood at 1.4 trillion yuan, down 8.5 percent on a year-on-year basis. In the first three quarters, paper financing increased by 160.1 billion yuan, an acceleration of 308.1 billion yuan from a year earlier, and the proportion of new paper financing escalated to 4.6 percent in new loans. Outstanding rediscounted bills amounted to 4.4 billion yuan, down 21.6 percent year on year.

As an important financing instrument of the small and medium enterprises (SMEs), paper financing accounted for a large share of their total financing. Commercial bills were mainly issued by large enterprises, and the SMEs that provide support services for large and medium-sized enterprises were usually the ultimate bearers and applicants for the discount. Active paper financing was conducive to expanding the financing channels of enterprises and supporting the development of SMEs.

4. The stock index tumbled amid fluctuations

Since the beginning of 2008, affected by the notably weakened market confidence, the stock market witnessed large fluctuations, with the transactions shrinking substantially. In the first three quarters, the total turnover of the Shanghai and Shenzhen Stock Exchanges amounted to 21.6 trillion yuan, a decrease of 15.5 trillion yuan year on year, and the daily turnover averaged 118 billion yuan, down 42.1 percent year on year. At end-September, market capitalization totaled 5.0 trillion yuan, down 46.2 percent and 16.1 percent respectively from that at end-2007 and end-June 2008.

At end-September, the Shanghai Stock Exchange Composite Index and the Shenzhen Stock Exchange Composite Index closed at 2294 points and 614 points respectively, down 56.4 percent and 57.6 percent respectively from the beginning of 2008. With the stock market going down amid large fluctuations, the average P/E ratios of A-shares on the Shanghai and Shenzhen Stock Exchanges declined from 59 and 72 at end-2007 to 19 at end-September.

Stock market financing declined. According to preliminary statistics, in the first three quarters of 2008, a total of 287.6 billion yuan was raised by Chinese enterprises (including financial institutions) through IPOs, secondary offerings, rights issues, and the issuance of convertible bonds on equity markets both at home and abroad, 246.9 billion yuan less than that during the same period of the last year. Among this total, 251.7 billion yuan was raised through IPOs and rights issues on the A-share market, 217.4 billion yuan less than that during the same period of the last year.

5. Premium income in the insurance industry increased rapidly

In the first three quarters of 2008 the total premium income in the insurance industry amounted to 794 billion yuan, up 49.0 percent year on year or an acceleration of 25.4 percentage points. Among this total, life insurance premium income increased by 63.0 percent, an acceleration of 41.9 percentage points from a year earlier; and property insurance premium income rose 18.6 percent. Claim and benefit payments in the insurance industry amounted to 222.7 billion yuan, 58.4 billion yuan more than that during the same period of the last year, representing a year-on-year growth of 35.5 percent. In particular, the growth of payments of property insurance and life insurance amounted to 28.1 billion yuan and 26.2 billion yuan respectively, up 40.2 percent and 32.2 percent over the previous year.

The growth of the total assets in the insurance industry moderated as a result of an evident deceleration in investment assets including equities. At end-September, total assets amounted to 3.19 trillion yuan, an increase of 14 percent year on year and a deceleration of 40.5 percentage points. In particular, investment-type assets grew 19.0 percent year on year, a deceleration of 48.9 percentage points; bank deposits fell by 4.5 percent from a year earlier, a deceleration of 37.4 percentage points.

Table 8: Use of insurance funds at end-September 2008

	Outstanding balance (100 million yuan)		As a share of total assets (%)	
	End-September, 2008	End- September, 2007	End-September, 2008	End- September, 2007
Total assets	31854	27954	100.0	100.0
Of which:Bank deposits	7040	7368	22.1	26.4
Investment	21722	18258	68.2	65.3

Source: The China Insurance Regulatory Commission.

6. The foreign exchange market developed in a sound manner and RMB swap transactions were active

The number of participants in the inter-bank foreign exchange market increased further. The spot foreign exchange market operated smoothly and the dominant role of OTC transactions was strengthened. RMB swap transactions were active, and the trading volume of currency pairs dropped notably. Because market members enhanced their awareness of using financial derivatives to hedge risks and the RMB exchange rate floated in both directions with strengthened flexibility, the RMB foreign exchange swaps traded briskly. In the first three quarters, the turnover of the RMB foreign exchange swap market totaled USD 328.3 billion, an increase of 40.3 percent year on year, and trading activities focused on products within three months (including overnight products). The turnover of the RMB foreign exchange forward market totaled USD15.8 billion, an increase of 5.6 percent year on year. The turnover of eight currency pairs decreased by 29.7 percent year on year to USD 50 billion, with transactions in the USD/HKD and EUR/USD currency pairs accounting for 77.6 percent of the total trading volume.

II. Financial market institutional building

1. Delivery versus Payment (DVP) settlement was launched on the inter-bank bond market

In July 2008 the PBC issued an announcement describing channels for DVP settlement[2] and related arrangements for non-banking institutions, stipulating the provisions for DVP settlement on the inter-bank bond market in a comprehensive manner based on the experiences of the commercial banks in DVP settlement. The rules of DVP settlement for non-banking institutions took effect on August 1, 2008, signaling the launch of DVP settlement on China's inter-bank bond market and representing major progress in bond market infrastructure building. This will improve settlement efficiency, reduce and control settlement risks, and provide technical support for the efficient and safe operation of the bond market.

2. Fundamental institutional building of the securities market made progress

First, the building of an information disclosure system for listed companies was further advanced. In August 2008, the China Securities Regulatory Committee (CSRC) issued the *Ad hoc Rules on Information Disclosure of Commercial Banks* to regulate and improve the transparency of information disclosure of commercial banks, to stabilize market expectations, and to concretely safeguard the legitimate rights of investors. Second, the building of a sound operating mechanism in the stock market was strengthened. In August, the CSRC revised Article 63 of the *Administrative Rules on the Acquisition of Listed Companies*, which enhanced the flexibility of the controlling shareholders of listed companies by increasing their shareholding in line

[2] DVP refers to a means of settlement whereby securities and funds are delivered against one another simultaneously. In November 2004 DVP settlement on China’s inter-bank bond market was carried out among commercial banks.

with the principles of openness, fairness, and equity. This will be conducive to regulating the behavior of controlling shareholders by increasing shareholding and will help the market fully assess the intrinsic value of listed companies whose shareholders increased their shareholding so as to safeguard market stability. Third, the trading modes of securities were steadily improved. According to the principle of steady promotion based on the experiences of pilot companies, the CSRC introduced the margin trading business for pilot securities companies, which, on the basis of controllable risks, will help improve the price discovery of the market, increase the liquidity in the securities market, and provide an instrument for investors to hedge market risks.

3. The insurance protection fund was further improved

In September 2008 the China Insurance Regulatory Committee (CIRC), Ministry of Finance, and the PBC jointly released the *Administrative Rules on the Insurance Protection Fund* (hereinafter referred to as the *Rules*), which clearly state the nature of the insurance protection fund, and revised the management system, payment basis, payment scope and ratio, and investment channels of the fund. The issuance of the *Rules* further improved the insurance protection fund system, regulated the operation of the fund, and provided a solid basis and guarantee for protecting the legitimate rights of policy holders, improving insurance supervision and preventing related risks.

Part 4 Macroeconomic Analysis

I. Global economic and financial developments

At the current juncture, fluctuations in international financial markets have heightened, the world economy has slowed down notably, and more uncertain and destabilizing factors have emerged in the international economic environment. The U.S. sub-prime crisis has evolved into a financial crisis and has spilled over to Europe and the world at large, possibly dealing a severe blow to the real economy worldwide. In November the International Monetary Fund projected that world economic growth in 2008 would be 3.7 percent, much lower than the actual growth of 5.0 percent recorded in 2007. According to the forecast, economic growth of the U.S., the euro area, and Japan would drop from 2.0 percent, 2.6 percent, and 2.1 percent in 2007 to 1.4 percent, 1.2 percent, and 0.5 percent respectively. The World Trade Organization predicted that world trade growth in 2008 would hit its lowest point since 2002.

1. Economic development of the major economies

The U.S. has slid into a serious financial crisis, and the real economy is facing great downside risks. Since the third quarter, affected by the substantial fall in individual consumption and the reduced export growth, the U.S. economy contracted to an annualized month-on-month GDP growth of –0.3 percent,[2] the slowest growth since the third quarter of 2001. The job market continued to deteriorate, and the unemployment rate in the three months of the third quarter stood at 5.7 percent, 6.1 percent (the highest in the past five years), and 6.1 percent respectively, representing a substantial rise from the same period of the previous year. Trade deficits in goods and services widened slightly, amounting to US$478.1 billion in the first eight months, an increase of US$7.09 billion compared with the same period of the last year. Fiscal deficits soared due to the economic slump, the massive economic stimulus package, and the financial rescue plan, and the federal budget deficit reached a historical high of US$455 billion in the 2008 fiscal year ending on September 30. Inflationary pressures eased, with the CPI in the three months of the third quarter registering 5.5 percent (the highest since February 1991), 5.4 percent, and 4.9 percent respectively year on year, averaging 5.3 percent. Though this figure is much higher than the 4.3 percent CPI in the previous quarter, it represents the first month-on-month decline in the past two years.

[2] The revised GDP growth in the fourth quarter of 2007 was –0.2 percent, the first negative growth since the third quarter of 2001 (-1.4 percent), while the revised GDP growth in the first quarter of 2008 and the second quarter of 2008 was 0.9 percent and 2.8 percent respectively.

The economy in the euro area slowed down. Affected by the simultaneous slowdown in consumption, investment, and exports, GDP in the second quarter of 2008 grew only by 1.4 percent year on year, or a seasonally adjusted annualized growth of –0.2 percent month on month, the first negative growth since the birth of the euro area. Unemployment rates edged up to 7.4 percent, 7.5 percent, and 7.5 percent in the three months of the third quarter, averaging 7.5 percent, an acceleration of 0.1 percentage points from that in the previous quarter. The trade deficit widened notably. The accumulated trade deficit in the first eight months reached 2.4 billion euros, in contrast to a surplus of 16.5 billion euros in the same period of 2007. Inflationary pressures eased slightly, with the Harmonized Index of Consumer Prices (HICP) up 4.0 percent (the highest since the founding of the euro area), 3.8 percent, and 3.6 percent year on year in the three months of the third quarter, averaging 3.8 percent. Though these figures were still higher than the inflation target of 2 percent set by the European Central Bank (ECB), they represented a notable slowdown in month-on-month terms.

The Japanese economic slump continued to deepen. Affected by weak household consumption and fixed-asset investment, and considerable contraction of industrial production and stagnation of export growth, the annualized month-on-month GDP growth in the second quarter stood at –3.0 percent, witnessing the largest deceleration since the third quarter of 2001. Unemployment rates continued to climb, registering 4.0 percent (the highest level since June 2006), 4.2 percent, and 4.0 percent in the three months of the third quarter, averaging 4.1 percent, much higher than the figures in the previous quarter. The trade surplus fell substantially as a result of reduced external demand. The trade surplus in the first three quarters reached 2.8 trillion yen, about 5.4 trillion yen less than that in the same period of the last year. August saw an enormous deficit and a historically high deceleration in exports to the U.S. Inflationary pressures eased slightly, posting 2.3 percent (the highest in the past ten years), 2.1 percent, and 2.1 percent in the three months of the third quarter, averaging 2.2 percent. Though these figures represented an obvious hike from the average CPI of 1.4 percent in the second quarter, a downward trend began to emerge.

The major emerging market economies and developing countries (regions) experienced varying slowdowns across the board, with mounting instability. With the unfolding adverse impact of the weakening external demand and the worsening environment for growth in the world economy caused by the recessions in the developed economies, most major emerging market economies and developing countries (regions) experienced a notable fall in exports, reduced industrial growth, a substantial slowdown in economic growth, and accelerated capital outflows, and some small open economies were severely hit. Though inflation in some emerging market economies and developing economies eased as a result of lower energy and grain prices in the international market, those economies generally faced relatively high inflation and will face economic and social pressures in the short run. Moreover, the escalating financial crisis will wreak havoc on the stock markets and exchange rates of the emerging markets and developing economies, heightening uncertainties in capital flows, in particular risks of capital outflows.

2. Global financial market development

Since the third quarter of 2008 the international financial market has become more volatile due to the escalating financial crisis and the world economic slowdown.

The exchange rates between the major currencies fluctuated in a widened band, and the U.S. dollar became stronger against the other major currencies. Since mid-July, due to the better performance of some economic indicators and in anticipation of a rate hike by the Federal Reserve, investors built up massive dollar asset positions. This, coupled with a weaker euro and yen due to the bleak economic outlook of the euro area and Japan, provided a strong boost to the dollar. The euro/dollar rate reached 1.3985 dollar per euro, and in the third quarter, the dollar appreciated by 12.66 percent against the euro compared to that in the second quarter. However, since mid-September, due to the crisis on Wall Street and concern over the accelerating inflation stoked by the fiscal deficits as a result of the US$700 billion rescue plan, the dollar pulled back and then rebounded. On September 30, the euro/dollar rate closed at 1.4102 dollar per euro, representing an appreciation of the dollar by 10.49 percent against the euro over the second quarter, while the dollar/yen rate closed at 106.03 yen per dollar, indicating a 0.06 percent depreciation of the dollar against the yen.

The U.S. dollar Libor on the London inter-bank market climbed up after a drastic hike in mid-September. In July and August, the U.S. dollar Libor remained stable and edged down. Thereafter, the Libor rate continued to rise after a jump on September 17 affected by the escalating U.S. sub-prime crisis and the liquidity crunch on the money market. The 1-year dollar Libor gained 0.65 percentage points from the end of the second quarter to close at 3.96 percent on September 30. The Euribor fluctuated slightly. Due to the rate hike by the European Central Bank and heightened international financial market turmoil, the Euribor fluctuated, with the 1-year Euribor reaching 5.495 percent on September 30, 0.11 percentage points higher than that at the end of the second quarter.

In general, major bond yields fell. After the Fannie Mae and Freddie Mac crisis erupted in July, a large amount of capital flew into the U.S. T-bond market as a safe haven, shoring up T-bond prices and pushing the yield curve to plummet. However, in mid-September, the escalating financial crisis weakened market confidence, and as a result capital flew out of the U.S. and European markets during a period of time, steepening the yield curves of the U.S. and European T- bonds before they began to flatten. On September 30, the 10-year T-bond yields in the U.S., the euro area, and Japan closed at 3.823 percent, 4.011 percent, and 1.463 percent respectively, representing decreases of 0.155, 0.612, and 0.132 percentage points respectively from the end of the second quarter.

The major stock markets plunged considerably. Affected by the Fannie Mae and Freddie Mac crisis, the major stock indices nosedived and then edged down amid fluctuations. The crisis on Wall Street triggered by the collapse of Lehman Brothers and other incidents resulted in a worldwide stock market tumble on September 16. The U.S. market saw the biggest daily loss since the September 11 terrorist attack, with all the three indices shedding over 3 percent. The European markets also fell by over 3 percent, and the Asian markets by over 5 percent. In Russia, plummeting oil prices triggered a massive stock sell-off, which forced the regulatory authorities to suspend stock trading. The global stock markets did not stabilize until the U.S. government unveiled its rescue plan and some countries launched policies prohibiting selling short. Thereafter, the markets remained in fluctuation and adjustment. On September 30, the Dow Jones Industrial Average, the Nasdaq, the STOXX50, and the Nikkei 225 closed at 10850.66 points, 2091.88 points, 3038.20 points, and 11259.86 points respectively, down 4.40 percent, 8.77 percent, 9.38 percent, and 16.48 percent respectively from the end of the second quarter.

3. Housing market developments in the major economies

The U.S. housing market remained sluggish. In the third quarter, the U.S. federal housing price index (OFHEO index), after falling by 0.33 percent and 3.53 percent in the first two quarters respectively, shed 4.80 percent year on year. At the same time, the start of new homes continued to slide. In September, this figure continued the downward trend witnessed in July and August, posting 817,000 units, down 31.1 percent year on year. The start of new homes and new homes yet to be sold dropped to 464,000 and 408,000 units respectively in September, down 33.1 percent and 25.4 percent on a seasonally adjusted annualized basis.

The European housing market slid markedly. Housing prices in Britain spiraled downward, with the Halifax housing price index plunging by 5.2 percent after losing 5.1 percent in the second quarter on a quarter-on-quarter basis. According to ECB statistics, the year-on-year growth of the housing commodity price index declined from 2.5 percent in February 2008 to 2.3 percent in July 2008. Housing prices in countries that had experienced a relatively rapid price hike in the past several years, such as Belgium, Ireland, Spain, and France, dropped by a larger margin.

The Japanese housing market continued to slide. Affected by the sub-prime crisis, foreign capital retreated from the Japanese property market, and domestic financial institutions were more cautious in providing financing, and signs of an economic recession emerged. As a result, the housing market cooled down considerably in the third quarter. A survey by the Ministry of Land, Infrastructure, and Transport on *todosuken* (the equivalent to provinces) land prices showed that the national average benchmark land price on July 1 fell 1.2 percent year on year, representing a larger deceleration from the same period of the last year. Land price hikes in the three major city circles decelerated, but land prices in other places in the country continued to drop. The start of new home construction did not present an optimistic outlook.

4. The monetary policy of the major economies

In the third quarter, the U.S. Federal Reserve kept the target Fed fund rate unchanged at 2 percent. The ECB raised the interest rate by 25 basis points on July 3, which meant that the minimum bid rate on the main refinancing operations, the marginal interest rate on deposit facilities, and the marginal interest rate on lending facilities were 3.25 percent, 5.25 percent, and 4.25 percent respectively. The Bank of Japan (BOJ) maintained the uncollateralized overnight call rate at 0.5 percent. The Bank of England (BOE) kept the official interest rate at 5 percent. Russia, India, Brazil, Thailand, Indonesia, South Korea, and other emerging market economies raised interest rates marginally in order to curb inflation.

On October 8, against the backdrop of the deteriorating international financial crisis and the increasing risks of an economic recession, the U.S. Federal Reserve, the ECB, the BOE, and the central banks of Canada, Sweden, and Switzerland announced a coordinated interest rate cut by 50 basis points. Though the BOJ did not participate in the rate cut, it expressed its strong support for this coordinated action by the six central banks. Thereafter, some emerging market economies such as Hong Kong, South Korea, India, and the Gulf countries followed suit. On October 29, the U.S. Federal Reserve announced another rate cut by 50 basis points to 1 percent. On October 31, the BOJ lowered the uncollateralized overnight call rate by 20 basis points to 0.3 percent, the first rate cut since February 2007. On November 6, the BOE slashed the benchmark interest rate by 150 basis points to 3 percent, and on the same day the ECB announced a rate cut by 50 basis points, which meant that the minimum bid rate on the main refinancing operations, the marginal interest rate on deposit facilities, and the marginal interest rate on lending facilities were 2.75 percent, 3.75 percent, and 3.25 percent respectively.

Box 2:Strengthened cooperation among the central banks to deal with the international financial crisis

The U.S. sub-prime crisis has evolved into an international financial crisis, and turbulence in global financial markets has worsened. On April 4, 2007, the New Century Financial Corporation filed for bankruptcy, signaling the start of the sub-prime crisis. With a number of U.S. hedge funds suffering huge losses from their investments in sub-prime-related mortgages, several sub-prime mortgage companies halted business or went bust. In the latter half of July 2007, the sub-prime crisis began to spread to Europe and other regions, characterized by increasing write-downs of sub-prime-related assets by major financial institutions represented by Northern Rock Bank in the U.K. and financing difficulties and an escalating short-term liquidity crunch in financial markets. Since the beginning of 2008, credit problems triggered by the sub-prime crisis have deteriorated, and heavily leveraged financial institutions that mainly relied on short-term financing have been seriously hit in succession, among which Bear Stearns was acquired by JP Morgan Chase. Fannie Mae and Freddie Mac suffered huge losses, and the Federal Deposit Insurance Corporation (FDIC) took over IndyMac, a housing mortgage finance company, both incidents signaling that the sub-prime crisis was deepening. In September 2008, the sub-prime crisis deteriorated dramatically, as Lehman Brothers declared bankruptcy, Merrill Lynch was sold, the government exercised conservatorship over Fannie Mae and Freddie Mac and the American International Group (AIG), Washington Mutual collapsed, Wachovia became entangled in problems, and some European financial institutions were also caught up in subsequent problems and some countries such as Iceland even experienced national crises.

To deal with this situation, the central banks of the major economies adopted a series of policy measures and strengthened international coordination to tide over the financial crisis. First, in tandem with interest rate instruments to balance price stability and economic growth, various liquidity instruments were used to inject liquidity into the market so as to deal with the persistent credit crunch. The U.S. Federal Reserve cut the federal funds rate on nine occasions and reduced the discount rate on eleven occasions from August 2007 to end-October 2008; new liquidity management instruments were created, including the Term Auction Facility (TAF), the Term Securities Lending Facility (TSLF), the Primary Dealer Credit Facility (PDCF), and the Commercial Paper Funding Facility (CPFF); credit support without recourse was rendered to depository institutions and bank holding companies, buying Asset-backed Commercial Papers (ABCP) from money market mutual funds, and outright purchases of discounted bills issued by Fannie Mae, Freddie Mac, and other government-sponsored entities from primary dealers in a bid to inject liquidity into the market. The European Central Bank (ECB), on the basis of regular open market operations, conducted irregular fine-tuning operations, supplementary longer-term refinancing operations, the U.S. dollar Term Auction Facility, and other operations to ease the liquidity scarcity in the European financial markets. At present, longer-term refinancing operations have become a major channel for providing liquidity. The emerging market economies have adopted corresponding measures. Second, coordination among the central banks has been enhanced. The current financial crisis has spread all over the world and is accompanied by systemic risks; therefore, resolution of the crisis cannot succeed without the concerted efforts of the international community. The U.S. Federal Reserve, the ECB, the BOE, the Bank of Canada, and other central banks have strengthened cooperation, including coordinated interest rate cuts on October 8 against the backdrop of eased inflationary pressures, and releasing joint statements on currency swaps to address the U.S. dollar liquidity crunch. At the current juncture, there is no upper limit for swap lines between the U.S. Federal Reserve and the ECB, the BOE, the National Bank of Switzerland, and the BOJ, and the terms of such swap lines have been extended to April 30, 2009. In addition, the U.S. Federal Reserve concluded with the central banks of Brazil, Mexico, South Korea, and Singapore currency swap agreements, each at US$30 billion, effective up to April 30, 2009, in an effort to improve dollar liquidity in the emerging markets. At the G20 Summit on Financial Markets and the World Economy on November 15, 2008, the G20 leaders decided to strengthen cooperation, restore global economic growth, and conduct the necessary reforms of the global financial system. Third, the central banks have worked closely with the fiscal authorities to combat the crisis. The U.S. Federal Reserve joined efforts with the Treasury Department to go beyond the traditional scope of the lender of last resort and to push the Congress to pass the *Emergency Economic Stabilization Act of 2008*. Governments of the member countries of the euro area took measures such as massive capital injections and partial nationalization of troubled financial institutions and the launching of unilateral deposit insurance schemes and financial rescue plans.

It is still too early to predict developments in the financial crisis and its impact on the real economy, but the crisis will have far-reaching repercussions on the global financial system. Morgan Stanley and Goldman Sachs have become bank-holding companies, which means that the banking operation model and financial supervisory system of U.S. banks will undergo significant changes in the future. Continued innovation of financial instruments and the evolution of the traditional role of the lender of the last resort of the major central banks represented by the U.S. Federal Reserve will impact future financial market operation mechanisms and financial supervisory mechanisms. Reflections on the causes of the financial crisis will trigger discussions on the existing system of international financial organizations, the international financial supervisory system, and the international monetary system. In addition, some central banks have begun to review their inflation-targeting monetary policy framework. These deliberations will be of great importance to the development of the financial sector of various countries during the period of economic and financial globalization.

5. World economic outlook

The future development of the financial crisis is a major factor determining future global economic development trends. Due to the contraction that began in the third quarter and the escalating domestic financial crisis, many European countries will face dual challenges, and the growth outlook of other developed economies will also remain bleak. As for the emerging market economies and developing economies, the repercussions of the financial crisis are becoming wider and deeper. Slower external demand growth, exchange rate and capital market volatility, and increased capital outflows will increase economic uncertainties and instability, and some of the economies highly dependent upon the external sector, with relatively small foreign exchange reserves or foreign trade surplus, might be hit more severely. In the context of the world economic slowdown and rising unemployment, the anti-globalization trend represented by the various forms of trade protectionism will persist in the long run, and the failure of the Doha Round negotiations is likely to engender trade protectionism, which will impact on the sustainable and healthy development of the world economy. The International Monetary Fund (IMF) predicted in November 2008 that world economic growth would slow down to 2.2 percent, with the U.S., the euro area, and Japan slowing to -0.7, -0.5, and -0.2 percent respectively (almost zero growth) and that of the emerging market economies slowing to 5.1 percent, notably lower than their trend.

II. Analysis of China's macroeconomic performance

In the third quarter of 2008 the Chinese economy maintained a momentum of stable and relatively rapid development. Investment, consumption, and exports grew in a balanced manner, and domestic demand, consumer demand in particular, became a stronger driving force for economic growth. The general price hike was put under control, and economic restructuring yielded good results. In general, the international financial crisis and the serious natural disasters in China have not changed the fundamentals of China's economic development. In the first three quarters, the Gross Domestic Product (GDP) posted 20.2 trillion yuan, up 9.9 percent year on year and a deceleration of 2.3 percentage points; the Consumer Price Index (CPI) grew 7.0 percent year on year, 2.9 percentage points higher than that in the same period of the last year; the trade surplus was down US$4.66 billion year on year to US$180.99 billion. Among these figures, the GDP increased by 9.0 percent and the CPI was up by 5.3 percent year on year in the third quarter.

1. Actual consumption growth accelerated, investment maintained a stable and relatively rapid growth momentum, and export growth fell moderately

Urban and rural household income continued to rise, and domestic consumer demand remained strong. In the first three quarters of the year, the per capita disposable income of urban residents registered 11,865 yuan, a year-on-year growth of 14.7 percent or 7.5 percent in real terms; the per capita cash income of farmers was 3,971 yuan, a year-on-year growth of 19.6 percent or 11.0 percent in real terms. In the third quarter, gross retail sales totaled 2.7 trillion yuan, posting a nominal year-on-year growth of 23.2 percent or an inflation-adjusted real growth of 16.3 percent, representing an acceleration of 5 percentage points. In terms of retail sales in the urban and rural areas, urban retail sales grew 23.9 percent to 1.8 trillion yuan and rural retail sales at the county level or below posted 0.8 trillion yuan, an increase of 21.8 percent but still 2.1 percentage points slower than the urban consumption growth.

Fixed-asset investments grew steadily with an improved investment structure. In the first three quarters of the year, fixed-asset investments totaled 11.6 trillion yuan, representing year-on-year growth of 27.0 percent and an acceleration of 1.3 percentage points. The inflation-adjusted real growth stood at 15.1 percent, down 5.8 percentage points over the same period of the previous year. Urban fixed-asset investments reached 10.0 trillion yuan, up 27.6 percent year on year, whereas rural fixed-asset investments posted 1.6 trillion yuan, up 23.3 percent year on year, an acceleration of 1.2 and 2.1 percentage points respectively from the same period of the last year. In terms of their geographical distribution, urban fixed-asset investments in eastern, central, and western China grew 22.7 percent, 35.4 percent, and 29.5 percent respectively, with central and western China growing much faster than eastern China. In terms of their sectoral distribution, fixed-asset investment growth in the three industries registered 62.8 percent, 30.2 percent, and 24.8 percent respectively, with primary industry representing an acceleration of 21.7 percentage points, much higher than that of the secondary and tertiary industries, where growth was relatively stable.

Export growth declined somewhat and import growth decelerated more rapidly, but the trade surplus in the third quarter still reached a record high. In the first three quarters of the year, imports and exports totaled US$1.97 trillion, up 25.2 percent year on year, representing an acceleration of 1.7 percentage points from the same period of the last year. Exports grew 22.3 percent to US$1074.1 billion, representing a deceleration of 4.8 percentage points from the same period of the last year, whereas imports increased 29.0 percent to US$893.1 billion, representing a year-on-year acceleration of 9.9 percentage points. Though import growth outpaced export growth, given the large amount of exports during the same period of 2007, the trade surplus in cumulative terms was US$181 billion, US$4.7 billion less than that during the same period of the last year. In the third quarter, the deceleration of import growth outpaced that of exports, with export growth in the three months posting 26.9 percent, 21.1 percent, and 21.5 percent respectively, and import growth registering 33.7 percent, 23.1 percent, and 21.3 percent respectively, pushing the trade surplus to a new historical high of US$83.3 billion.

2. Agricultural production was stable and industrial output growth decelerated

In the first three quarters of the year, the added value of primary industry was up 4.5 percent to 2.18 trillion yuan, an acceleration of 0.2 percentage points from the previous year; the added value of secondary industry was up 10.5 percent to 10.11 trillion yuan, a deceleration of 3.0 percentage points; the added value of tertiary industry was up 10.3 percent to 7.87 trillion yuan, a deceleration of 2.4 percentage points.

Agricultural production maintained a momentum of stable growth, and gross grain production increased for the fifth consecutive year. Summer crop production totaled 120.41 million tons, an increase of 2.6 percent year on year. Early season rice production posted 31.58 million tons, a slight increase of 62,000 tons from the previous year. Autumn production is expected to be a bumper crop because of the increase in both sowing acreage and unit output. Meat output continued to increase, and live pig production recovered rather rapidly. In the first three quarters, the selling rate of live pigs grew 5.8 percent, whereas the piglet population was up by 6.6 percent. In the first three quarters, the national producer prices of agricultural products (the price at which farmers sell their products) rose 19.8 percent year on year, an acceleration of 7.1 percentage points from the same period of the last year, lower than the 21.7 percent growth in the prices of agricultural capital goods, exerting greater pressures on the income gains of farmers.

Industrial production slowed down. In the first three quarters of the year, the added value of statistically large enterprises rose 15.2 percent year on year, a deceleration of 3.3 percentage points from the previous year. Growth in the three months of the third quarter posted 14.7 percent, 12.8 percent, and 11.4 percent respectively. Industrial production was well connected with sales, and 97.6 percent of the industrial products manufactured in September were sold, a decline of 0.6 percentage points from the same period of 2007. Affected by factors such as rising production costs, capital market volatility, and the global economic slowdown, corporate profits moderated. In the first eight months of 2008, the profits of statistically large enterprises registered 1.87 trillion yuan, an increase of 19.4 percent year on year and a deceleration of 17.6 percentage points from the same period of the previous year.

3. Pressures pushing up the CPI obviously eased

The CPI continued to decline on a year-on-year basis. In the third quarter, the CPI grew 5.3 percent year on year, showing a declining trend month by month, posting 6.3 percent, 4.9 percent, and 4.6 percent in the three months respectively. If the CPI basket were to be broken down by food and non-food items, food prices fell substantially, while the price hike of non-food items accelerated somewhat. In the third quarter, food prices increased by 11.5 percent, a deceleration of 8.3 percentage points from the previous quarter, while non-food prices rose by 2.1 percent, 0.3 percentage points faster than that in the second quarter. Broken down by consumer products and services, the price hike of consumer products continued to decline, while the price increase of services remained stable. In the third quarter, consumer prices increased 6.5 percent, a deceleration of 3.3 percentage points from the previous quarter; services prices gained 1.4 percent, a deceleration of 0.1 percentage points from the last quarter. Broken down by base period factors and new factors for price hikes, price hikes driven by base period factors decelerated month by month to close at 2.6 percent in the third quarter, a deceleration of 2.3 percentage points from the second quarter, while new price growth factors increased by 2.7 percent. Food price declines and weakening base period factors were the major causes behind the continued deceleration of the CPI.

The Producer Price Index (PPI) declined from a high level. At the end of the third quarter, due to the substantial drop in the price of crude oil and other commodities in the international market and reduced demand for coal, steel, and other raw materials as a result of the domestic economic slowdown, the PPI declined from a high level. In the third quarter, the purchasing price of raw materials, fuel, and power gained 14.9 percent year on year, an acceleration of 2.5 percentage points from the previous quarter, with the monthly increase posting 15.4 percent, 15.3 percent, and 14.0 percent in the three months. The producer prices of industrial products grew 9.7 percent year on year, an acceleration of 1.3 percentage points, registering 10.0 percent, 10.1 percent, and 9.1 percent respectively in the three months of the quarter. The price of agricultural capital goods grew 23.8 percent year on year, on a par with the last quarter, posting 24.8 percent, 23.8 percent, and 22.9 percent in the three months of the third quarter respectively. In the third quarter, producer prices of agricultural products increased 12.6 percent year on year, among which producer prices of crops gained 13.2 percent and those of animal husbandry products gained 15.9 percent.

Price hikes of imports and exports moderated. In the third quarter, import prices grew 20.7 percent year on year, representing a deceleration of 0.2 percentage points, with the monthly increase posting 21.9 percent, 22.7 percent, and 17.5 percent in the three months respectively; export prices were up 8.5 percent, 10.6 percent, and 6.9 percent in the three months of the quarter respectively, averaging 8.7 percent year on year and representing a deceleration of 1.8 percentage points from the previous quarter. Cheaper international commodities were the major reason for the decline in import prices. At end-September, the price of crude oil futures closed at US$100.64 per barrel on the New York Commodity Exchange, and the Brent crude oil spot price reached US$97.47 per barrel, declines of 30.4 percent and 33.0 percent respectively from their respective peaks. In the third quarter, the prices of soybeans, wheat, corn, and rice futures dropped by 4.7 percent, 5.4 percent, 7.3 percent, and 11.7 percent respectively on the Chicago Commodities Futures Exchange; copper and aluminum spot prices traded 5.0 percent and 8.9 percent lower in the third quarter on the London Metal Exchange quarter on quarter.

Labor compensation grew rapidly. In the first three quarters, the national average salary of urban employees was 2,192 yuan, up 18.3 percent year on year. Broken down by entity, employees in state-owned entities, urban collectively owned entities, and other types of entities earned 2,332 yuan, 1,333 yuan, and 2,132 yuan per month respectively, up 17.8 percent, 20 percent, and 18.9 percent year on year. A sampling survey showed that in the first three quarters of the year, the wage income of farmers averaged 1,358 yuan per month, an increase of 19.2 percent year on year.

The GDP deflator moderated. GDP in the first three quarters of the year posted 20.2 trillion yuan, representing real growth of 9.9 percent. The GDP deflator (as a ratio of nominal GDP versus real GDP) was 8.5 percent, up 4.3 percentage points year on year and 0.1 percentage points lower than that in the second quarter.

The pricing reform of resource goods pressed ahead. On September 11, the National Development and Reform Commission (NDRC), the Ministry of Housing and Urban-Rural Development, and the Ministry of Finance issued a joint circular allowing local governments to adjust heating prices according to the coal price increases in the various regions. On September 30, the NDRC and the Civil Aviation Administration of China issued a joint notice that slashed the comprehensive purchasing price of aviation fuel in Q4 by 570 yuan to 7,750 yuan per ton, effective on October 1. At present, given the substantial fall in the prices of resource products such as crude oil in the international market and the easing inflationary pressures on the domestic market, it is advisable to proactively and prudently push forward the pricing reform of resource goods so as to allow the market to play a fundamental role in resources allocation.

Box 3:Analysis of current price movements

As suggested by historical data, inflation exhibits periodic fluctuations, influenced by both the business cycles as well as psychological and other factors. While the exact inflation rate is rather difficult to forecast when prices fluctuate unexpectedly, the trend of price movements can be presented through an analysis of the inherent principles of the business cycles.

The study of inflationary cycles shows a declining trend of inflation in times of recession and a rising trend in times of economic expansion. Normally, an inflationary peak is preceded by a peak in the economic growth cycle. For instance, from World War II to the 1990s, seven out of the ten business cycles defined by the U.S. Bureau of Economic Analysis demonstrated such a pattern. A similar link also exists between the inflationary cycle and the GDP growth cycle in China. China’s GDP growth cycles can be divided into several stages according to the different peak and trough levels. The first stage (from the first quarter of 1993 to the second quarter of 1998) saw a general downward trend in the GDP growth rate, which was then followed by the second stage (from the second quarter of 1998 to the second quarter of 2007), when GDP growth generally accelerated. The third stage started from the second quarter of 2007. The fluctuation in the price index was largely consistent with that in GDP growth, with only slight lags. Macro-controls focused on fighting inflation in 1993 and 1994, on anti-deflation from 1998 to 2002, and later again on countering inflation from 2003 to 2007. At present, the GDP growth rate has dropped following its peak in the second quarter of 2007, while the rise in the consumption retail price index and the CPI began to decline after peaking in the first quarter of 2008.

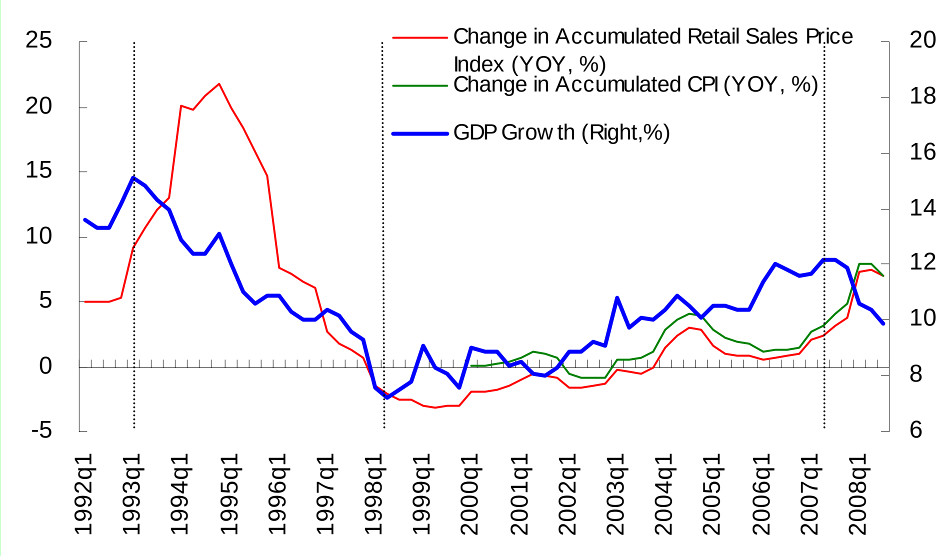

Figure 2:Fluctuations in GDP growth and the rise of the price index since 1992

Source: National Bureau of Statistics.

Inflationary pressures have eased markedly at present, as indicated by both the domestic and international cycles. As the deleveraging process in the financial sector continues and producer and consumer confidence remain low, the world economy has witnessed a substantial slowdown. Commodity prices dropped in international markets, oil prices plunged below US$ 60 dollars a barrel, and the prices of copper, coal, and agricultural produce futures also plummeted. The drop in commodity prices resulted in a deceleration of the already high import price hike, which helped to ease inflationary pressures. With leading economic indicators, the consumer expectation indicator, the business survey indicator, and other macroeconomic indicators dropping, the domestic economy shows signs of weakening. Inflation expectations are also falling. The results of a survey of urban depositors in the third quarter of 2008 indicate that the future price expectation index hit a two-year low of 33.9 percent, down 9.9 percentage points over the previous quarter.

The easing of inflationary pressures offers a window of space and time for economic restructuring. Efforts can be made to advance the reform of the resources pricing mechanism in due time so as to improve the economic structure and shift the development strategy, laying a foundation for maintaining overall prices at a basically stable level in the long term. However, as the supply of domestic labor approaches the Lewis Turning Point[3] and the restrictions imposed by limited energy and resources on economic growth become increasingly acute, labor costs as well as energy and resources prices will be driven up in the long run. Internationally, as more economies begin to adopt relatively loose monetary policies in response to the financial crisis, massive liquidity is being injected into the market, which may contribute to the building up of inflationary

[3] An economic term proposed by Arthur Lewis, a Nobel laureate in economics, in his migration model, referring to the sharp increase in salary as the surplus labor force in rural areas gradually diminishes as a result of a shift to non-agricultural industries during the industrialization process.

pressures in the future. Consequently, monetary policy should aim at avoiding deflation in the short term and preventing inflation in the long term.

In general, economic growth and inflation are subject to periodic fluctuations under the combined influence of various factors. The extent and duration of the fluctuations, however, depend not only on objective factors but also on the focus, pace, and intensity of macro controls. As an important macroeconomic policy, monetary policy should play a critical role in maintaining the stability of the RMB, thus promoting economic growth.

4. Fiscal revenues decelerated and the expenditure structure further improved

In the first three quarters of the year, total fiscal revenues (excluding debt income) reached 4894.7 billion yuan, up 25.8 percent year on year and representing an acceleration of 5.6 percentage points from the same period of the last year; fiscal expenditures totaled 3642.8 billion yuan, up 25.5 percent year on year and representing an acceleration of 0.2 percentage points. As a result, revenue exceeded expenditures by 1251.9 billion yuan, representing an increase of 261.8 billion yuan from the same period of the last year.

Tax revenue growth was rapid at the beginning of the year but decelerated month by month thereafter. Data show that in the first half of the year, national tax revenues grew by 33.3 percent in cumulative terms; growth in the three months of the third quarter was 16.5 percent, 10.1 percent, and 3.1 percent respectively, averaging 10.5 percent. The business tax and individual income tax decelerated by a larger margin. In the first three quarters, growth of the business tax and individual income tax was 10.5 and 7.8 percentage points slower respectively than the growth during the same period of the last year. The growth of the domestic value added tax (VAT) and the corporate income tax in the first three quarters decelerated from where they were in the first half of the year, by 1.2 and 9.7 percentage points respectively.

In terms of fiscal expenditures, expenditures for education, science and technology, medical and health care, social security, and environmental protection increased, but general public expenditures were reduced. In contrast to merely 13.6 percent growth in general public expenditures in the first three quarters of the year, expenditures for education, science and technology, medical and health care, social security, and environmental protection grew 21.2 percent, 26.4 percent, 35.8 percent, 40.4 percent, and 50.5 percent respectively year on year.

5. The balance of payments (BOP) surplus continued to widen but at a slower pace

The current account remained the primary source of the BOP surplus in the first half of 2008, while the capital and finance account surplus was reduced slightly. In the third quarter, affected by the worsening U.S. sub-prime crisis, the heightened international financial market turmoil, and other factors, the momentum of net foreign capital inflows moderated. Foreign direct investment (FDI) surged, with the actual utilization of FDI totaling US$74.4 billion, up 39.9 percent year on year and representing an acceleration of 29.0 percentage points from the same period of the previous year. At end-September 2008, official foreign reserves posted US$1905.6 billion, representing growth of US$377.3 billion from the end of 2007 or US$10 billion more than the gain in the corresponding period of the last year.

Growth of the external debt accelerated. At end-June 2008, the outstanding external debt totaled US$427.4 billion, representing growth of 14.4 percent from end-2007. Among this total, the outstanding registered external debt increased 15.9 percent from end-2007 to US$278.8 billion; and the short-term external debt increased 20.6 percent from end-2007 to US$265.4 billion, accounting for 62.1 percent of the total external debt, 3.2 percentage points more than that at end-2007.

6. Industrial analysis

Industrial production decelerated, and profit growth of the various industries diverged. From January to August, 30 out of 39 major industries saw declined profit growth in year-on-year terms. Profit gains in the coal mining, metallurgy, construction materials, machinery and light industries grew relatively rapidly; profits of the textile industry dwindled notably, growing by merely 4.3 percent; the petrochemical industry put an end to the sustained declining profits since the beginning of 2008 and profits grew by 3.3 percent; profits of the power and the non-ferrous metals industries fell 78.5 percent and 3.7 percent respectively. Industrial restructuring made positive progress with an improved industrial structure. In the first three quarters, output of the highly energy-consuming industries grew 13.2 percent year on year, representing a deceleration of 6.4 percentage points from the same period of the last year; the added value of the high-tech industry and the equipment manufacturing industry gained 16.5 percent, about 1.3 percentage points higher than the value added growth of the statistically large enterprises. Oil production and freight transport accelerated, while the momentum of power and coal production growth slowed down. In the first three quarters, crude oil production and completed freight transportation registered 142 million tons and 18 billion tons respectively, up 2.0 percent and 12.5 percent year on year, representing an acceleration of 0.3 and 0.8 percentage points from the first half of the year. In the first three quarters, electricity generation and coal output posted 2.6 trillion kilowatt hours and 1.93 billion tons respectively, representing a year-on-year increase of 9.9 percent and 14.4 percent and a deceleration of 3.0 and 0.4 percentage points from the first half of the year.

(1) The real estate industry

In the third quarter of 2008, the real estate sector continued its adjustment, with commercial housing turnover falling substantially and sales prices beginning to decline. Changes in the real estate market drove down investment in real estate development, the growth of acreage for the start of new home construction and the acreage for land purchases fell, and commercial housing loans decelerated notably.

Investment in real estate development decelerated. In the first three quarters of the year, completed investment in real estate development registered 2.1 trillion yuan, up 26.5 percent year on year, a deceleration of 7 percentage points from the first half of the year and a deceleration of 3.8 percentage points from the same period of the last year. Broken down by type of housing, investment in residential housing grew 28.7 percent year on year to 1.6 trillion yuan, a deceleration of 7.9 percentage points from the first half of the year and accounting for 72.9 percent of the total investment. Broken down by regions, growth of investment in real estate development in Guizhou and Tibet accelerated slightly from the first half of the year, but growth in the other regions decelerated from the first six months.

The growth of acreage for the start of new home construction decelerated by a large margin, the acreage of land purchases fell notably, and the sales volume of commercial housing dropped substantially. In the first three quarters of the year, the acreage for the start of new home construction registered 740 million square meters, up 10.2 percent year on year, representing a deceleration of 8.9 percentage points from the first six months and a deceleration of 11.4 percentage points from the same period of the last year. The acreage for completed land purchases by real estate developers posted 280 million square meters nationwide, representing a year-on-year decrease of 2.9 percent and a deceleration of 10.5 percentage points from the first half of the year. The sold acreage of commercial housing stood at 400 million square meters, down 14.9 percent year on year, a deceleration of 7.7 and 47 percentage points from the first half of the year and from the same period of the last year respectively. Sales revenue from commercial housing reached 1.6 trillion yuan, representing a year-on-year decrease of 15.0 percent, a deceleration of 12 percentage points from the first half of the year and a deceleration of 65.5 percentage points from the same period of the previous year. Among this total, the sold acreage and sales revenue of commercial residential housing dipped 15.3 and 15.5 percent respectively, with the sold acreage of residential housing in Beijing, Shanghai, Shenzhen, and Guangzhou experiencing year-on-year decreases of 55.8 percent, 41.1 percent, 46.2 percent and 25.9 percent respectively. The main reasons for the falling transaction volume of residential housing included: first, the inherent demand of the market correction due to the over rapid growth of housing prices before the third quarter; second, the changed price and income expectations of home buyers and the resultant wait-and-see attitude because of uncertainties in economic development and the fall in the stock market.

Home sales prices began to fall on month-on-month terms as a result of the continued decrease in trading volume. Growth in sales prices decelerated month by month in year-on-year terms from the beginning of 2008, and a downward trend measured in month-on-month terms began in August. In the third quarter of 2008, home sales prices grew 5.3 percent, a deceleration of 3.9 percentage points from the second quarter. In the three months of the third quarter, home sales prices grew 7.0 percent, 5.3 percent, and 3.5 percent. Broken down by type, sales prices of new homes, sales prices of pre-owned homes, and rents increased by 6 percent, 4.2 percent, and 1.1 percent respectively year on year, representing decelerations of 4.1, 4.7, and 1.1 percentage points from the second quarter.

Growth of commercial real estate loans slowed down markedly. Affected by the reduced trading volume and the slowed investment growth, commercial real estate loans decelerated notably. At the end of the third quarter, outstanding commercial real estate loans had grown 14.3 percent year on year to 5.3 trillion yuan, a deceleration of 8.2 and 15.3 percentage points from the first half of the year and from the same period of the last year respectively. Outstanding real estate development loans registered 1.97 trillion yuan, representing a year-on-year increase of 12 percent and a deceleration of 14.9 percentage points over the same period of the last year; outstanding home purchase loans posted 3.3 trillion yuan, an increase of 15.8 percent year on year and a deceleration of 15.5 percentage points from the same period of the previous year. New housing loans for individuals in the first three quarters of the year reached 243.2 billion yuan, about 311.9 billion yuan less than new housing loans during the same period of the last year. This decline was mainly related to the small turnover volume on the real estate market, cautious investment in housing loans by financial institutions, and a wait-and-see attitude among households.

To deal with the potential impact of the international financial crisis on China, expand domestic demand, improve financial services for households purchasing common self-occupied homes, and improve the life of the people, the PBC lowered the floor interest rates on commercial individual housing loans to 70 percent of the benchmark lending interest rate and reduced the minimum down payment ratio to 20 percent, effective on October 27, 2008. At the same time, the interest rates on individual housing provident fund loans were slashed. Broken down by types of loans, the interest rate on loans with a maturity of no more than 5 years (inclusive) was reduced from 4.32 percent to 4.05 percent, and the interest rate on loans with a maturity of over 5 years was down to 4.59 percent from 4.86 percent, both cut by 0.27 percentage points. The floor interest rate on self-occupied housing loans, the minimum down payment ratio, and the preferential interest rates on housing provident fund loans in the areas affected by the Wenchuan earthquake remained unchanged. At the same time, the Ministry of Finance stipulated that starting from November 1, 2008, the contract tax rate would be tentatively reduced to 1 percent for first-time home buyers purchasing ordinary housing with an acreage of 90 square meters or less; the stamp tax on the purchase and sale of homes by individuals was suspended; and individual home sales were exempt from the land VAT on a temporary basis.

The real estate sector, as a pillar sector of the national economy, plays an important role in driving the development of such sectors as steel, construction materials, and home appliances, hence it is critical for financial stability and development as well as for the structural upgrading of household consumption and the improvement of the people's livelihood. Efforts should be made to implement and improve policy measures boosting rational housing consumption and to promote the stable and healthy development of the real estate market.

(2) Iron and Steel Industry

Iron and steel are the main raw materials feeding industrial development, and the demand for iron and steel is closely related to economic growth. In the third quarter, affected by the economic slowdown, the demand for iron and steel cooled down, driving down steel prices and the profitability of the iron and steel industry.

Demand for steel slowed down, but the growth in exports offset the impact of the weak demand in the downstream industries. In the third quarter, most downstream industries in the steel industry, including real estate, machinery, automobiles, and home appliances, grew at a slower pace, driving down the demand for steel. In August, apparent domestic steel consumption[4] experienced negative growth for the first time. Against this background, steel exports exhibited a strong rebound. In the third quarter, exports of steel registered 21.56 million tons, up 36.8 percent year on year.

Growth of steel production slowed down and inventories piled up. In the first three quarters, production of raw steel and rolled steel totaled 390.95 million tons and 445.15 million tons respectively, up 6.2 percent and 8.1 percent, a deceleration of 11.4 and 15.9 percentage points from the same period of the last year. In August steel output experienced its first negative growth in year-on-year terms; in September, the output of raw steel and rolled steel dropped by 9.1 percent and 5.5 percent respectively. An overcapacity in the steel industry began to emerge, building up the pressure on inventories. At end-August, large- and medium-sized steel companies had inventories of 9.49 million tons, an increase of 61.3 percent year on year.

[4] Apparent consumption refers to output plus net imports, or output minus net exports. Actual consumption is arrived at by deducting other wear and tear and inventories (including inventories at factories and social inventories) from the apparent consumption.

Falling steel prices drove down corporate profits. Affected by weak demand, declining costs of iron ore, coking coal, steep scrap, and other furnace feed as well as falling shipping freight, the year-on-year steel price increase began to decline in the third quarter of 2008. In the third quarter, the purchasing price of the ferrous metal smelting and rolling industry rose 28.5 percent, with the price up 24.7 percent in September. The profitability of the industry fell appreciably compared to a year earlier. From January to August, the sales income of the ferrous metal smelting and rolling industry fell 0.5 percentage points year on year to 5.1 percent.

In general, the iron and steel industry is currently facing some difficulties, which, however, present an important opportunity for the industry to upgrade itself comprehensively. Efforts should be made to promote sustained and healthy development of the iron and steel industry by implementing the scientific approach to development. First, mergers and acquisitions (M&A) should be promoted, and post-M&A resource integration should be carried out in an earnest manner so as to put into play the existing advantages of steel companies and to avoid homogenous competition. The industrial concentration of the iron and steel industry is slightly lower than that at the international level. At present, there are about 1,200 steel companies, out of which 66 companies with the highest capacity only account for merely 79 percent of the total capacity of the industry. Second, the growth pattern should be changed by continuing energy conservation and pollution reduction, scraping backward production capacity, achieving industrial upgrading, optimizing geographical distribution, promoting innovative capacity, and enhancing competitiveness. Third, the industrial structure should be optimized by combining aggregate control and restructuring, and improving product portfolio and quality so as to change the status quo whereby the iron and steel industry is big but not strong and with an irrational product mix.

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

I. Outlook for the Chinese economy

Currently, with the accelerating correction of the global economy and the worsening impact inflicted by the international financial crisis, the domestic economy is facing more uncertainties and greater downward risks, presenting a complex and changing picture for macroeconomic management. However, China's economy still enjoys a fairly large potential of sustainable growth and the overall momentum for stable economic development remains unchanged.

At present, the U.S., Europe, and Japan are risking recession, and the emerging market economies face fairly large downside risks. This is likely to exert a relatively large impact on China's external demand. In the meantime, the uncertainties in the domestic economy are increasing. The correction pressures weighing on the real estate and related industries may affect many other industries. The third quarter business survey conducted by the PBC indicated that the export order index, which reflects external demand, continued to fall, hitting a record low since July 2005; the domestic order index, which reflects internal demand, fell 3.7 percentage points from the second quarter, representing the largest drop in a decade. The banking survey suggested that the demand for loans index in the third quarter was 67.4 percent, a notable fall from the last quarter. The urban depositors' survey showed that the ratio of residents intending to buy homes in the coming three months was down 1.8 percentage points compared with that in the second quarter and down by 2.8 percentage points from the same period of the last year, hitting its lowest level since the survey began. The stock market slump and the negative wealth effects will also exert an adverse impact on consumption growth. In the context of weakening demand, enterprise profitability and fiscal revenues will suffer to some extent.

However, it is noteworthy that China's economy still maintains a fairly great potential for growth. First, the long-term fundamentals promoting economic growth, such as industrialization, urbanization, internationalization, and industrial and consumption structural upgrading, remain unchanged. Second, consumption growth is expected to remain stable and play a more important role in stimulating economic growth. In particular, various policies have been adopted and have been gradually implemented in recent years to expand consumption and to improve the people's living conditions, which have improved the consumption environment and contributed to relatively stable consumption growth. Third, the demand for large-scale fixed-asset investment in the post-earthquake reconstruction will spur domestic demand. Fourth, the strengthening and improvement of macroeconomic management, the relatively large room for policy maneuver, and the strong policy flexibility are conducive to better coping with the potential impact on China's economy and finance. The recent years have witnessed a notable increase in government fiscal revenues, considerable progress in financial reform, and a generally safe and sound financial system. Fifth, the deepening reform in the rural areas will become a new engine driving rural economic growth. Sixth, different market participants have enhanced their ability for self-adaptation and the market is able to adjust itself and find new engines for growth.

Price levels and their trends should be watched closely. Currently, in the economy there are both cost-driven factors that push up price levels and the possibility of further price declines. The inflationary pressures mainly derive from factors that push up the price levels. Affected by the financial crisis, more and more economies are shifting their policy focus from containing inflation to maintaining growth. In the context of a relatively loose monetary policy, the prices of commodities in the international market are expected to rebound if market confidence recovers. As the industrialization and urbanization of the developing economies accelerate, the possibility of price hikes of resources and production factors still exists. However, with the global economic slowdown and falling commodity prices, the external forces that pushed up the price levels will weaken. The third quarter urban depositors' survey conducted by the PBC indicated that the ratio of residents expecting a price rise was still relatively high, up to 42.8 percent, but this ratio was remarkably lower compared with the second quarter and the same period of the last year. The time has come to adjust the prices of energy, transportation, electricity, gas, and water, etc. so as to lay a solid foundation for sustainable development.

The ongoing global economic and financial correction is an inevitable outbreak of long-accumulated imbalances, exerting negative effects on China's economy that cannot be underestimated. It is noteworthy that China not only possesses the potential to maintain relatively rapid economic development and generally stable price levels, but also is able to accelerate domestic restructuring and to reform and transform the development mode in the context of weakening external demand.

II. Monetary policy stance in the next stage

In the next stage, the PBC will, in line with the overall arrangements of the CPC Central Committee and the State Council, the guidelines outlined at the 17th CPC Congress and the 3rd Plenary Session of the 17th CPC Central Committee, and the scientific approach to development, adopt a moderately loose monetary policy, conduct timely, flexible, and appropriate policy adjustments according to the changing situations, ensure adequate liquidity in the banking system, maintain a reasonable growth of money and credit, safeguard monetary and financial stability, support the fiscal efforts to stimulate domestic demand, and beef up financial support for economic growth.

First, the PBC will timely initiate plans to maintain stable economic and financial performance and will strengthen international coordination to cope with the uncertain impact of the financial crisis according to the changing situations. Efforts will be made to reinforce the monitoring of the changing international financial situation and to closely watch domestic economic and financial developments, so as to make, improve, and launch plans targeting various emergencies in a timely manner. Meanwhile, the PBC will strengthen international coordination to boost market confidence and to maintain the stability of the financial market and financial system.

Second, the PBC will ensure adequate liquidity in the financial system and will provide timely liquidity support to financial institutions. The PBC will modestly reduce the intensity of open market operations when appropriate, monitor the changes in the liquidity distribution structure in the banking system, fully adopt tools such as the Term Auction Facility (TAF) to provide support to financial institutions suffering temporary liquidity difficulties.

Third, the PBC will maintain stable growth of money and credit to beef up support of bank lending for economic development. Various policy instruments will be coordinated to satisfy the reasonable needs of economic development for money and credit. The PBC will guide policy banks to bolster financial support for the construction of priority projects and for the purchase of agricultural products; will guide commercial banks to issue matching loans to projects invested in by the central government; and will to continue to expand the credit supply.

Fourth, the PBC will strengthen window guidance and policy guidance and intensify efforts to optimize the credit structure. Based on the principle of differentiated treatment to different sectors, financial institutions are encouraged to beef up their credit support to the following areas: 1) the construction of key projects, small- and medium-sized enterprises, agriculture, rural areas, and farmers, post-disaster reconstruction, student loans, and employment; 2) technological upgrading, industrial rationalization through mergers and acquisitions, relocation of excessive production capacity overseas, energy savings and pollution reduction, and developing cyclical economy, etc; 3) fostering and boosting new engines for consumer credit growth with better targeting. In the meantime, financial institutions will be discouraged from providing loans to highly energy-consuming and heavily polluting industries, to industries with an overcapacity, and to low-quality enterprises.

Fifth, the PBC will put the role of the bond market in fund-raising into a better play.

Efforts will be made to develop financing instruments issued by non-financial enterprises, such as corporate bonds, enterprise bonds, short-term financing bills, and medium-term notes, so as to increase the funding channels for enterprises.

Sixth, the PBC will strengthen the monitoring and analysis of international economic and financial developments and capital flows. Financial services will be further improved to facilitate international trade and investment. Measures will be taken to better alert domestic entities to the risks associated with outward investment and to better regulate such investment activities, and to steadily advance the convertibility of the RMB under the capital account.