

# **China Monetary Policy Report**

## **Quarter One, 2013**

(May 9, 2013)

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

## Executive Summary

In Q1 2013 economic activities and social endeavors made a steady start and economic growth remained stable. Consumer demand was stable, investment grew rapidly, import and export growth rebounded, the agricultural sector was in good shape and industrial-sector profits increased after decelerating. Overall price levels were stable and urban job creation remained within a reasonable range. The GDP reached 11.9 trillion yuan, up 7.7 percent year on year; the consumer price index was up 2.4 percent year on year.

The PBC has followed the overall arrangements of the State Council and has continued to implement a sound monetary policy. Given the large inflows of foreign exchange and the build-up of pressures from money and credit expansion, fine-tuning and preemptive adjustments were conducted in a forward-looking manner. Liquidity in the banking system was flexibly adjusted in both directions. The liquidity management mechanism was further improved with the creation of short-term liquidity operations (SLO) and the standing lending facility (SLF). The dynamic adjustment to the differentiated reserve requirement continued to play a counter-cyclical role in guiding stable and reasonable lending growth. Coverage of agro-linked central bank lending was expanded nationwide to allow rural financial institutions to lend more to the agricultural sector, rural areas, and farmers. Assessments were made of the effects of credit policy guidance in facilitating improvements to the credit structure. On April 10, 2013, direct trading between the RMB and the Australian dollar was launched. The use of the RMB in cross-border trade and investment activities was expanded. Reform of financial institutions was advanced and reform of foreign exchange administration was deepened.

The growth of money, credit and all-system financing aggregates was fairly rapid. At end-March 2013 outstanding M2 increased 15.7 percent year on year. Outstanding RMB loans were up 14.9 percent year on year, an increase of 2.8 trillion yuan from the beginning of 2013, 294.9 billion yuan more than the growth registered in the first three months of the last year. In Q1, all-system financing aggregates totaled 6.16 trillion yuan, an increase of 2.27 trillion yuan year on year, and the financing structure was further diversified. Lending rates offered by financial institutions to their clients declined slightly. In March, the weighted average lending rate offered to non-financial enterprises and other sectors was 6.65 percent, a decline of 0.19 percentage point from the beginning of the year. At end-March, the central parity of the RMB against the US dollar was 6.2689 yuan per dollar, an appreciation of 0.26 percent from the end of 2012. According to estimates of the Bank for International Settlements, in Q1 the real effective exchange rate of the RMB appreciated 3.52 percent. RMB exchange-rate expectations have been stable.

Looking ahead, the fundamentals driving long-term growth in China remain unchanged. With these factors supported by the macroeconomic policies and structural adjustment reform measures, stable economic development is expected to continue. Nevertheless, it should be noted that China faces complex domestic and external environments. The basis for stable economic growth is not sufficiently solid and endogenous drivers need to be strengthened. Borrowing and leveraging by some enterprises has increased, and the financing channels of some local government financing platforms have become even more complex. Furthermore, due to the growing negative spillover effect of the monetary easing in the major economies, the pro-cyclical expansion of domestic credit was boosted. At the moment, because prices are fairly sensitive to expansion of demand, there should be forward-looking guidance to keep inflation expectations stable as overall price levels decline.

The PBC will follow the overall arrangements of the State Council, focus on the theme of higher quality and higher efficiency in terms of economic growth, follow the principle of seeking progress amidst stability, continue to implement a sound monetary policy, make policy measures more forward-looking, targeted, and flexible, consider the overall need to pursue stable growth, control inflation, and prevent risks, and properly manage the focus, intensity, and pace of its policy measures. A variety of monetary policy tools will be used, including quantity-based and price instruments, and the macro-prudential policy framework will be improved to guide money, credit, and all-system financing aggregates to grow in a stable and appropriate manner, to maintain a stable monetary environment, to optimize the allocation of credit resources, to improve financial services to the real sector, and to keep overall price levels basically stable. Furthermore, efforts will be made to deepen ongoing reforms to strengthen the role of market mechanisms, improve the monetary policy transmission mechanism, effectively prevent systemic financial risks, and promote the sound and sustainable growth of the economy.

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## Part 1 Monetary and Credit Performance

In Q1 2013 liquidity in the banking sector was relatively abundant. Monetary, credit, and financing aggregates saw relatively rapid growth and financial market operations were stable.

### I . Money supply registered accelerated growth

At end-March 2013, outstanding M2 stood at 103.6 trillion yuan, up 15.7 percent year on year, an acceleration of 1.9 percentage points from the end of the last year. Outstanding M1 stood at 31.1 trillion yuan, up 11.8 percent year on year, an acceleration of 5.3 percentage points from the end of the last year. Currency in circulation M0 totaled 5.5 trillion yuan, up 11.8 percent year on year, an acceleration of 4.1 percentage points from the end of the last year. Net cash injections totaled 80.1 billion yuan in Q1 2013, 195.5 billion yuan more than Q1 2012.

The growth rate of M2 accelerated in the first quarter of 2013. This can be attributed to the following factors: the large increase in RMB counterparts of foreign exchange reserves, the rapid increase of new loans, and money creation through channels such as bond purchases by financial institutions and interbank transactions. The growth rate of M1 picked up noticeably, matching the trend in stable economic growth.

At the end of March 2013, outstanding base money registered 25.4 trillion yuan, up 11.9 percent year on year and 130.6 billion yuan more than that at the beginning of the year. The money multiplier stood at 4.08, which was 0.22 higher than that at the end of 2012. The excess reserve ratio of financial institutions was 2.0 percent and that of rural credit cooperatives (RCCs) was 4.5 percent.

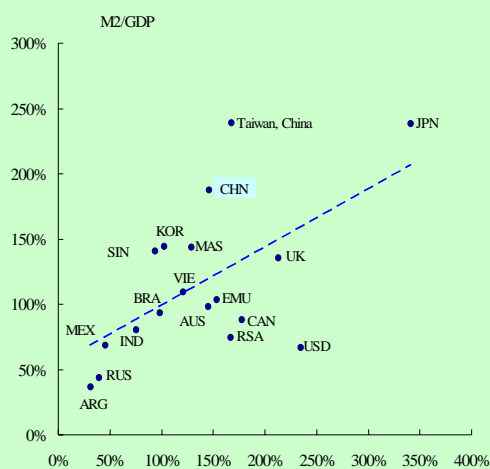
### Box 1 Financing Structure, Savings Rate, and Monetary Aggregates

When observing different economies, we find that under the similar conditions of economic and price stability, some economies have sizable monetary aggregates and a higher proportion of monetary aggregates to GDP, while other economies have smaller money aggregates and a lower proportion of monetary aggregates to GDP. This is an interesting phenomenon. Indeed, the size of monetary aggregates has a lot to do with the financing structure and the savings rate in the economy. This phenomenon requires objective and scientific analysis.

**In general, economies with a large share of bank financing in their financing structures have more monetary aggregates.** The following tables indicate the share of bank financing and the size of monetary aggregates in 18 economies. Table 1 shows that where indirect financing and bank financing play a dominant role, the

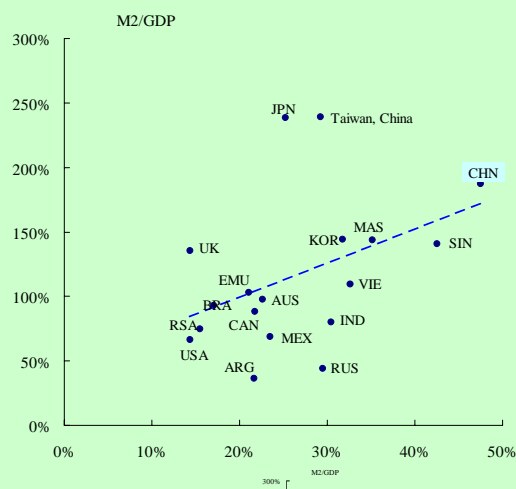
economies have larger monetary aggregates and a higher proportion of monetary aggregates to GDP. In contrast, economies with a developed direct-financing market have smaller monetary aggregates and a lower proportion of monetary aggregates to GDP. This situation should be analyzed from the perspective of money creation. Asset expansion by banks (such as lending, purchase of non-bank bonds and foreign exchange, etc.) will give rise to direct deposits. Monetary aggregates will increase correspondingly because deposits constitute a major part of monetary statistics. Direct financing (such as issuing and purchasing stocks, bonds, and etc.) only results in the transfer of money among different enterprises and people and there is no change in monetary aggregates. As the volume of direct financing becomes larger, the share of money supply in total financial assets will become smaller, leading to a lower ratio of monetary aggregates to GDP. In sum, because money is created by the banking system, as an economy relies on more bank lending, the larger its monetary aggregates will be. Internationally. The Asian economies generally rely on their banking systems to provide domestic credit. Their banking systems supply a lot of money by purchasing foreign exchange. The dominant role of bank financing leads to a higher ratio of monetary aggregates to GDP in these economies. For example, in 2012 the ratio of monetary aggregates to GDP was 238.7 percent in Japan and 144.3 percent in Korea. This can be attributed to their financing structures.

**Figure 1 Bank Credit as a Percentage of GDP and M2/GDP**



2011 Domestic Credit of Banks/GDP

**Figure 2 Savings Rates and M2/GDP**



2000-2012 Annual Savings Rates

Note 1: Due to differences in the scope of monetary statistics among various economies, Table 1 and Table 2 use the most broad-based broad money.

Note 2: M2/GDP in Australia and Vietnam utilize 2011 data, and M2/GDP in the other economies utilize 2012 data.



Sources: WB/IMF/CEIC/Wind.

**Economies with higher savings rates have larger monetary aggregates.** This is clearly indicated in Table 2. Monetary statistics is mainly based on bank deposits. A higher savings rate will mean higher demand for deposits. In particular, where the financial market is underdeveloped with a relatively small amount of financial assets, there will be more deposits because the deposits serve as storage of value, and the monetary aggregates will be relatively large. Furthermore, if enterprises have only limited access to direct financing channels, they will borrow from banks and this will give rise to new deposits, correspondingly increasing the monetary aggregates. Taking the Asian economies as an example, their savings rates are generally higher than those in Europe and North America. People put their savings in bank deposits, thereby greatly increasing the demand for money. The ratio of monetary aggregates to GDP is generally higher in the Asian economies than it is in Europe or North America.

In summary, in an economy with a high savings rate that relies on bank financing, monetary aggregates will be large. Along with the progress in the adjustment of economic structure, the share of bank financing in total financing will decrease and the financing channels will become more diversified. Households will have more diversified asset portfolios. In the meantime, with the expansion of consumption and a decline in the savings rate, growth of money will decelerate and the ratio of monetary aggregates to GDP will gradually moderate, and may decrease. Therefore, it is not plausible to evaluate monetary conditions and even inflation pressures only by comparing the ratio of monetary aggregates to GDP. Economies with developed direct-financing channels may have a large volume of total financial assets, including bonds, equities, and etc., and the ratio of total financial assets to GDP may be relatively high.

In addition, we should take into consideration the coverage and scope of the monetary statistics when making international comparisons. In general, an economy has multiple indexes of monetary aggregates with different coverages. For M2 alone, there are varying definitions in different economies. When fixed-term deposits are included in M2, the U.S. chooses fixed-term deposits of less than USD 100,000; the Euro area and Korea choose those with a maturity of no more than two years (with no limits to the amount), Japan chooses deposits that are not in postal savings banks and cooperatives. China chooses all fixed-term deposits. Comparatively, the coverage of M2 in China is relatively large, so international comparisons should be conducted on a comparable basis.

## **II. A larger year-on-year increase in deposits at financial institutions**

At the end of March 2013, outstanding deposits of domestic and foreign currencies in all financial institutions (including foreign-funded financial institutions, the same hereinafter) reached 100.7 trillion yuan, up 16.0 percent year on year and an acceleration of 1.9 percentage points from the end of 2012. Outstanding deposits were

6.3 trillion yuan more than that at the beginning of the year, an year-on-year acceleration of 2.1 trillion yuan. Outstanding RMB deposits registered 97.9 trillion yuan, up 15.6 percent year on year and an acceleration of 2.3 percentage points from the end of 2012. This was 6.1 trillion yuan more than that at the beginning of 2013, representing a year-on-year acceleration of 2.3 trillion yuan. Outstanding deposits in foreign currencies posted USD 441.6 billion, an increase of 29.2 percent year on year, or USD 31.4 billion more than that at the beginning of 2013, which was USD 35.4 billion less than that during the same period of the previous year.

Broken down by sectors, growth of household deposits was stable and growth of non-financial institutions recovered. At the end of March 2013, outstanding household deposits in financial institutions posted 44.3 trillion yuan, up 16.5 percent year on year, an acceleration of 0.2 percentage point from the end of the last year; this was 3.7 trillion yuan more than that at the beginning of 2013 and represented an acceleration of 558.7 billion yuan year on year. Outstanding RMB deposits of non-financial enterprises registered 34.3 trillion yuan, up 14.5 percent year on year, 6.6 percentage points higher than that at the end of the last year; this represented a rise of 1.6 trillion yuan compared with that at the beginning of the year and an acceleration of 1.7 trillion yuan year on year. At the end of March 2013, outstanding fiscal deposits registered 2.5 trillion yuan, up 93.1 billion yuan from the beginning of the year, representing an acceleration of 25.2 billion yuan year on year.

### **III. Medium and long-term loans grew rapidly**

At the end of March, outstanding loans in domestic and foreign currencies at all financial institutions registered 70.5 trillion yuan, up 16.0 percent year on year, an acceleration of 0.4 percentage points over the end of the last year. This was an increase of 3.2 trillion yuan from the beginning of the year and an acceleration of 599.2 billion yuan year on year. At the end of March, outstanding RMB loans stood at 65.8 trillion yuan, up 14.9 percent year on year or a deceleration of 0.1 percentage point over that in the last year; outstanding RMB loans registered an increase of 2.8 trillion yuan from the beginning of 2013, an acceleration of 294.9 billion yuan year on year. In general, there is strong motivation to lend due to the pursuit of a high growth rate in the localities, the easing of the monetary environment around the globe, and the drive among financial institutions for business development.

Medium- and long-term loans rose rapidly. At the end of March 2013, RMB household loans increased 21.3 percent year on year, an acceleration of 2.7 percentage points from the end of the last year, up 975.1 billion yuan from the beginning of 2013, an acceleration of 475.6 billion yuan year on year. Among which, home mortgage loans increased by 416.2 billion yuan from the beginning of the year, 286 billion yuan more than that registered in the same period of the last year. The growth rate of home mortgage loans was 17.6 percent at the end of March, setting a new high since May 2011. Home mortgage loans grew rapidly due to the following reasons: First, the real estate market rallied, leading to a rise in the demand for home mortgage loans. Before

the adoption by state of the *five new measures to regulate the real estate market* and the provincial regulations for their implementation, the large number of transactions increased the demand for housing loans. Second, due to the low risk weight of housing mortgage loans, financial institutions were eager to expand this business to save capital. Loans to non-financial enterprises and other sectors rose by 12.8 percent year on year, an increase of 1.8 trillion yuan from the beginning of 2013, 175.1 billion yuan less than that registered in the corresponding period of the last year. Broken down by maturities, medium- and long-term loans increased by 1.4 trillion yuan from the beginning of the year, 591.1 billion yuan more than that registered in the corresponding period of the last year. Medium- and long-term loans accounted for 51.7 percent of new loans, 16.6 percentage points more than the average level in 2012. The growth rate of medium- and long-term loans was 10.5 percent at the end of March, up 1.5 percentage points from the end of the last year, a new high since March 2012. Home mortgage loans and fixed-asset loans contributed to the rapid increase in medium- and long-term loans. Short-term loans, including bill financing, increased by 1.3 trillion yuan from the beginning of the year, 295.3 billion yuan less than that registered in the corresponding period of the last year. Broken down by institutions, lending by Chinese-funded large-sized national banks, Chinese-funded small- and medium-sized national banks and Chinese-funded small- and medium-sized local banks accelerated year on year.

**Table 1 RMB Loans of Financial Institutions in Q1 2013**

Unit: 100 million yuan

	Q1, 2013		Q1, 2012	
	New Loans	Acceleration	New Loans	Acceleration
Chinese-funded large-sized national banks <sup>1</sup>	12,835	783	12,052	1,029
Chinese-funded small- and medium-sized national banks <sup>2</sup>	7,227	1,259	5,968	-621
Chinese-funded small- and medium-sized local banks <sup>3</sup>	4,405	1,129	3,277	1,410
Rural cooperative financial institutions <sup>4</sup>	5,038	215	4,824	232
Foreign-funded financial institutions	73	-80	154	-32

Notes: 1. Chinese-funded large-sized banks operating nationwide refer to banks with assets denominated in domestic and foreign currencies equivalent to no less than 2 trillion yuan (according to the amount of total assets in both domestic and foreign currencies at end-2008).

2. Chinese-funded small- and medium-sized banks operating nationwide refer to banks operating across different provinces with assets of less than 2 trillion yuan denominated in domestic and foreign currencies.

3. Chinese-funded small- and medium-sized local banks refer to banks operating within a single province with total assets of less than 2 trillion yuan denominated in domestic and foreign currencies.

4. Rural cooperative financial institutions refer to rural commercial banks, rural cooperative banks, and rural credit cooperatives.

Source: People's Bank of China.

Foreign currency-denominated loans grew rapidly. At the end of March, outstanding foreign-currency loans of financial institutions reached USD754.3 billion, up 35 percent year on year. This was USD70.9 billion more than that at the beginning of the year and USD49.9 billion more than that registered in the corresponding period of the last year. In terms of the loan structure, trade financing increased by USD55 billion yuan, accounting for 78 percent of new foreign currency-denominated loans. Lending to support the *Going Global* enterprises and medium- and long-term loans increased by USD10.2 billion yuan, accounting for 14 percent of the new foreign currency-denominated loans.

#### **IV. All-system financing aggregates increased year on year, and the share of RMB loans decreased**

According to preliminary statistics, all-system financing aggregates in the first quarter of 2013 reached 6.16 trillion yuan, an increase of 2.27 trillion yuan from the same period of the last year. In particular, all-system financing aggregates totaled 2.54 trillion yuan in March, up 1.48 trillion yuan and 673.9 billion yuan over the last month and the same period of the last year respectively. All-system financing aggregates increased year on year, and all means of financing, with the exception of equity financing on the domestic stock market by non-financial enterprises, were quite active.

The financing structure became more diversified. First, new RMB loans increased from the same period of the last year, but their share fell. In Q1, RMB loans accounted for 44.7 percent of all-system financing aggregates, down 18.6 percentage points year on year. Second, the growth of foreign-currency denominated loans accelerated and their share rose. New foreign-currency denominated loans accounted for 7.2 percent of all-system financing aggregates, up 3.8 percentage points year on year. Third, net financing of corporate bonds hit a historical high, but equity financing on the domestic stock market by non-financial enterprises continued to decrease year on year. Bond issuances by enterprises totaled 752 billion yuan, accounting for 12.2

percent of all-system financing aggregates, up 2.0 percentage points year on year. Equity financing on the domestic stock market by non-financial enterprises totaled 61.7 billion yuan, down 25.8 billion yuan year on year. Fourth, the real economy was increasingly financed by the off-balance-sheet activities of financial institutions. In the first quarter, the real economy received 2.02 trillion yuan in the form of entrusted loans, trust loans, and undiscounted bankers' acceptances, up 1.33 trillion yuan over the same period of the last year. In particular, trust loans increased by 823 billion yuan, hitting their highest quarterly level, up 644.3 billion yuan year on year. In addition, the total of claim payments of insurance companies and new loans from micro-credit companies and credit companies reached 124.8 billion yuan, up 6.3 billion yuan over the same period of the last year.

**Table 2 All-system Financing Aggregates since the Beginning of 2002**

Unit:100 million yuan

	All-system Financing aggregates <sup>1</sup>	Of which						
		RMB loans <sup>3</sup>	Foreign currency-denominated loans (RMB equivalent)	Entrusted loans	Trust loans	Undiscounted bankers' acceptances	Corporate bonds	Financing by domestic non-financial institutions via the domestic stock markets
2002	20112	18475	731	175	—	-695	367	.628
2003	34113	27652	2285	601	—	2010	499	559
2004	28629	22673	1381	3118	—	-290	467	673
2005	30008	23544	1415	1961	—	24	2010	339
2006	42696	31523	1459	2695	825	1500	2310	1536
2007	59663	36323	3864	3371	1702	6701	2284	4333
2008	69802	49041	1947	4262	3144	1064	5523	3324
2009	139104	95942	9265	6780	4364	4606	12367	3350
2010	140191	79451	4855	8748	3865	23346	11063	5786
2011	128286	74715	5712	12962	2034	10271	13658	4377

2012	157631	82038	9163	12838	12845	10499	22551	2508
Q1,2013	61567	27551	4453	5235	8230	6704	7520	617

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

2. Data for the current period are preliminary.

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

4. “—” indicates that the data are either unavailable or can be omitted due to a negligible transaction volume.

Sources: People’s Bank of China, National Development and Reform Commission, China Securities Regulatory Commission, China Insurance Regulatory Commission, China Government Securities Depository Trust and Clearing Co., Ltd., National Association of Financial Market Institutional Investors, etc.

## Box 2 Fund Pooling Wealth Management Products

### 1. Features and Potential Risks of Bank Fund Pooling Wealth Management Products

In recent years, wealth management products offered by banks have mushroomed, as reflected in the diversified types and gradual optimization of maturities. These products have become an important tool for wealth management. At the end of 2012, there were 31,000 active wealth management products, with an outstanding volume of 6.7 trillion yuan, up 64.4 percent year on year. Fund pooling wealth management products are sold and managed by banks as an investment program. The funds are generally raised by rolling issuances of various wealth management products with different maturities, so the sources of the funds can be maintained and the use of the funds can be balanced. The pooled money can be invested in bonds, commercial paper, trust programs, and etc. Currently, the number of fund pooling wealth management products account for over 50 percent of the total collection off-balance-sheet wealth management products. Recently there has been much concern about the implicit risks of bank fund pooling wealth management products due to some of their features.

First, the investment income of the separate issues of wealth management in the same pool is not accounted for individually. The funds raised by multiple issues of wealth management products are put into one pool for investment, thus the source and use of the funds raised by any particular issue are not separated from those of others in the accounting books. So the investment income of each issue of a pool cannot be accounted for individually. This may cause a mismatch between the risks and the

income of the wealth management products in the pool. That is, it is possible that banks may shift the investment income among the different wealth management products in the pool.

Second, there is a maturity mismatch. Investment of the pool is supported by the rolling issuance of short-term wealth management products to maintain the scale of the pool. The majority of the products are those with a maturity of less than 6 months, and the pooled money is invested in a portfolio including long-term assets, such as loans and bonds, thus leading to a maturity mismatch. If the issuance date and the maturity date are not appropriately managed, or the rolling issuance encounters difficulties, liquidity risks will rise.

Third, both assets and liabilities are kept off the balance sheet. In the model of fund pooling wealth management products, deposits become off-balance-sheet products, that is, off-balance-sheet liabilities, and the assets invested with the pooled money are also recorded outside of the off-balance-sheet, that is, as off-balance-sheet assets. This may cause risks in two respects. First, risks of inadequate capital constraints. If commercial banks are overly active without adequate provision of capital, the associated risks may exceed their management ability. Second, cross risks between balance-sheet and off-balance-sheet businesses. These two businesses are in effect connected, so the risks of wealth management products in the capital pool might spread to the balance-sheet business.

Fourth, information is not transparent. When an issue of a wealth management product is offered on the market, there is only a general description of the intended investment. Later, there is inadequate disclosure of the portfolio, risk conditions, and profit and loss conditions. Investors have little knowledge about the products in which they have invested.

Fifth, rights and responsibilities are not clearly defined, especially in the case of non-principal guaranteed floating income products. On the surface, banks are only managing their clients' assets, for which they charge a fee. They do not bear joint liability for the profits and losses of their clients' assets. But, in fact, clients seldom assume the risks on their own due to bank concerns about their reputations, so there are certain legal risks.

In general, banks manage the pooled fund on behalf of their clients. That is to say, clients have all the investment income after deducting the necessary fees, and they assume all of the investment risks by themselves. But in practice, if the investment income of the pool exceeds the expected income offered at the time of issuance, the extra income will be taken by the banks. The wealth management business is more like bank proprietary business. If the investors do not assume the risks on their own, these wealth management products will be similar to deposit products.

## **2. Regulating the Development of Bank Wealth Management**

While supporting the active role of wealth management business, it is also necessary

to guide commercial banks to develop innovative wealth management business prudently from the perspective of preventing systematic risks.

First, the investment returns should match the risks. Regulation of wealth management products should focus on whether the sharing of the risk and returns is rational. The different issues of wealth management products in the same pool should be accounted for individually; this is the foundation for measurement of risks and returns. The risks should be matched with the returns, reflecting the principle of *high risks, high returns, low risks, low returns*. Banks should design a reasonable mechanism for income- and loss-sharing, and prudently run their wealth management based on their operational and risk management capacities.

Second, strengthen risk management of off-balance-sheet wealth management businesses. On the one hand, risk measurement by commercial banks should be strict. The provision of capital and risks should be timely and fully based on the nature of the business and the risk conditions; however, it is necessary to establish and strengthen the firewall between the balance-sheet business and the off-balance-sheet business of commercial banks, and the firewall between commercial banks and securities funds, insurance, and trusts companies to prevent off-balance-sheet risks from spreading to other markets.

Third, improving the mechanism for information disclosure. Banks should disclose information timely, accurately, and fully, including information about the investment portfolio, the risk rating, the clients' returns at the time of the issuing, in the duration of the products and when the wealth management product matures, to improve the transparency of the products.

Fourth, improving laws and regulations and clearly defining rights and responsibilities. Wealth management products should be more clearly defined in terms of their legal status so as to clarify the rights and responsibilities of the banks and the investors and between the banks and the investment assets, and they should uphold the sanctity of the wealth management contracts. Because banks have advantages in terms of professional skills, information, decision-making, and negotiating ability, they should give top priority to the interests of the investors and make prudential investments.

Fifth, strengthening the education of investors. There should be education to improve understanding among financial consumers about the wealth management products and their capacities to identify risks and to change their ideas about taking the wealth management products as another form of deposits with stable investment income so that they will buy wealth management products rationally and the development of the wealth management products will be healthy and sustainable.



## V. The deposit and lending rates of financial institutions declined slightly

Since the beginning of 2013, the lending rates of financial institutions declined slightly. In March, the weighted average lending rate offered to non-financial enterprises and other sectors was 6.65 percent, down 0.19 percentage point compared with that at the beginning of the year. In particular, the weighted average interest rate of loans registered 7.22 percent, up 0.15 percentage point over that at the beginning of the year. The weighted average bill financing rate posted 4.62 percent, down 1.17 percentage points from that at the beginning of the year. The weighted average home mortgage rate rose slightly to reach 6.27 percent in March, up 0.05 percentage point compared with that at the beginning of the year.

The share of loans with interest rates lower than or flat with the benchmark rate declined slightly, and the share of loans with interest rates higher than the benchmark rate increased. In March, the shares of loans with interest rates lower than or flat with the benchmark rate were 11.44 percent and 23.79 percent respectively, down 2.72 and 2.31 percentage points from the beginning of the year, and the share of loans with interest rates higher than the benchmark rate was 64.77 percent, up 5.03 percentage points from the beginning of the year.

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

Unit: %

Month	Lower than the benchmark	At the benchmark	Higher than the benchmark					
	[0.7, 1.0]	1	Subtotal	(1.0, 1.1]	(1.1, 1.3]	(1.3, 1.5]	(1.5, 2.0)	Over 2.0
January	10.62	25.08	64.30	19.84	25.23	7.87	8.29	3.07
February	11.69	25.05	63.26	19.57	23.96	7.88	8.83	3.02
March	11.44	23.79	64.77	19.55	24.71	8.15	9.27	3.09

Source: People's Bank of China.

The deposit and lending rates of foreign currencies fluctuated slightly due to the downward movements of interest rates on the international market and changes in the supply and demand of foreign currencies in China. In March, the weighted average rates of large-value US dollar demand deposits and of US dollar deposits with a

maturity of less than 3-month were 0.11 percent and 0.92 percent respectively, down 0.06 percentage point and up 0.41 percentage point from the beginning of the year. The weighted average rates of US dollar loans of less than 3 months and 3 to 6 months (inclusive of 3 months) posted 1.97 percent and 2.16 percent respectively, down 0.05 percentage point and up 0.20 percentage point from the beginning of the year.

**Table 4 Average Interest Rates of Large-value Deposits and Loans Denominated in US Dollars, January through March 2013**

Unit: %

Month	Large-value deposits						Loans				
	Demand Deposits	Within 3 months	3-6 months (inclusive of 3 months)	6-12 months (inclusive of 6 months)	1 year	Over 1 year	Within 3 months	3-6 months (inclusive of 3 months)	6-12 months (inclusive of 6 months)	1 year	Over 1 year
January	0.11	0.90	1.35	1.75	1.90	2.45	1.74	2.04	1.87	2.00	3.25
February	0.12	0.84	1.42	1.75	2.04	2.12	2.18	1.91	1.82	2.14	4.08
March	0.11	0.92	1.57	1.91	2.44	1.54	1.97	2.16	2.07	2.35	3.03

Source: People's Bank of China.

**VI. The flexibility of the RMB exchange rate increased significantly** Since the beginning of 2013, the RMB exchange rate moved in both directions and appreciated slightly. There was stronger flexibility and stable expectations. At the end of March, the central parity of the RMB against the US dollar was 6.2689 yuan per dollar, representing an appreciation of 166 basis points or 0.26 percent. From the beginning of the RMB exchange rate regime reform in 2005 to the end of March, 2013, the RMB appreciated 32.02 percent against the US dollar. The BIS estimated that in the first quarter of 2013 the nominal effective exchange rate of the RMB appreciated 3.41 percent and the real effective exchange rate appreciated 3.52 percent; from the beginning of the RMB exchange rate regime reform in 2005 to March 2013 the nominal effective RMB exchange rate appreciated 27.45 percent and the real effective exchange rate appreciated 36.49 percent.

## Part 2 Monetary Policy Operations

Since the beginning of 2013, following the overall arrangements of the State Council, the PBC has continued to implement a sound monetary policy. In view of more inflows of foreign exchange and increasing credit expansion pressures, preemptive adjustments and fine-tuning were carried out in a timely and appropriate manner.

### I. Flexibly conducting open market operations

The target, intensity, and pace of open market operations were conducted in a flexible way to promote the stable operation of liquidity in the banking system. Analysis and monitoring of the liquidity in the banking system were further enhanced, open market operations were conducted flexibly based on the need of liquidity management, and two-way open market operations were carried out in a timely and appropriate manner. In accordance with the seasonal features, such as the Spring Festival, a total of 1.34 trillion yuan of short-term repo operations was conducted, and the volume of reverse repo operations totaled 253 billion yuan in the first quarter.

The maturity mix of open market operations was optimized to further tap the fine-tunings and forward adjustment functions of open market operations. In view of the seasonal large cash demand in the run-up to the Spring Festival, 14-day short-term repo operations were conducted before the Spring Festival, effectively smoothing out the liquidity fluctuations in the banking system resulting from seasonal factors. After the Spring Festival, 28-day reverse repo operations were conducted to drain liquidity from the banking system to bring about a moderate balance in the supply and demand of liquidity in the banking system.

Interest rates for open market operations generally remained stable. Facing the complex and changing external environment, coordination of open market operations with other monetary policy tools was enhanced to keep interest rates basically stable and to effectively guide market expectations. At end-March, the interest rate for 28-day reverse repo operations was 2.75 percent.

#### Box 3 Innovative Liquidity Management Tools

Due to the unstable external conditions and the volatility in capital flows, in recent years fluctuations in supply and demand for short-term liquidity in the banking system have increased to a certain extent. In particular, when multiple factors are working together or when market expectations change, there are cases where the gap between the supply and demand for short-term liquidity cannot be bridged via financing on the money market. This will not only make liquidity management by financial institutions more difficult, but will also make it more difficult for the central bank to adjust aggregate liquidity. To increase the effectiveness of monetary policy, effectively

prevent liquidity risks in the banking system and strengthen effectiveness in the adjustment of money-market interest rates, further innovations and improvements to liquidity supply, demand and adjustment mechanism are needed so as to better address the volatility in short-term liquidity and to provide adequate liquidity to maintain the normal functioning of the financial system.

Based on the current monetary policy framework and drawing on the relevant experiences of the advanced economies, in early 2013 the PBC announced the launch of the Short-term Liquidity Operations (SLO) and the Standing Lending Facility (SLF) to be used on a discretionary basis to manage the temporary liquidity fluctuations in the banking system.

As a necessary supplement to the regular open market operations, SLOs are mainly repurchase operations with a maturity of less than seven days, but they can be extended when necessary during holidays. The operations are carried out in market-based interest-rate tenders. The PBC will, based on the need for monetary policy conduct, take into account the supply and demand for liquidity in the banking system, the interest-rate levels on the money market, and etc., and make flexible decisions about the timing, scale, maturity, and other operational specifications. SLOs are conducted with financial institutions that are primary dealers in OMO markets and that have systemic importance, quality assets, and a strong capacity in the transmission of monetary policies.

The main function of the SLF is to meet the large-scale demands for long-term liquidity of financial institutions. The maturity of the SLF is up to three months, and currently the majority of operations have maturities of one to three months. Their interest rates are determined based on the requirements of monetary policy management, how the liquidity is provided, etc. The SLF is extended mainly on collaterals. Eligible collaterals include highly rated bonds and high-quality credit assets. When necessary, the SLF can be extended based on credit. Recipients of the SLF are mainly policy banks and large-sized national commercial banks.

The above liquidity management tools will not only effectively adjust the supply of short-term funds, smooth the large volatilities in market supply and demand stemming from sudden and temporary factors, and maintain stable operation of the financial markets, but also will help anchor market expectations and effectively prevent financial risks. In the first quarter of 2013, the PBC released a list of selected financial institutions to participate in the SLF in 2013. The SLF operations, conducted based on the liquidity supply and demand situation in the banking system, achieved good results. The SLO, SLF, and other monetary policy tools work together and mutually reinforce one another. The launch of new liquidity management tools will further enhance the flexible and active liquidity management by the central bank and will enrich and improve the monetary policy operational framework.

## **II. Macro-prudential regulation was strengthened, and the dynamic adjustment mechanism of the differentiated reserve requirement continuing to play a counter-cyclical role**

In the first quarter of 2013, the PBC continued to use the dynamic adjustment mechanism of the differentiated reserve requirement to strengthen macro-prudential regulation. Based on developments in the domestic and global economy and financial markets and the soundness of financial institutions, and implementation of the credit policy, the PBC dynamically adjusted the parameters of the differentiated reserve requirement mechanism to guide stable and reasonable credit growth so as to improve the resilience of financial institutions and to support financial institutions in intensifying credit support to the weak links in the economy, such as small- and micro-sized enterprises and the agricultural sector, rural areas, and farmers. In the meantime, the PBC guided rural financial institutions to respond to seasonal credit demand during the agricultural cycle and to timely extend agricultural loans to support farming activities in the spring season in an effort to meet the credit demands of the agricultural sector, rural areas, and farmers.

## **III. Strengthening window guidance and credit policy guidance**

The PBC further improved guidance for macro-credit policy, strengthened its coordination with industrial policy, and enhanced the effects of credit-policy guidance so that credit policy will continue to play an active role in promoting sustainable and healthy economic development, harmony, and stability in the society. Financial institutions were guided to intensify support for structural adjustments and to sectors crucial for economic and social development, such as the agricultural sector, rural areas, and farmers, small- and micro-sized enterprises, strategic emerging industries, energy conservation and emission reductions, to meet the credit demands of ongoing or follow-up key national projects, and to promote the upgrading of the industrial structure and the accelerated transformation of the economic growth pattern. Financial services to programs bearing on the people's livelihood were further improved to support balanced development of the regional economy. Credit support to industries with high energy consumption and high emissions and industries with an overcapacity needs to be controlled. The differentiated home mortgage credit policy was strictly implemented to curb home purchases for speculative investments and to continuously support the development of affordable housing and ordinary commercial residential property with modest floor plans as well as purchases by first-time home buyers.

Credit support to small- and micro-sized enterprises and to the agricultural sector, rural areas, and farmers maintained a strong growth momentum. At end-March, outstanding RMB loans to small- and micro-sized enterprises extended by major financial institutions, small rural financial institutions, and foreign-funded banks

registered year-on-year growth of 13.5 percent, outpacing that of loans to large and medium enterprises by 1.6 percentage points and 1.9 percentage points respectively. Outstanding agro-linked loans in both domestic and foreign currencies by the major financial institutions, small rural financial institutions, village and township banks, and finance companies grew relatively rapidly. At end-March, outstanding loans to rural areas, farmers, and the agricultural sector grew by 18.4 percent, 16.9 percent, and 12.3 percent respectively. New loans to rural areas, farmers, and the agricultural sector posted 828.8 billion yuan, 247.9 billion yuan, and 170.3 billion yuan respectively in the first quarter.

#### **IV. Agro-linked central bank lending played an effective role to support greater credit extensions to the agricultural sector, rural areas, and farmers**

The PBC expanded coverage of agro-linked central bank loans to support financial institutions to increase lending to the agricultural sector, rural areas, and farmers. In March, the PBC introduced the policy of expanding coverage of agro-linked central bank loans across the country. Based on the precondition that agro-linked loans account for no less than 70 percent of the total loans, the recipients eligible for agro-linked central bank loans were expanded from deposit-taking financial institutions with legal-person status incorporated in counties and townships, such as rural commercial banks, rural cooperative banks, rural credit cooperatives, and village and township banks, to the aforementioned four types of financial institutions incorporated in urban areas so that agro-linked central bank loans can play a bigger role in guiding lending by rural financial institutions to the agricultural sector, rural areas, and farmers, and support financial services to farming activities in the spring season.

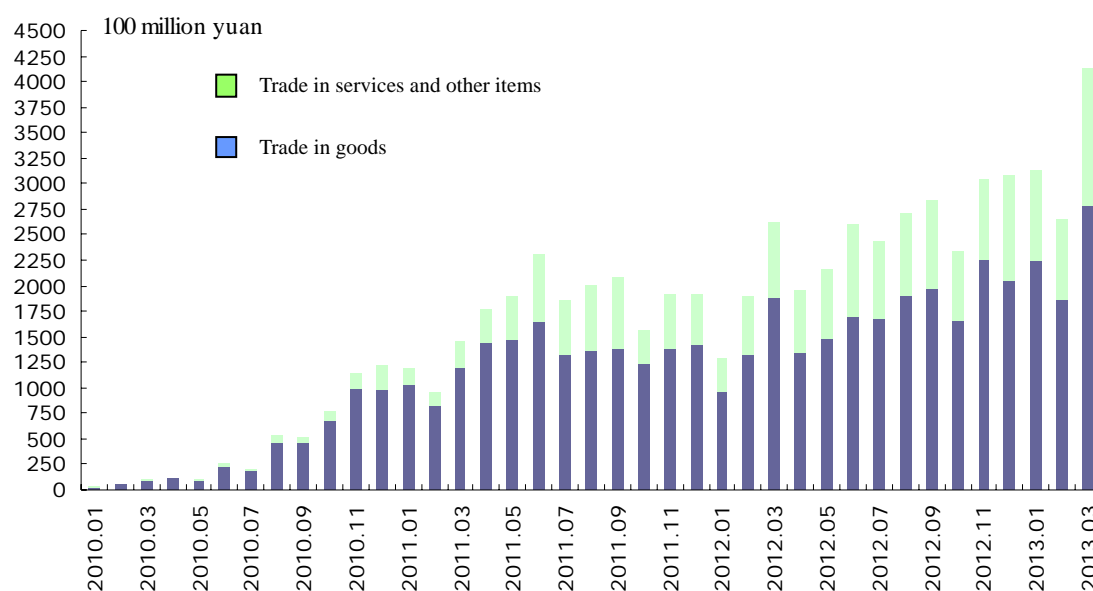
Agro-linked central bank lending was increased. In accordance with the principle of strengthening positive incentives, the nationwide agro-linked quota was increased by 40.5 billion yuan. Among the total increase, an agro-linked quota of 35 billion yuan was allocated to institutions with legal-person status incorporated in counties and townships, such as rural cooperative banks and village and township banks that have reached standards in the follow-up monitoring of assessment after special bill redemption and have lent a certain proportion of new deposits to local borrowers, to encourage rural cooperative banks to consolidate the reform achievements and to deepen reforms. The agro-linked quota was increased by 5.5 billion yuan to guide rural financial institutions to increase lending to the agricultural sector to support farming activities in the spring season, with a focus on the grain-producing provinces (regions) and those with a huge demand for agro-linked central bank loans.

Liquidity management of local legal-person financial institutions was strengthened and short-term central bank lending played a role in the supply of liquidity. Financial institutions were guided to consider short-term central bank lending as a normal channel for the supply of short-term liquidity to meet the reasonable demand for liquidity among financial institutions. In order to ensure liquidity supply for local legal-person financial institutions such as urban commercial banks before the Spring Festival, an additional short-term central bank lending quota was increased by 20 billion yuan.

## V. Cross-border RMB business developed rapidly

The volume of RMB settlements of cross-border trade and investment continued to increase rapidly. According to preliminary statistics, in the first quarter commercial banks processed 1.00392 trillion yuan of RMB settlements of cross-border trade, representing year-on-year growth of 72.3 percent. In particular, settlements of trade in goods registered 699.23 billion yuan and settlements of trade in services and other items under the current account registered 304.69 billion yuan. Actual RMB receipts and payments in cross-border trade registered 416.71 billion yuan and 587.21 billion yuan respectively. Bank settlement of cross-border RMB direct investments reached 85.38 billion yuan. In particular, outward direct investments settled in RMB totaled 7.95 billion yuan, and foreign direct investments settled in RMB totaled 77.43 billion yuan.

**Figure 3 RMB Settlement of Cross-border Trade**



Source: People's Bank of China.

## VI. The RMB exchange-rate regime was improved

The RMB exchange-rate regime reform was further improved in self-initiated, controllable, and gradual process. Based on market supply and demand and with

reference to a basket of currencies, the flexibility of the RMB exchange rate was enhanced and the exchange rate was kept basically stable at an adaptive and equilibrium level.

In the first quarter of 2013, the central parity of the RMB against the US dollar peaked at 6.2898 yuan per dollar and reached a trough of 6.2689 yuan per dollar. In the 56 trading days of the quarter, the RMB appreciated on the interbank foreign-exchange market on 26 days and depreciated on 30 days. In the first quarter, the largest single-day appreciation was 0.17 percent (or 105 points), whereas the largest single-day depreciation was 0.09 percent (or 54 points). The RMB exchange rate moved in both directions against the euro, the Japanese yen, and the other major currencies. At end-March, the central parity of the RMB against the euro registered 8.0383 yuan per euro, an appreciation of 3.47 percent from end-2012, and the central parity of the RMB against the yen stood at 6.6486 yuan per 100 yen, an appreciation of 9.87 percent from end-2012. Beginning from the RMB exchange-rate regime reform in 2005 to end-March 2013, the RMB appreciated 24.58 percent and 9.89 percent against the euro and the Japanese yen respectively.

To promote bilateral trade and investment, China and Australia launched direct trading of the RMB against the Australian dollar on the China interbank foreign-exchange market and the Australian foreign exchange market on April 10, producing a direct exchange rate for the RMB against the Australian dollar. Market makers were introduced for direct trading on the interbank foreign exchange market in China to improve how central parity of the RMB against the Australian dollar was formed. Since the launch of direct trading of the RMB against the Australian dollar, transactions were active, liquidity improved notably, and the bid-ask spreads on the interbank market and bank counters narrowed, helping to reduce the costs of currency conversions for economic entities and to facilitate use of the RMB and the Australian dollar in bilateral trade and investment.

**Table 5 Trading Volume of the RMB against Other Currencies on the Spot Interbank Market in the First Quarter of 2013**

Unit: 100 million yuan

Currency	USD	Euro	Japanese Yen	HKD	GBP	Australian Dollar	Canadian Dollar	Malaysian Ringgit	Russian Ruble	Thai Baht
Trading volume	52306.5	410.5	3774.2	228.9	7.4	25.4	0.9	3.5	10.0	2.5

Source: China Foreign Exchange Trade System.



## VII. Reform of financial institutions was deepened

The performance of large commercial banks was stable. The Industrial and Commercial Bank of China (ICBC), the Agricultural Bank of China (ABC), the Bank of China (BoC), the China Construction Bank (CCB), and the Bank of Communications (BoCOM) further transformed their business models and deepened internal reforms to cope with the challenges of the impact of the global financial crisis, the accelerated development of market-based reform of interest rates, and higher regulatory requirements, and to maintain stable and healthy business development.

**Table 6 Main Business Indicators of the Five Large Commercial Banks at the End of 2012**

	Capital Adequacy Ratio (%)	NPL Ratio (%)	Net Profit	
			Net Profit Basis (100 million)	Y-O-Y Growth (%)
Industrial and Commercial Bank of China (ICBC)	13.66	0.85	2386.91	14.51
Agricultural Bank of China (ABC)	12.61	1.33	1451.31	19.00
Bank of China (BoC)	13.63	0.95	1455.22	11.67
China Construction Bank (CCB)	14.32	0.99	1936.02	14.26
Bank of Communications (BoCOM)	14.07	0.92	583.73	15.05

Sources: 2012 Annual Reports of the Five Banks.

The reform of the Rural Finance Division of the Agricultural Bank of China (ABC) was advanced steadily. In March, the PBC issued a new standard for implementation of the differentiated reserve requirement for the pilot reform of the Rural Finance Division of the ABC by incorporating the new deposit to loan ratio into the assessment indicators, making favorable policies more targeted and effective, and strengthening positive incentives and guidance. A total of 549 ABC county Rural Finance Divisions reached the standards, with a compliance rate of 58 percent.

Remarkable achievements were made in reforming the rural credit cooperatives (RCCs). First, there were improvements in asset quality and enhanced capacities for sustainable development. At end-March, the capital adequacy ratio of the RCCs averaged 11.3 percent, the outstanding NPL and NPL ratio were 352.5 billion yuan and 4.2 percent respectively, a reduction of 1.5 billion yuan and 0.3 percentage point from end-2012. Second, agro-linked services were intensified, and agro-linked

lending increased by a large margin. At end-March, the outstanding loans of the RCCs totaled 8.3 trillion yuan, accounting for 12.7 percent of the total loans of all financial institutions, up 0.3 percentage point over that at the end of the last year. RCC agro-linked loans and lending to rural households totaled 5.6 trillion yuan and 2.8 trillion yuan respectively, up 4.7 percent and 5.6 percent over the end of the last year. Third, the reform of property rights arrangements was advanced, and there was continuous improvement in the capacity for business management. At end-March, there were 1,795 RCCs, 352 rural commercial banks, and 141 rural cooperative banks with legal-person status at the county (city) level. Some RCCs have further clarified their property-rights arrangements, improved legal-person governance and internal management, effectively enhanced their business-management capacity.

### **VIII. Reform of foreign-exchange administration deepened**

Monitoring, analysis, and warnings of cross-border capital flows were strengthened. Changes in cross-border capital flows were closely watched, and developments that indicated change of trend were monitored and analyzed in a timely manner. Efforts were made to improve policy scenarios to prevent large fluctuations in cross-border capital flows, improve foreign assets and liabilities statistics, and consolidate the foundation for statistics and monitoring.

Action was taken to promote facilitation of trade and investment. A pilot program was launched for foreign exchange payments of cross-border e-commerce among payment institutions. Efforts were also made to improve administration of the external debt index. The index structure was optimized and adjustments were made to support financing for small- and medium-sized enterprises.

RMB convertibility under the capital and financial account made steady progress. Administration of the foreign debt was streamlined to establish a registration-oriented management system. The RMB Qualified Foreign Institutional Investor (RQFII) scheme was also further improved to include more institutions and channels for investment.

## **Part 3 Financial Market Analysis**

In Q1 2013, performance of China's financial market was healthy and stable. Transactions on the money market increased rapidly and interest rates declined slightly. Both bond transactions and bond issuances grew rapidly. Stock indices edged down while turnover on the stock markets increased to a certain extent. Total assets of the insurance industry continued to grow rapidly. Trading on the foreign-exchange market was active.

## I. Financial market analysis

### 1. Transactions on the money market increased rapidly, and interest rates declined at the end of March

Repo transactions and interbank borrowing on the interbank money market were brisk, with the trading volume increasing significantly. In the first quarter of 2013, the turnover of bond repos totaled 37.8 trillion yuan, with an average daily turnover of 630.6 billion yuan, up 25.5 percent year on year. The turnover of interbank borrowing reached 10.29 trillion yuan, with an average daily turnover of 171.4 billion yuan, up 3 percent year on year. Overnight products still dominated bond repo and interbank borrowing transactions, accounting for 82.1 percent and 85.2 percent of their respective turnovers, up 6 and 0.4 percentage points from the same period of the last year. The turnover of government securities repos on the stock exchanges soared 46.4 percent year on year to reach 10.1 trillion yuan, and both the turnover and growth showed an accelerating trend.

**Table 7 Fund Flows among Financial Institutions in Q1 2013**

Unit: 100 million yuan

	Repo		Interbank lending	
	Q1 2013	Q1 2012	Q1 2013	Q1 2012
Domestically-funded large banks <sup>①</sup>	-127,464	-115,482	-19,508	-21,874
Domestically-funded small- and medium-sized banks <sup>②</sup>	27,354	49,142	-6,580	7,791
Securities and fund management companies	38,383	26,664	12,690	6,945
Insurance companies	18,544	11,526	—	—
Foreign-funded financial institutions	5,903	4,792	3,311	1,620
Other financial institutions <sup>③</sup>	37,280	23,359	10,087	5,518

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

2 Domestically-funded small- and medium-sized banks include the China Merchants Bank and 16 other medium-sized banks, small-sized city commercial banks, rural commercial banks, rural cooperative banks, and village and township banks.

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

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

Source: China Foreign Exchange Trade System.

In terms of financing among the various financial institutions, the flow of funds showed the following characteristics: First, on the whole domestically-funded large banks remained the net fund provider, and the amount of their net lending increased slightly; second, the net borrowing of small- and medium-sized banks declined notably; third, there was an increasing demand for funding among securities firms and fund management companies, and their net borrowing in the first quarter posted 5.11 trillion yuan, 1.75 trillion yuan more than that during the same period of the last year.

Interest rates on the money market were stable, with much less volatility. At the end of March, interest rates edged down and in general were lower than those during the same period of the last year. In March, the weighted average interest rate of bond-pledged repo and interbank borrowing posted 2.46 percent and 2.47 percent respectively, down 0.16 and 0.14 percentage points from December 2012 and down 0.20 and 0.11 percentage points year on year. As the central bank launched new liquidity management tools, interest-rate movements on the money market around the time of the Spring Festival was much less volatile than in previous years. Due to factors such as brisk transactions on the stock market and the issuance of convertible bonds, interest rates reached a quarterly high at the end of February and declined rapidly thereafter. At end-March, the overnight and 7-day Shibor rate posted 2.68 percent and 3.39 percent respectively, down 118 and 119 basis points from end-2012, and the 3-month and 1-year Shibor rates were 3.88 percent and 4.40 percent, down 2 basis points and flat with end-2012, respectively.

Trading of RMB interest-rate swaps increased slightly. In the first quarter of 2013, the aggregate notional principal of RMB interest-rate swaps amounted to 737.58 billion yuan, an increase of 50.1 percent year on year. In terms of the maturity structure, RMB interest-rate swaps with maturities within one year traded most briskly, and their aggregate notional principal amounted to 577.02 billion yuan, accounting for 78.2 percent of the total. In terms of the reference rate, the base rate of the floating end of the RMB interest-rate swaps mainly included the 7-day fixing repo rate and the Shibor, and their notional principal accounted for 55.7 percent and 43.1 percent of the total respectively. Transactions of bond forwards posted 100 million yuan.

Table 8 Transactions of Interest-Rate Derivatives, 2006 through Q1 2013

	Interest-rate swaps		Bond forwards		Forward-rate agreements	
	Transactions (lots)	Amount of notional principal (100 million yuan)	Transactions (lots)	Amount (100 million yuan)	Transactions (lots)	Amount of notional principal (100 million yuan)
2006	103	355.7	398	664.5	—	—
2007	1,978	2,186.9	1,238	2,518.1	14	10.5

2008	4,040	4,121.5	1,327	5,005.5	137	113.6
2009	4,044	4,616.4	1,599	6,556.4	27	60.0
2010	11,643	15,003.4	967	3,183.4	20	33.5
2011	20,202	26,759.6	436	1,030.1	3	3.0
2012	20,945	29,021.4	56	166.1	3	2.0
Q1 2013	5,533	7,375.8	1	1.0	—	—

Note: In 2009, the statistics for forward bond transactions were changed to the settlement amount.  
Source: China Foreign Exchange Trade System.

## 2. Both bond transactions and bond issuances increased rapidly

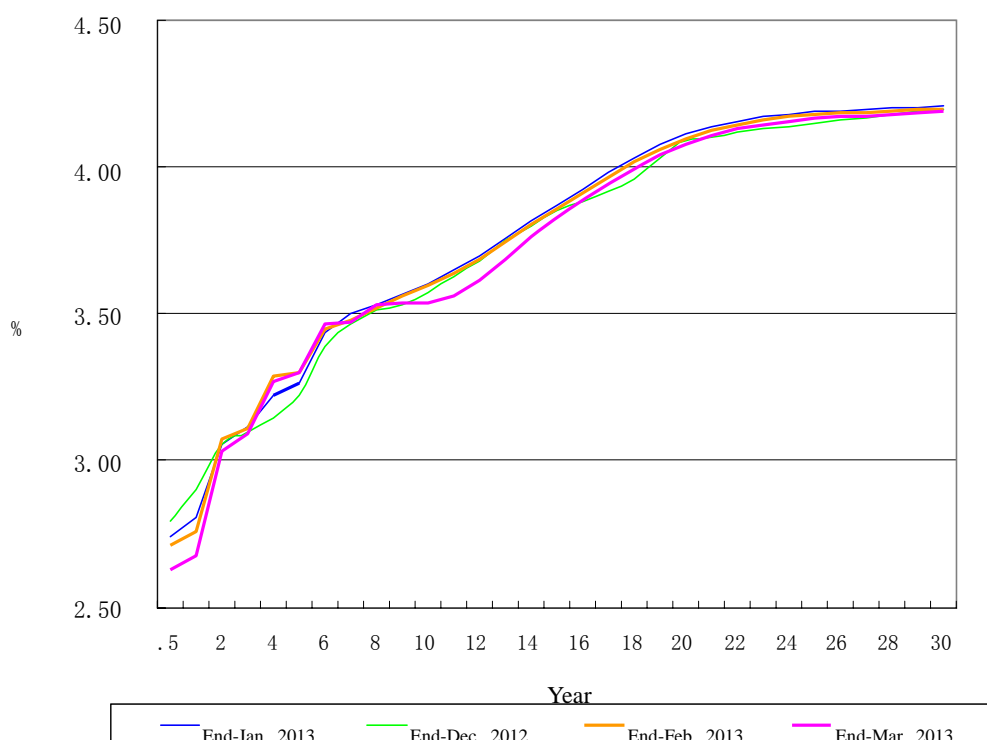
The turnover of spot bond transactions on the interbank market grew significantly. In the first quarter of 2013, a total of 21.7 trillion yuan of spot bonds was traded, with a daily average of 361.6 billion yuan, up 48.5 percent year on year. In terms of trading entities, domestically-funded large banks and foreign-funded financial institutions were net bond buyers on the interbank bond market, with net purchases of 113.7 billion yuan and 70 billion yuan respectively; domestically-funded small- and medium-sized banks were net bond sellers, with a total amount of 225 billion yuan. A total of 20.5 billion yuan of government securities was traded on the stock exchanges in the first quarter of 2013, representing a decline of 2.5 billion yuan year on year.

The bond indices rose slightly. The China Bond Composite Index (net price) rose from 100.69 points at the beginning of the year to 101.17 points at end-March, up 0.48 percent, whereas the China Bond Composite Index (full price) rose from 111.63 points to 112.44 points, up 0.73 percent. The government securities index on the stock exchange rose from 135.80 points at the beginning of the year to 136.96 points at end-March, up 0.85 percent.

The yield curves of government securities showed a pattern of moving downward at the short ends, moving upward at the medium ends, and a leveling off at the long ends. At end-March, the average yields of 6-month, 10-year, 15-year, and 20-year government securities were 17, 3, 2, and 1 basis points lower than those at the beginning of the year, whereas the average yields of 5-year and 7-year government securities were higher than those at the beginning of the year.

Bond issuances grew significantly. In the first quarter of 2013, a total of 1.95 trillion yuan of bonds was issued, 405.4 billion yuan more than that during the same period of the last year. In particular, the issuance of corporate debenture bonds posted 1079.5 billion yuan, 405.4 billion yuan more than that during the same period of the last year, due mainly to the increase in the issuance of debt-financing instruments, corporate bonds, and enterprise bonds by non-financial institutions. At end-March, outstanding bonds of all kinds posted 27.85 trillion yuan, an increase of 23.1 percent year on year.

### Figure 4 Yield Curves of Government Securities on the Interbank Bond Market



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

Table 9 Issuance of Major Bonds in Q1 2013

Type of bonds	Issuance (100 million yuan)	Year-on-year growth (100 million yuan)
Government securities <sup>1</sup>	2,634	455
Financial bonds <sup>2</sup>	6,039	-456
Of which: Policy financial bonds issued by the China Development Bank and other policy banks	4,896	-376
Corporate debenture bonds <sup>3</sup>	10,795	4,054
Of which: Debt-financing instruments issued by non-financial firms	7,473	2,827
Enterprise bonds	2,161	485
Corporate bonds	951	536
Sub-total	19,469	4,054

Notes: 1. Including municipal bonds issued by the Ministry of Finance on behalf of local governments.

2. Including policy financial bonds issued by the China Development Bank and other policy banks, bank ordinary bonds, bank subordinate bonds, bank hybrid bonds, bonds issued by securities companies, etc.

3. Including debt-financing instruments issued by non-financial firms, enterprise bonds and corporate bonds, convertible bonds, bonds with detachable warrants, privately placed SME debts, etc.

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

Co., Ltd.

The issuance rates of government securities were generally stable, with a slight increase. The interest rate of 5-year government bonds issued in March 2013 was 3.15 percent, up 20 basis points from those of the same maturity issued in November 2012; the interest rate of 7-year government bonds was 3.42 percent, up 17 basis points from those of the same maturity issued in November 2012; the interest rate of 10-year government bonds was 3.52 percent, down 3 basis points from those of the same maturity issued in December 2012. The Shibor played a greater role in bond pricing. In the first quarter of 2013, 145 fixed-rate enterprise bonds issued on the primary market were all based on the Shibor, with a gross issuance volume of 215.1 billion yuan. In addition, a total of 113.1 billion yuan of short-term fixed-rate financing bills was issued based on the Shibor, accounting for 55 percent of total issuances of short-term fixed-rate financing bills.

### **3. The volume of bill financing increased slightly, while bill financing rates showed a downward trend**

The bill acceptance business grew rapidly. In the first quarter of 2013, commercial bills issued by enterprises totaled 5.4 trillion yuan, representing year-on-year growth of 35.1 percent; outstanding commercial bills at end-March 2013 posted 9.2 trillion yuan, representing year-on-year growth of 27.9 percent. At end-March, outstanding bankers' acceptance bills increased 897.3 billion yuan from the beginning of the year, representing an acceleration of 329.6 billion yuan year on year. In terms of issuing entities, outstanding bankers' acceptance bills were mainly issued by enterprises in the manufacturing, wholesale, and retail industries. In particular, small- and medium-sized enterprises issued about two-thirds of the total bankers' acceptance bills. The steady growth of the bill acceptance business provided greater funding support to the real sector, in particular to small- and medium-sized enterprises.

The amount of bill financing increased slightly, whereas bill financing rates showed a downward trend. In the first quarter of 2013, the cumulative amount of commercial bills discounted by financial institutions posted 9.5 trillion yuan, representing year-on-year growth of 67.3 percent; at end-March the outstanding balance of commercial bills increased 21.6 percent year on year to 2.2 trillion yuan. The balance of bill financing at end-March increased by 102.9 billion yuan from the beginning of the year, with a deceleration of 154.6 billion yuan year on year and accounting for 3.3 percent of all categories of loans, up 0.2 percent year from the corresponding period during the last year. Because there was abundant liquidity in the banking system during the first quarter of 2013, interest rates on the money market showed a declining trend, and while the funding supply on the bill market increased, the interest rates also showed a downward trend.

#### **4. Stock indices declined slightly, and turnover on the stock market increased to some extent**

Stock indices declined slightly while the Growth Enterprise Board Index rebounded. At end-March 2013, the Shanghai Stock Exchange Composite Index and the Shenzhen Stock Exchange Component Index closed at 2,237 and 8,890 points respectively, shedding 33 and 227 points from end-2012. The Growth Enterprise Board (GEB) Index (Chinext Price Index) of the Shenzhen Stock Exchange closed at 867 points, gaining 153 points from end-2012. The weighted average P/E ratio on the A-share market of the Shanghai Stock Exchange declined from 12.3 times at end-2012 to 12.2 times at end-March 2013, while that of the Shenzhen Stock Exchange rose from 22.2 times to 24.1 times.

Trading volume on the stock market increased somewhat. Affected by a number of factors, such as sanguine sentiments among investors that were boosted by the rally in the stock market in early 2013 and the increase in the number of new accounts, turnover on the Shanghai and Shenzhen stock exchanges increased 26.1 percent year on year to 11.2 trillion yuan in the first quarter of 2013; the daily average turnover posted 200.3 billion yuan, 47 billion yuan more year on year. The volume of transactions on the Growth Enterprise Board amounted to 854.7 billion yuan, up 42.8 percent year on year. At end-March 2013, the market capitalization of the Shanghai and Shenzhen Stock Exchanges posted 18.5 trillion yuan, up 7.1 percent year on year, and the market capitalization of the Growth Enterprise Board amounted to 443 billion yuan, up 69.3 percent year on year.

Financing on the stock markets declined slightly year on year. In the first quarter of 2013, a total of 108.3 billion yuan was raised by enterprises and financial institutions on the domestic and overseas stock markets by way of IPOs, additional offerings, and right issuances, representing a deceleration of 2.1 billion yuan year on year. Among this total, 85.4 billion yuan was raised on the A-share market, 13.9 billion yuan less than that raised during the same period of the last year.

#### **5. Total assets in the insurance industry maintained rapid growth**

In the first quarter of 2013, total premium income in the insurance industry amounted to 515.1 billion yuan and total claim and benefit payments amounted to 148.8 billion yuan, representing year-on-year growth of 27 percent. Specifically, total claim and benefit payments in the property insurance sector increased 27.4 percent, while those in the life insurance sector increased 26.5 percent.

Total assets of the insurance industry registered steady growth. At end-March, total assets of the insurance industry posted 7.67 trillion yuan, an increase of 20.4 percent year on year. Among this total, bank deposits increased 15.9 percent, while



investment-linked assets increased 22.8 percent.

**Table 10 Use of Insurance Funds at End-March 2013**

	Outstanding balance (100 million yuan)		As a share of total assets	
	End-March 2013	End-March 2012	End-March 2013	End-March 2012
Total assets	76,686	63,679	100	100
Of which: Bank deposits	23,992	20,699	31.3	32.5
Investments	46,875	38,184	61.1	60.0

Source: China Insurance Regulatory Commission.

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

In the first quarter of 2013, the turnover of spot RMB/foreign exchange transactions totaled USD 912.4 billion, representing an increase of 4.6 percent year on year. The turnover of RMB/foreign exchange swap transactions totaled USD 725.3 billion, representing an increase of 33.2 percent year on year. Among this total, overnight USD swap transactions amounted to USD 389 billion, accounting for 53.6 percent of the total; the turnover of the RMB/foreign-exchange forward market totaled USD 2.1 billion, a decline of 96.1 percent year on year. The turnover of foreign-currency pair transactions amounted to USD 17.5 billion, a decline of 22.9 percent year on year. In particular, the Euro/USD accounted for the lion's share, or 55.3 percent, up 22.8 percentage points from the same period of the last year. The number of participants in the foreign-exchange market expanded further. At end-March, there were 368 members on the foreign-exchange spot market, 83 members on the forward and swap markets, and 32 members on the foreign-exchange options market.

## 7. The price of gold declined amid fluctuations

The price of gold fluctuated and moved downward. In the first quarter of 2013, the afternoon fixing price of gold on the London market reached a peak of USD 1,693.75 per ounce and a trough of USD 1,568.5 per ounce, and at end-March it closed at USD 1,598.25. On the domestic market, the price of gold (AU9995) peaked at 340.2 per gram and reached a trough of 316.9 yuan per gram. The price of gold closed at 320.0 yuan per gram at end-March, a decline of 14.3 yuan per gram from the end of 2012.

The volume of transactions on the Shanghai Gold Exchange increased steadily. In the first quarter of 2013, a total of 974.04 billion yuan of precious metals was traded on the Shanghai Gold Exchange, representing an increase of 15.1 percent year on year. In particular, the trading volume of gold was 1,932.4 tons, an increase of 16.4 percent

year on year, and the turnover posted 633.0 billion yuan, an increase of 10.9 percent year on year; the trading volume of silver was 54,000 tons, an increase of 36.4 percent year on year, and the turnover posted 336.15 billion yuan, an increase of 24.1 percent year on year; the trading volume of platinum was 14.5 tons, an increase of 7.2 percent year on year, and the turnover posted 4.89 billion yuan, an increase of 5.9 percent year on year.

## **II. Institutional Building in the Financial Market**

### **1. Allowing QFIIs to invest in the interbank bond market**

To broaden the investment channels for QFIIs and to regulate their investment behavior, in March 2013 the PBC issued the *Notice on Issues Related to Investments in the Interbank Bond Market by Qualified Foreign Institutional Investors*, allowing QFIIs that have secured a qualification certificate from the CSRC and an investment quota from the SAFE to apply to the PBC to invest in the interbank bond market.

### **2. Improving institutional arrangements in the securities market**

The building of a multi-tiered capital market made new progress. On January 16, the National SME Share Transfer System became operational and began to provide services for public transfers, financing, and M&A activities of non-listed shareholding companies. Since then, the pilot program of small-scale and regional share transfers for non-listed companies has been gradually rolled out nationwide.

Innovation in securities products was further promoted. On February 18, the CRBC issued the *Interim Rules on the Operation of Public-Placed Securities Investment Funds by Asset-Management Institutions*, which lowered the threshold for securities companies, insurance asset-management companies, and privately-placed securities fund management institutions to engage in the public fund management business. In addition, eligible equity investment companies, private equity investment companies, and other asset-management institutions can apply to engage in the fund management business. On March 15, the CSRC issued the *Administrative Measures on the Asset Securitization Business of Securities Companies*, specifying the underlying asset categories, trading structure, and transaction models and broadening the business space for securities companies.

### **3. Improving institutional arrangements in the insurance market**

Strengthening the building of the insurance market system. The CIRC released basic service standards for three types of intermediary institutions, including specialized insurance agents, insurance brokers, and public assessment institutions, and required that these intermediary institutions formulate their business operational standards and strengthen their service procedural management. Examination and approval work for branch offices of insurance companies was standardized and simplified.

Advancing the reform of the insurance fund-use system. With respect to the pilot program of the asset-management business for insurance asset-management companies, efforts were made to strengthen and improve their investment management capacity, specify the investor base, types of products, examination and approval procedures, and investment areas of raised capital. Insurance asset-management companies can, after receiving approval from the CSRC, engage in publicly-placed fund management business.

The coverage of insurance services was broadened. Efforts were made to promote the pilot mandatory insurance program for localities with industries with high environmental risks, such as the heavy metal industries and the oil and petrochemical industries, and to promote the sound development of insurance business for major illnesses.

In addition, the financing channels for insurance companies were broadened. Insurance groups (or shareholding companies) were allowed to issue subordinated bonds.

#### **4. Promoting the sound development of the gold market**

On March 25 RMB/gold forward transactions were launched in the Shanghai Gold Exchange. The new business will help meet the hedging needs of market players, further increase liquidity for gold price inquiries in the interbank market, and enhance the functions of the gold market.

## **Part 4 Macroeconomic Analysis**

### **I. Global economic and financial developments**

Global economic prospects have improved since the beginning of 2013. The recovery of the U.S. economy gained momentum with multiple indicators posting readings better than expected. Supported by stronger domestic consumption and other factors, the Japanese economy also showed some positive signs. Growth remained vibrant in most of the emerging markets. But recent events in Cyprus cast a shadow over the development of the European sovereign debt crisis and prospects for growth in the euro zone remained dim.

#### **1. Economic development in the major economies**

Growth in the U.S. gained momentum. The first estimate for annualized quarter-on-quarter growth in Q1 was 2.5 percent. But industrial output and retail sales outperformed market expectations, showing a stronger momentum for growth. The

housing market continued to recover. Further improvements were also seen on the labor market, with unemployment dropping to 7.6 percent in March. Inflation was kept at a subdued level. However, uncertainties remained due to the lack of a solution to the pending budget cuts and the debt ceiling problems, as well as due to the absence of a medium-term fiscal consolidation framework, which may put a drag on economic growth. The still high unemployment rate may undermine the sustainability of the recovery of consumption.

Growth in the euro zone was weak, with a 0.6 percent year-on-year contraction of GDP in 2012. Since the beginning of 2013, the momentum for consumption and investment growth remained lackluster. At end-March, the reading of the PMI was below 50 for 14 consecutive months, and the HICP declined to 1.7 percent, a record low since September 2010. Meanwhile, unemployment reached a historical high of 12.1 percent since the establishment of the euro zone. On March 7, the ECB made downward adjustments to projections of euro zone growth in 2013 and 2014, to -0.5 percent and 1.0 percent respectively, each 0.2 percentage point lower than the estimation made in December of last year.

The Japanese economy showed positive signs. The Household Consumer Confidence Index surged from 39.2 in December 2012 to 44.8 in March 2013, indicating enhanced domestic demand. Due to the increase in energy imports and the higher costs of imports as a result of the depreciation of the yen, Japan's trade account continued to register a deficit. Deflation did not end in Japan, and implementation of the monetary easing and the yen depreciation had not yet fanned inflationary expectations. In order to meet the 2 percent inflation target within two years, the Bank of Japan announced more aggressive "quantitative and qualitative monetary easing." The monetary and fiscal policies in Japan were subject to great uncertainties due to domestic political pressures.

**Table 11 Macroeconomic and Financial Indices of the Major Economies**

Country	Index	2011Q4			2012Q1			2012Q2			2012Q3			2012Q4		
		Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.
United States	Real GDP Growth Rate (annualized quarterly rate,%)	2.0			1.3			3.1			0.4			2.5 (initial value)		
	Unemployment Rate (%)	8.3	8.3	8.2	8.1	8.2	8.2	8.2	8.1	7.8	7.9	7.8	7.8	7.9	7.8	7.8
	CPI (YOY,%)	2.9	2.9	2.7	2.3	1.7	1.7	1.4	1.7	2.0	2.2	1.8	1.7	1.6	1.8	1.7
	DJ Industrial Average (closing number)	12633	12952	13212	13214	12393	12880	13009	13091	13486	13096	13025	13104	13861	13025	13104
	NASDAQ (closing number)	2814	2967	3092	3046	2827	2935	2940	3067	3116	2977	3010	3019	3142	3010	3019

Euro Area	Real GDP Growth Rate (quarterly YOY, %)	-0.1			-0.2			-0.1			-0.6					
	Unemployment Rate (%)	10.8	10.9	11.0	11.2	11.3	11.4	11.4	11.5	11.6	11.7	11.8	11.8	12.0	11.7	11.7
	HICP (YOY, %)	2.7	2.7	2.7	2.6	2.4	2.4	2.4	2.6	2.6	2.5	2.2	2.2	2.0	2.2	2.2
	EURO STOXX 50 (closing number)	2422	2477	2459	2423	2257	2381	2479	2509	2518	2525	2551	2569	2641	2551	2569
Japan	Real GDP Growth Rate (annualized quarterly rate, %)	6.1			-0.9			-3.7			0.2					
	Unemployment Rate (%)	4.5	4.5	4.5	4.5	4.4	4.3	4.3	4.2	4.3	4.2	4.2	4.3	4.2	4.1	4.2
	Core CPI (YOY, %)	-0.1	0.1	0.2	0.2	-0.1	-0.2	-0.3	-0.3	-0.1	0.0	-0.1	-0.2	-0.2	-0.1	-0.2
	NIKKEI225 (closing number)	8455	8803	9723	10084	9521	8543	9007	8695	8840	8928	9446	10395	11139	9446	10332

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

In the majority of the emerging markets, growth momentum remained robust, but external uncertainties were heightened. The EMI rose to 53.9 in January, a record high since September 2012, and the Manufacturing New Orders component reached a historical peak since April 2011. The EMI stood at 52.3 in February and remained in the territory above 50, showing strong growth momentum in the majority of the emerging markets. However, the monetary easing in the advanced economies that was unprecedented in terms of both duration and size already posed challenges to cross-border capital flows in some of the emerging markets. Such pressures will add to the difficulties of macroeconomic management in these countries. Also, the possibility of imported inflation in the medium and long term should not be neglected.

## 2. Development of the global financial market

Amidst continued monetary easing by the advanced economies and a brighter global economic outlook in Q1, risk aversion faded on the international financial market. Major stock indices went all the way up, while the price of gold plunged. Due to the announcement by the Japanese government that it would launch a huge fiscal stimulus and more aggressive monetary easing, the yen depreciated rapidly and the yield of Japanese government bonds ratcheted down. Moreover, the Cyprus rescue sent a shock to the European and international financial markets.

Major reserve currencies depreciated against the US dollar while there was differentiation in the movement of the currencies in the major emerging market against the US dollar. On March 29, the exchange rate of USD/EUR, USD/GBP, and

JPY/USD closed at 1.2818, 1.5201, and 94.19 respectively. Since the end of 2012, the euro, British pound, and Japanese yen depreciated by 2.8 percent, 6.5 percent, and 7.9 percent respectively against the US dollar. Among the major emerging market currencies, the South African rand, the South Korean won, and Argentinean peso depreciated by more than 4 percent over end-2012, and the depreciation of rand was as much as 8.3 percent. However, the Mexican peso and the Thai baht appreciated by more than 4 percent against the US dollar.

The USD Libor edged down while the Euribor fluctuated at a subdued level. On March 28, the 1-year Libor was 0.7315 percent, a decline of 0.112 percentage point from the end of 2012. The 1-year Euribor registered 0.547 percent, an increase of 0.005 percentage point from the end of the last year.

T-bond yields in the U.S. and Germany went sideways with fluctuations, while those in Japan continued to fall. On March 28, 10-year T-bond yields in the U.S., Germany, and Japan closed at 1.852 percent, 1.27 percent, and 0.516 percent respectively, up 15.7 basis points, and down 3 and 28.7 basis points compared with end-2012.

The major stock indices continued to rally. On March 28, the Dow Jones Industrial Average Index and the NASDAQ Composite Index closed at 14579 and 3268 points respectively, gaining 11.3 percent and 8.2 percent over end-2012. In particular, the Dow Jones hit record highs on several trading days. The STOXX50 Index closed at 2698 points, climbing 5 percent over end-2012. On March 29, the Nikkei 225 Index closed at 12398 points, surging by 19.3 percent over the end of the last year.

After increasing, international oil prices dropped. On March 28, the Brent Crude Oil Futures Price closed at USD 110.02, decreasing by 1.0 percent compared with end-2012, while the NYMEX WTI futures price closed at USD 97.23, 5.9 percent higher compared with the end of the last year.

### 3. Monetary policies in the major economies

The major advanced economies continued to implement quantitative easing policies and some even launched additional quantitative easing policies. In its January and March statements, the FOMC announced that it would keep the target range for the federal funds rate at 0 to 0.25 percent and it would continue to link the adjustment of the interest rate with the development of inflation and the unemployment rate. After the conclusion of Operation Twist, the Fed began to purchase agency mortgage-backed securities at a pace of USD 40 billion per month and longer-term Treasury securities at a pace of USD 45 billion per month. On March 7, the ECB announced that it would keep the interest rate on the main refinancing operations, the rate on the deposit facility, and the rate on the marginal lending facility at the historically low levels of 0.75 percent, 1.5 percent, and 0 percent, and it decided that it would continue monetary accommodations. Up till now, the ECB has not yet

activated the Outright Monetary Transactions. The Bank of Japan kept the range of the uncollateralized overnight call rate at 0 to 0.1 percent. In a joint statement with the government, the Bank of Japan set an inflationary target of 2 percent and introduced a method for asset purchases without a termination date at a pace of 13 trillion yen per month, which will not end until the price target is met. At the beginning of April, the Bank of Japan decided to change the target for monetary policy operations from the uncollateralized overnight call rate to the monetary base. Quantitative and qualitative monetary easing was introduced in order to double the monetary base and the outstanding amounts of Japanese Government Bonds (JGB), as well as more than double the average remaining maturity of JGB purchases, so as to achieve the 2 percent inflation target within two years. The Bank of England maintained the Bank Rate at 0.5 percent, and the size of asset purchases at 375 billion pounds remained unchanged.

Monetary policy in some of the emerging markets was more accommodative. The Reserve Bank of India lowered the repo rate on January 29 and March 19, each by 25 basis points to 7.5 percent. The cash reserve ratio was reduced by 25 basis points to 4 percent. On March 8, the Central Bank of Mexico cut the benchmark interest rate by 50 basis points to 4 percent. The Central Bank of the Republic of Turkey cut the overnight lending rate, which is at the upper end of the interest-rate corridor, on three occasions by a total of 150 basis points to 7.5 percent. The National Bank of Poland reduced the target benchmark interest rate on three occasions to 3.25 percent. The Magyar Nemzeti Bank lowered the benchmark interest rate by 25 basis points on three occasions to 5 percent. The State Bank of Vietnam cut its benchmark interest rate by 100 basis points to 8 percent.

#### 4. World economic outlook and major risks

Uncertainty is still weighing on global economic prospects, and global growth in 2013 is expected to remain low. In the *World Economic Outlook* released in April, the International Monetary Fund (IMF) revised downward the projection for global growth to 3.3 percent. The IMF made downward revisions to the projections for growth in the U.S. to 1.9 percent and in the emerging markets and developing economies to 5.25 percent. Growth in the euro area was forecast to be -0.3 percent. The forecast for growth in Japan was revised upward to 5.25 percent.

Going forward, major risks in the global economy include the following: First, the sovereign debt crisis remains the most prominent risk threatening global growth. Although the Cyprus rescue plan alleviated the European sovereign debt situation for the time being, risks still remain. Risks in the Slovenian banking system are looming large, and political uncertainty in Italy and its impact on the reform process should also be watched. Spain is troubled by a serious deficit and banking problems, while the long-term fiscal sustainability of Greek government finances faces severe challenge. In France, fiscal consolidation progressed slower than market expectations,

and unemployment went up further. All these factors may undermine efforts to seek a solution to the sovereign debt crisis.

Second, uncertainties surrounding U.S. fiscal policy might continue to pose risks for both U.S. and global growth. Fiscal problems will remain a challenge for the U.S. government in the months to come. The Republicans and Democrats will continue to wrestle with the spending cuts and the debt ceiling. If not handled properly and promptly, these may adversely impact the U.S. and global economies.

Third, the accommodative monetary policy adopted by the advanced economies and its negative spillovers should be watched carefully. The introduction of the qualitative and quantitative easing monetary policy by the Bank of Japan may aggravate concerns about competitive currency devaluation. Moreover, negative spillovers, such as large fluctuations of capital flows and exchange movements caused by an unconventional monetary policy, should not be ignored.

Fourth, trade and investment protectionism is on the rise. The slow and difficult recovery of the major advanced economies, the persistently high unemployment rate, the lack of effective measures and sufficient room to stimulate growth, as well as the acute political polarization and rising populism in some of the advanced economies have caused frictions in international trade and risks in cross-border investments.

## **II. Analysis of China's macroeconomic performance**

China began the year 2013 with stable economic and social development and steady economic growth in the first quarter. Consumption remained relatively stable, investment grew rapidly, and growth of imports and exports rebounded. The agricultural sector performed well, while profits in the industrial sector rose to previous levels. Price levels remained stable. Job creation in urban areas remained within a reasonable range. In the first quarter, the Gross Domestic Product (GDP) reached 11.9 trillion yuan, growing by 7.7 percent year on year, a deceleration of 0.4 percentage point from the same period of 2012, expanding by 1.6 percent on a quarter-on-quarter basis. The Consumer Price Index (CPI) rose 2.4 percent in year-on-year terms. The trade surplus totaled USD 43.1 billion.

### **1. Consumption remained steady, investment growth accelerated, and the growth of imports and exports rebounded**

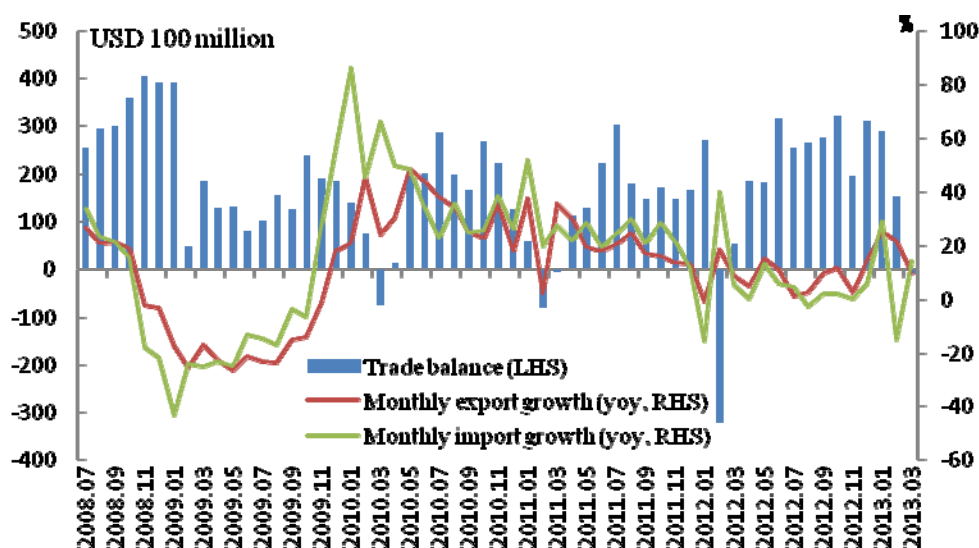
The income of urban and rural residents continued to rise and consumer demand grew steadily. In the first three months of 2013, the per capita disposable income of urban residents reached 7,427 yuan, representing year-on-year growth of 9.3 percent in nominal terms or 6.7 percent in real terms; the per capita cash income of rural residents registered 2,871 yuan, up 12.2 percent in nominal term, or 9.3 percent in real terms. The PBC survey of urban depositors in the first quarter shows that the



residents' income sentiment index rose for the third consecutive quarter to reach 54.6 percent. Retail sales of consumer goods totaled 5.5 trillion yuan, representing year-on-year growth of 12.4 percent in nominal terms, down 2.4 percentage points compared with the first quarter of 2012 mainly due to a moderation in price increases and a marked drop in the retail growth of statistically large catering businesses. Adjusted for inflation, retail sales grew by 10.8 percent year on year, a modest acceleration of 0.1 percentage point. Growth of rural retail sales outpaced that in urban areas, with urban retail sales increasing 12.2 percent year on year to 4.8 trillion yuan, while rural retail sales expanded 13.9 percent to 755.7 billion yuan.

Fixed-asset investments grew at a relatively rapid pace. In the first quarter, fixed-asset investments (excluding investments by rural households) totaled 5.8 trillion yuan, up 20.9 percent year on year in nominal terms. The price-adjusted real growth posted 20.7 percent, an acceleration of 2.5 percentage points from the same period of the last year. Broken down by region, fixed-asset investments in the eastern, central, and western regions grew 19.4 percent, 24.1 percent, and 24.2 percent respectively, showing that investment growth in the central and western regions remained faster, albeit at a smaller pace. Broken down by industry, fixed-asset investments in the primary, secondary, and tertiary industries grew 31.4 percent, 16.2 percent, and 24.5 percent respectively year on year.

**Figure 5 Growth of Imports and Exports, and the Trade Balance**



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

Growth of imports and exports rebounded, and the trade surplus widened. In the first quarter, imports and exports increased 13.4 percent year on year to USD 974.61 billion. Exports recorded USD 508.87 billion, up 18.4 percent year on year, an acceleration of 10.8 percentage points; imports registered USD 465.74 billion, up 8.4 percent year on year, an acceleration of 1.5 percentage points. The trade surplus

totaled USD 43.1 billion, an increase of USD 42.9 billion year on year. Trade volume with the United States and the ASEAN countries grew steadily, whereas trade volume with the EU and Japan dropped. Broken down by structure, exports of mechanical and electronic products, high-tech products, and labor-intensive products rose in a steady manner. Gaining momentum, imports and exports by private enterprises expanded by 50.7 percent year on year, bringing their share of total imports and exports to 37.1 percent, up 9.2 percentage points from the same period of the last year. Utilized FDI recorded USD 29.91 billion, up 1.4 percent year on year. FDI utilization by the western region grew at a rapid pace of 18.3 percent year on year.

## **2. The agricultural sector performed well and the growth of industrial output moderated**

In the first quarter, the value-added of the primary, secondary, and tertiary industries reached 742.7 billion yuan, 5,456.9 billion yuan, and 5,685.9 billion yuan respectively, up 3.4 percent, 7.8 percent, and 8.3 percent year on year. The shares of the three industries as a percentage of GDP were 6.25 percent, 45.91 percent, and 47.84 percent respectively, with the share of tertiary industry increasing 1.89 percentage points from the first quarter of 2012.

The agricultural sector performed well. A survey of the agricultural production plans of over 90,000 rural households across the country shows that in 2013 planned rice-growing acreage rose 1.0 percent and planned corn-growing acreage expanded 4.1 percent. The total output of meat, including pork, beef, mutton, and poultry, posted 22.87 million tons, up 2.6 percent year on year. Among this total, pork production reached 15.54 million tons, an increase by 2.8 percent year on year.

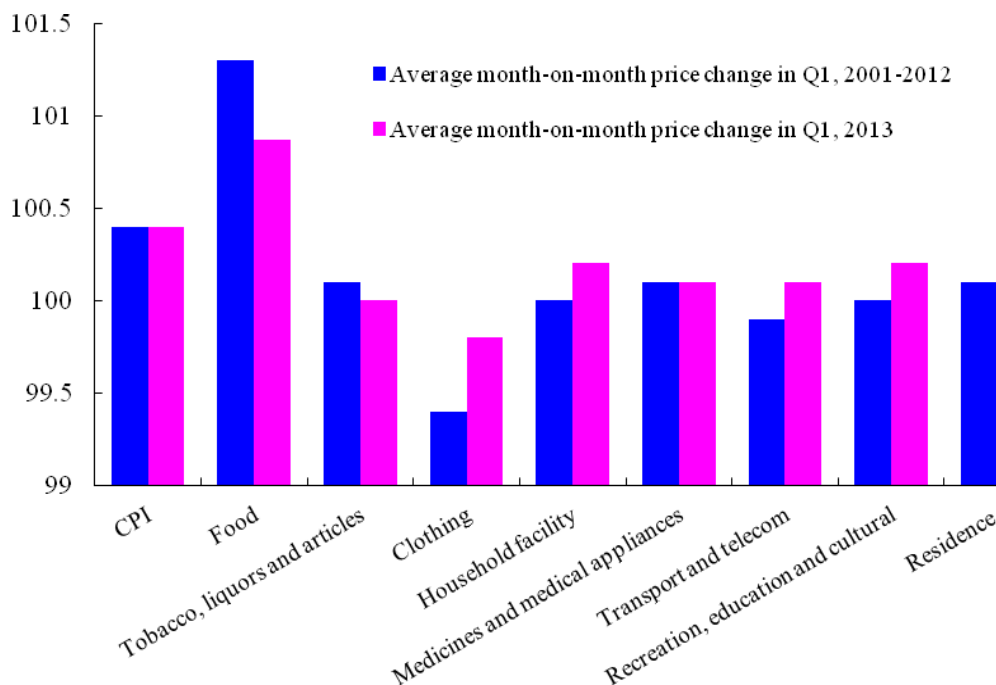
Growth of industrial output moderated. In the first three months, the value-added of statistically large enterprises grew by 9.5 percent year on year, representing a deceleration of 2.1 percentage points from the first quarter of 2012 or a decline of 0.5 percentage point from 2012 as a whole. Profits of industrial enterprises increased. Statistically large enterprises reported total profits of 1.2 trillion yuan in the first quarter, up 12.1 percent year on year and an acceleration of 13.4 percentage points. Returns on total assets of statistically large enterprises from their main businesses posted 5.28 percent, which was flat with the level in the first quarter of 2012. The share of sold industrial products of statistically large enterprises declined 0.2 percentage point year on year to 97.2 percent. The PBC survey of 5,000 industrial enterprises in the first quarter shows a pickup in the business index, rising 0.8 percentage point quarter on quarter to 62.6 percent. The enterprise market demand index posted 52.4 percent, up 1.4 percentage points from the last quarter of 2012.

## **3. Overall price levels remained stable**

After picking up, consumer price growth moderated due to seasonal factors. The CPI rose 2.4 percent year on year in the first quarter, representing a modest rise of 0.3

percentage point compared with the previous quarter. In the first three months, the CPI rose 2.0 percent, 3.2 percent, and 2.1 percent respectively. Food prices increased 3.8 percent year on year, accounting for 1.3 percentage points in the rise of the CPI; prices of non-food items rose 1.7 percent year on year, contributing to a 1.1 percentage point rise in the CPI. Broken down by goods and services, prices grew 2.3 percent year on year for consumer goods, and 2.8 percent for services. In month-on-month terms, the overall average CPI increase in the first quarter was flat with the historical average. Specifically, the average month-on-month price increases were below the historical averages of food, tobacco, liquors and articles, flat with the historical averages of medicine and medical appliances, and above the historical averages of other items.

**Figure 6 Average Month-on-Month CPI in Q1 Compared with the Historical Averages**



Sources: National Bureau of Statistics; Calculations by PBC staff.

The quarter-on-quarter drop in producer prices continued to slow down. In the first quarter, the Producer Price Index (PPI) fell by 1.7 percent year on year, representing a deceleration of 0.6 percentage point from the last quarter. Specifically, the prices of consumer goods, which reversed the downward trend in the previous quarter, went up by 0.6 percent year on year and contributed to a PPI rise of 0.2 percentage point, while the prices of capital goods dropped 2.5 percent, contributing to a PPI decrease of 1.9 percentage points. Industrial producer purchasing prices dropped by 1.9 percent year on year, down 0.9 percentage point from the previous quarter. The CGPI declined by 1.3 percent year on year, representing a deceleration of 0.8 percentage point

quarter on quarter. In terms of monthly changes, the producer price indexes in March dropped from February at an accelerated pace, ending the rebound during the previous months. In the first quarter, producer prices of agricultural products went up by 1.9 percent year on year, a rise of 1.6 percentage points from the last quarter, and the prices of agricultural capital goods went up by 3.5 percent, down 0.1 percentage point from the last quarter.

The prices of imports dropped at a slower pace. In the first quarter, import prices went down by 1.8 percent year on year, down 0.5 percentage point from the last quarter. Monthly growth registered -5.0 percent, -1.7 percent, and 1.3 percent respectively in the first three months of 2013. Export prices declined by 0.1 percent year on year, compared with a rise of 0.2 percent in the last quarter, and monthly growth registered 0.7 percent, -0.2 percent, and -0.9 percent respectively. The movement of import prices was driven by changes in commodity prices. The average price of crude oil futures on the New York Mercantile Exchange dropped by 8.4 percent year on year in the first quarter, a quarter-on-quarter rise of 7.0 percent; the average prices of spot copper and aluminum on the London Metals Exchange dropped by 4.5 percent and 8.0 percent respectively year on year, or a rise by 0.3 percent for each on a quarter-on-quarter basis.

The GDP deflator fell slightly. The GDP registered 11.9 trillion yuan in the first quarter, up 7.7 percent year on year in real terms. The change in the GDP deflator (as a ratio of the nominal GDP versus the real GDP) was 1.7 percent, down 1.3 percentage points year on year or 0.1 percentage point from 2012 as a whole.

The price reform of resource products was advanced. The National Development and Reform Commission (NDRC) announced a set of measures to further improve the pricing of oil products, including reviewing the price levels at shorter intervals of 10 working days instead of the previous 22 working days, removing the price adjustment threshold, which was a 4 percent change in the average oil price in international markets, and updating the list of oil products in international markets that are used as reference for domestic oil prices to reflect the evolving structure of crude oil imports and the development of crude oil trade in international markets, effective March 27. With these improvements, price reviews will become more frequent and the timings of the price reviews will be more transparent, which will make domestic oil prices more responsive to price changes in international oil markets.

#### **Box 4 Correct Readings of the Price Indexes**

Many indicators are used to measure inflation or deflation in an economy, for example, the Consumer Price Index (CPI), the Producer Price Index (PPI), and the GDP deflator. Depending on the base period that is used for comparison, these price indicators are categorized as fixed-base price indexes, year-based price indexes, or chain price

indexes. A fixed-base price index measures price changes over different periods against the price level in a fixed-base period, a year-based price indicator tracks price changes relative to the price level in the same period of the previous year, while a chain price indicator measures prices in each period against the price in the previous period. Indicators from these different categories can be convertible using the following formula:

$$\text{Chain price index} = \frac{\text{fixed-base price index in the reporting period (month)}}{\text{fixed-base price index in the previous period (month)}}$$
$$\text{Year-based price index} = \frac{\text{fixed-base price index in the reporting period (month)}}{\text{fixed-base price index in the same period (month) of the previous year}}$$
$$\text{Annual price index} = \frac{\text{average of the cumulative fixed-base price indexes in the year}}{\text{average of the cumulative fixed-base price indexes in the previous year}}$$

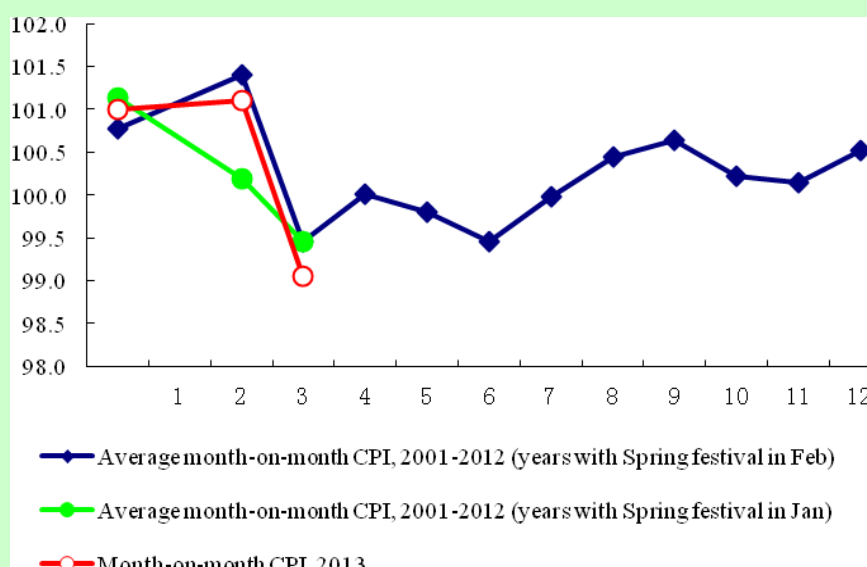
Different price indicators are used for different purposes. Fixed-base price indicators capture longer-term price trends as they track price changes from the same price level during a fixed-based period. Year-based price indicators represent price movements within one year and thus exclude disruptions from seasonal factors. It is also easier to conduct a relevancy analysis across different year-based index series. The weakness of year-based price indicators, however, is that they do not reflect short-term price changes and there is a certain lag. Chain price indicators are more relevant to capture the most recent price changes. Month-on-month chain price indicators capture price movements in one month in comparison with the price level in the previous month, thus reflecting price changes between two consecutive months and the latest price developments.

It is important to note that chain indicators have strong seasonal fluctuations and before being used they need to be adjusted for seasonal factors. In the case of the CPI, the month-on-month CPI goes up faster before and during the Spring Festival, but it slows down quickly after the festival. As shown in Figure 7, the average month-on-month CPI tends to peak in January and fall sharply in February when the Spring Festival falls in January of the year. Similarly, it goes up dramatically in

February before a sharp drop in March when the Spring Festival falls in February. As the Spring Festival fell in February 2013 and in January 2012, the combined effects of a low base level and seasonal hikes drove the year-on-year CPI from 2.0 percent in January to 3.2 percent in February, and then dragged it down to 2.1 percent in March. Moreover, the month-on-month CPI typically goes up faster in September and December, and moderates in March and June.

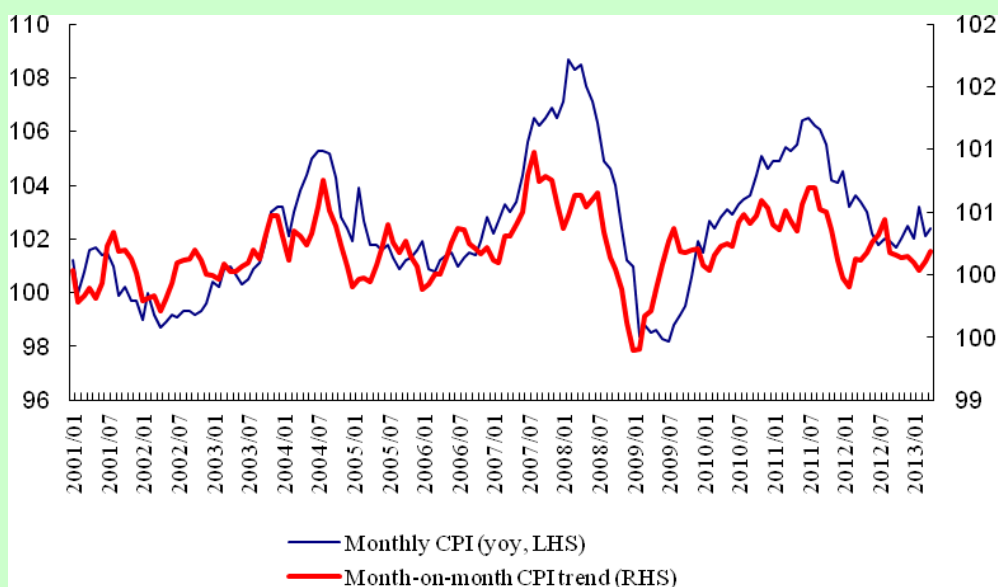
Seasonally adjusted chain price indexes are more efficient to capture the latest price movements. For example, the seasonally adjusted month-on-month CPI reached a peak in August 2007 before starting the downward trend, while the year-on-year CPI dropped in February 2008. In another case, the seasonally adjusted month-on-month CPI trend troughed in February 2009 and then picked up, while the year-on-year CPI followed suit in July 2009 (Figure 8). It should be noted that different seasonal adjustment techniques may result in different seasonally adjusted series. An accurate and timely analysis of price developments requires a comprehensive reading of the fixed-based, year-based, and chain price indexes and a focus on the seasonally adjusted chain price indexes.

**Figure 7 Seasonal fluctuations of the month-on-month CPI**



Sources: National Bureau of Statistics; Calculations by PBC staff.

**Figure 8 Year-on-Year CPI and Seasonally Adjusted Month-on-Month CPI Trends**



Sources: National Bureau of Statistics; Calculations by PBC staff.

#### 4. Growth of fiscal revenue slowed down

In the first quarter, fiscal revenue grew by 6.9 percent year on year to 3.2 trillion yuan, representing a deceleration of 7.8 percentage points from the first quarter of 2012, whereas fiscal expenditures registered 2.7 trillion yuan, up 12.1 percent year on year, down 21.5 percentage points from the first quarter of 2012. As a result, revenue was 499.72 billion yuan more than expenditures.

In the fiscal-revenue structure, tax revenue posted 2.7 trillion yuan, up 6.0 percent year on year and representing a deceleration of 4.3 percentage points from the first quarter of 2012. Tax revenue growth decelerated markedly mainly because of the moderation in economic growth, structural tax cuts, and the moderation in the growth of imports. The deceleration also reflected the effect of a strong base because part of the end-2011 revenue was registered at the beginning of 2012. In particular, year-on-year growth of the domestic VAT, the domestic consumption tax, the business tax, the corporate income tax, the VAT and excise tax on imported products, and the personal income tax were 5.2 percent, 2.2 percent, 14.0 percent, 25.6 percent, -28.7 percent, and 9.0 percent respectively.

In the fiscal-expenditure structure, social security and employment, education, and

general public services were large expenditure items, accounting for 15.6 percent, 14.1 percent, and 10.3 percent of total fiscal expenditures respectively. Fiscal expenditures on programs related to people's well-being and other key programs were enhanced, with the fastest growing spending items being culture, sports, and media, health care, government-subsidized housing, and energy conservation and environmental protection, growing by 21.9 percent, 22.2 percent, 26.4 percent, and 28.0 percent year on year respectively.

### **5. Employment remained stable**

In the first quarter, a total of 3.42 million people joined the urban work force. The registered unemployment rate in urban areas posted 4.1 percent at end-March, at a par with that at end-2012.

A statistical analysis conducted by the China Human Resources Market Information Monitoring Center on public employment service agencies in 100 cities shows that in the first quarter, overall supply and demand in the labor market were balanced, with the ratio of job vacancies to job seekers remaining at 1.1, exceeding 1 for eleven consecutive months. Both job openings and job seekers declined compared with during the same period of 2012. Broken down by region, job vacancies and job seekers grew in the western region and dwindled in the eastern and central regions. Most job vacancies were concentrated in the secondary and tertiary industries. Broken down by sectors, demand for labor rose in the manufacturing, construction, leasing and commercial services, resident services, and other service sectors. In the labor market, job seekers with medium or high skill levels were in short supply, with the ratio of job vacancies to job seekers reaching high levels in job openings for senior technicians, technicians, engineers, and advanced skilled workers, and the demand for medium-level skilled workers going up significantly year on year.

### **6. The balance of payments became more balanced**

The overall Balance of Payments (BOP) registered a net surplus, but the surplus narrowed significantly. In 2012, the overall BOP surplus decreased by 56 percent year on year to USD 176.3 billion. The current account surplus was USD 193.1 billion, or 2.3 percent of GDP, a level that is within a reasonable range by international standards. The capital and financial account registered a net outflow, running a deficit of USD 16.8 billion, compared with a surplus of USD 265.5 billion in 2011.

The growth of external debt moderated, and the share of the outstanding short-term external debt rose. As of end-2012, the stock of China's external debt stood at USD 737.0 billion, up 6.0 percent year on year. Among this total, registered external debt outstanding posted USD 445.5 billion, at par with that of last year, whereas outstanding short-term external debt posted USD 540.9 billion, growing by 8.0 percent and accounting for 73.4 percent of the total, up 1.3 percentage points year on year.



## 7. Sectoral analysis

Industrial profits continued to rebound. In the first quarter, among the 41 industrial sectors, 29 reported a year-on-year growth in profits, 9 saw declines in profits, 2 saw profits as compared with losses in the first quarter of 2012, and 1 suffered losses. Specifically, profits rose by 330.0 percent in the ferrous metal smelting and rolling industry, 90.5 percent in the electricity and heat generation and distribution industry, and 10.6 percent in the auto industry. The oil refinement industry reported profits, compared with losses in the same period of the last year.

### (1) The real-estate sector

In the first quarter, sales of commercial housing grew rapidly year on year, but the growth slowed down significantly from the first two months. Among the 70 large and medium cities, more cities reported year-on-year increases in housing prices. Growth of investment in property development as a whole went up from 2012.

The number of cities where housing prices registered increases in year-on-year and month-on-month terms increased. In March, the price of newly built commercial residential housing increased year on year in 67 out of the 70 large and medium cities, representing an increase of 27 cities from December 2012, and the largest year-on-year growth was 11.2 percent. It increased in 68 cities in month-on-month terms, a rise of 14 from December 2012, or the sharpest increase since 2011. The price of pre-owned residential housing gained year on year in 59 cities and month on month in 66 cities, which were 24 and 20 cities more than the number in December 2012 respectively.

Growth of commercial housing sales in the first quarter was faster than that in 2012 as a whole, but it slowed down from the first two months. The sold floor area of commercial real estate nationwide posted 210 million square meters, up 37.1 percent year on year, an acceleration of 35.3 percentage points from 2012 or a deceleration of 12.4 percentage points from the first two months. Sales of commercial real estate reached 1,399.2 billion yuan, representing year-on-year growth of 61.3 percent, an acceleration of 51.3 percentage points from 2012 or a deceleration of 16.3 percentage points from the first two months. Commercial residential housing accounted for 90.4 percent of the total in terms of sold floor area and 85.7 percent of the total in terms of the volume of turnover.

Investment in real-estate development gained pace year on year, but slowed down from the first two months. In the first quarter, completed investment in real-estate development rose 20.2 percent year on year to 1,313.3 billion yuan, up 4.0 percentage points from 2012 but down 2.6 percentage points from the first two months of this year. In particular, completed investment in commercial residential housing reached 901.3 billion yuan, or 68.6 percent of the total. The floor area of newly built housing dropped 2.7 percent year on year to 390 million square meters, a deceleration of 4.6

percentage points from 2012. The floor area of housing under construction grew by 17.0 percent to a total of 4.79 billion square meters, an acceleration of 3.8 percentage points from 2012. The floor area of completed housing increased 8.9 percent year on year to a total of 190 million square meters, representing an acceleration of 1.6 percentage points from the last year.

In line with the *Circular of the General Office of the State Council on Further Improving Management of the Real-Estate Market Management* (State Council General Office Document [2013] No.7), measures will be taken to speed up the planning and construction of affordable housing projects with the aim of completing 4.7 million units and beginning the construction of 6.3 million units of affordable housing in 2013.

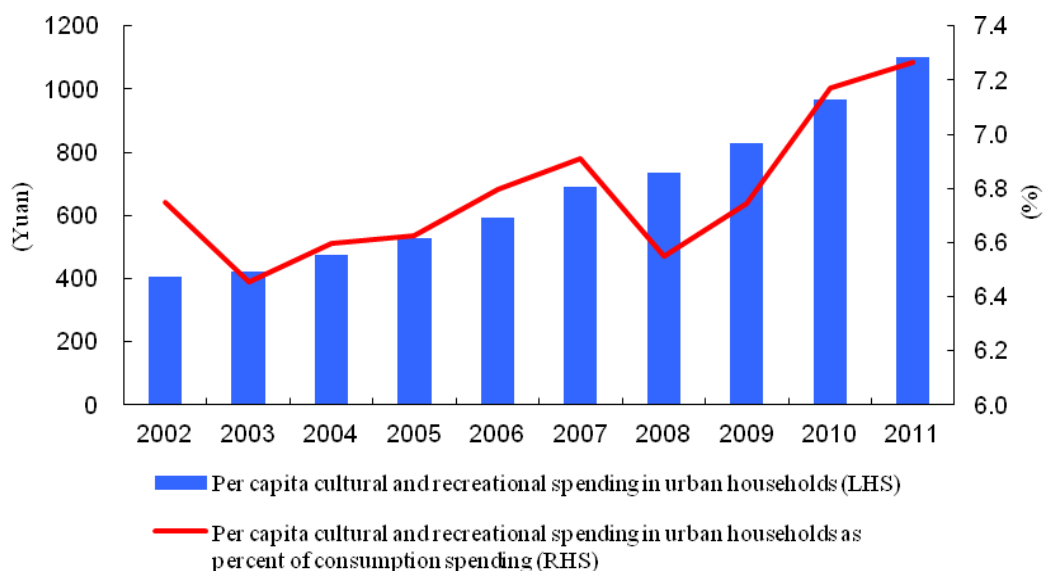
As of end-March, outstanding loans for affordable housing development stood at 613.99 billion yuan, up 42.4 percent year on year, outpacing the overall growth of real-estate development lending by 30.1 percentage points. Moreover, the pilot program that allows the use of housing provident fund loans to finance affordable housing development was advanced steadily. As of end-March, a total of 47.02 billion yuan of loans was disbursed under that program to 193 affordable housing projects in 52 cities based on their construction progress, and recovery of the principal reached 7.02 billion yuan.

## **(2) Cultural industry**

The cultural industry is an important vehicle that promotes the flourishing and development of socialist culture in a market economy. It is an important way to satisfy the diversified cultural needs of the people and a key area where progress will contribute to adjustments in the economic restructuring and the shift in the economic development pattern. As envisioned in the blueprint set out in the statement of the 6<sup>th</sup> plenary session of the 17<sup>th</sup> CPC Central Committee, by 2020 the cultural industry will become a pillar of economic development.

The total output of the cultural industry is growing steadily, as is the consumption of cultural products increasing. With years of growth, the cultural industry has revealed enormous potential and prospects and has become a new area that fuels economic growth. As of end-2012, overall audience coverage of broadcast programs reached 97.5 percent and that television programs reached 98.2 percent. In 2012, the cultural industry produced 506 television dramas in 17,703 episodes, and 745 drama movies. The industry published 47.6 billion pieces of newspaper, 3.4 billion issues of magazines, and 8.1 billion copies of books. Public demand for cultural products continues to grow.

**Figure 9 Size and Share of Per Capita Cultural and Recreational Spending in Urban Households**



Sources: National Bureau of Statistics; Calculations by PBC staff

A diversified and multi-layered investment financing system has been established, providing more financing channels for the cultural industry. The government has increased support to the cultural industry and budget funds are playing an effective role in leveraging funding from other sources. Banks also enhanced financial support to the cultural industry with innovative financial products and credit lines. As of end-March 2013, outstanding medium and long-term loans by key financial institutions to cultural, sports, and recreational programs reached 121.9 billion yuan, representing a year-on-year increase of 35.1 percent. The securities market became a new source of funding, as a large number of cultural companies went public in domestic and overseas markets, and investment funds, including equity investment funds, targeted the cultural and creative industries, leading to the growth of private investment institutions. Insurance companies also developed pilot insurance products tailored for cultural companies to support the development of the cultural industry.

The cultural industry must grow stronger and more competitive before it becomes a pillar industry in the economy. An industrial upgrading is necessary by improving the economies of scale and making the industry more intensive and professional. Making innovative cultural products and services, fostering a stronger sense of cultural-product consumption, and developing new bestsellers are needed to reflect structural changes in consumption and new demands. More financial products that suit the needs of the cultural industry, and a strong multi-layered risk-sharing lending and compensation mechanism, as well as access to direct financing by qualified cultural companies and investments of different kinds, are important to enhance

financial support to the cultural industry.

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

### **I. Outlook for the Chinese economy**

Looking ahead, the environment for the development of the Chinese economy will remain complicated, including both positive factors to support stable growth as well as challenges and constraints. Overall, the fundamentals that support long-term growth remain unchanged. Human capital, infrastructure, industrial capacity, and supporting industries have all improved. With the great potential of industrialization and urbanization and supported by the macro-economic policies and the structural adjustment measures, the economy is expected to continue its stable development.

In terms of the external environment, the engines for strong global growth have not yet emerged and some deep-rooted institutional problems are yet to be resolved. Despite the many uncertainties, positive changes are taking place. The leveraged ratio of the U.S. household sector has declined notably, helping the recovery of consumer spending and the real-estate sector. The development of new energy industries also is supporting stronger growth from the supply side. The economy in the euro area has become more stable after the liquidity support measures of the ECB and the global economy is expected to continue its slow recovery. The OECD Composite Leading Indicators have rebounded for several months. According to the Quarterly Entrepreneur Survey conducted by the PBC in Q1, the export order expectation index reached 51.1 percent, a rise of 3.2 percentage points quarter on quarter.

On the domestic front, the localities are still keen to pursue growth. Demand for investment is rather large, as reflected by the rebound of total planned investment for new projects. The number of ongoing projects has remained stable and the rapid growth of investment is expected to continue. In Q1, the total planned investment for new projects increased 14.0 percent year on year to 4.1 trillion yuan; the total planned investment for ongoing projects increased 19.1 percent year on year to 45.7 trillion yuan. The contribution of consumption is expected to grow as the consumption rate began to rebound in 2012. In Q1, final consumption contributed 4.3 percentage points to GDP growth, exceeding that of capital formation by 2 percentage points. According to the Depositors' Survey conducted in Q1, the future income confidence index went up 0.9 percentage point year on year to reach 55.8 percent. Development of the tertiary industry accelerated. In Q1, the tertiary industry's share in GDP reached 47.8 percent and contributed a larger share to GDP growth than that of the secondary industry. Confidence in the enterprise sector was strengthened, as reflected by the rise

in the entrepreneur confidence index for two consecutive quarters to reach 68 percent in Q1, growth of the market demand expectation index and the domestic order expectation index rose by 4.3 percentage points and 2.8 percentage points to reach 56.5 percent and 51.4 percent respectively, and the enterprise performance expectation index and the profit expectation index recovered from the lows in the previous quarter. In general, domestic demand has the potential to achieve sustainable development.

Nevertheless, there are risks and challenges in the current economic situation. Some chronic problems remain to be resolved. The foundation for stable growth and endogenous drivers are yet to be strengthened. As exports, real estate, and other existing drivers have revealed some weaknesses, investment depends to a very large extent on infrastructure and state investment. The debt and leveraging levels of some enterprises have increased, and the fund-raising channels of some local platforms have become more complicated. Resources and the environment are overstretched and will further constrain economic activities. The major economies are increasing their monetary accommodation, the Bank of Japan has adopted an unprecedented monetary easing, and some central banks have further reduced interest rates. Therefore, global capital flows will continue to be massive and volatile. The stronger spillovers and growing volume of capital inflows have supported pro-cyclical credit expansion in China and have increased difficulties for macro-economic management through financial sector policies. It is necessary to accelerate structural adjustments and reform, transform the pattern of economic development, and improve the quality of growth. Effective measures will be taken to establish various mechanisms, including new financing mechanisms for urbanization, mechanisms to support the development of the service industry, long-term mechanisms to boost consumer spending, and incentive mechanisms to enhance environmental protection, so that new sources of sustainable growth will emerge and the endogenous drivers and dynamics of economic growth will become stronger.

The price situation is relatively stable. However, it is necessary to closely monitor the uncertain factors. In Q1, quarter-on-quarter GDP growth moderated, economic performance was generally stable, and the prices of commodities and production factors were stable. All these are positive factors supporting price stability. According to the quarterly Depositors' Survey conducted by the PBC in Q1, the future price expectation index declined 3.3 percentage points from the previous quarter. However, the unstable factors should be watched closely. First, the prices of services and agricultural produce face upward pressures. Prices of resource products and some other regulated prices are gradually being straightened out. Therefore, potential upward pressures are building. Second, given the trend of moderation in the growth rate, price demand elasticity is on the rise. As such, it is easier for the recovery of aggregate demand and macro-economic stimulus policies to drive up prices. The recent round of housing price hikes may be transmitted to and amplify cost pressures in related sectors. In addition, due to climatic factors, there are still some uncertainties

regarding maintaining stable agricultural output this year. The recent decline in consumer prices was related to special factors including containment of extravagant activities and the spread of epidemics. In general, it is not advisable to be overly optimistic about price movements during the next stage. Forward-looking measures will be taken to guide and manage inflationary expectations and prevent inflationary risks.

## **II. Monetary policy in the next stage**

The PBC will follow the overall arrangements of the State Council, follow the principle of seeking progress amidst stability, focus on the theme of higher quality and higher efficiency in economic growth, continue to implement a sound monetary policy, make policy measures more forward-looking, targeted, and flexible, consider the overall need to pursue stable growth, control inflation, and prevent risks, properly manage the focus, intensity, and pace of policy measures, preserve a stable monetary environment, make efforts to improve financial services to the real sector, and maintain stability of overall price levels. Reform will be deepened to further strengthen the role of market mechanisms and improve the allocation of financial resources and the transmission mechanism for monetary policy in order to promote sustainable and sound growth of the economy.

First, a mix of monetary policy instruments will be used, including quantity-based and price tools, and the macro-prudential policy framework will be improved to properly manage liquidity and guide the stable and proper growth of money, credit, and all-system financing aggregate. In view of the balance of payments situation and the supply and demand of liquidity, a combination of liquidity management instruments will be used, such as open market operations, the deposit reserve requirement ratio, central bank lending and discounts, and other innovative instruments to keep liquidity in the banking system at reasonable levels and to guide the stable movement of market interest rates. The macro-prudential policy will continue to play a counter-cyclical role, and the parameters will be adjusted as appropriate based on the changes in economic performance indicators, the soundness of financial institutions, and implementation of credit policy to guide financial institutions to support the development of the real sector in a more targeted manner.

Second, credit resource allocations will be optimized and structural adjustments of credit assets will be enhanced. Financial institutions will be guided to enhance credit support for economic structural adjustments, in particular, lending to farmers, the agricultural sector, and rural customers, micro and small enterprises, the modern service sector, and the emerging strategic industries, and to satisfy the financing needs of ongoing and follow-up key national projects. Financial services to improve the people's livelihood will be further improved, and financial support and services will be provided to support balanced regional development. Lending to energy-intensive, highly polluting industries and those with excess capacity will be strictly controlled.

Differentiated housing mortgage policies will continue to be implemented to support the construction of welfare housing and common commercial housing projects that have apartments with modest floor plans and purchases by first-time home buyers of common commercial housing for one's own use, and to contain purchases for speculative investment purposes.

Third, the market-based interest-rate reform and the RMB exchange-rate regime reform will be advanced to improve allocation efficiency in the financial system and to improve the monetary policy framework. The market-based interest-rate mechanism will be established and improved. Financial institutions will be guided to strengthen pricing capability, properly use their discretion in offering rates within a floating range of the benchmark interest rates, strengthen non-deposit liability management and cost constraints, properly assess interest-rate risks, and maintain pricing order. Furthermore, financial market development and innovation will be advanced, more efforts will be made to build a market interest-rate system and to improve market-based interest-rate transmission channels. Measures will be adopted to improve the ability of the central bank to guide market interest rates, strengthen price-based adjustment mechanisms, and promote the balanced growth of the real and financial sectors. The RMB exchange-rate regime will be improved to enhance the two-way flexibility of the RMB exchange rate, to enable market demand and supply to play a larger role, and to keep the exchange rate basically stable at an adaptive and equilibrium level. Development of the foreign-exchange market will be accelerated to facilitate innovation in exchange-rate risk management. An operational plan for RMB convertibility under the capital and financial account will be formulated. Measures will be taken to support the use of the RMB in cross-border trade and investment activities and more channels will be available for the inflows and outflows of RMB funds. Direct trading of the RMB against other currencies will be promoted to provide better services for RMB settlement of cross-border trade. The impact of the changing international situation on capital flows will be carefully watched and effective monitoring of cross-border capital will be strengthened.

Fourth, there will be continued efforts to promote bond market development and to broaden the direct-financing channels available to enterprises. Innovation will be encouraged as a driver of market development. The market orientation will continue to be followed to facilitate development of the OTC bond market for qualified institutional investors. Risk awareness will be enhanced to promote sound development of the bond market. Eligible small and medium-sized enterprises will be encouraged to raise funds by issuing small and medium-sized enterprise collective bills; eligible commercial banks will be allowed to issue financial bonds earmarked to support micro and small enterprises. The custodian and settlement system, clearing system, centralized trading platform, trade repository, and other core infrastructures will be strengthened to improve efficiency and to prevent systemic risks. The corporate debenture bond inter-agency coordination mechanism will be tapped to enhance regulatory coordination and cooperation and to combine the strength of

various agencies in promoting market development. Market-based constraints and risk-sharing mechanisms will be improved, information disclosure arrangements, the credit-rating system, and the mechanism for investors to use their own judgment and to be responsible for risks in investment activities will be strengthened. The opening-up of the bond market will be advanced gradually to build its international competitiveness.

Fifth, reform of financial institutions will be deepened. Reform of large commercial banks will be boosted so that they will continue to improve corporate governance, improve the modern financial enterprise system, internal governance, and risk management, speed up transformation of the growth pattern and the profit model, and build a capability for innovation and international competitiveness. The Rural Financial Business Division of the Agricultural Bank of China will be advanced to explore sustainable models for financial institutions to provide services on a commercial basis to the agricultural sector, rural customers, and farmers. Development of policy-based finance will be considered as an independent category of financial institutions; the reform of the Export-Import Bank of China and the Agricultural Development Bank of China will be advanced based on the principle of one set of specific policies for each bank and provision of specific guidance. Work will continue to promote the market-based transformation of asset-management companies. A pilot reform of cross-sectoral operations will be implemented on a prudent but progressive basis. Development of financial institutions established with private capital will be supported and the pilot program for local financial sector reform will be advanced to promote the sound development of fund-raising activities outside the financial system.

Sixth, effective measures will be adopted to mitigate systemic financial risks and to preserve stability in the financial system. Macro-prudential regulations will be enhanced to guide financial institutions to operate on a sound basis. Financial institutions will be urged to strengthen internal control and risk management and to continue to improve monitoring of potential risks in innovation and business development. The framework for early warnings and assessments of systemic financial risks will be improved, monitoring and regulation of local government borrowing and bank credit risks will be intensified, while monitoring and assessment of cross-sector, cross-market, and cross-border financial risks will be strengthened to prevent the spread to the financial system of the risks associated with the real economy in some regions, industries, and enterprises and risks arising from financing activities outside the formal financial system. It is necessary to build a crisis management and risk disposal framework and to further efforts to build a deposit insurance scheme. A variety of measures will be taken to preserve financial stability and to safeguard the bottom line in preventing systemic and regional financial risks.