

# **China Monetary Policy Report Quarter Three, 2015**

(November 7, 2015)

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

## **Executive Summary**

In Q3 2015 the performance of the Chinese economy was stable, with positive progress in structural adjustments and new emerging industries, new business models, and new growth drivers. The employment situation was stable. Consumption was making a greater contribution to economic growth. The share of tertiary industry continued to increase. Export growth declined whereas consumer prices picked up moderately. In general, the imbalances in the economic structure remained serious as endogenous drivers need to be strengthened. In Q3, GDP growth was up 6.9 percent year on year and the consumer price index was up 1.7 percent year on year.

Since Q3, in accordance with the decisions and overall arrangements of the Party Central Committee and the State Council, the PBC has continued its sound monetary policy, furthered market-based reforms of the financial market, made efforts to clear up the monetary-policy transmission mechanism, and improved the efficiency of allocations of financial resources. First, a variety of instruments, including open-market operations, medium-term facilities, and a general reduction in the deposit reserve requirement ratio, were used to adjust the liquidity in the banking system. In general, liquidity in the system remained adequate. Second, the benchmark interest rate of RMB deposits and lending as well as the interest rate of open market repo operations were reduced to guide the downward movement of market interest rates and to maintain the real interest rate at a stable level. The monetary environment remained sound and neutral due to the use of quantitative and pricing instruments. Third, management of desirability lending was improved, targeted deposit reserve requirement ratio reduction was applied, and the pilot program of central bank lending with credit assets as collateral was expanded. The credit policy supporting central bank lending, central bank discounts, and pledged supplementary lending was used to guide financial institutions to provide more support to small and micro enterprises, agricultural-related sectors, the reconstruction of shantytowns, and other key areas and weak links in the economy. The financial-market reform was furthered to support economic development and to enable the market to play a decisive role in resource allocations and to further improve the monetary-policy framework. The upper limit of the floating band of deposit rates was removed and the quote mechanism for the central parity rate of the RMB against the US dollar was improved. The time-point assessment of the reserve requirement ratio was replaced by a review of the average level during the assessment period. Measures were taken to enable policy banks and development financial institutions to raise more capital. Capital account convertibility made step-by-step progress and in line with this progress the macro-prudential regulatory framework was

improved. The China International Payment System (Phase I), that is, the RMB's cross-border payment system, began operations to provide clearing and settlement services for the cross-border and offshore RMB business of financial institutions at home and abroad.

The effects of the sound monetary policy continued to unfold. Liquidity in the banking system was adequate and the growth of money and credit was stable and fairly rapid. Interest rates declined notably. The RMB exchange rate was more flexible. At the end of September 2015, outstanding M2 was up 13.1 percent year on year, an acceleration of 1.3 percentage points from the end of June. Outstanding RMB loans were up 15.4 percent year on year, an acceleration of 2.0 percentage points from the end of June, registering an increase of 9.9 trillion yuan from the beginning of 2015, 2.3 trillion yuan more than the increase during the corresponding period of the last year. The stock volume of all-system financing aggregates grew by 12.5 percent year on year, an acceleration of 0.6 percentage point from the end of June. In September, the weighted average loan interest rate offered to non-financial enterprises and other sectors was 5.7 percent, a decline of 0.35 percentage point from June and a decline of 1.08 percentage points from December of last year. At the end of September, the central parity of the RMB against the US dollar was 6.3613 yuan per dollar.

In general, the performance of the global economy was still weak and there was a trend of differentiation, with numerous uncertainties, tepid growth of trade, and more turbulence in the financial markets. Against the background of a global readjustment, the Chinese economy has entered a state of a new normal, facing both structural and cyclical problems. The major challenge is to address the structural problems and to transform the growth model. In the short run, there will be downward pressures. Yet structural adjustments and reforms will inject new vitality for growth in the medium and long run and the economy is expected to be on a path of higher quality and more sustainable growth. It is desirable to achieve breakthroughs in terms of structural adjustments, transformation of the growth model and reform, and a combination of the top-level institutional design with grassroots innovations, nurturing and strengthening of new growth points and expanding the space for the effective allocation of financial resources.

Going forward, the PBC will follow the strategic arrangements of the CPC Central Committee and the State Council, continue to seek progress while maintaining stability, take initiatives to adapt to the new normal, continue its sound monetary policy, and maintain the stability and continuity of a policy stance that is neither too tight nor too loose. When necessary, there will be preemptive adjustments and fine-tuning measures

to prevent a decline in aggregate demand for structural adjustments and to avoid an excessive liquidity supply that might prevent market clearing, so that a neutral and appropriate monetary and financial environment will be created for structural adjustments and transformations and for the upgrading of the economy. A variety of quantitative and price-based monetary instruments will be used, macro-prudential regulation will be enhanced and improved, and the policy mix will be optimized to keep liquidity at adequate levels and to achieve the proper growth of money, credit, and all-system financing aggregates. The fundamental principle of having the financial sector serve the real economy will be followed to activate the stock of credit assets and to optimize the increment for the purpose of improving the financing and credit structure. Numerous measures will be adopted to address the symptoms and root causes and to reduce the financing costs of the real economy. Moreover, there will be an increased focus on reform and innovation. Reform measures will be combined with adjustments and the conduct of monetary policy will be integrated with measures to deepen the reform so as to enable the market to play a decisive role in resource allocations. In view of the financial deepening and innovations, the approach to monetary-policy conduct will be improved, including measures to guide expectations, to step up price-based adjustments and the transmission mechanism, and to smooth out the channels for monetary-policy transmission in order to improve the efficiency of the financial system and services to the real sector. A variety of measures will be adopted to maintain financial stability and to hold on to the bottom line so that neither systemic nor regional financial risks will be allowed to emerge.

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## **Part 1 Money and Credit Analysis**

During the first three quarters of 2015 liquidity in the banking sector was sufficient, with money and credit growing in a stable and relatively rapid manner. The structure of loans continued to improve, there was a marked fall in interest rates, and the RMB exchange rate became more flexible.

### **I. Monetary aggregates grew rapidly**

At the end of September 2015, outstanding M2 stood at 136.0 trillion yuan, up 13.1 percent year on year, representing an acceleration of 1.3 and 0.9 percentage points from end-June and end-2014 respectively. Outstanding M1 stood at 36.4 trillion yuan, up 11.4 percent year on year, marking a notable rebound during the third successive month and representing an acceleration of 7.1 percentage points from end-June. M0 grew by 3.7 percent year on year to 6.1 trillion yuan, representing an acceleration of 0.8 percentage point from end-June. On a net basis, during the first three quarters of the year the central bank pumped cash in the amount of 76.3 billion yuan into the economy, an increase of 48.9 billion yuan year on year. From the start of 2015, M2 growth picked up and increased by 13.1 trillion yuan during the first three quarters, representing an acceleration of 3.6 trillion yuan from the same period of the last year. Commercial banks, through purchases of local government bonds, supplied a substantial amount of money. At present, growth of M2 outpaces that of nominal GDP by a relatively large margin, and thus monetary supply is generally sufficient.

At end-September, outstanding base money registered 28.0 trillion yuan, a decrease of 1.4 trillion yuan from the beginning of the year. The drop was mainly due to hefty liquidity released by cuts in the reserve requirement ratio from the start of 2015, whereas cuts in the reserve requirement ratio did not increase base money. This is also an important reason why outstanding base money dropped but the monetary multiplier increased. At end-September, the money multiplier stood at 4.86, which was 0.24 and 0.69 higher than that at end-June and at end-2014 respectively. The excess reserve ratio of financial institutions was 1.9 percent and that of rural credit cooperatives was 6.7 percent.

### **II. Growth of deposits in financial institutions was generally stable**

At the end of September, outstanding deposits of domestic and foreign currencies in all financial institutions posted 137.9 trillion yuan, up 12.4 percent year on year and an acceleration of 1.8 percentage points from end-June. This was an increase of 13.4 trillion yuan from the beginning of the year and an acceleration of 1.5 trillion yuan year on year. Outstanding RMB deposits registered 133.7 trillion yuan, up 12.6



percent year on year and an acceleration of 1.9 percentage points from end-June. This was an increase of 13.0 trillion yuan from the beginning of the year and an acceleration of 1.9 trillion yuan year on year. Outstanding deposits in foreign currencies registered USD 652.2 billion, up 2.4 percent year on year. This was an increase of USD 41.7 billion from the beginning of the year and a deceleration of USD 94.6 billion year on year. Such developments were related to the RMB exchange rate and expectations about its future movements, but the end-September figure still represented an acceleration of USD 3.2 billion compared with the growth at end-September 2013.

Broken down by sectors, growth of deposits rebounded across the board. At end-September, outstanding household deposits posted 54.2 trillion yuan, up 8.8 percent year on year and an acceleration of 2.6 percentage points from end-June. This represented an increase of 4.0 trillion yuan from the beginning of the year and an acceleration of 291.5 billion yuan year on year. Outstanding deposits in the non-financial corporate sector registered 40.5 trillion yuan, up 9.6 percent year on year, an acceleration of 5.8 percentage points from end-June. This was an increase of 2.7 trillion yuan from the beginning of the year, representing an acceleration of 1.6 trillion yuan year on year. Outstanding fiscal deposits registered 4.1 trillion yuan, an increase of 571.2 billion yuan from the beginning of the year and a deceleration of 546 billion yuan year on year. Outstanding deposits of non-deposit-taking financial institutions registered 13.0 trillion yuan, up 52.5 percent year on year. This represented a deceleration of 11.7 percentage points from end-June, largely due to capital market fluctuations and other factors. However, the end-September figure represented an increase of 3.6 trillion yuan from the beginning of the year and an acceleration of 936.1 billion yuan. In particular, the margins of clients of securities firms declined by 1.1 trillion yuan from the level at end-June, but they increased by 1.6 trillion yuan from the beginning of the year, representing an acceleration of 1.2 trillion yuan year on year. Deposits of special purpose vehicles (including off-balance-sheet wealth management and securities investment funds, trust plans, and so forth) grew by 278.6 billion yuan and 1.1 trillion respectively from end-June and the beginning of the year, representing a deceleration of 788.7 billion yuan year on year.

### **III. Loans of financial institutions registered relatively rapid growth**

At end-September, outstanding loans in domestic and foreign currencies of all financial institutions posted 97.8 trillion yuan, up 14.5 percent year on year and an acceleration of 2.0 percentage points from end-June. This was an increase of 10.1 trillion yuan from the beginning of the year and an acceleration of 1.9 trillion yuan year on year. At end-September, outstanding RMB loans stood at 92.1 trillion yuan, representing growth of 15.4 percent year on year and an acceleration of 2.0 percentage points from end-June. This was an increase of 9.9 trillion yuan from the beginning of the year and an acceleration of 2.3 trillion yuan year on year.

Broken down by sectors, growth of RMB loans to the household sector continued to accelerate, whereas loans to non-financial businesses and other sectors remained relatively stable. At end-September, outstanding RMB loans to the household sector posted 26.2 trillion yuan, up 16.2 percent year on year and representing an acceleration of 0.7 percentage point from end-June. This was an increase of 3.0 trillion yuan from the beginning of the year and an acceleration of 346.1 billion yuan from the same period of the previous year. Among this total, home mortgage loans grew by 1.8 trillion yuan from the beginning of the year, an acceleration of 599.2 billion yuan year on year. At end-September, outstanding loans to non-financial businesses and other sectors posted 64.4 trillion yuan, up 13.2 percent year on year at par with that at the end of the previous two quarters. This was an increase of 6.0 trillion yuan from the beginning of the year and an acceleration of 958.9 billion yuan year on year. In terms of the maturity brackets of RMB loans, new medium- and long-term RMB loans increased 5.2 trillion yuan from the beginning of the year, an acceleration of 689.5 billion yuan year on year. The share of new medium- and long-term RMB loans in total new loans was 52.9 percent. Outstanding short-term loans (including bill financing) increased by 4.3 trillion yuan from the beginning of the year, an acceleration of 1.4 trillion yuan year on year. Among this total, bill financing grew by 1.4 trillion yuan from the beginning of the year, representing an acceleration of 662 billion yuan year on year. Broken down by institutions, the loan growth of Chinese-funded large-sized banks and small- and medium-sized banks registered a larger year-on-year acceleration.

**Table 1 RMB Loans of Financial Institutions during the First Three Quarters of 2015**

Unit: 100 million

	New loans	Acceleration
Chinese-funded large-sized banks ①	48497	11287
Chinese-funded small- and medium-sized banks②	47299	12223
Small-sized rural financial institutions③	12212	-388
Foreign-funded financial institutions	289	-368

Notes: ①Chinese-funded large-sized banks refer to banks with assets (both in domestic and foreign currencies) of 2 trillion yuan or more (according to the amount of total assets in both domestic and foreign currencies at end-2008).

②Chinese-funded small- and medium-sized banks refer to banks with total assets (both in domestic and foreign currencies) of less than 2 trillion yuan (according to the amount of total assets in both domestic and foreign currencies at end-2008).

③Small-sized rural financial institutions include rural commercial banks, rural cooperative banks, and rural credit cooperatives.

Source: People's Bank of China.

The growth of foreign-currency–denominated loans decelerated year on year. At end-September, outstanding foreign-currency loans of financial institutions posted USD 884.3 billion, down 1.6 percent year on year. This was an increase of USD 3.8 billion from the beginning of the year, representing a year-on-year deceleration of USD 95.6 billion. In particular, in September foreign-currency–denominated loans fell by USD 50.5 billion. In terms of the loan structure, outward loans increased by USD 45.6 billion from the beginning of the year, and short-term loans to non-financial businesses and other sectors decreased by USD 41.8 billion.

#### **IV. Growth of stocks of all-system financing aggregates**

According to preliminary statistics, stocks of all-system financing aggregates reached 134.7 trillion yuan at end-September, up 12.5 percent year on year, posting growth for three consecutive months and representing an acceleration of 0.5 percentage point from end-June. Flows of all-system financing aggregates were 11.94 trillion yuan during the first three quarters, a deceleration of 578.6 billion yuan year on year. With regard to the composition of the flows, off-balance-sheet financing and foreign-currency–denominated loans registered a large year-on-year deceleration. It is worth noting that new issues of local government bonds posted over 2 trillion yuan during the first three quarters of the year, most of which was used for the replacement of debt stocks of local government financing vehicles (such as bank loans, trust loans, and so forth). Since in the statistics of all-system financing aggregates local government financing vehicles are included in the non-financial corporate sector, whereas local governments are not covered in the all-system financing aggregates, the replacement of local government debt in effect reduces the stocks of all-system financing aggregates. If this is factored in, the financial system’s support of the real economy was larger than that in previous years.

Growth of all-system financing aggregates during the first three quarters of the year was characterized by the following: first, RMB loans to the real economy grew markedly and their share of all-system financing aggregates increased significantly. During the same period, new RMB loans accounted for 75.3 percent of the flows of all-system financing aggregates, up 14.2 percentage points from the same period of the previous year. Second, foreign-currency–denominated loans decelerated notably from the same period of the last year. New loans denominated in foreign currencies decreased by an equivalent of 266 billion yuan during the first three quarters of the year, a deceleration of 504.4 billion yuan year on year. Third, the combined amount of bond and equity financing on the domestic market by non-financial enterprises posted 2.38 trillion yuan during the first three quarters of the year, an acceleration of 180 billion yuan year on year. This amount accounted for 20 percent of the increment in all-system financing aggregates during the same period of the last year, hitting a new historical high and representing an acceleration of 2.4 percentage points year on year.

At end-September, enterprise bond financing registered month-on-month growth during four consecutive months, with the amount during the third quarter accelerating by 318.3 billion yuan year on year. Fourth, the growth of off-balance-sheet financing, including trust loans, entrusted loans, and undiscounted bankers' acceptances, decelerated year on year. During the first three quarters of the year, the combined amount of new entrusted loans, trust loans, and undiscounted bankers' acceptance bills registered 476.6 billion yuan, a decrease of 1.56 trillion yuan year on year, accounting for 4.0 percent of the increment in the all-system financing aggregates, down by 12.3 percentage points from the same period of the last year.

**Table 2 The Increment in All-system Financing Aggregates during the First Three Quarters of 2015**

Unit: 100 million yuan

	All-system financing aggregates <sup>①</sup>	Of which:						
		RMB loans	Foreign-currency-denominated (RMB equivalent)	Entrusted loans	Trust loans	Undiscounted bankers' acceptances	Enterprise bonds	Financing by domestic institutions via domestic stock markets
First three quarters of 2015 <sup>②</sup>	119,408	89,923	-2,660	10,081	566	-5,871	18,460	5,383
Y-o-y change	-5,786	13,475	-5,044	-5,466	-3,036	-7,063	-550	2,350

Notes: ① The increment in the all-system financing aggregates refers to the total volume of financing provided by the financial system to the real economy (the non-financial corporate sector and the household sector in the domestic market) during a certain period of time.

② Data for the current period are preliminary, and the y-o-y change is calculated on a comparable basis.

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

**Table 3 Stocks of All-system Financing Aggregates at End-September 2015**

Unit: 100 million yuan

	All-system financing aggregates <sup>①</sup>	Of which:						
		RMB loans	Foreign-currency-denominated (RMB equivalent)	Entrusted loans	Trust loans	Undiscounted bankers' acceptances	Enterprise bonds	Financing by domestic institutions via domestic stock markets
End-September 2015 <sup>②</sup>	1,347,032	904,756	33,329	103,498	54,057	63,240	134,654	43,045
Y-o-y change <sup>③</sup>	12.5	14.0	-7.5	18.8	4.2	-10.8	20.4	17.4

Notes: ① All-system financing aggregates refer to the total volume of financing provided by the financial system to the real economy (the non-financial corporate sector and the household sector in the domestic market) during a certain period of time.

② Data for the current period are preliminary.

③ Stocks are based on the value as shown in the accounts or the face value. The y-o-y change is annualized and based on comparable data.

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

## **V. Interest rates on deposits and loans of financial institutions generally declined**

Lending rates continued to drop. In September the weighted average loan interest rate offered to non-financial companies and other sectors was 5.70 percent, down 0.35 percentage point and 1.08 percentage points from June 2015 and December 2014 respectively. In particular, the weighted average of ordinary loans posted 6.01 percent, down 0.45 percentage point from June; the weighted average bill financing rate was 4.29 percent, up 0.28 percentage point from June. The home mortgage loan interest rate generally fell, with the weighted average rate posting 5.02 percent in September, down 0.51 percentage point from June.

The share of loans with interest rates below, at, or above the benchmark rates remained generally stable. In September, the share of loans with interest rates lower than the benchmark rate was 15.59 percent, down 1.84 percentage points from June, whereas the share of loans offered at the benchmark rate was 17.61 percent, up 1.84 percentage points from June; and loans offered above the benchmark rate accounted for 66.80 percent of the total, at par with that in June.

**Table 4 Shares of Loans with Rates at, above, or below the Benchmark Rate, January through September 2015**

Unit: %

Month	Lower than the benchmark	At the benchmark	Higher than the benchmark					
			Sub-total	(1, 1.1]	(1.1, 1.3]	(1.3, 1.5]	(1.5, 2.0]	2.0 以上
January	10.20	19.93	69.87	19.90	25.31	11.87	9.37	3.42
February	10.83	19.40	69.77	19.18	23.72	12.22	10.89	3.76
March	11.30	19.77	68.93	18.65	23.14	12.55	10.58	4.01
April	12.33	16.59	71.08	19.18	22.98	12.79	11.53	4.60
May	12.58	16.20	71.22	17.08	24.00	12.95	12.34	4.85
June	17.43	15.77	66.80	15.70	21.18	12.63	12.42	4.87
July	13.91	15.76	70.33	15.55	22.32	13.00	13.44	6.02
August	15.88	14.81	69.31	15.22	21.69	13.00	13.12	6.28
September	15.59	17.61	66.80	16.50	20.03	11.40	12.57	6.30

Source: The People's Bank of China.

The deposit and lending rates of foreign currencies edged down due to fluctuations in the interest rates on international markets and changes in supply and demand for foreign currencies on the domestic market. In September, the weighted average interest rate of large-value US dollar demand deposits and large-value US dollar deposits with maturities within 3 months registered 0.12 percent and 0.57 percent respectively, down 0.04 and 0.06 percentage point respectively from June. The weighted average interest rates of US dollar loans with maturities within 3 months and of those with maturities between 3 to 6 months (including 3 months) posted 1.43 percent and 1.93 percent respectively, down respectively 0.13 percentage point and up 0.20 percentage point from June.

**Table 5 Average Interest Rates of Large-value Deposits and Loans Denominated in US Dollars, January through September 2015**

Unit: %

Month	Large-value deposits	Loans
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	Demand deposits	Within 3 months	3–6 months (including 3 months)	6–12 months (including 6 months)	1 year	More than 1 year	Within 3 months	3–6 months (including 3 months)	6–12 months (including 6 months)	1 year	More than 1 year
January	0.14	0.87	1.33	1.75	2.25	1.50	2.06	1.97	2.24	2.50	3.44
February	0.22	0.64	1.35	1.50	1.92	1.54	1.90	2.08	2.15	2.48	3.50
March	0.15	0.71	1.18	1.45	1.97	1.25	1.73	2.28	1.77	2.42	3.42
April	0.13	0.70	1.28	1.46	1.82	1.02	1.66	1.92	1.44	2.21	3.14
May	0.14	0.80	1.28	1.36	2.01	1.05	1.81	1.93	1.92	2.13	2.93
June	0.16	0.63	1.22	1.26	1.94	2.14	1.56	1.73	1.90	2.33	2.86
July	0.17	0.72	1.18	1.36	1.73	1.87	1.82	2.34	2.09	2.13	3.35
August	0.17	0.65	1.15	1.58	1.73	1.68	1.57	1.87	2.02	2.26	3.00
September	0.12	0.57	1.02	1.45	1.53	1.60	1.43	1.93	2.20	2.21	2.88

Source: The People's Bank of China.

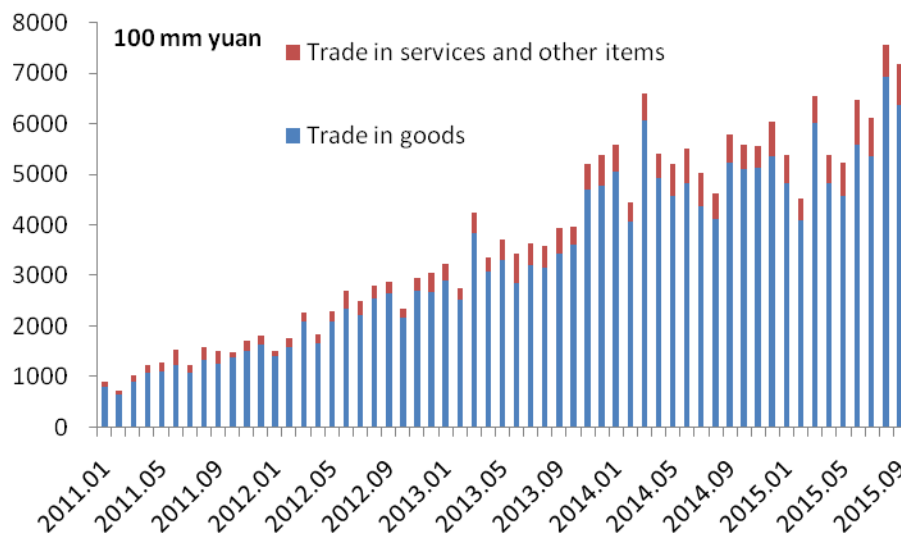
## VI. The RMB exchange rate exhibited more flexibility

The RMB exchange rate depreciated slightly, experiencing two-way fluctuations and exhibiting improved flexibility, and exchange-rate expectations were generally stable. At end-September, the central parity of the RMB against the US dollar was 6.3613 yuan per US dollar, representing a depreciation of 2,477 basis points, or 4.05 percent, from end-June. From the reform of the RMB exchange-rate regime in 2005 to the end of September 2015, the RMB registered a cumulative appreciation of 30.11 percent against the US dollar. According to calculations by the Bank for International Settlements (BIS), during the three quarters of 2015 the NEER of the RMB depreciated by 0.06 percent, and the REER of the RMB appreciated by 0.69 percent, and from the RMB exchange-rate regime reform in 2005 to September 2015, the NEER and REER of the RMB exchange rate appreciated by 45.54 percent and 56.76 percent respectively.

## VII. Cross-border RMB businesses maintained relatively rapid development

During the first three quarters of 2015, cross-border receipts and payments in RMB totaled 8.90 trillion yuan, an increase of 24 percent year on year. In particular, RMB receipts and payments registered 4.84 trillion and 4.07 trillion yuan respectively, resulting in a net inflow of 733.31 billion yuan and a receipt-to-payment ratio of 1:0.84. RMB cross-border receipts and payments under the current account posted 5.46 trillion yuan, up 13 percent year on year. In particular, settlements of trade in goods registered 4.87 trillion yuan, whereas settlements of trade in services and other

items under the current account registered 590.3 billion yuan. Cross-border RMB receipts and payments under the capital account totaled 3.44 trillion yuan, an increase of 46 percent year on year. On October 8, the first phase of the China International Payment System (CIPS) was successfully launched, providing cross-border and offshore RMB clearing and settlement services for financial institutions at home and abroad. This represents an important step forward in the building of a modern payment system that balances domestic and international RMB payment transactions.



Source: The People's Bank of China.

**Figure 1 Monthly RMB Settlements of Cross-border Trade**

## Part 2 Monetary Policy Operations

Since the beginning of the third quarter, the Chinese economy has faced extensive downward pressures and inflation has been moderate, with uncertainties growing in the trend of the RMB equivalent of foreign-exchange purchases and expectations of a rate hike by the Federal Reserve. Facing the complicated internal and external environments, the PBC continued to implement a sound monetary policy that was neither too tight nor too loose and conducted timely and appropriate fine-tunings and preemptive adjustments. At the same time, the pace of various financial reforms was accelerated so as to promote development through reform and to allow the market to play a more decisive role in resource allocations.

### I. Flexible open market operations were conducted

With the growing fluctuations in domestic and international financial markets and the increasing uncertainties affecting demand and supply of liquidity, the PBC paid close attention to liquidity demand and supply conditions and to the movements of money-



market interest rates, conducted open market operations mainly by using repo operations as a major tool, supplemented by short-term liquidity adjustment tools and in coordination with other policy tools such as the required reserve ratio, and it enhanced fine-tunings and preemptive actions to keep liquidity in the banking system at an adequate level. During the third quarter of 2015, repo operations injected a total of 1675 trillion yuan of liquidity and SLO operations provided a total of 340 billion yuan of liquidity.

The PBC further enhanced guidance for and adjustments to the money-market interest rate by focusing on the stability of short-term interest rates, improved the efficiency of the transmission, and kept the movement of the interest rate within a reasonable range. From the beginning of the third quarter until the end of August, the interest rate for 7-day repo operations remained stable at 2.50 percent. On August 27 and October 25, in line with the two downward adjustments of the benchmark deposit and loan interest rates, the interest rate of 7-day repo operations fell to 2.35 percent and 2.25 percent respectively, a drop of 25 basis point from the level at the end of June, thus helping to guide and stabilize market expectations and to reduce financing costs for the real economy.

Central treasury cash management operations were conducted at appropriate times. During the third quarter, a total of 230 billion yuan of treasury funds was deposited in commercial banks on four separate operations, including 170 billion yuan in three-month deposits and 60 billion yuan in six-month deposits.

## **II. Medium-term lending facility (MLF) operations were carried out at appropriate times and on a suitable scale**

In order to keep the volume of liquidity in the banking system at an appropriate level and to meet the liquidity demands of commercial banks, during the first three quarters of 2015 the PBC recovered a net amount of 154.5 billion yuan of the medium-term lending facilities (MLFs), including 24.5 billion yuan recovered in Q3, leading to an outstanding amount of 490 billion yuan at the end of the third quarter. While providing MLFs, the PBC also guided financial institutions to beef up support for small and micro firms, the agricultural sector, rural areas, farmers, and other key areas and weak links in the economy.

In view of the overall liquidity situation in the money market, during the first three quarters of 2015 the PBC carried out a total of 334.7 billion yuan of standing lending facilities (SLFs) operations and recovered all of the funds upon maturity. No SLFs were carried out during the third quarter, thus the outstanding amount of SLFs at the end of the period was zero.

### **III. Targeted and universal cuts in the reserve requirement ratio were combined, and an average arithmetic approach for assessing the reserve requirement ratio was implemented**

In September 2015 the PBC reduced the universal and targeted reserve requirement ratio (RRR) for financial institutions. First, the RRR for all financial institutions was lowered by 0.5 percent, Second, an additional RRR cut was provided for selected financial institutions: An extra 0.5 percent was cut for rural financial institutions, including county-level rural commercial banks, rural cooperative banks, rural credit cooperatives, and village and township banks, to beef up the capability of these financial institutions to provide services to the agricultural sector, rural areas, and farmers and to support micro and small companies; an extra 3 percent was cut for financial leasing companies and automobile financing companies to strengthen their roles in supporting consumption. In October 2015, the PBC once again cut the RRR for all financial institutions by 0.5 percent and provided an extra 0.5 percent cut for targeted financial institutions that met prescribed criteria.

To further improve the RRR mechanism, enhance the flexibility of financial institutions in terms of managing liquidity, and to smooth fluctuations in the money market, in September 2015 the PBC reformed the method of RRR assessments, replacing the daily assessment with an average arithmetic approach, i.e., requiring the percentage of the arithmetic average of the end-of-day balance of the reserve deposited by financial institutions within the maintenance period to the base amount of the reserve requirement assessment to be no lower than the reserve requirement ratio. To encourage sound operations of financial institutions, a lower daily limit was prescribed for the assessment of the reserve ratio, i.e., within the maintenance period, at the end of each business day the ratio of the balance of the reserve deposited by financial institutions to the base amount of the reserve requirement assessment could be lower than the required RRR by a maximum of 1 percentage point.

#### **Box 1 Adopting an Averaging Method for Reserve Assessments**

Currently, the central banks of the major economies in the world are using an averaging method for RRR assessments. For example, the Federal Reserve applies an averaging method for assessments while using end-of-month data for reserve base provisions. The averaging method provides more conveniences in terms of liquidity management to financial institutions, but it requires higher-quality liquidity management by the central banks. In more sophisticated markets in the developed economies, such as Europe and the U.S., financial institutions have a stronger ability to manage liquidity, therefore an averaging method was implemented relatively earlier. With the deepening of financial reform, the development of payment and settlement systems, and improvements in internal management of financial institutions, in recent years the conditions in China are gradually maturing for adoption of the averaging method for RRR assessments.

The reform of the RRR assessments so far has proceeded by small steps and in a prudent manner. It includes two parts. First, for each legal-person financial institution, the average arithmetic of the end-of-day reserve balances between the fifth day of a ten-day period and the fourth day of the next ten-day period, divided by the deposit balance at the end of the previous ten-day period, shall be no less than the RRR. Second, during the initial period of implementing the averaging method, a floor limit will be established for RRR assessments each day, and each financial institution can have an overdraft within 1 percentage point below the RRR (including 1 percentage point). The main purpose of implementing the averaging assessment is to improve the flexibility and the convenience for liquidity management of financial institutions, rather than to enhance their overdraft capabilities. The RRR assessment system after the reform will help financial institutions to balance the relationship between fund efficiency and liquidity security, thereby promoting their sound operations.

The shift in the RRR assessment from the time-point method to the averaging method reduces the excess reserves of financial institutions to deal with sudden demands for payment, and in fact provides an important buffer mechanism. During the assessment period, the reserves of a financial institution may be less than the requirement at some points, as long as the overall average reaches the reserve requirement. Thus, financial institutions have larger space for liquidity management. This will help smooth out volatility in the money market, improve the monetary-policy transmission mechanism, and create conditions for the transition in the framework of monetary-policy conduct. In fact, after implementing the averaging method in the RRR assessments, the level of bank reserves has been stable with a slight decrease, and the interest rates on the money market have also remained stable. The vast majority of commercial banks have basically remained prudent in their liquidity preferences and management strategies, aiming not to overdraw the reserve account while modestly reducing their excess reserves so as to maintain a reasonable buffer for safety. In the meantime, a small number of banks have slightly overdrawn their reserve accounts when facing substantial demands for payments as an effective response to meet short-term fluctuations. Such behavior has promoted market stability at the macro level.

Going forward, the PBC will continue to follow the requirements of the prudent monetary policy and advance the reform of the deposit reserve system. In view of the liquidity situation, the PBC will further increase the flexibility of open market operations, maintain reasonable and adequate liquidity, support the stable functioning of financial markets, and guide steady and moderate credit growth.

#### **IV. Macro-prudential management was enhanced**

The dynamic adjustment mechanism of the differentiated reserve requirements continued to play a role in counter-cyclical management and structural adjustments.

The parameters of the dynamic adjustment mechanism were recalibrated based on the performance of financial institutions in five respects, including the recipients of agro-supporting and micro-enterprise supporting loans, the capital adequacy ratio, internal and risk controls, the launch of new branch offices, and regional development, so that the mechanism can be more differentiated and targeted to guide financial institutions to keep the pace of credit extensions in line with real and seasonal demands and to increase the proportion of lending to small and micro enterprises, the agricultural sector, rural areas, and farmers, businesses in the central/western and underdeveloped regions, and other key areas and weak links in the economy, and to facilitate appropriate growth of development of credit and support of the real economy. In accordance with the development of the situation, studies were carried out to further improve the macro-prudential assessment system and to expand and improve the tools for macro-economic management.

Commercial banks' forward foreign-exchange purchases and sales were included in the macro-prudential policy framework. Starting from September 2015, additional risk reserves were applied to the forward foreign-exchange sales contracts signed by banks on behalf of their clients, the period for freezing the deposits was set at one year, and the reserve requirement ratio was set at 20 percent and subject to future adjustments. The measure is expected to promote sound operations of financial institutions and to prevent macro-financial risks.

## **V. Comprehensive measures were taken to guide financial institutions to optimize their loan structures**

Monetary policy, macro-prudential policy tools, and credit policy were used to send out signals and to facilitate structural adjustments, coordinate credit, industrial, and fiscal policies, and to guide financial institutions to optimize their loan structures.

The PBC actively employed credit policy-supporting central-bank lending, discounts, and Pledged Supplementary Lending (PSL) to guide financial institutions to step up credit support to key areas in the economy, such as small and micro enterprises, the agricultural sector, rural areas, and farmers, and shantytown renovation projects. The interest rates of credit policy-supporting central-bank lending and PSL were cut in a timely manner to help cut financing costs for the real economy. At end-September, the central bank's outstanding loans to support agriculture reached 212.6 billion yuan, outstanding loans to support micro enterprises registered 70.8 billion yuan, the outstanding amount of central bank discounts was 128.1 billion yuan, and the combined amount of central bank discounts and loans increased by 23.1 billion yuan year on year. In accordance with the timeline of the shantytown renovation projects, the PBC issued PSL in the amount of 575.8 billion yuan to the China Development Bank during the first three quarters of 2015. As a result, the bank received a total of 958.9 billion yuan in PSL.

Financial institutions were guided to make good use of new loans, mobilize the stock of credit assets, make innovations in their organizational structure, collaterals, and

product and service modes, and provide more credit to important areas and to weak links in the economy so as to improve the efficiency of growth and to ensure the sustainable and sound development of the economy. First, banking financial institutions were encouraged and guided to provide full support for projects that will help build China into a strong manufacturing power, to continue to provide financial services to strategic adjustments of the industrial structure, infrastructure construction, and development and reform in key areas such as shipbuilding, railways, logistics, and energy industries, and to step up support for care of the elderly and the healthcare industries. Second, they were encouraged to provide quality financial services for the agricultural sector and micro and small enterprises, focusing on new types of operational entities in the agricultural sector, to continue to implement major bank practices and to prudently conduct a pilot program of loans collateralized with operation rights for contracted land and user rights for rural housing land. Support was given to qualified financial institutions to issue earmarked financial bonds to use the proceeds to grant loans to micro and small enterprises. Third, banking financial institutions were urged to implement policies to eliminate excess capacity, and a policy framework for green financing was established and improved. With respect to financial services for industries with excess capacity, in line with the principle of “differentiated treatment and no one-size fit all,” the PBC urged financial institutions to strengthen and improve credit management by absorbing, relocating, consolidating, and eliminating excess capacity. Fourth, financial support for the coordinated development of the Beijing-Tianjin-Hebei region and for the construction of the Yangtze River economic belt was provided to promote the quality of financial services for coordinated regional development. Fifth, policy for home mortgage credits was further improved to facilitate the purchase of owner-occupied or improvement-oriented homes. Sixth, financial institutions were guided to reinforce innovations in credit products for consumption to meet the proper needs for credit in six categories of consumption. Seventh, financial services for poverty alleviation, employment, education, ethnic minorities, migrant workers, and college-graduate-turned-village-officials were further improved. In addition, financial institutions were encouraged to revitalize their stocks of credit assets through credit-asset securitization and by properly using recollected funds, optimizing fund allocations, and increasing the amount of loanable funds.

As a result, in general, credit support for key areas such as small and micro enterprises, the agricultural sector, rural areas, and farmers was strong. At end-September, outstanding RMB loans to small and micro enterprises amounted to 16.7 trillion yuan, an increase of 14.5 percent year on year. The growth rate was at the same level as that at end-June and it was 4.2 and 3.7 percentage points higher than the growth of loans for large and medium-sized enterprises respectively during the same period of the last year. Outstanding RMB and foreign-exchange agricultural-related loans issued by financial institutions registered 25.6 trillion yuan, up 11.7 percent year on year and accounting for 27.4 percent of the total loans during the same period.

## **VI. The pilot program for PBC loans against credit-asset pledges was expanded**

To replicate the experience of the pilot program for PBC loans against credit-asset pledges in Shandong and Guangdong provinces, the PBC decided to expand the areas for the pilot program to nine other provinces (municipalities), namely in Shanghai, Tianjin, Liaoning, Jiangsu, Hubei, Sichuan, Shaanxi, Beijing and Chongqing. Under the pilot program, the branches of the PBC in the aforementioned areas will perform internal credit-rating assessments of local financial institutions within their jurisdictions and will include the credit assets that meet the criteria into the range of eligible assets that can be accepted as pledges. The pilot program of credit assets pledged as central bank loans is one important policy measure to improve the framework of the central bank for managing collateral and it will help improve the effectiveness and flexibility of monetary-policy operations, resolve the problem of the comparative inadequacy of collateral for local financial institutions, guide local financial institutions to expand credit support for small and micro-enterprises, the agricultural sector, rural areas, and farmers, reduce social financing costs, and support the development of the real economy. While the inclusion of credit assets as eligible collateral for central bank loans provides the pre-conditions for local financial institutions to gain access to central bank liquidity, it does not necessarily mean that local financial institutions can automatically receive liquidity support from the central bank. The PBC will continue to implement a sound monetary policy, properly manage liquidity injections, and ensure overall liquidity at an appropriate level. The expansion of the range of eligible pledge assets will not lead to a massive scale of liquidity injections.

## **VII. Benchmark deposit and lending interest rates were lowered and the ceiling for deposit rates was lifted**

Following the three consecutive cuts in interest rates during the first half of 2015, in order for the benchmark interest rates to continuously guide market interest rates, to reduce the social financing costs, and to reinforce support of financing for the real economy, the PBC on two occasions cut the RMB benchmark deposit and lending interest rates, on August 26 and on October 24. The one-year benchmark loan interest rates were adjusted downward by a cumulative 0.5 percentage point to 4.35 percent, and the one-year deposit interest rates were adjusted downward by a cumulative 0.5 percentage point to 1.5 percent. As the policies gradually took effect, the loan interest rates of financial institutions declined remarkably and the money-market interest rates remained low, effectively reducing the financing costs for enterprises. In general, the deposit interest rates also declined, and a tiered, differentiated, and competitive deposit-rate pricing mechanism was basically put in place. The effects of the benchmark deposit and lending rate cut are gradually unfolding at the current stage and they will continue to contribute to a reduction in financing costs.

The ceiling of the deposit interest rate was removed as an adjustment as well as a

reform measure. In parallel with the reduction in the benchmark lending interest rate, on August 26 the ceiling of the interest rates for time deposits beyond 1 year (excluding 1 year) was removed for financial institutions; on October 24 the ceiling of interest rates for demand deposits and time deposits within one year (including one year) was removed for commercial banks and rural cooperative financial institutions. The removal of the upper limit on the interest rates of the deposits marked the end of interest-rate controls and represented a key step in the market-based interest-rate reform. The reform has now entered a new phase. The removal of the controls on interest rates will enhance the role of interest rates as a price leverage and will optimize the allocation of resources; furthermore, it will also promote the pricing capability of financial institutions, accelerate the transformation of their operational model, and improve the quality of financial services. It will also create conditions for the conduct of monetary policy to shift from quantitative measures to price measures and will help improve the efficiency of macro-economic management.

### **Box 2 A Significant Step in the Market-based Interest-Rate Reform**

With the approval of the State Council and in parallel with the cut in interest rates and the RRR, on October 24 the PBC decided to remove the upper limit for deposit interest rates of commercial banks and rural cooperative financial institutions. This marked the end of interest-rate controls in China and was a significant step in the market-based interest-rate reform. This is a milestone in the reform of China's financial sector, demonstrating the firm determination and confidence in promoting reforms.

The removal of the controls on interest rates has great significance for optimizing the allocation of resources. With the market-based interest rates, the function of the price leverage of interest rates will be further enhanced, which will facilitate the allocation of financial resources to industries and enterprises with real demand for capital and prospects for development. It will also promote the determining role of the market in resource allocations and will improve the efficiency of resource allocations. Especially at the current critical stage when the economy of China is experiencing a shift of industries and driving forces, the removal of controls on interest rates will provide greater room for financial institutions to select industries and enterprises for support in accordance with market principles, which will be beneficial for stabilizing economic growth, adjusting the economic structure, improving the livelihood of the people, and promoting the healthy and sustainable growth of the economy.

The removal of controls on interest rates will also provide a new impetus for the transformation and development of financial institutions. With the removal of the upper limit of the deposit interest rates, the traditional "scale brings profits" business model under the circumstance of interest-rate protection will no longer be sustainable. This will allow financial institutions to focus on profits in their philosophy on business operations and to accelerate the transformation of business models. It will also help improve the mechanism for interest-rate pricing, enhance the interest-rate

pricing capability of financial institutions, and bring about differentiated interest-rate offerings to meet the diversified demands for financial services and to improve the quality of financial services.

The removal of interest-rate controls will create conducive conditions for the transformation of the monetary-policy framework. With innovation and development in the financial industry, the correlation between monetary aggregates as the intermediary goal and the economic growth rate, price levels as the ultimate goal of monetary policy will become weaker. The market-based interest rates reflect demand and supply conditions in the market and thus are more effective in adjusting resource allocations. This will promote the conduct of monetary policy to shift from quantitative measures to price measures. It can be learned from international experiences that the scaling up of price measures will improve efficiency in macro-economic management, and the removal of the interest-rate controls will be a pre-condition for realizing this shift.

At the current stage, the subdued price levels and the downward trends in market interest-rate movements provide a comparatively stable macro-economic environment for advancing the market-oriented interest-rate reform and for removing the upper limit for deposit interest rates as a parallel measure with the cuts in the interest rates and the RRR. Immediately after implementation of the policy, both the deposit and lending rates of financial institutions declined. On the deposit front, the pricing behavior of financial institutions is relatively rational. Differentiated pricing and tiered competition in prices have become more prevalent.

As of November 5, the average level of the one-year deposit interest rates quoted at bank counters by state-owned large banks, joint stock banks, city commercial banks and rural cooperative financial institutions was 1.75 percent, 1.94 percent, 2.03 percent, and 2.04 percent respectively, 25, 26, 34, and 33 basis points lower than the level before the cut in the interest rates. On November 5, the quote for one-year loan interest rates registered at 4.3 percent, which was 25 basis points lower than that before the cut in interest rates. The cut in the benchmark interest rates is producing effects. It is estimated that the real lending interest rates of financial institutions will also decline, which will further reduce the social financing costs.

The removal of administrative controls on interest rates does not necessarily mean that the central bank will no longer regulate interest rates. On the contrary, regulation by the central bank and the transmission mechanism of the interest rates will be more important. The central bank will rely even more on market-based monetary policy tools and the transmission mechanism. From this perspective, the market-based interest-rate reform and monetary-policy conduct have entered a new phase, focusing on establishing an interest-rate pricing and regulation mechanism that is compatible with the market. During the next stage, the central bank will continue to encourage commercial banks to improve their capability for independent and rational pricing, to



better adapt to market competition, and to cater to customer demand. At the same time, the central bank will pursue further improvements in the interest-rate regulation mechanism, a complete benchmark interest-rate system will be nurtured, and the transmission channel for interest rates will be further improved.

After the removal of controls on interest rates, supervision and self-regulation by market interest rates should be carried out to prevent and discipline potential irrational pricing in the market. With progress in the market-based interest-rate reform, the central bank will continue to release benchmark deposit and lending interest rates for some period to provide guidance and reference for pricing by financial institutions. At the same time, the PBC will guide the self-regulatory mechanism for market interest-rate pricing to tap into the role of self-regulation in the financial industry based on the principle of incentives and discipline. In addition, the pricing behavior of deposit and lending interest rates by financial institutions will be included in the macro-prudential regulatory framework and effective tools will be implemented to guide rational pricing behavior and prudent operations of financial institutions.

## **VIII. The RMB exchange-rate regime was further improved**

The RMB exchange-rate regime was further improved in a self-initiated, controllable, and gradual manner. The RMB exchange rate was kept basically stable at an adaptive and equilibrium level based on market supply and demand and with reference to a basket of currencies. In order to strengthen the market orientation and the benchmark nature of the RMB central parity against the US dollar, the PBC decided to improve the quotation mechanism for the RMB central parity against the US dollar. Effective from August 11, 2015, the market-makers report quotes the parity to the CFETS on each business day before the market opening by referring to the closing rate of the inter-bank foreign-exchange market on the previous day and taking into consideration the demand and supply conditions in the foreign-exchange market and the exchange-rate movements of the major currencies. In Q3 2015, the highest and lowest central parity of the RMB against the US dollar were 6.1133 yuan and 6.4085 yuan respectively. Among the 64 trading days, the RMB appreciated on 35 days and depreciated on 29 days. The biggest daily appreciation and depreciation were 0.22 percent and 1.82 percent respectively.

The RMB fluctuated in both directions against the other major international currencies, including the euro and the Japanese yen. At end-September, the central parity of the RMB against the euro and the Japanese yen was 7.1608 yuan per euro and 5.3043 yuan per 100 yen respectively, a depreciation of 4.06 percent and 5.64 percent respectively from the end of June. Between the start of the RMB exchange-rate regime reform in 2005 and end-September 2015, the RMB appreciated by 39.85 percent against the euro and 37.74 percent against the Japanese yen.

As of the end of September, under the bilateral currency swap agreements with the relevant foreign monetary authorities, the foreign monetary authorities used a total of 23.05 billion yuan, and the PBC used USD 1.406 billion. The use of swap funds played a positive role in promoting trade between the two countries.

**Table 6 The Trading Volume of the RMB against Foreign Currencies in the Inter-bank Foreign-Exchange Spot Market in Q3 2015**

Unit: 100 million yuan

Currency	USD	Euro	Japanese yen	HKD	GBP	Australian dollar	New Zealand dollar	Singapore dollar	Canadian dollar	Malaysian ringgit	Russian ruble	Thai baht
Trading volume	95639	960	807	532	121	290	43.8	827	50.3	3.9	117.4	0.45

**Source: China Foreign Exchange Trade System.**

### **Box 3 Improving the Quotation Mechanism for the Central Parity of the RMB**

Since the reform of the exchange rate regime in 2005, the RMB central parity, which serves as the benchmark of China's exchange rate, has played an important role in guiding market expectations and in stabilizing the RMB exchange rate. Not long ago, market expectations of a 2015 rate hike by the Federal Reserve led to a strengthening of the US dollar, and the real effective exchange rate of the RMB appreciated against many global currencies. According to estimates of the Bank for International Settlements, between the beginning of 2014 and July 2015, the nominal effective exchange rate and the real effective exchange rate of the RMB appreciated by 11.6 percent and 11.3 percent respectively. At the same time, there continued to be a large surplus in the balance of trade in goods. The diversity in the perceptions of market participants of trends in the RMB exchange rate have caused the central parity of the RMB to deviate consistently from the market rate by a large margin, which, to some extent, has undermined the market benchmark status and the authority of the central parity. In order to avoid an excessive accumulation of imbalances, adjustments were needed to increase the market orientation and the role of the benchmark of the central parity rate.

On August 11, 2015, the PBC announced it would improve the RMB to USD central parity rate formation mechanism. The daily quotes of the central parity that market-makers report to the CFETS before the market opens should refer to the closing rate of the inter-bank foreign-exchange market on the previous business day, and it should take into account the demand and supply conditions in the foreign-exchange market and the exchange-rate movements of the major currencies. On the one hand, the decisive role of market supply and demand in the formation of the exchange rate has been enhanced. On the other hand, the RMB exchange rate has been adjusted

consistent with market forces to a more adaptive and equilibrium level. The deviation of the central parity rate from the market exchange rate has been corrected, and its benchmark status has obviously also been strengthened. There have been positive comments on the reform and the reform has achieved the expected results.

Immediately after the launch of the reform measure, there was a brief period of fluctuations in the foreign-exchange market. The PBC strengthened communications to guide expectations, provided liquidity to the market, and also took macro-prudential measures to curb speculative trading and to prevent pro-cyclical behavior and "herding effects." These macro-prudential measures were not administrative controls; rather they were price-based, transparent, non-discriminatory, and temporary measures. Due to these comprehensive measures, the current situation of supply and demand of foreign exchange gradually moved to a better balance, exchange-rate expectations stabilized, and stability returned to the foreign-exchange market.

The current international and domestic economic and financial situations do not provide any basis for a continued depreciation of the RMB exchange rate. First, China's economic growth is relatively high. During the first three quarters of 2015, in spite of the grim and complex domestic and international environments as well as the various challenges and difficulties, the China economy still recorded a GDP growth rate of 6.9 percent, which was a comparatively high growth rate in the world. The major economic indicators were relatively stable. Positive changes have emerged in the economy, which have provided a good macro-economic environment for the RMB exchange rate to remain stable.

Second, for quite a long period China has had surplus in its current account. During the first three quarters of 2015, the trade surplus amounted to USD 424.1 billion, a major fundamental underpinning of the supply and demand in the foreign-exchange market and also an important foundation to support a stable RMB exchange rate. Third, in recent years, the processes of the RMB internationalization and the opening up of financial markets have accelerated, increasing the demand for RMB in trade and investment as well as in asset allocations. This will inject a fresh impetus for the stability of the RMB exchange rate. Fourth, market expectations that the Fed will raise interest rates has caused a strengthening of the dollar for a longer period of time. This has been priced in by the market. After the one-time shock of future rate hikes by the Federal Reserve, the market is believed to have made more rational judgments. Fifth, the adequate foreign-exchange reserves, sound fiscal conditions, robust financial system, and sound financial system will provide strong support for the RMB exchange rate to remain stable.

In the future, the PBC will continue its market orientation, follow the reform decisions of the central government, monitor the changes in the balance of payments, improve the market-oriented exchange-rate regime in a stable and orderly manner,

increase the decisive role of the market, enhance the two-way floating elasticity of the RMB exchange rate, and establish a market-oriented long-term mechanism to adjust the balance of payments through exchange rates to promote the balance of payments. The PBC will also continue to promote the development and opening-up of the foreign-exchange market, to diversify foreign-exchange products, to extend the trading hours of the foreign-exchange market, to introduce qualified foreign institutions as participants, and to facilitate consistent onshore and offshore RMB exchange rates.

## **IX. Reforms of financial institutions were deepened**

The deposit insurance scheme was steadily implemented. Establishment of the deposit insurance scheme is a significant step in improving the financial safety net, straightening out the relationship between the government and the market, deepening financial reforms, and maintaining financial stability and promoting the competitiveness of the financial sector. The deposit insurance regulation was promulgated on March 31, 2015 and it was formally implemented on May 1. As of June 30, 2015, all deposit-taking banking institutions had completed the procedure of joining the deposit insurance scheme. As of July 20, 2015, collection of the due premium for May and July had already been completed. Work to implement the deposit insurance scheme has been making steady progress. Until now, the overall responses to the scheme have been positive, the functioning of the financial market has been stable, and operations of banking financial institutions have been orderly and smooth.

Breakthroughs have been made in the reform of policy-based and development-oriented financial institutions. In July 2015, the China Development Bank and the Export-Import bank of China received capital injections of USD 48 billion and USD 45 billion respectively from the foreign-exchange reserves, thus meeting the recapitalization requirements of their reform plans. Meanwhile, work of the business divisions of the three banks, governance structural improvements, and revision of their articles of incorporation have also made steady progress. The reform has raised the capital adequacy level of the three banks and has improved their risk resistance capacity, which will enhance the effectiveness and functions of the policy-based and development-oriented banks to support the weak links and key areas in the economy, facilitating efforts to achieve stable economic growth, adjusting the economic structure and improving the people's livelihood, and promoting social and economic development.

Reform of the agricultural credit cooperatives (RCCs) proceeded smoothly. First, their capital quality improved remarkably. At end-September, the outstanding amount and the ratio of the NPLs of the RCCs were 500 billion yuan and 4.2 percent respectively; the capital adequacy ratio was 11 percent, an increase of 0.2 percentage point year on

year. Second, agricultural-related financial services improved significantly. At end-September, total deposits and outstanding loans of the RCCs reached 18.3 trillion yuan and 11.9 trillion yuan respectively, up 14.7 percent and 15.1 percent year on year. Their share in total loans of financial institutions throughout the country was 12.9 percent; their outstanding amounts of agro-related loans and farmers loans were 7.7 trillion yuan and 3.7 trillion yuan respectively, up 10.5 percent and 9.2 percent year on year. Third, the property-rights reform continued. At end-September, there were 759 rural commercial banks, 79 rural cooperative banks, and 1,397 RCCs with legal-person status at the county (city) level. As a result of steady progress in the property-rights reform, the RCCs have established mechanisms for sustainable development.

## **X. Deepening of the reforms of the foreign-exchange administration**

Efforts were made to facilitate trade and investment. First, centralized operations of the foreign-exchange funds of multinational companies were promoted to better serve the export-oriented economy. In August 2015, policy for centralized operations and management of foreign-exchange funds of multinational companies was further adjusted and optimized, with the account opening and usage requirements and foreign-exchange payment and receipt procedures simplified, and the policy of self-discipline by multinational companies to manage the ratio of foreign debt was implemented on a pilot basis to enable good companies to optimize their use of capital. Second, quotas for institutional investors were properly allotted to support the development of the capital market. During the first three quarters, the PBC granted USD 27.6 billion of the QFII quota to 65 institutions, RMB 117.8 billion yuan of the RQFII quota to 48 institutions, and USD 50.38 billion yuan of the QDII to 40 institutions.

The capital account has become more convertible. First, the pilot program for macro-prudential management of the external debt was steadily advanced. In August 2015, the policy of the pilot program for Zhongguancun Science and Technology Park was upgraded, expanding the channels for the use of the external debt, relaxing management over the external debt account, and granting minimum external debt quotas to some high-tech enterprises so to better serve the “massive entrepreneurship and innovation” strategy. Second, operational guidelines for the Mainland–Hong Kong Mutual Fund Recognition Scheme were compiled to facilitate money exchanges and fund flows related to cross-border fund issuances and sales in Hong Kong and mainland China.

Surveillance and management of cross-border capital flows were enhanced. First, management of overseas cash withdrawals with the Unionpay RMB card was strengthened. Starting from January 1, 2016, the total amount of overseas cash

withdrawn with the Unionpay bankcard shall not exceed the equivalent of 100,000 yuan per card. Between October 1 and December 31, 2015, an upper limit of the equivalent of 50,000 yuan per card was imposed. This measure will effectively reduce overseas large-value cash withdrawals and will curb illegal capital transfers. Second, ex-post and in-process supervision was enhanced. The authenticity review was strengthened for foreign-exchange purchases and payments. Special investigations were conducted on the phenomenon of no foreign-exchange receipts after export transactions and on the holding of foreign-currency cash by individuals, and special examinations were conducted of entrepôt trade, forward foreign-exchange surrenders, import financing of the rubber industry, financial leasing companies, and so forth to forestall shocks of cross-border capital flows. Fourth, a special campaign was carried out to clamp down on the transfer of criminal proceeds through offshore companies and underground banks and illegal foreign-exchange transactions.

## **Part 3 Financial Market Analysis**

In Q3, the overall performance of financial markets was stable. The money market traded briskly and market interest rates remained low. The issuance of bonds increased notably and issuance interest rates declined. The inter-bank bond index moved up modestly and the government securities yield curve flattened. The stock market experienced large-scale turbulence. The assets of the insurance industry grew rapidly and the volume of foreign currency swaps and forward transactions surged.

### **I. Financial market analysis**

#### **1. The money market traded briskly and market interest rates remained low**

Growth of repo transactions on the inter-bank market surged, while the turnover of inter-bank borrowing increased rapidly. During the first three quarters, the cumulative turnover of bond repos reached 300.5 trillion yuan on the inter-bank market, representing an average daily turnover of 1.6 trillion yuan, up 92.3 percent year on year. The cumulative turnover of inter-bank borrowing reached 42.2 trillion yuan, with an average daily turnover of 225.6 billion yuan, up 54.2 percent year on year. In terms of the maturity structure, overnight products still dominated bond repos and inter-bank borrowing transactions, accounting for 83.5 percent and 82.6 percent of their respective turnovers, an acceleration of 4.4 and 2.5 percentage points from the corresponding period of the last year. The turnover of bond repos on the stock exchanges rose 40.7 percent year on year to reach 90 trillion yuan.

The flow of funds among financial institutions displayed the following characteristics. First, the volume of money-market trading surged year on year. Net lending of large commercial banks through repos and inter-bank lending increased 131.6 percent year

on year to 137.7 trillion yuan. Net borrowing of Chinese-funded small- and medium-sized banks was almost 2 times the amount during the corresponding period of 2014. Second, large banks became the only major fund providers, and fund demands of insurance firms declined. Third, borrowing by foreign-funded and other financial institutions and vehicles surged. In particular, borrowing by foreign-funded institutions increased 44.5 times year on year to 9.4 trillion yuan; other financial institutions and vehicles borrowed 47.8 trillion yuan, an increase of 211 percent year on year.

**Table 7 Fund Flows among Financial Institutions, Q1–Q3, 2015**

Unit:100 million yuan

	Repos		Inter-bank borrowing	
	Q1–Q3,2015	Q1–Q3, 2014	Q1–Q3, 2015	Q1–Q3, 2014
Chinese-funded large banks <sup>①</sup>	-1,259,771	-548,416	-117,287	-46,217
Chinese-funded small- and medium-sized banks <sup>②</sup>	458,211	207,857	-34,003	-29,114
Securities and fund management companies <sup>③</sup>	248,820	139,948	76,203	57,296
Insurance institutions <sup>④</sup>	56,246	62,953	38	142
Foreign-funded financial institutions	72,531	2,191	21,471	-124
Other financial institutions and vehicles <sup>⑤</sup>	423,962	135,466	53,578	18,016

Notes : ① Large Chinese-funded 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 Small- and medium-sized Chinese-funded banks include the China Merchants Bank and sixteen other medium-sized banks, small-sized city commercial banks, rural commercial banks, rural cooperative banks, and village and township banks.

③ Securities and fund management institutions include securities firms and fund management companies.

④ Insurance institutions include insurance firms and company annuities.

⑤ 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, mutual funds, wealth management products, trust plans, and other investment vehicles. Some of these financial institutions and vehicles do not participate in the inter-bank funding market.

⑥ A negative sign indicates net lending and a positive sign indicates net borrowing.

Source: China Foreign Exchange Trade System.

Interest-rate swap transactions boomed. During the first three quarters, the total notional principal volume reached 5830.93 billion yuan. In Q3, 16,474 deals of RMB interest-rate swaps were reached in the market, with the notional principal

volume totaling 2253.11 billion yuan, up 135.2 percent year on year. In terms of the maturity structure, contracts with maturities of within one year traded most briskly and their aggregate notional principal posted 2017.03 billion yuan, accounting for 89.5 percent of the total. In terms of the reference rates, the base rate of the floating leg of the RMB interest-rate swaps mainly included the 7-day fixing rate (FR007) and the Shibor, and their notional principal accounted for 92.9 percent and 7.1 percent respectively of the total notional volume. A total of 235 deals of standard interest-rate derivatives was reached, with a notional principal volume of 168.8 billion yuan.

**Table 8 Transactions of Interest-Rate Derivatives, Q1–Q3, 2015**

	Interest-rate swaps		Bond forwards		Forward-rate agreements		Standard Interest-rate derivatives	
	Number of deals (lots)	Amount of notional principal (100 million yuan)	Transactions (lots)	Amount (100 million yuan)	Transactions (lots)	Amount of notional principal (100 million yuan)	Transactions (lots)	Amount of notional principal (100 million yuan)
Q1-Q3 2015	16,474	22,531.1	—	—	—	—	235	1,688
Q1-Q3 2014	11,137	9,569.2	—	—	—	—	—	—

Source: China Foreign Exchange Trade System.

The issuance and trading of inter-bank certificates of deposit (CD) increased. As more members joined the market interest-rate pricing self-regulatory mechanism, a larger group of financial institutions were eligible for issuing inter-bank certificates of deposit, thus issuances and trading both increased. At the end of September, 193 financial institutions had disclosed CD issuance plans, among which 171 institutions executed the issuance plans on the inter-bank market. During the first three quarters, a total of 3,849 inter-bank CDs were issued, raising 3.29 trillion yuan. The trading volume on the secondary market was 6.77 trillion yuan. The issuance and trading were both priced based on the Shibor. The rapid development of the CD market has helped enhance the role of the Shibor at the medium to long ends. In September, the weighted average interest rate for the issuance of 3-month CDs was 3.22 percent, 10 basis points higher than the 3-month Shibor. Moreover, issuing and trading of CDs made progress. The group of issuers was expanded and the maturity of the CDs was diversified. At the end of September 2015, 1,860 CDs were issued, with a total volume of 1.36 trillion yuan. The development of the CD market further expanded the range of market-priced liability products and helped build the liability product-pricing capacity of financial institutions.

Interest rates on the money market remained low, the interest-rate differential between over-night and 7-day products declined. Due to the large concentration of



cash supply around the National Day holiday, and the larger share of 7-day products in the total trading volume before the holiday and the higher over-night interest rate, the weighted average interest rate of inter-bank borrowing and pledged repos posted 2.05 percent and 2.01 percent respectively in September, 61 and 60 basis points higher than that in June 2015, and a decline of 92 basis points year on year. At end-September, the overnight and 7-day Shibor was 1.99 percent and 2.41 percent, a growth of 73 and a decline of 24 basis points respectively from end-June 2015. The differential between the two declined from 140 basis points at end-June to 42 basis points. The 3-month and 1-year Shibor posted 3.15 percent and 3.41 percent respectively, a decline of 8 basis points and a growth of 2 basis points respectively from end-June.

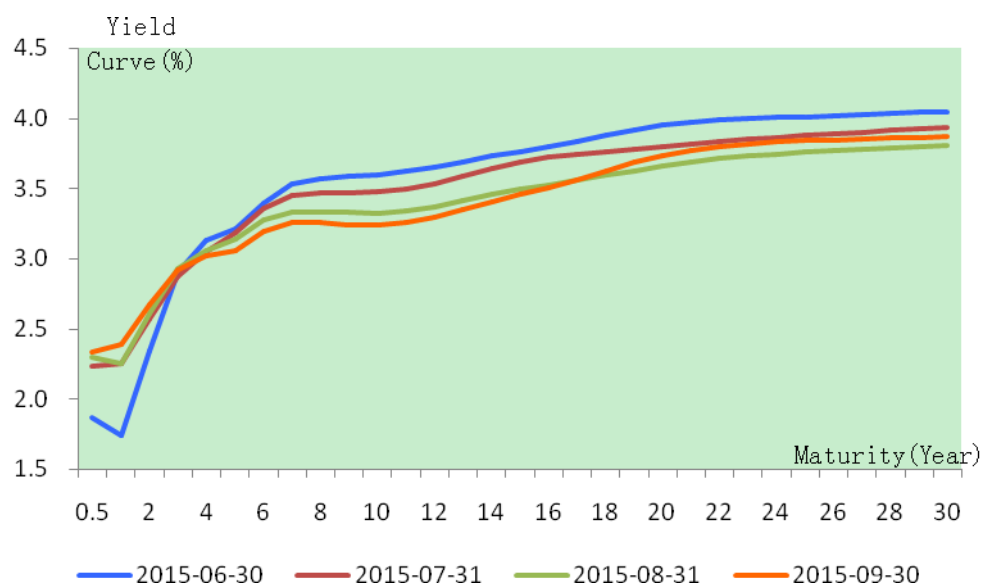
## **2. Spot bond trading was brisk and bond issuances expanded notably, whereas coupon rates generally declined**

During the first three quarters, the volume of spot bond trading on the inter-bank market posted 58 trillion yuan, with the daily trading volume averaging 309.1 billion yuan, up 103 percent year on year. The turnover of spot bond trading totaled 2.6 trillion yuan on the exchange market, 791.4 billion yuan more than the total volume during the corresponding period of the last year. In terms of the trading entities, Chinese-funded small- and medium-sized banks and securities firms, as net bond sellers, sold 1.2 trillion yuan of spot bonds in Q3; other financial institutions and vehicles, as net bond purchasers, bought 1.3 trillion yuan in spot bond trading. In terms of the traded products, a total of 3 trillion yuan of spot government securities was traded, accounting for 12 percent of the total spot bond transactions on the inter-bank market; the turnover of spot financial bonds and corporate debenture bond transactions was 13.4 trillion yuan and 8.1 trillion yuan respectively, accounting for 54 percent and 32.6 percent respectively.

Bond indices on the inter-bank markets moved up slightly. The China Bond Composite Index (net price) increased from 102.21 points at the end of June to 103.20 points at end-September, up 0.97 percent; the China Bond Composite Index (full price) grew 1.12 percent from 115.87 points at end-June to 117.17 points at end-September. The Government Securities Index on the stock exchanges rose 1.32 percent from 149.64 points at end-June to 151.62 points at end-September.

The yield curve of government securities on the inter-bank market flattened, with the yield of short-term bonds moving upward and that of long-term bonds moving downward. In Q3, due to downward pressures, sluggish stocks and commodities markets, and adequate liquidity in the money market, market demand for bonds with medium to long durations surged, pushing down the yield of medium- to long-term government securities and resulting in a flattening yield curve. At end-September, the yield of 1-year and 3-year government securities were up 65 basis points and 2 basis points respectively from the level at end-June, while those of 5-year, 7-year, and 10-year government securities declined by 16, 27, and 36 basis points respectively

from end-June. The interest-rate differential between 10-year and 1-year government securities was 84 basis points, a reduction of 102 basis points from end-June.



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

**Figure 2 Yield Curves of Government Securities on the Inter-bank Bond Market**

The volume of bond issuances expanded significantly. From January through September, a total of 8.6 trillion yuan of bonds was issued. This represented an increase of 7.3 trillion yuan year on year, among which the year-on-year increase in the issuance of central government securities was 2.3 billion yuan, the year-on-year increase in the issuance of inter-bank certificates of deposit (a component of financial bonds) was 2.9 trillion yuan, and the year-on-year increase in the issuance of corporate debenture bonds was 778 billion yuan. At end-September, the outstanding volume of bonds was 44.8 trillion yuan, up 30.9 percent. On September 21, the PBC granted approval to the Hong Kong and Shanghai Banking Corporation Limited (HSBC) and the Bank of China (Hong Kong) Limited to issue financial bonds on the inter-bank bond market, the first approval for internationally active banks to issue RMB bonds on the inter-bank bond market. In 2005 and 2013, international development organizations and overseas non-financial corporations were given approval to issue RMB bonds on the inter-bank bond market, the first time ever that overseas institutions were issuers.

**Table 9 Bond Issuances, Q1–Q3, 2015**

Type of bonds	Issuances (100 million yuan)	Year-on-year growth (100 million yuan)
Government securities <sup>①</sup>	39,670	23,085
Central bank bills	0	0
Financial bonds <sup>②</sup>	71,753	43,373
Of which: Financial bonds issued by the China Development Bank and policy financial	20,756	1,662

bonds		
Inter-bank certificates of deposit	32,726	29,443
Corporate debenture bonds <sup>③</sup>	46,116	6,586
Of which: Debt-financing instruments of non-financial enterprises	39,049	7,780
Enterprise bonds	3,467	-3,878
Corporate bonds	3,474	2,783
<b>Total</b>	<b>157,539</b>	<b>73,044</b>

Notes: ① Including municipal bonds.

② Including financial bonds issued by the China Development Bank, policy financial bonds, ordinary bonds issued by commercial banks, subordinated bonds issued by commercial banks, hybrid bonds issued by commercial banks, bonds issued by securities firms, inter-bank certificates of deposit, and so forth.

③ Including debt-financing instruments issued by non-financial enterprises, enterprise bonds, corporate bonds, convertible bonds, bonds with detachable warrants, privately placed SME bonds, and so forth.

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

The coupon rates of various kinds of bonds all declined. At end-September, the coupon rate of 10-year government securities was 3.51 percent, a decline of 13 basis points from that of bonds of the same maturity issued at end-June. The coupon rate of 10-year financial bonds issued by the China Development Bank was 3.71 percent, down 37 basis points from that of bonds of the same maturity issued at end-June. The average coupon rate of short-term financing bills (rated A-1) issued by AAA-rated enterprises was 3.52 percent, down 46 basis points from end-June; the average coupon rate of 7-year corporate bonds was 4.48 percent, down 32 basis points from end-June. The Shibor played an increasingly greater role in bond pricing. From January through September 2015, 46 floating-rate bonds and inter-bank certificates of deposits were issued based on the Shibor, with a gross issuance volume of 23.8 billion yuan; 214 fixed-rate enterprise bonds were issued, with a gross issuance volume of 230.7 billion yuan, all based on the Shibor; and a total of 691.6 billion yuan of fixed-rate short-term financing bills was issued based on the Shibor, accounting for 92 percent of all fixed-rate short-term financing bills.

### **3. The outstanding volume of bill financing increased rapidly and interest rates declined**

The growth of the bill acceptance business slowed down. From January through September, commercial bills issued by enterprises totaled 16.6 trillion yuan, up 2.3 percent year on year. At end-September, outstanding commercial bills posted 10.6 trillion yuan, up 9.3 percent year on year. The balance of bill acceptances increased 747.2 billion yuan from the beginning of 2015, 61.1 billion yuan more than the growth registered during the same period of the last year. Looking at the industries of the issuing enterprises, outstanding bankers' acceptances were mainly issued by

enterprises in the manufacturing, wholesale, and retail industries. Small- and medium-sized enterprises accounted for about two-thirds of all commercial bills issued by enterprises.

The outstanding balance of bill financing increased rapidly and the interest rates on the bill market revealed a downward trend. From January through September, commercial bills discounted by financial institutions totaled 75.2 trillion yuan, up 77.0 percent year on year; the outstanding balance of bill discounts stood at 4.3 trillion yuan, up 59.7 percent year on year. At end-September, the outstanding amount of bill financing had increased by 1,400.3 billion yuan from the beginning of 2015, 664.8 billion yuan more than the growth registered during the corresponding period of the last year; the share of outstanding bill financing in the total outstanding loans was 4.7 percent, up 1.3 percentage points year on year. Given the balanced supply and demand in the bill market, the downward trend in the bill interest rates was mainly affected by interest-rate movements on the money market.

#### **4. Stock indices tumbled while the volume of trading and financing declined**

The stock indices tumbled. At end-September, the Shanghai Stock Exchange Composite Index closed at 3,053 points, losing 28.6 percent and 5.6 percent respectively from end-June and end-December; the Shenzhen Stock Exchange Component Index closed at 9,988 points, down 30.3 percent and 9.3 percent respectively from end-June and end-2014; the Growth Enterprise Board (GEM Board) Index (Chinext Price Index) closed at 2,083 points, down 27.1 percent from end-June but up 41.5 percent from end-2014. The weighted average P/E ratio of the A-share market on the Shanghai Stock Exchange fell from 21.0 times at end-2014 to 15 times at end-June, while during the same period that of the Shenzhen Stock Exchange fell from 55.0 times to 39 times.

In Q3, the combined turnover of the Shanghai and Shenzhen Stock Exchanges reached 60 trillion yuan, with a daily turnover averaging 327.9 billion yuan, down 72 percent from that during the first six months of the year; turnover on the GEM Board totaled 6.7 trillion yuan, down 48.4 percent year on year. At end-September, the combined market capitalization of the Shanghai and Shenzhen Exchanges posted 33.9 trillion yuan, up 39.4 percent year on year; the market capitalization of the GEM Board posted 2.3 trillion yuan, up 66.3 percent year on year. A total of 195.1 billion yuan was raised by enterprises and financial institutions by way of IPOs, additional offerings, rights issuances, and warrant exercises, a decline of 207.4 billion yuan quarter on quarter.

#### **5. Assets in the insurance industry grew rapidly**

From January through September, total premium income in the insurance industry amounted to 1.9 trillion yuan, representing year-on-year growth of 19.5 percent and an acceleration of 0.9 percentage point year on year; total claim and benefit payments amounted to 626.1 billion yuan, representing year-on-year growth of 19.5 percent. Specifically, total claim and benefit payments in the property-insurance sector

increased 79.5 percent year on year, while those in the life-insurance sector increased 29.7 percent.

Insurance assets grew rapidly. At end-September, total assets in the insurance industry posted 11.6 trillion yuan, representing year-on-year growth of 20.5 percent and an acceleration of 1.2 percentage points. Among this total, bank deposits increased 1.3 percent year on year, while investment-linked assets increased 25.5 percent.

**Table 10 Use of Insurance Funds, End-September 2015**

	Outstanding balance (100 million yuan)		As a share of total assets (%)	
	End-September 2015	End-September 2014	End-September 2015	End-September 2014
Total assets	115,780	96,076	100	100
Of which: Bank deposits	25,425	25,095	22.0	26.1
Investments	78,510	62,582	67.8	65.1

Source: China Insurance Regulatory Commission.

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

From January through September, the turnover of spot RMB/foreign-exchange transactions totaled USD 3.6 trillion, up 19.4 percent year on year. The turnover of RMB/foreign-exchange swap transactions totaled an equivalent of USD 5.5 trillion, up 67.9 percent year on year, among which overnight RMB/USD swap transactions posted USD 3.6 trillion, accounting for 65.1 percent of the total turnover in swap transactions. Turnover on the RMB/foreign-exchange forward market totaled USD 27.9 billion, down 31 percent year on year. The turnover of foreign currency pair transactions amounted to an equivalent of USD 81.8 billion, up 88.4 percent year on year. In particular, EUR/USD pairs were the most traded, accounting for 43.42 percent of the total.

The number of participants on the foreign-exchange market increased further. At end-September, there were 503 members on the foreign-exchange spot market, 111 members on the foreign-exchange forward market, 110 members on the foreign-exchange swap market, 91 members on the currency swap market, and 55 members on the foreign-exchange options market. In addition, there were 30 market-makers on the spot market and 27 market-makers on the forward and swap markets.

## **7. Turnover on the gold market expanded and the price of gold fluctuated**

After declining, the price of gold rallied and then continued to fluctuate. In Q3, the price of spot gold on the international market peaked at USD 1,171.7 per ounce and reached a trough of USD 1,080.05 per ounce, closing at USD 1,114.00 per ounce at end-September and representing a decline of 4.87 percent from end-June. The peak price of gold (AU9999) on the Shanghai Gold Exchange was 241.82 yuan per gram, and the lowest price was 210.79 yuan per gram. At end-September, the price of gold closed at 230.50 yuan per gram, representing a decline of 4.44 yuan per gram, or down 1.89 percent from end-June. The differential between domestic and international gold prices expanded in Q3, averaging 0.81 yuan per gram on a daily basis, an increase of 42.11 percent year on year.

The gold market on the Shanghai Gold Exchange operated smoothly and the volume of transactions surged. In Q3, the trading volume of gold was 9,256.9 tons, an increase of 144.6 percent year on year, and the turnover posted 2.1 trillion yuan, an increase of 121.5 percent year on year. The trading volume of silver was 24.8 trillion tons, an increase of 203.4 percent year on year, and the turnover posted 0.8 trillion yuan, up 137.8 percent year on year. The trading volume of platinum was 18.0 tons, a decline of 2.8 percent year on year, and the turnover posted 3.84 billion yuan, down 30.2 percent year on year.

## **II. Institutional building in the financial markets**

### **1. Measures were adopted to promote the development of the inter-bank bond market**

The *Notice of the People's Bank of China Concerning Investments in the Inter-Bank Market of Foreign Central Banks, International Financial Institutions, and Sovereign Wealth Funds with RMB Funds* (PBC [2015]220) was released to provide clear provisions on how and through what kind of procedures such investments are to be made, as well as the qualification requirements for the institutional investors and the requirements for the various agents to facilitate foreign investments by central banks and similar institutions in the inter-bank bond market and to improve investment efficiency.

### **2. Institutional arrangements in the equity market were improved**

First, the *Administrative Rules on the Margin Trading Business of Securities Firms* were revised to establish a counter-cyclical adjustment mechanism for margin trading, to establish a reasonable limit for such business, to allow an extension of securities loan contracts, and to improve the criteria and methods of treatment of the collateral in cases of default. Second, illegal securities businesses were cleaned up. Access to outside information system was regulated. Regulation for real names on securities accounts were implemented. Account holders were not allowed to open sub-accounts, subsidiary accounts, or virtual accounts, while the securities firms were banned from allowing non-holders to use their clients' fund accounts and securities accounts. Public comments were solicited on the draft program of a circuit breaker mechanism.

### **3. Institutional arrangements in the insurance market were further improved**

First, efforts were made to promote the insurance industry to support economic and social development. Rules were clarified for business operations, investment management, and risk control and supervision of the pension products of the insurance companies. Insurance companies were encouraged to take part in investments in major projects through bond purchases and by establishing investment funds, and to beef up insurance services to major projects through engineering insurance, calamity insurance, and reinsurance services. Second, measures were adopted to support the use of insurance funds. The upper limit of investments in single blue-cap stocks was adjusted. The trading structure, operational framework, operational details, and regulation of asset-backed businesses of insurance companies were clarified. Registration practices were established for private equity funds established with insurance money, in which the categories of such funds, their direction of investments, governance structures, and operational structures were regulated. Third, regulation of the Internet insurance business was improved. The basic principles regarding qualifications to run an Internet insurance businesses, and the geographical coverage of Internet insurance business, information disclosures, supervision, and regulation of such businesses were established. It is stipulated that insurance firms are to manage and to be responsible for sales and the underwriting of policies, claim settlements, cancellation of insurance, handling of complaints and customer services, while third-party Internet platforms are to provide network support services for Internet insurance businesses; the geographical limit for certain personal insurance products and property insurance products for individual customers was relaxed. Fourth, reform of the insurance intermediary market was deepened. The overall objective and key tasks of the insurance intermediary reform were defined in a comprehensive and systematic way, i.e., the establishment of an insurance intermediary market system with clearly defined functions and sound access and exit mechanisms that support the orderly flow of various factors. Fifth, the rate reform of life insurance products that pays dividends has been introduced. Starting on October 1, the upper limit of 2.5 percent on the pre-set dividend interest rates was lifted.

### **4. Promoting the development and opening-up of the gold market**

First, the Shanghai Gold Exchange worked jointly with the Chinese Gold and Silver Exchange Society and launched the Shanghai Hong Kong Gold Connect business to promote the opening up of the gold market. Second, the Shanghai Gold Exchange launched the business of accepting marketable assets as margin collateral to help reduce the transaction costs for investors and to increase market liquidity.

## **Part 4 Macro-economic Analysis**

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

The global economy remained complex with increasing uncertainties. The recovery momentum of the U.S. economy was fundamentally steady despite the weakening of some economic indicators. There were signs of a recovery in the euro area, but the foundation was not yet solid. The credit rating of Japan was adjusted downward and the outlook for a recovery needs to be monitored. Growth in some emerging market economies slowed down and the outlook for their trade and fiscal conditions was not optimistic.

#### **1. Developments in the Major Economies**

The U.S. economy continued to recover moderately, with several economic indices weakening since Q3. The increasing momentum of the U.S. economy was strong during the last quarter and GDP grew substantially by 3.9 percent quarter on quarter (annualized). During the third quarter, major economic indices experienced large fluctuations. Consumption growth was stable. In September, the Michigan Consumer Sentiment Index (MCSI) fell to 87.2, the third fall in three months, before rallying to 92.1 in October. The production situation generally weakened. The Industrial Output Index (IOI) increased by only 0.4 percent year on year in September, recording a new low since February 2010. Manufacturing PMI hit a new low that had not been seen since June 2013. With the US dollar index remaining elevated, U.S. exports recorded negative year-on-year growth for nine consecutive months. The inflation rate remained subdued, and the labor market improved with mixed results. The unemployment rate continued to drop, but the labor market faced structural problems, with the growth of non-farm employment falling by a large margin and the rate of participation declining.

There were signs of an economic recovery in the euro area, but the foundation was not yet solid. During the second quarter, GDP growth in the euro area was up by 1.5 percent year on year, accelerating for four consecutive quarters. During the third quarter, the moderate recovery continued. But as the effects of the easing policies weakened, the growth momentum showed signs of a slowdown. Expenditures grew modestly and growth of retail sales volume accelerated from the second quarter, whereas the Consumer Confidence Index (CCI) continued to slide. The Manufacturing PMI continued to expand, but the growth of exports exhibited a modest slowdown. The labor market improved further, and the unemployment rate declined. Meanwhile, a risk of deflation still exists, with the year-on-year growth of the Harmonized Index of Consumer Prices (HICP) close to zero. However, the outlook for the Greek debt problem added uncertainties. According to the Congressional Budget Office of Greece, the economy could shrink by 4 percent in 2015. Moreover, due to the massive inflow of refugees, the associated economic and social problems may also have a negative impact on economic growth.



Japan's economic prospects need to be watched, and its credit rating was lowered. During the second quarter, affected by sharply shrinking private consumption and net exports, Japan's economy contracted slightly, with GDP decreasing by 1.6 percent quarter on quarter (annualized). Since the beginning of the third quarter, recovery was still relatively weak. Important indices such as the unemployment rate, the industrial production index, the manufacturing PMI, consumption growth, and exports all declined to varying degrees. Meanwhile, the risks of deflation rose again as the growth rate of the CPI dropped sharply during the second quarter and the core CPI fell 0.1 percent year on year both in August and September. Based on the sluggish growth in recent years and the sustained low inflation rate, which will make it difficult for the Bank of Japan to achieve its inflation target, the S&P lowered Japan's sovereign credit rating to A + from AA – in September.

**Table 11 Macro-economic and Financial Indices in the Major Economies**

Country	Index	2014Q3			2014Q4			2015Q1			2015Q2			2015Q3		
		Jul.	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.
United States	Real GDP Growth Rate (annualized quarterly rate, %)	3.9			2.2			-0.2			3.9			1.5 (primary estimate)		
	Unemployment Rate (%)	6.2	6.1	5.9	5.7	5.8	5.6	5.7	5.5	5.5	5.4	5.5	5.3	5.3	5.1	5.1
	CPI (YOY, %)	2	1.7	1.7	1.7	1.3	0.8	-0.1	0	-0.1	-0.2	0	0.1	0.2	0.2	0
	DJ Industrial Average (closing number)	16563	17098	17043	17391	17828	17983	17165	18133	17776	17841	18010	17620	17689	16528	16285
Euro Area	Real GDP Growth Rate (annualized quarterly rate, %)	1			1.6			2.1			1.4			...		
	Unemployment Rate (%)	11.6	11.5	11.5	11.5	11.5	11.4	11.3	11.2	11.2	11.1	11.1	11.1	10.9	10.9	10.8
	HICP (YOY, %)	0.4	0.4	0.3	0.4	0.3	-0.2	-0.6	-0.3	-0.1	0	0.3	0.2	0.2	0.1	-0.1
	EURO STOXX 50 (closing number)	3115	3044	3067	2998	3076	3004	3198	3401	3435	3439	3444	3285	3432	3110	2977
Japan	Real GDP Growth Rate (annualized quarterly rate, %)	-1.6			2.2			2.4			-1.6			...		
	Unemployment Rate (%)	3.7	3.5	3.6	3.5	3.5	3.4	3.6	3.5	3.4	3.3	3.3	3.4	3.3	3.4	3.4
	Core CPI (YOY, %)	3.4	3.3	3.2	2.9	2.4	2.4	2.4	2.2	2.3	0.6	0.5	0.4	0.2	0.2	0
	NIKKEI 225 (closing number)	15621	15425	16174	16414	17460	17451	17674	18847	19207	19983	20563	20236	20585	18890	17388

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

Growth in some emerging market economies slowed down, and their trade and fiscal conditions were less than optimistic. Due to numerous factors, including domestic structural problems, the continued weakening of commodity prices, the reverse in global capital flows, and geopolitical shocks, growth slowed in the emerging market economies. Specifically, since Brazil's GDP fell by 2.6 percent during the second quarter and recorded negative growth for five consecutive quarters, the S&P downgraded the credit rating of Brazil to junk. Due to the downturn in growth and the

rising inflation, Russia faced risks of stagflation. In some commodity exporting countries, trade volume declined sharply, weakening the pull effect on the economy. At the same time, the fiscal deficit as a share of GDP was elevated in some emerging market economies, and it is expected that the fiscal gap will expand further due to the slowdown in economic growth.

## **2. Developments in global financial markets**

The euro and the Japanese yen appreciated modestly against the US dollar, whereas the pound sterling and the currencies in the major emerging market economies depreciated against the US dollar. On September 30, the exchange rates of the euro, the pound sterling, and the Japanese yen against the US dollar were 1.1176 dollar per euro, 1.5127 dollar per pound, and 119.84 yen per dollar respectively, an appreciation of 0.37 percent, a depreciation of 3.68 percent, and an appreciation of 2.21 percent respectively from the end of June. At the same time, most of the emerging market currencies depreciated. Among them, the Brazilian real, the Russian ruble, the Malaysia ringgit, and the South African rand lost 21.42 percent, 15.34 percent, 14.16 percent, and 12.11 percent against the US dollar.

The dollar Libor in the London Inter-bank Market rose slightly, while the Euribor continued to decline. Due to the gradual improvement in the U.S. economy, as a whole the dollar Libor edged up. On September 30, the 1-year dollar Libor was 0.8511 percent, an increase of 8 basis points from the end of June. The 1-year Euribor registered 0.142 percent, a decrease of 2.2 basis points from the end of June.

The yields of government securities in the advanced economies and in many emerging market economies diverged. The yields of many advanced economies declined. On September 30, the yield of 10-year government bonds in the United States, Germany, and Japan closed at 2.06 percent, 0.59 percent, and 0.35 percent respectively, down by 27.3, 18, and 10.8 basis points from the end of June. Meanwhile, the yields of 10-year government bonds in most emerging market economies went up, with those in Brazil, Turkey, and Indonesia surging by 309, 157, and 124 basis points respectively.

The stock markets in the major advanced economies and in most emerging market economies declined to varying degrees. On September 30, the Dow Jones Industrial Average Index, the STOXX 50 Index, and the Nikkei 225 Index closed at 16,285, 2,977, and 17,388 respectively, down by 7.6 percent, 9.4 percent, and 14.1 percent from the end of the last quarter. The stock markets in the emerging market economies declined considerably. The stock indices in Brazil, Russia, Indonesia, and Argentina lost 19.7 percent, 16.0 percent, 14.0 percent, and 13.1 percent respectively from the end of June.

## **3. Monetary policies in the major economies**

During the third quarter, the major advanced economies continued their accommodative monetary policies. At its regular meetings in July and September, the

Federal Open Market Committee (FOMC) of the U.S. Fed maintained the current 0 to one-quarter percent target range for the federal funds rate, reiterated that it would be appropriate to raise the target range for the federal funds rate when it saw further improvements in the labor market, and stated that it was reasonably confident that inflation would return to its 2 percent target over the medium term. The FOMC clearly stated at its regular meeting in October that in determining whether it will be appropriate to raise the target range at its next meeting the Committee will assess the progress, both realized and expected, toward its objectives of maximum employment and 2 percent inflation.

The European Central Bank (ECB) continued its easing monetary policies, keeping the interest rates of the main refinancing operations (MROs), the marginal lending facility, and the deposit facility at 0.05, 0.3, and -0.2 percent respectively. On September 3, Mario Draghi, president of the ECB, announced that the Governing Council had decided to increase the issue share limit from the initial limit of 25 percent to 33 percent, and he emphasized the Governing Council's willingness and ability to act, if warranted, by using all the instruments available within its mandate. The Bank of Japan (BOJ) continued to carry out its quantitative and qualitative monetary easing policy and promised to maintain it until the inflation target of 2 percent is reached. The Bank of England (BOE) maintained the Bank Rate at 0.5 percent and the scale of asset purchases at GBP 375 billion. In its annual report to Parliament in September, Mark Carney, governor of the Bank of England, reiterated that the decision as to whether to start raising interest rates will be clearer by the end of the year. Meanwhile, in order to boost their economies, in succession the central banks of Sweden, Canada, New Zealand, and Norway lowered their benchmark rates. Responding to inflationary pressures, in August the central bank of Iceland raised the benchmark rate by 50 basis points to 6.25 percent.

The emerging market economies were working to reach a balance between addressing the slowdown, inflation, and an easing of capital outflow pressures. Some economies lowered their benchmark rates so as to boost their economies or to reduce their financing costs for sovereign debts. On July 21, for the fifth consecutive month the Central Bank of Hungary lowered the benchmark rate by 15 basis points to 1.35 percent. On July 31, the Central Bank of Russia lowered its benchmark rate by 50 basis points to 11.0 percent, the fifth rate cut this year, which meant that so far in 2015 the cumulative rate cut was 550 basis points. After reaching a debt restructuring agreement with creditors in August, the central bank of Ukraine immediately lowered the interest rate by 300 basis points to 27 percent. On September 29, the Reserve Bank of India lowered its repos rates by 50 basis points to 6.75 percent, the fourth rate reduction in 2015. Meanwhile, Brazil, Peru, and South Africa chose to raise the policy rates in response to inflationary pressures. On July 29, the Central Bank of Brazil increased its benchmark interest rate on a fifth occasion by 50 basis points to 14.25 percent. Worried about possible price hikes as a result of the currency depreciation, on September 12 the Central Bank of Peru raised the interest rate by 25 basis points to

3.5 percent. To curb inflation, on July 23 the Reserve Bank of South Africa raised the deposit rate by 25 basis points to 6 percent while keeping the lending rate unchanged.

#### **4. The global economic outlook and the major challenges**

In its *World Economic Outlook (WEO)* released in October 2015, the International Monetary Fund (IMF) revised downward the projection for global growth in 2015 from 3.3 percent to 3.1 percent. Projections for growth in the United States were revised upward from 2.5 percent to 2.6 percent; projections for growth in the euro zone remained unchanged; projections for Japan were revised downward from 0.8 percent to 0.6 percent; and growth in the emerging market and developing economies was revised downward from 4.2 percent to 3.9 percent. Overall, the global economy may face the following risks.

There might be financial market volatilities with spillovers and contagions to other markets and other regions. Earlier, as the expected interest-rate hike by the Federal Reserve approached, triggered by the volatility in the financial markets of the emerging economies, global financial markets experienced a drastic decline. In particular, stock market volatility was substantial. After August 20, the world's major stock markets all declined and volatility in the currency markets intensified, as the exchange rates of some countries in Latin America and emerging market economies depreciated precipitously. Commodities prices were also impacted, especially that of oil. If the development of the international economic and financial environments and monetary policy adjustments by other major economies are beyond market expectations, they may trigger chaotic cross-border capital flows and a revaluation of global risk assets, thereby undermining overall stability in the financial markets.

The outlook for the Greek debt problem still faces uncertainties and may become the tail risk for the euro zone and international financial markets. Since 2015, negotiations between Greece and its creditors have seen twists and turns, and even crises. After the Greek parliament voted to adopt the structural reforms and fiscal consolidation plans proposed by its international lenders, the euro group in August approved the third round of a Greece bailout agreement. However, implementation of the structural reforms still faces large uncertainties and may bring tail risks to the euro area and global financial markets.

Certain emerging market economies may face even more serious challenges. Affected by numerous factors such as the structural problems, limited fiscal space, weak external demand, falling commodity prices, and expectations that the Fed will raise interest rates, the growth momentum in certain emerging market economies weakened and there were volatilities in their financial markets. Those economies with fragile foundations and that were heavily dependent on resource exports are more vulnerable to shocks from international capital flows.

## **II. Analysis of China's macro-economic performance**

The Chinese economy performed in a stable manner with positive developments in its structural adjustments. The contribution of consumption to growth increased, while the decline in export growth narrowed. Consumer prices rose moderately and employment remained basically stable. During the first three quarters, China's GDP gained 6.9 percent year on year to reach 48.8 trillion yuan, growing at 7.0 percent, 7.0 percent, and 6.9 percent respectively from the first to the third quarter of this year. Quarter-on-quarter GDP growth during the third quarter stood at 1.8 percent, which was flat with the previous quarter. During the first three quarters, the CPI increased by 1.4 percent and the trade surplus posted USD 424.09 billion.

### **1. The contribution of consumption to growth increased and the decline in export growth narrowed**

The income of urban and rural residents continued to grow. The contribution of consumption to growth increased and consumption via the new business model grew particularly rapidly. During the first three quarters, final consumption contributed 58.4 percent to GDP growth, which was 9.3 percentage points higher than that during the same period of the previous year. Per capita disposable income of urban residents registered 23,512 yuan, which was up 8.4 percent year on year in nominal terms and up 6.8 percent in real terms; per capita disposable income of rural residents reached 8,297 yuan, increasing by 9.5 percent year on year in nominal terms and 8.1 percent in real terms. According to the Q3 Urban Depositors' Survey conducted by the People's Bank of China, resident consumption intentions increased. The share of residents willing to consume more registered 20.4 percent, an increase of 3.5 percentage points from the previous quarter. During the first three quarters, total retail sales increased by 10.5 percent year on year to 21.6 trillion yuan, accelerating by 0.1 percentage point compared with the first half of this year. Broken down by the urban and rural areas, retail sales in the urban areas gained 10.3 percent year on year to reach 18.6 trillion yuan, while retail sales in the rural areas grew by 11.7 percent year on year to reach 3.0 trillion yuan, indicating a continued trend of higher rural growth as compared to urban growth. The new business model achieved rapid growth and resident consumption rebounded. The consumption of energy-saving products prospered. During the first three quarters, total online retail sales increased by 36.2 percent year on year to 2591.4 billion yuan; sales of building materials, furniture, and home appliances by statistically large institutions grew by 18.6 percent, 16.7 percent, and 10.8 percent respectively, 4.8, 2.2, and 2.1 percentage points more year on year respectively; total sales of new-energy vehicles increased by 2.3 times year on year.

Growth of fixed-asset investments continued to slow down, while investment growth in the central region remained relatively rapid. During the first three quarters, fixed-asset investments (excluding those by agricultural households) reached 39.5 trillion yuan, up 10.3 percent year on year in nominal terms, representing a deceleration of 1.1 percentage points compared with the first half of this year. Broken

down by regions, investments in the central region remained rapid. Investments in the eastern, central, and western regions grew by 8.6 percent, 14.5 percent, and 8.7 percent year on year to 17.9 trillion yuan, 11.4 trillion yuan, and 9.9 trillion yuan respectively. Broken down by industries, investments in the primary and tertiary industries grew more rapidly. Investments in the primary, secondary, and tertiary industries grew 27.4 percent, 8.0 percent, and 11.2 percent respectively year on year to 1.1 trillion yuan, 16.2 trillion yuan, and 22.1 trillion yuan. Investments in construction projects grew 4.5 percent year on year to reach 89.3 trillion yuan; planned investments in new projects increased by 2.8 percent to 30.0 trillion yuan.

The decline in export growth narrowed and imports remained lackluster. During the first three quarters, total exports and imports reached 17.9 trillion yuan, down 7.9 percent year on year. Among this total, exports fell by 1.8 percent year on year to 10.2 trillion yuan; imports declined by 15.1 percent to 7.6 trillion yuan; the cumulative trade surplus registered 2.6 trillion yuan. In September, export growth went down by 1.1 percent year on year, which was 5 percentage points less than that during the previous month. Broken down by categories, export growth of machinery and electronics and high- and new-tech products grew more rapidly, while exports of some commodities registered a growth in volume despite a fall in prices. During the first three quarters, actually utilized foreign direct investment gained 9 percent to reach 584.74 billion yuan (or USD 94.9 billion); outbound direct investments by non-financial companies grew 16.5 percent to reach 538.9 billion yuan (or USD 87.3 billion).

## **2. Agricultural production was in good shape and industrial restructuring made further progress**

The value-added and contribution of tertiary industry continued to increase. During the first three quarters of 2015, the value-added of the primary, secondary, and tertiary industries were 3.9 trillion yuan, 19.8 trillion yuan, and 25.1 trillion yuan respectively, up 3.8 percent, 6.0 percent, and 8.4 percent year on year, and accounting for 8.0 percent, 40.6 percent, and 51.4 percent of GDP. The share of the tertiary industries was 2.3 percentage points higher year on year. The contribution of the primary, secondary, and tertiary industries to GDP growth stood at 4.4 percent, 36.7 percent, and 58.9 percent respectively, among which the contribution of tertiary industry was 9.0 percentage points higher than that during the same period of the previous year.

Production of summer grain reaped a bumper harvest, and agricultural production was in good shape. Nationwide production of summer grain totaled 141.07 million tons, growing by 3.3 percent year on year. During the first three quarters of 2015, the combined output of pork, beef, mutton, and poultry declined 1.3 percent year on year to reach 58.96 million tons, among which the output of pork dropped by 3.6 percent to reach 38.28 million tons.

Affected by capacity reductions in the traditional industries, secondary industry felt

intensive pressures and continued its structural adjustments. During the first three quarters of 2015, the value-added of statistically large enterprises, if calculated at comparable prices, grew by 6.2 percent year on year, representing a deceleration of 0.1 percentage point compared with that during the first half of the year. In September, the rate of sales of industrial products stood at 98.0 percent, which was 1.0 percentage point higher than that in June. During the first three quarters, actual profits of statistically large enterprises posted 4.3 trillion yuan, down 1.7 percent year on year. The profit margins of major business lines of statistically large enterprises reached 5.4 percent. According to the Entrepreneurs' Survey conducted by the PBC during the third quarter, the business climate index was 49.4 percent, 2.3 percentage points lower than that during the previous quarter; the domestic order index rose by 3.7 percentage points to reach 46.3 percent; the corporate profitability index declined by 1.6 percentage points to 51.1 percent; the export order and domestic order indices stood at 46.3 percent and 43.3 percent respectively, 2.4 percentage points and 2.9 percentage points lower than those during the previous quarter.

### **3. Consumer prices rose moderately**

Consumer prices grew at an accelerated pace. During the third quarter of 2015, the CPI rose 1.7 percent year on year, an acceleration of 0.3 percentage point from the previous quarter, and growth from July through September was 1.6 percent, 2.0 percent, and 1.6 percent respectively. Specifically, food prices increased by a larger margin, while the price hike in non-food items remained basically stable. The prices of food gained 3.0 percent year on year, an acceleration of 0.9 percentage point from that during the previous quarter, contributing 1.0 percentage point to CPI growth, and the price of non-food items rose by 1.1 percent year on year, an acceleration of 0.1 percentage point from the previous quarter and contributing 0.7 percentage point to CPI growth. Broken down by consumer goods and services, consumer prices rose by a larger margin while the inflation of service prices was stable. Meanwhile, the price of consumer goods went up by 1.6 percent year on year, an acceleration of 0.5 percentage point from the previous quarter, and the price of services grew 2.2 percent year on year, an acceleration of 0.1 percentage point from the previous quarter.

The decline in producer prices widened. From July through September, the PPI decreased by 5.4 percent, 5.9 percent, and 5.9 percent year on year, averaging a decline of 5.7 percent, which was 1.0 percentage point more than the decline during the previous quarter. Among this total, the price of capital goods declined by 7.4 percent year on year, which was 1.4 percentage points more than the decline during the previous quarter; the price of consumer goods fell by 0.3 percent year on year, which was flat with Q2. During the third quarter, the producer purchasing index went down by 6.5 percent year on year, which was 6.5 percentage points more than the decline during the previous quarter. The producer prices of agricultural products grew by a larger margin than the prices of agricultural capital goods. The producer prices of agricultural products gained 4.1 percent year on year, which was 2.6 percentage points more than that during the previous quarter; the prices of agricultural capital goods

grew 1.1 percent year on year, which was 0.5 percentage point higher than that during the previous quarter. During the third quarter, the CGPI decreased by 7 percent year on year, which was 1.5 percentage points more than that during the previous quarter. The prices of primary goods declined by a large margin, with the decline in capital goods exceeding that of consumer products.

Due to the decline in international commodity prices, the fall in import prices widened. In Q3, the average price of Brent Crude oil futures on the Intercontinental Exchange plunged by 19.2 percent quarter on quarter and by 50.4 percent year on year. The average price of spot copper on the London Metal Exchange plummeted by 13.0 percent quarter on quarter and by 24.8 percent year on year. The average price of spot aluminum fell by 9.9 percent quarter on quarter and by 19.9 percent year on year. From July through September, import prices fell by 11.3 percent, 15.0 percent, and 13.4 percent respectively, averaging 13.2 percent. This was 1.6 percentage points more than the decline during the previous quarter. Export prices grew by -0.7 percent, -3.5 percent, and 1.1 percent respectively, averaging -1.0 percent, which was 0.1 percentage point less than the decline during the previous quarter.

The GDP deflator registered a year-on-year decline. During the third quarter of 2015, the GDP deflator (the ratio of nominal GDP to real GDP) fell by 0.6 percent year on year,<sup>1</sup> as compared to a 0.1 percent year-on-year increase during the previous quarter.

The price reform continued. On October 8, the National Development and Reform Commission (NDRC) released a revised version of the *Directory of Centrally Priced Items*, which will take effect on the first day of 2016. The categories of centrally priced items were reduced from 13 to 7, and compared to 2001 the number of centrally priced items was cut from 100 to 20. On October 12, the CPC Central Committee and the State Council issued *Several Opinions on Promoting the Pricing Mechanism Reform*, arranging for pricing reforms at the current and future stages. It was noted that prices in competitive areas and links will be liberalized by 2017. Pricing by the government will be limited to important public utilities, public services, and areas that are naturally monopolized; by 2020, a market-determined pricing mechanism will be in place; a scientific, well-regulated, and transparent pricing regulatory rules and an enforcement system for the Anti-Monopoly Law will be established, and a pricing adjustment mechanism will be established.

#### **Box 4 Discussion on the Real Interest Rate and Debt**

Since the second half of 2014, price dynamics in China have seen diverging movements and structural changes. The widening gap between the CPI and the PPI, the PPI in negative territory for more than forty consecutive months, and the fairly high PPI-deflated real interest rate have attracted much attention. Some assessments based on the PPI point to mounting deflationary pressures and high real interest rates.

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<sup>1</sup> Calculated according to the current price and constant price quarterly GDP absolute value released by the National Statistics Bureau since Q3 2015



The high debt level, they argue, may interact with deflation to bring about a downward spiral in PPI contraction, higher real interest rates, aggravated indebtedness, and further economic contractions. An objective and comprehensive observation is thus necessary from both a theoretical and an empirical perspective in order to come up with an appropriate policy response.

The real interest rate is the rate of interest after allowing for inflation. When calculating the real interest rate, a proper index for inflation should be adopted. When deflated by the PPI, the derived real interest rate will be relatively high. In an open economy, there are numerous factors influencing price dynamics, including endogenous factors such as supply, demand, and money, and also imported variants such as international commodity price developments. The PPI reflects price changes in a range of primary products, such as petroleum, natural gas, iron ore, copper, aluminum, zinc, and so forth. A plunge in international commodity prices brings strong downward pressures on the PPI, which is not highly related to economic development and domestic monetary policy. This is also the rationale why some small economies mainly refer to the energy price-excluded core CPI when devising macro-economic policies. Others argue that tumbling commodity prices are related to changes in Chinese demand. Since 2015, however, China's GDP growth has been stable, and the volume of commodity imports, such as iron ore, aluminum, copper, and petroleum, have continued to increase. The imported factors have a larger impact on the PPI in the context of a significant decline in international commodity prices. Indeed, this round of tumbling oil prices has lasted for quite some time, and the supply side, such as the shale gas revolution in the United States, has played a significant role. Some studies reveal that commodities increasingly have been traded as financial products in recent years and have been more affected by the liquidity situation and speculative factors, and as a result they have experienced large swings in prices. In addition, overcapacity in some domestic sectors is another reason behind the negative growth of the PPI. Adoption of the PPI as the index to derive the real interest rate and an assessment of the policy stance are based on an implicit assumption: the current economic and industrial structure is appropriate and the major problem is a lack of short-term demand rather than an overcapacity and a structural mismatch. Taking stock of all the above-mentioned factors, further study should be carried out to judge which index should be adopted to calculate the real interest in the making of monetary policy. Comparatively, the CPI and the GDP deflator are more appropriate indices.

The interactive impact between the real interest rate and debt has its origins in the Debt-Deflation Theory of Irvin Fisher. It holds that the decline in prices lies at the core of a downward spiral, and indebtedness exacerbates the impact of deflation, which makes the economic system more vulnerable and enhances the probability of triggering a vicious circle. Therefore, the most direct way to curb and prevent a crisis is to make the price level return to normal, namely to achieve reflation via a stimulus. The Debt-Deflation Theory, which interprets some major historical economic and

financial crises from a new perspective, is very valuable. It should not be neglected, however, that the theory focuses on short-term demand analysis and partial equilibrium. From the perspective of a general equilibrium and long-term developments, even though implementation of a large-scale stimulus without an efficient restructuring and market adjustments may help to fill the demand gaps and maintain basically stable price levels, such expansionary investments may build up capacity and supply, which may aggravate overcapacity and debt accumulation and cause heavier downward pressures on price levels. The correlation between the debt level, money, and the price level is even more complicated. When the economy lacks an endogenous growth impetus and investment returns remain subdued, growth is boosted mainly by the accumulation of debts, and under this scenario the debt level may rise rapidly. China's overall debt ratio (total debt/ nominal GDP) remained basically stable and was declining from 2003 to 2008. The Chinese economy was deleveraging during that period, largely as a result of the strong growth momentum and the high corporate profitability, and thus there was a reduced demand for debt. Therefore, amidst the structural adjustments, macro policy makers should closely monitor the latest developments and strengthen policy fine-tunings so as to prevent a freefalling aggregate demand during the rebalancing process on the one hand, and they should also remain calm and refrain from injecting excessive liquidity, which may entrench or even exacerbate the structural problems. The key to enhancing momentum for endogenous growth is to promote structural adjustments and reforms so as to unleash the potential and space for growth and to channel more economic and financial resources to the more robust and efficient parts of the economy. A balance should be reached between stable growth, structural adjustments, and risk prevention to safeguard the bottom line in preventing regional and systemic financial risks.

#### **4. Fiscal revenue and expenditures posted low growth**

During the first three quarters of 2015, fiscal revenue rose 5.4 percent in comparable terms<sup>2</sup> to 11.4 trillion yuan, decelerating by 2.7 percentage points year on year. Fiscal expenditures reached 12.1 trillion yuan, up 15.1 percent year on year in comparable terms, an acceleration of 1.9 percentage points year on year. The fiscal deficit registered 625 billion yuan, as compared to the 272.23 billion yuan surplus during the same period of the previous year. In terms of the structure of fiscal revenue, non-tax revenue rose 10.6 percent in comparable terms year on year to a total of 2.0 trillion yuan, and tax revenue went up 4.3 percent year on year to 9.5 trillion yuan. Among this total, the domestic value-added tax, consumption tax, and turnover tax went up by 1.1 percent, 17.3 percent, and 9.6 percent respectively year on year; the value-added tax and consumption tax on imported goods declined by 14.8 percent year on year, whereas the corporate and personal income tax increased by 6.2 percent and 18.6 percent year on year. Outlays for energy conservation and environmental protection, urban and

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<sup>2</sup>The Ministry of Finance adjusted the statistical standards for fiscal revenue and expenditures by moving eleven items of government funds into the category of the general public budget. "Comparable terms" here refer to comparable growth calculated after the adjustment of the base during the previous year, which is consistent with the statistical standard in the draft budget for 2015. Growth of other items refers to growth in the absolute value of revenue and expenditures in 2015, as compared to that during the same period of the previous year.

rural communities, social security and employment, and transportation rose fairly rapidly, by 29.3 percent, 27.5 percent, 22.4 percent, and 22.3 percent respectively.

## **5. The employment situation was basically stable**

During the first three quarters of 2015, new urban employment reached 10.66 million, fulfilling the target for the year ahead of schedule, which was 160,000 less than that during the same period of the last year. By end-Q3, the urban registered unemployment rate remained low, at 4.05 percent. In Q3, a statistical analysis by the China Human Resources Market Information Monitoring Center, based on market supply and demand information provided by public employment service institutions in 101 cities, indicated that the labor market was generally balanced, with market demand slightly exceeding supply and the ratio of job seekers to job vacancies at 1.09, an increase of 0.03 quarter on quarter and a decline of 0.01 year on year. Compared with the same period of the previous year and the last quarter, both supply and demand were on a decline. Broken down by industry, demand for labor in sectors such as information transmission, computer services, and software, household services and other services, transportation, warehousing and postal services, the production and supply of electricity, and gas and water increased year on year, while the demand for labor in other sectors fell. Compared with the last quarter, demand for labor in industries such as information transmission, computer services, and software, and public administration and social organizations rose, and the demand for senior technicians also increased.

## **6. International payments and expenditures were generally balanced**

The balance of payments registered a small surplus. During the first half of 2015, the current account surplus registered USD 48.6 billion, accounting for 3.1 percent as a share of GDP, which was within the internationally accepted reasonable range. The capital and financial account deficit stood at USD 58.5 billion, among which the capital account surplus was USD 300 million and the financial account deficit was USD 58.7 billion. By end-June 2015, total reserve assets reached USD 3.69 trillion, which was USD 150 billion less than that at the end of the last year.

By end-June 2015, the total outstanding external debt posted USD 1680.1 billion. Among this total, outstanding medium- and long-term debt registered USD 510 billion, accounting for 30 percent of the total, and outstanding short-term debt stood at USD 170.1 billion, accounting for 70 percent of the total. Among the outstanding short-term external debt, 48 percent was trade-related credit.

## **7. Sector analysis**

### **(1) The real-estate sector**

Nationwide turnover of commercial real estate continue to recover. Among the seventy large and medium-sized cities, more cities reported a rise in housing prices. Growth of investment in real-estate development continued its declining trend.

Urban areas reported higher housing prices, among which some cities reported a wider increases. In September, the price of newly-built commercial residential housing increased month on month in thirty-nine out of seventy large- and medium-sized cities, twelve more cities than in June 2015, and twenty-six cities reported larger price increases than those in June; housing prices rose year on year in twelve cities, ten more than in June 2015, and twelve cities reported a larger price hike than that in June. The price of pre-owned residential housing increased month on month in thirty-nine cities, three cities less than in June 2015, and fifteen cities witnessed a higher price rise than in June 2015; in fifteen cities housing prices grew year on year, eleven cities more than in June, and fifteen cities saw larger increases than in June.

The turnover of commercial real estate continued to recover. During the first three quarters of 2015, the nationwide floor area of sold commercial real estate posted 830 million square meters, up 7.5 percent year on year. Since 2015, the year-on-year increase of sold floor area of nationwide commercial housing continued to recover, entering positive territory in June. The sales value of commercial real estate rose 15.3 percent year on year to 5.7 trillion yuan, which was 5.3 percentage points more than the increase during the first half of the year. Among this total, the sold floor area and sales value of commercial residential housing accounted for 88.3 percent and 84.4 percent of the total sold floor area and the turnover in commercial real estate respectively.

The growth of investment in real-estate development continued to decline. During the first three quarters of 2015, nationwide investment in real-estate development went up by 2.6 percent year on year to reach 7.1 trillion yuan, a deceleration of 2 percentage points compared with growth during the first half of 2015, marking the nineteenth month of deceleration. In particular, investment in residential housing posted 4.8 trillion yuan, up 1.7 percent year on year and a deceleration of 1.1 percentage points from H1 2015, accounting for 67.3 percent of the total investment in real-estate development. The floor area of newly started real-estate projects declined 12.6 percent year on year to 1.15 billion square meters, which was 3.2 percentage points less than the growth during the first half of 2015. The floor area of real-estate projects under construction grew 3.0 percent year on year to 6.94 billion square meters, representing a deceleration of 1.3 percentage points compared with the first half of the year. The floor area of completed real-estate projects posted 0.51 billion square meters, representing a year-on-year decline of 9.8 percent, which was 4 percentage points less than the decline during the first two quarters.

The growth in real-estate lending rose steadily. As of end-September 2015, outstanding real-estate loans of major financial institutions (including foreign-funded financial institutions) stood at 20.2 trillion yuan, up 20.9 percent year on year, which was 1.5 percentage points more than that at end-June 2015. Outstanding real-estate loans accounted for 22.0 percent of total outstanding loans, which was 0.2 percentage point higher than that at the end of June 2015. In particular, outstanding mortgage loans rose

21.6 percent year on year to 12.4 trillion yuan, an acceleration of 3.4 percentage points from end-June 2015; outstanding housing-development loans gained 21.0 percent year on year to 3.8 trillion yuan, a deceleration of 0.9 percentage point from end-June 2015; outstanding land-development loans rose 28.2 percent year on year to 1.6 trillion yuan, a deceleration of 4.6 percentage points from end-June 2015. During the first three quarters of 2015, new real-estate loans registered 2.8 trillion yuan, an increase of 701.6 billion yuan year on year, accounting for 28.4 percent of total new loans, which was 0.3 percentage points lower than that during the first half of 2015.

The growth of welfare-housing loans continued to increase. By end-September 2015, outstanding loans for the development of welfare housing posted 1.7 trillion yuan, up 61.7 percent year on year, which was 3.5 percentage points higher than that at end-June 2015; among this total, new development loans for welfare housing reached 544.6 billion yuan during the first three quarters of 2015, accounting for 80.1 percent of the new real-estate development loans during the same period, which was 11.5 percentage points more than that during the first half of the year. In addition, the pilot program of using housing provident fund loans to support the construction of affordable housing proceeded steadily. At end-September 2015, 364 welfare-housing projects in 83 cities were granted loan approvals and received 82.17 billion yuan in loan disbursements based on their construction progress, and 42.19 billion yuan of the principal was repaid.

## **(2) Internet finance**

In recent years, booming Internet finance has played a positive role in promoting financial inclusion, mass entrepreneurship, and innovation, enhancing the quality and efficiency of financial services and building a multi-tiered financial system. In July 2015, approved by the CPC Central Committee and the State Council, the PBC issued the *Guiding Opinions on Promoting the Healthy Development of Internet Finance* (PBC document [2015] No.221) (hereafter referred to as the *Guiding Opinions*) in joint efforts with other nine ministries. Based on the principle of “encouraging innovation, preventing risks, drawing on advantages and avoiding disadvantages, and promoting healthy development,” the *Guiding Opinions* contain a series of policy measures supporting innovation and development of the Internet finance industry, and define the regulatory responsibilities and basic business rules of the major business formats.

The major business lines of Internet finance all grew rapidly. First, Internet payments, which have provided corporate and individual customers with more conveniences, increased rapidly. During the second quarter of 2015, 10.4 billion online payment transactions were conducted by nationwide banking institutions, amounting to a value of 464.3 trillion yuan, up by 55.6 percent and 44.6 percent year on year respectively; the number and value of mobile payment transactions rose 141.3 percent and 445.1 percent year on year respectively to reach 2.29 billion yuan and 26.8 trillion yuan; the number and value of online payment transactions by non-bank payment institutions grew 142.1 percent and 107.8 percent to reach 20.66 billion yuan and 11.1 trillion

yuan respectively. Second, the P2P online lending platforms, which provide intermediary services for information exchanges, matching, and credit ratings, continued to increase in both number and business turnover. It is estimated that by end-September 2015 the total number and turnover of platforms (including platforms with normal operations and platforms with problems) reached more than a cumulative 3,400 billion yuan and 900 billion yuan. Third, online microcredit businesses, drawing on the advantages brought about by Internet technologies and big data, played a positive role in enhancing financing efficiencies and the availability of funds for micro and small customers. Fourth, Internet insurance continued to grow rapidly, accounting for an increasingly larger share. In 2014 total proceeds of Internet insurance registered 85.59 billion yuan, and the premiums grew 26 times that in 2011, contributing 18.9 percent to the total premium income in the insurance sector. Fifth, fund management companies, trust companies, and consumption finance companies set up proprietary online platforms or worked together with Internet firms, thus enhancing the Internet-related portions of their businesses. Moreover, in September 2015, the State Council released the *Guiding Opinions on Accelerating Platforms Supporting Mass Entrepreneurship and Innovation* (State Council Document [2015] No. 53), requiring steady promotion of pilots for equity crowd-funding. At present, administrative measures for such pilots are in the pipeline.

Virtuous competition among Internet financing institutions is taking shape. With deeper integration of the Internet and finance, traditional financial institutions and Internet firms are bringing their own advantages into full play in a virtuous competition, providing diversified products and services for customers, which will facilitate the building of a more competitive and inclusive financial system. The Internet firms and traditional financial institutions have much room for cooperation in terms of establishing a virtuous Internet financing ecology and industrial chain. At present, some of the banking financial institutions are actively engaged in innovations, providing fund depositories and trusts, and payment and settlement services for third-party payment institutions and Internet lending platforms. Some small and micro-financial institutions have been engaged in active cooperation with Internet firms in terms of upgrading operations systems, data digging, and precision marketing, which have made positive progress. Securities, funds, trusts, and consumption financing firms have been cooperating with Internet firms to complement each other's advantages, which have expanded the sales channels for financial products and have provided more wealth management instruments for financial consumers. Relying on technological advantages in cloud computation, big data, and Internet platforms, some large-scale Internet companies have provided technological and systemic support for traditional financial institutions to develop diversified financial products tailored to customers' specific demands.

The industrial regulatory system has been improved. Along with the industrial development and the launch of a top-down design, efforts have been made to formulate and launch regulatory rules. The PBC drafted the *Administrative Measures*

on *Online Payment Businesses of Non-bank Payment Institutions (Draft)*, and solicited public comments. The CBRC is formulating detailed rules on Internet lending businesses. The CSRC is carrying out special inspections on Internet equity financing activities and enacted the *Administrative Measures on the Pilot of Equity Crowd-funding*. The CIRC has formally launched *Provisional Measures on the Regulation of Internet Insurance Business* (CIRC Document [2015] No. 69), stipulating operating conditions and rules and information requirements for Internet insurance. The launch of regulatory rules facilitated the transition from a “no threshold, no rules, and no regulation” status to a legalized and well-regulated industry operating in the sunshine.

During the next stage, the relevant departments will continue to formulate relevant regulatory rules to define market-access requirements and detailed operational rules, improve information disclosures and on-process and ex-post regulatory mechanisms, and ensure that the *Guiding Opinions* and other policy measures are well implemented. Meanwhile, efforts will also be made to accelerate the establishment of the China Internet Finance Association to strengthen self-discipline in the industry. In line with the *Guiding Opinions* and other regulatory requirements, relevant institutions will continue to make rules on third-party deposits of customers’ funds, and on information disclosures, risk warnings, the establishment of qualified investors, and consumer protection, and will fulfill the obligations covering online security, anti-money laundering and preventing financial crime and enhancing business performance and risk management capacities so as to better satisfy the multi-tiered investment and financing needs of the real economy.

## **Part 5 Monetary Policy Stance to be Adopted during the Next Stage**

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

The global economy continues to rebalance and readjust. The Chinese economy has entered a new normal, featuring economic restructuring and transformation of the development pattern. A new perspective is thus needed to observe and understand both the global and the Chinese economy based on these new developments. It is a hard-won achievement that the Chinese economy has maintained a stable and relatively rapid growth momentum since the beginning of 2015 against the backdrop of complexity and diverging growth in the world economy. In terms of the quality of growth, employment remains basically stable, consumption contributes a larger share to GDP, and tertiary industry accounts for over 50 percent of GDP, up 2.3 percentage points year on year. The Chinese economy has registered more balanced growth with an improved structure. More importantly, endogenous growth dynamics are being

strengthened in some sectors. Business start-ups and innovations are burgeoning, with new businesses and new models developing very rapidly. The share of private investment is high, and the investment structure has been rationalized. In terms of industrial profits, although industrial profits in certain provinces (and autonomous regions) and in mining and other industries have posted large declines, industrial profits in other provinces (and autonomous regions) and other industries have continued their double-digit growth. In general, resilient regions and industries that have undergone rapid market clearing and structural adjustments reveal a stronger growth momentum, revealing the typical characteristics of structural adjustments. In the medium- and long-term, as a major developing country China still has a great potential for economic growth, with large room for further development of the new type of urbanization and the services sector. Given the vast regional disparities, the Chinese economy will remain resilient, with huge potentials and ample leeway. The twin engines of massive entrepreneurship and innovation, as well as the increased supply of public goods and services, are playing their due role. The growth potential will be released as the structural adjustments and reforms are further implemented. In the short run, the effects of the previous macro-economic policies are gradually unfolding. Liquidity is generally adequate, market interest rates remain stable at a low level, and financing costs through lending and bond issuances are on a decline. Market-based interest rates and the exchange-rate regime reforms are making new progress, and the mechanism of market allocations and adjustments of financial resources has been further improved. All these developments are helping to beef up support of the financial sector to the real economy and to enhance the efficiency of resource allocations. Convergence of the potential output of the economy has been going on for some time, and therefore a more objective and comprehensive perception of changes in economic growth, structural adjustments, the release of risks, and the transformation of the developmental pattern are gradually taking hold. These will contribute to a further deepening of the economic adjustments and reforms and will promote sustainable and higher-quality growth.

Of course, it is worth noting that there are still challenges before the new growth momentum comes into being by fully unleashing the development potentials. With sluggish growth in global trade, the world economy remains tepid, with external demand less of a driving force for economic growth. The expectation that the Federal Reserve will raise interest rates has led to a reallocation of global financial assets, heightened financial market fluctuations, and complicated the external investment environment. Looking at the domestic front, the structural imbalances between supply and demand still exist, and the inertia of downward adjustments in certain traditional and over-capacity industries remains. While poorly performing enterprises absorb a large amount of resources, the growth potentials in some new areas are not adequately tapped. These combined factors have hampered economic vitality and placed downward pressures on the economy, and the debt volume has continued to build up. While the cyclical and structural problems are intertwined, structural imbalances and the need to shift the development pattern remain an overarching priority. In order to



address these problems, it is necessary to make breakthroughs in structural adjustments, transformation, and reform, to overcome the institutional problems inhibiting urbanization, to remove the obstacles to developing the services sector, to improve the mechanism that expands consumption, to make strenuous efforts to tackle the overcapacity issue, to allow the market to play a decisive role in resources allocations, to combine top-down institutional designs with bottom-up innovations, to use new mechanisms to encourage local governments to take initiatives, to foster new growth points, to improve the quality and efficiency of growth, to improve incentives and discipline mechanisms of financial institutions, to make financing sustainable, and to expand areas for effective allocation of financial resources.

Price levels remain low and stable, with structural factors lagging. In the context of the structural adjustments, due to the downward pressures on the economy, the overcapacity in some sectors and the cheap commodity prices, price levels are likely to remain low. Due to the overall moderation of aggregate demand, price hikes in certain goods are insufficient to push up the general price levels. There is a large gap between the PPI and the CPI. The PPI has been in a negative zone for over forty consecutive months, reflecting the acute problem of overcapacity in traditional industrial areas and the slump in oil prices in international markets. CPI growth is positive but remains low, reflecting generally stable consumer demand, and labor costs, prices, and other services have a certain rigidity. There are increasingly complex factors affecting the CPI, as the prices in the real-estate sector continue to rise and transmission to other sectors is possible. Future price movements will be closely watched and a comprehensive variety of differentiated measures will be adopted and prioritized to tackle the situation.

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

The PBC will earnestly implement the decisions of the 18<sup>th</sup> CPC National Congress, the Third, Fourth, and Fifth Plenary Sessions of the 18<sup>th</sup> CPC Central Committee, the Central Economic Work Conference, and the Report on the Work of the Government, and will follow the strategic arrangements of the Party Central Committee and the State Council. The PBC will adhere to the guidelines of seeking progress while maintaining stability and the overall principle of maintaining stable macro-economic policies while adopting flexible micro policies, taking initiatives to adapt to the new normal in the economy, maintaining policy consistency and stability, and continuing to implement a sound monetary policy that is neither too tight nor too loose. Fine-tunings and preemptive adjustments will be adopted as necessary, while policy measures will be better targeted and more flexible in order to create a neutral monetary and financial environment for structural adjustments, to upgrade and transform the economy, and to promote sustainable and balanced development. There will be an increased focus on reform and innovation and more measures to integrate reform and macro-economic management, to combine monetary-policy conduct with continued reform, and to enable the market to play a decisive role in resource allocations. Measures will be adopted in view of the financial deepening and

innovations to improve the monetary-policy framework, to support the smooth transmission of monetary policy to the real economy, to resolve the outstanding issues in economic performance and the functioning of the financial sector, and to improve the efficiency of the financial system and its capacity to render services to the real sector.

First, a combination of monetary-policy instruments will be employed, macro-prudential management will be improved, and a mixture of policy measures will be optimized to keep liquidity at appropriate volumes and to bring about reasonable growth of money, credit, and all-system financing aggregates. In view of the developments in the economic and financial market situations at home and abroad, the PBC will flexibly utilize various monetary-policy tools, improve the central bank collateral management framework, maintain liquidity at appropriate levels, and preserve stability in the money market. Continued efforts will be made to guide the commercial banks to enhance liquidity and balance-sheet management, manage the volume of assets and liabilities and the maturity structure, and improve liquidity risk management. The mechanisms and tools of macro-prudential regulation will be improved in order to streamline the macro-prudential policy framework.

Second, the stock of credit assets will be revitalized and good use will be made of new loans to support the structural adjustments, the transformation of the growth model, and the upgrading of the economy. In accordance with the basic principle of the financial sector providing services to the real sector, efforts will be made to optimize the direction and structure of liquidity, to implement measures for a targeted reduction in the reserve requirement ratio, and to make good use of the credit policy to support central bank lending, central bank discounts, and pledged supplementary lending to guide financial institutions to optimize the credit structure. The role of development financing and policy financing will be tapped to beef up financial services to shantytown rebuilding, water conservation projects, and railway construction in central and western China. Financial institutions will be encouraged to enhance support to the strategy of transforming China from a manufacturer of quantity to a manufacturer of quality by providing good financial services for the strategic adjustment of the industrial structure, infrastructure construction, ship building, logistics, energy, science and technology, culture, and other key areas, increasing support to pensions, healthcare, and other service sectors, and providing financial products and services to massive entrepreneurship and innovation. Efforts will be made so that banking institutions earnestly implement measures to remove excess capacity, develop green financing, and provide financial services for the integrated development of Beijing, Tianjin, and Hebei, and the Yangtze River Delta. Sound and sustainable development of the credit-asset securitization market will be promoted. Efforts will be made to improve financial services for new types of agro businesses, prudently advance the pilot program on loans pledged with contracted farmland operational rights and rural home property rights, and guide financial institutions to gear up support for agricultural infrastructure, agricultural cooperation

with overseas partners, modern plantation, new types of urbanization, and other agro-linked key areas. Policy measures supporting micro and small businesses will continue to be implemented and implementation will be monitored in order to broaden the channels for the financing of micro and small businesses. Financial services for poverty alleviation will be improved and financial inclusion will be promoted so as to break new ground to provide support for financial services related to the people's livelihood, including employment and education. A variety of measures will be taken to address both the symptoms and the root causes for reducing financing costs.

Third, the market-based interest-rate reform and the RMB exchange-rate regime reform will be deepened to improve efficiency in the allocation of financial resources and to improve the monetary-policy framework. Efforts will be made to encourage financial institutions to strengthen internal controls, improve their capacity for interest-rate pricing and risk management, develop market benchmark interest rate and yield curves, and improve market-based interest rates. The PBC will improve its policy interest-rate system, enhance interest-rate regulatory capability, and bring about a smooth transmission of policy interest rates to financial markets and the real economy at large. Supervision and regulation over irrational pricing behavior will be strengthened and will put into play the important role of self-regulatory mechanisms for market interest-rate pricing and to maintain fair pricing, effective incentives for interest-rate pricing will be adopted, and self-discipline and risk prevention will be reinforced. The RMB exchange-rate regime will be further improved to allow market demand and supply to play a greater role, to enhance two-way flexibility of the RMB exchange rate, and to keep the exchange rate basically stable at an adaptive and equilibrium level. Development of the foreign-exchange market will be accelerated based on the principle of serving the real economy to provide exchange-rate risk management services to importers and exporters based on their actual needs. Measures will be taken to support the use of RMB in cross-border trade and investment activities, and more channels will be made available for the outflow and inflow of RMB funds. Direct trading of the RMB against other currencies will be promoted to provide better services for RMB settlements of cross-border trade activities. The impact of the changing international situation on capital flows will be carefully watched and macro-prudential management of cross-border capital movements will be improved.

Fourth, there will be continued efforts to improve financial markets, to support the role of financial markets in preserving stable economic growth, supporting economic structural adjustments and transformation, deepening the reform and opening up, and preventing financial risks. The financial infrastructure and the institutional arrangements will be strengthened to provide a more efficient investment and financing market for economic structural adjustments and upgrading. Market innovations will be encouraged to diversify the products and layers in the bond market and to better meet investor demands. The market-making mechanism will be improved to enhance liquidity in the bond market and to lay a solid foundation for an

effective yield curve. The investor base will be expanded and market participants will be diversified. Diversity of financial markets, financial products, investors, and financing intermediaries will be further promoted. Qualified foreign and domestic institutional investors will be welcomed to invest in the inter-bank bond market. Market-discipline and risk-sharing mechanisms will be strengthened. The sound development of the credit-asset securitization market will be encouraged. There will be enhanced measures to promote direct financing and to develop a multi-tiered capital market. Further opening up will be pursued to encourage foreign institutions to issue RMB-denominated bonds in the domestic market. Market supervision and the role of the corporate debenture bond joint ministerial coordination mechanism will be enhanced. We will further strengthen regulatory coordination and facilitate the development of market-discipline mechanisms, such as information disclosures and credit ratings, to regulate the trading behavior of market participants, to prevent financial risks, and to promote the efficient operation and sound development of financial markets.

Fifth, the reform of financial institutions will be deepened and financial services will be improved by increasing supply and enhancing competition. Reform of large commercial banks and other large financial institutions will be furthered to continue to improve corporate governance, to build effective mechanisms for decision making, execution, and checks and balances, and to translate the principle of corporate governance into daily operations and risk-control behavior. The reform of the management and operations of the Agricultural Bank of China will be promoted, and its Agricultural and Rural Services Division will continue to improve its capacity to provide services at the county levels. The program of deepening reforms will be implemented by the Bank of Communications in order to enhance its competitiveness. A reform program for policy and development financial institutions will be implemented to segregate development business from commercial business, improve the governance structure and the risk compensation mechanism, and amend their articles of agreement in order to ensure that reform of the three policy banks will proceed smoothly in accordance with the laws, and to fully realize their roles in supporting national strategies. The shift to market-based operations of asset-management companies will be further promoted.

Sixth, effective measures will be adopted to mitigate systemic financial risks and to preserve stability in the financial system. Macro-prudential regulation will be enhanced to guide financial institutions to operate on a sound basis and to encourage them to strengthen internal controls, improve credit and liquidity management, and improve their risk-control capabilities. The financial risk early-warning mechanism and the identifying and resolution mechanism will be improved. The monitoring and analysis of local government debts, the real-estate sector, industries suffering from overcapacity, shadow banking businesses, and mutual guarantees and joint peer guarantees of enterprises will be enhanced to identify potential risks on a continual basis and to urge financial institutions to draft response plans for various scenarios.

The Financial Regulatory Coordination Joint Ministerial Conference will play a role in enhancing risk monitoring and in regulating coordination of cross-sector and cross-market products. Supervision over Internet banking will be strengthened in accordance with a division of responsibilities. The responsibility of financial regulation at the local levels will be clearly defined and implemented in order to mitigate various financial risks in a timely manner. Earnest efforts will be made to operate the deposit insurance regime. A comprehensive set of measures will be taken to preserve financial stability and to safeguard the bottom line in preventing systemic and regional financial risks.