

China Monetary Policy Report Quarter Four, 2015

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

Executive Summary

In 2015 the internal and external environments were complex and changing. Faced with downward restructuring pressures, the PBC has continued its sound monetary policy, strengthened preemptive adjustments and fine-tuning measures, and further improved the focus and the effects of macro-economic management in accordance with the decisions and overall arrangements of the Party Central Committee and the State Council. First, a variety of instruments, including open-market operations, the medium-term facility, and general reduction in the deposit reserve requirement ratio, were used to adjust liquidity in the banking system and to fill the liquidity gap caused by the decrease in net purchases of foreign exchange. Liquidity in the system remained reasonable and sufficient. Second, the PBC cut the benchmark interest rates of RMB deposits and lending on five occasions, guided the downward movement of the interest rates of open market repo operations on nine occasions, and cut the interest rates of credit policy-supporting central-bank loans, the medium-term facility, and Pledged Supplementary Lending (PLS) to further stabilize short-term interest rates. The role of Standing Lending Facility interest rates to serve as the ceiling of the interest-rate corridor was explored to stabilize market expectations through price levers and to reduce financing costs. Third, a reduction in the targeted deposit reserve requirement ratio was applied and the pilot program of central-bank loans against credit-asset pledges and internal ratings was expanded. The dynamic adjustment of the differentiated reserve requirement mechanism played a role in counter-cyclical adjustments and served as a directional signal of the structural adjustments. The quota for central-bank lending and discounts was raised on several occasions, and the scope of the recipients of the PLS was enlarged to guide financial institutions to increase support to key areas and weak sectors in the economy, including small and micro enterprises, the agricultural sector, rural areas, and farmers, and renovation programs for shantytowns.

The market-oriented financial reform was firmly promoted and a series of major reform measures were taken to support economic development and to optimize the monetary-policy transmission mechanism, to enable the market to play a decisive role in resource allocations, and to further improve the monetary-policy regulatory framework. The lifting of the deposit interest-rate ceiling was a major step forward in the market-based

interest-rate reform. The quotation mechanism for the RMB central parity against the US dollar was improved, the RMB exchange-rate index was released, and the decisive role of the market in the RMB exchange-rate regime was enhanced; the time-point assessment of the reserve requirement ratio was replaced by a review of the arithmetic average level during the maintenance period; the macro-prudential policy framework was further improved, and the dynamic adjustment of the differentiated reserve requirement mechanism was upgraded to become a macro-prudential assessment system. Foreign-exchange liquidity and cross-border capital flows were covered by macro-prudential management. A reform program for policy and development financial institutions was successfully implemented. A deposit insurance system was smoothly launched. The RMB was included in the Special Drawing Rights currency basket.

In general, the sound monetary policy produced fairly good results. Liquidity has been maintained at a reasonable and sufficient level, and the real interest rate has been maintained at a stable level. The monetary environment remained sound and neutral from both quantitative and price perspectives. At the end of 2015, outstanding M2 was up 13.3 percent year on year, an acceleration of 1.1 percentage points from the end of the last year. Outstanding RMB loans were up 14.3 percent year on year, an acceleration of 0.6 percentage point from the end of the last year, registering an increase of 11.7 trillion yuan from the beginning of 2015, 1.8 trillion yuan more than the increase in the corresponding period of the last year. The stock volume of all-system financing aggregates grew by 12.4 percent year on year. In December, the weighted average loan interest rate offered to non-financial enterprises and other sectors was 5.27 percent, a decline of 1.51 percentage points from December of the last year. At the end of 2015, the central parity of the RMB against the US dollar was 6.4936 yuan per dollar, and the CFETS RMB exchange-rate index closed at 100.94. The RMB exchange rate against a basket of currencies remained basically stable.

Performance of the Chinese economy was stable, with positive developments in structural adjustments as a result of a series of policies and measures. China's GDP grew by 6.9 percent year on year, with final consumption contributing to more than 60 percent of GDP growth, and the share of tertiary industry reaching more than 50 percent. Emerging industries and new business models developed robustly, consumer prices grew moderately, and employment remained stable.

The global economy continued its profound adjustments. The global value chain and trade and investment flows underwent changes, and the monetary policies in the major economies diverged further. The geopolitical landscape was becoming more complex, with many uncertainties and destabilizing factors. On the domestic front, supply and

demand structural imbalances were acute, with oversupply coexisting with undersupply. The downward pressures on the Chinese economy were mainly from resources, energy, and other traditional industries as well as industries with excess capacity. But new growth dynamics were in the pipeline. This will be a vital period for structural adjustments and transformation of the Chinese economy. The key to solving the structural problems is to advance supply-side reform while reasonably expanding aggregate demand. The five major tasks of removing excess capacity, reducing inventories, reducing leveraging and costs, and shoring up weak spots will be implemented to enable markets to play a decisive role in resource allocations and to beef up the quality and efficiency of growth.

During the next stage, the PBC will follow the strategic arrangements of the Party Central Committee and the State Council to continue the reform and opening up and adhere to the guidelines for seeking progress while maintaining stability. Efforts will be made to adapt to the new normal in the economy, to maintain policy consistency and stability, and to continue to implement a sound monetary policy that is neither too tight nor too loose. Fine-tunings and preemptive adjustments will be adopted as necessary, and with proper strength, in order to manage aggregate demand for the ongoing supply-side structural reforms. A variety of quantitative and price monetary instruments will be used and the policy mix will be optimized. Macro-prudential regulations will be enhanced and improved and transmission of the monetary policy will be smoothed in order to provide a monetary and financial environment to facilitate structural adjustments and transformation from the perspectives of price and volume. The stock of credit assets will be revitalized and good use will be made of new loans to optimize the financing and credit structures and to nurture new drivers for economic growth. In the meantime, 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. In view of the financial deepening and innovation, the monetary-policy framework and guidance expectations will be improved in order to strengthen price tools and the transmission mechanism, to bring about the smooth transmission of the monetary policy to the real economy, and to improve the efficiency of the financial system and its capacity to render services to the real sector. Comprehensive measures will be adopted to prevent and reduce financial risks, to preserve stability in the financial system, and to safeguard the bottom line of preventing systemic and regional financial risks.

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Part 1 Money and Credit Analysis

In 2015 liquidity in the banking sector was reasonable and sufficient, with money, credit, and aggregate social financing growing in a stable and relatively rapid manner. The structure of loans continued to improve and there was a marked fall in interest rates; the RMB exchange rate became more flexible and the monetary and financial environment remained basically stable.

I. Monetary aggregates grew rapidly

At the end of 2015, outstanding M2 stood at 139.2 trillion yuan, up 13.3 percent year on year, representing an acceleration of 1.1 percentage points from end-2014. Outstanding M1 stood at 40.1 trillion yuan, up 15.2 percent year on year, representing an acceleration of 12 percentage points from end-2014. M0 grew by 4.9 percent year on year to 6.3 trillion yuan, representing an acceleration of 2 percentage points from end-2014. On a net basis, the central bank pumped cash in the amount of 295.7 billion yuan into the economy throughout 2015, an increase of 126.9 billion yuan year on year.

In 2015 M2 growth picked up after a slow start. In the first half of the year, growth hovered around 11–12 percent, but it jumped to 13 percent in July after the launch of several growth-supporting measures. M2 maintained relatively rapid growth throughout the year. The channels for monetary supply underwent significant changes. First, loans of financial institutions to the non-financial-sector increased by 1.5 trillion yuan year on year, by and large representing significant financial-sector support to the real economy. Second, money created through bond investments, equity, and other investment channels accelerated markedly, becoming one of the major channels for monetary supply. Third, net purchases of foreign exchange decreased for the first time since 2001. Fourth, the non-regulated inter-bank business of financial institutions, including inter-bank payments and repurchases of trust benefits, contracted considerably and accordingly reduced the money supply.

At end-2015, outstanding base money registered 27.6 trillion yuan, a decrease of 1.8 trillion yuan from the beginning of the year and a decrease of 6 percent year on year. The drop was mainly due to the massive volume of liquidity released by cuts in the reserve requirement ratio from the beginning of 2015. Since the cuts in the reserve requirement ratio did not increase base money, outstanding base money dropped but the monetary multiplier increased. At end-2015, the money multiplier stood at 5.04, an increase of 0.86 from end-2014. The excess reserve ratio of financial institutions was 2.1 percent¹ and that of rural credit cooperatives was 13.4 percent.

¹ In January 2015 the PBC adjusted the coverage of the reserve requirement. Deposits of non-deposit-taking financial institutions are now recorded as “all deposits.” The excess reserve requirement ratio calculated on the basis of the expanded coverage is not comparable with the previous data. If calculated based on the previous coverage, the excess reserve requirement ratio should be higher than 2.1 percent.

II. Growth of deposits in financial institutions was generally stable

At the end of 2015, outstanding deposits of domestic and foreign currencies in all financial institutions posted 139.8 trillion yuan, up 12.4 percent year on year and representing a deceleration of 0.2 percentage point from end-2014. This was an increase of 15.3 trillion yuan from the beginning of the year and an acceleration of 1.6 trillion yuan year on year. Outstanding RMB deposits registered 135.7 trillion yuan, up 12.4 percent year on year and an acceleration of 0.3 percentage point from end-2014. This was an increase of 15.0 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 627.2 billion, up 3.2 percent year on year. This was an increase of USD 16.7 billion from the beginning of the year and a deceleration of USD 90.5 billion year on year. These developments were related to the interest-rate hike by the Federal Reserve, the RMB exchange rate, and expectations about its future movements.

Broken down by sectors, growth of household deposits remained stable, whereas deposits in the non-financial corporate sector accelerated markedly. At end-2015, outstanding household deposits posted 54.6 trillion yuan, up 8.7 percent year on year, on par with the figure at the end of 2014. This represented an increase of 4.4 trillion yuan from the beginning of the year and an acceleration of 259.9 billion yuan year on year. Outstanding deposits in the non-financial corporate sector registered 43.0 trillion yuan, up 13.7 percent year on year and representing an acceleration of 9.1 percentage points from end-2014. This was an increase of 5.3 trillion yuan from the beginning of the year, representing an acceleration of 3.3 trillion yuan year on year. Outstanding fiscal deposits registered 3.4 trillion yuan, a decrease of 91.4 billion yuan from the beginning of the year, and the decrease represented an acceleration of 644.5 billion yuan year on year. Outstanding deposits of non-deposit-taking financial institutions registered 12.9 trillion yuan, with a growth rate of 37.8 percent year on year, much faster than the growth rate of deposits in the household sector and the non-financial corporate sector. This represented an increase of 3.5 trillion yuan from the beginning of the year, on par with that in 2014. In particular, deposits of securities and transaction settlements posted 4.3 trillion yuan, an increase of 63.7 percent 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 65.6 percent year on year to reach 4.9 trillion yuan.

III. Loans of financial institutions registered stable and relatively rapid growth

At end-2015, outstanding loans in domestic and foreign currencies of all financial institutions posted 99.3 trillion yuan, up 13.4 percent year on year and on par with the figure at end-2014. This was an increase of 11.7 trillion yuan from the beginning of the year and an acceleration of 1.3 trillion yuan year on year. Outstanding RMB loans stood

at 94.0 trillion yuan, representing growth of 14.3 percent year on year and an acceleration of 0.6 percentage point from end-2014. This was an increase of 11.7 trillion yuan from the beginning of the year and an acceleration of 1.8 trillion yuan year on year.

Broken down by sectors, growth of RMB loans to the household sector, non-financial businesses, and other sectors accelerated slightly, and loans to non-banking financial institutions increased. At end-2015, outstanding RMB loans to the household sector posted 27.0 trillion yuan, up 16.8 percent year on year and representing an acceleration of 0.2 percentage point from end-2014. This was an increase of 3.9 trillion yuan from the beginning of the year and an acceleration of 581.4 billion yuan from the same period of the last year. Among this total, home mortgage loans grew by 2.5 trillion yuan from the beginning of the year, an acceleration of 925 billion yuan year on year. Outstanding loans to non-financial businesses and other sectors posted 65.8 trillion yuan, up 12.7 percent year on year and representing an acceleration of 0.2 percentage point from end-2014. This was an increase of 7.4 trillion yuan from the beginning of the year and an acceleration of 898.7 billion yuan year on year. Outstanding loans to non-banking financial institutions grew by 376.7 billion yuan from the beginning of the year to reach 853.9 billion yuan, representing year-on-year growth of 260.5 billion yuan. In terms of the maturity brackets of RMB loans, new medium- and long-term RMB loans increased by 6.7 trillion yuan from the beginning of the year, an acceleration of 633.2 billion yuan year on year. The share of new medium- and long-term RMB loans in total new loans was 57.1 percent. Outstanding short-term loans (including bill financing) increased by 4.7 trillion yuan from the beginning of the year, an acceleration of 1.2 trillion yuan year on year. Among this total, bill financing grew by 1.7 trillion yuan from the beginning of the year, representing an acceleration of 706.2 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 in 2015

Unit: 100 million

	New loans	Acceleration
Chinese-funded large-sized banks ①	53060	6525
Chinese-funded small- and medium-sized banks②	62072	13583
Small-sized rural financial institutions③	13433	-1426
Foreign-funded financial institutions	473	-795

Notes: ① Chinese-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).

② Chinese-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).

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

Source: People's Bank of China.

The growth of foreign-currency-denominated loans decelerated year on year. At end-2015, outstanding foreign-currency loans of financial institutions posted USD 830.3 billion, down 5.8 percent year on year. This was a decrease of USD 50.2 billion from the beginning of the year, representing a year-on-year acceleration of USD 132.3 billion. In terms of the loan structure, outward loans increased by USD 50.5 billion from the beginning of the year and short-term loans to non-financial businesses and other sectors decreased by USD 100.5 billion.

IV. All-system financing aggregates remained generally appropriate

According to preliminary statistics, stocks of all-system financing aggregates reached 138.14 trillion yuan at end-2015, up 12.4 percent year on year and representing a deceleration of 1.9 percentage points from end-2014. In 2015 flows of all-system financing aggregates were 15.41 trillion yuan, a deceleration of 467.5 billion yuan year on year. With regard to the composition of the flows, RMB-denominated loans and direct financing grew by a large margin, whereas off-balance-sheet financing and foreign-currency-denominated loans registered a large year-on-year deceleration. It is worth noting that in 2015 new issues of local government bonds posted over 3.5 trillion yuan, 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). Because in the statistics of the 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, support of the financial system to the real economy has been greater than that in previous years.

The growth of all-system financing aggregates in 2015 was characterized by the following. First, RMB loans to the real economy grew markedly. In 2015 new RMB loans accounted for 73.1 percent of the flows of all-system financing aggregates, up 11.7 percentage points from the same period of the last year. Second, foreign-currency-denominated loans decelerated notably. In December 2015 new loans denominated in foreign currencies decreased for the sixth successive month. Third, bond and equity financing by non-financial enterprises increased significantly. In 2015 the combined amount of bond and equity financing by non-financial enterprises in the domestic market posted 3.7 trillion yuan, an increase of 832.4 billion yuan from the same period

of the last year. This accounted for 24 percent of the increment in the all-system financing aggregates during the same period of time, reaching a new historical high. Fourth, the growth of off-balance-sheet financing, including trust loans, entrusted loans, and undiscounted bankers' acceptances, decelerated by a large margin year on year. In 2015 the combined amount of new entrusted loans,² trust loans, and undiscounted bankers' acceptance bills registered 576.6 billion yuan, a decrease of 1.99 trillion yuan year on year and accounting for 3.7 percent of the increment in the all-system financing aggregates, down by 12.5 percentage points from 2014.

Table 2 The Increment in All-system Financing Aggregates in 2015

Unit: 100 million yuan

	All-system financing aggregates ^①	Of which:						
		RMB loans	Foreign-currency-denominated (RMB equivalent)	Entrusted loans	Trust loans	Undiscounted bankers' acceptances	Enterprise bonds	Financing by domestic institutions via the domestic stock markets
2015 ^②	154086	112693	-6427	15911	434	-10569	29399	7604
Year-on-year change	-4675	15241	-7662	-5829	-4740	-9371	5070	3254

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 year-on-year 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-2015

Unit: 100 million yuan

	All-system	Of which:
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² Beginning in January 2015, the statistical coverage of entrusted loans was adjusted and divided into the two categories of entrusted loans under cash management operations and general entrusted loans. In the statistics of the all-system financing aggregates, entrusted loans only refer to general entrusted loans, i.e., loans issued by financial institutions (lenders or entrusted agents) to specified borrowers in specific volumes on specified terms with money provided by companies, organizations, individuals, and other principals.

	financing aggregates ^①	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- 2015 ^②	1381383	927526	30193	109328	53925	58542	146258	45251
Year-on-year change ^③	12.4	13.9	-13.0	17.2	0.8	-14.8	25.1	20.2

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 year-on-year 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 fell markedly. In December 2015, the weighted average loan interest rate offered to non-financial companies and other sectors was 5.27 percent, down 1.51 percentage points from December 2014. In particular, the weighted average interest rate on ordinary loans posted 5.64 percent, down 1.28 percentage points from December 2014; the weighted average bill financing rate was 3.33 percent, down 2.34 percentage points from December 2014. The interest rate for home mortgage loans fell steadily, with the weighted average rate posting 4.70 percent in December, down 1.55 percentage points from December 2014.

The share of loans with interest rates below the benchmark rates increased, whereas the share of loans with interest rates at or above the benchmark rates dropped. In December 2015, the share of loans with interest rates lower than the benchmark rate was 21.45 percent, up 8.34 percentage points from December 2014, whereas the share of loans with interest rates offered at the benchmark rate was 18.60 percent, down 1.04 percentage points from December 2014, and loans offered with interest rates above the benchmark rate accounted for 59.95 percent of the total, down 7.30 percentage points from December 2014.

Table 4 Shares of Loans with Rates At, Above, or Below the Benchmark Rate, January through December 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
October	18.00	17.13	64.87	14.80	18.52	11.59	12.84	7.12
November	17.82	17.86	64.32	14.24	18.57	10.79	13.10	7.62
December	21.45	18.60	59.95	13.56	17.68	9.89	11.77	7.05

Source: People's Bank of China.

The deposit and lending rates of foreign currencies fluctuated slightly due to volatility in the interest rates in international markets and changes in supply and demand for foreign currencies on the domestic market. In December 2015, the weighted average interest rate of large-value US dollar demand deposits and large-value US dollar deposits with maturities within 3 months registered 0.16 percent and 0.56 percent respectively, up 0.02 percentage point and down 0.08 percentage point respectively from December 2014. The weighted average interest rates of US dollar loans with maturities within 3 months and of those with maturities between 3 and 6 months (including 3 months) posted 1.65 percent and 1.80 percent respectively, down 0.64 percentage point and up 0.42 percentage point respectively from December 2014.

Table 5 Average Interest Rates of Large-value Deposits and Loans Denominated in US Dollars, January through December 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
October	0.14	0.55	1.02	1.28	1.49	1.50	1.46	2.17	2.04	2.41	2.89
November	0.15	0.60	1.04	1.30	1.60	1.73	1.43	2.02	1.93	2.25	3.18
December	0.16	0.56	1.07	1.32	1.59	1.79	1.65	1.80	1.92	2.61	3.36

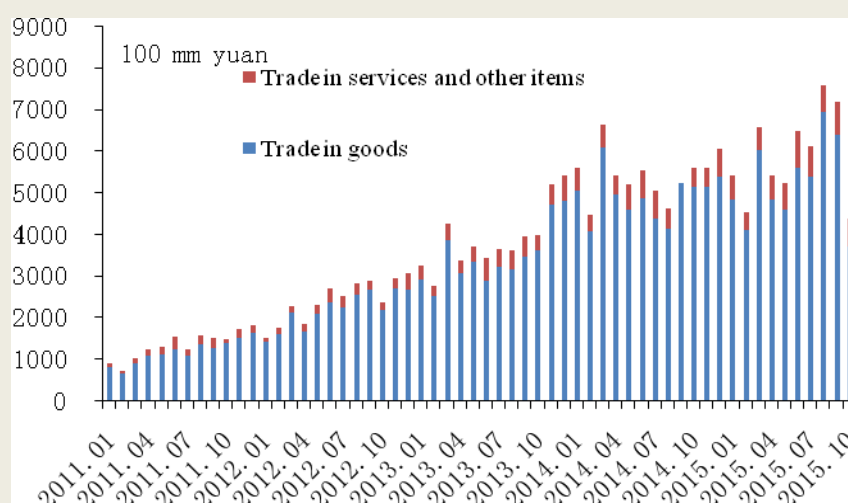
Source: People's Bank of China.

VI. The flexibility of the RMB exchange rate strengthened in both directions

The RMB exchange rate depreciated slightly against the US dollar, experiencing marked two-way fluctuations and exhibiting improved flexibility. The RMB exchange rate against a basket of currencies remained basically stable, and exchange rate expectations were generally secure. As of December 31, 2015, the CFETS RMB exchange-rate index closed at 100.94, gaining 0.98 percent from the end of 2014; the RMB exchange-rate index based on the Bank for International Settlements (BIS) basket and the RMB exchange-rate index based on the SDR basket closed at 101.71 and 98.84 respectively, gaining 1.71 percent and losing 1.16 percent from the end of 2014. The mixed movements of the three RMB exchange-rate indices are a reflection of the overall stability of the RMB exchange rate in 2015 against a basket of currencies. According to calculations by the BIS, in 2015 the NEER and the REER of the RMB appreciated by 3.66 and 3.93 percent respectively; from the RMB exchange-rate regime reform in 2005 to December 2015, the NEER and REER of the RMB exchange rate appreciated by 45.87 percent and 56.15 percent respectively. At end-2015, the central parity of the RMB against the USD was 6.4936, a depreciation of 3746 basis points, or 5.77 percent, from end-2014. From the RMB exchange-rate regime reform in 2005 to end-2015, the RMB gained 27.46 percent against the USD.

VII. Cross-border RMB businesses maintained steady growth

In 2015 cross-border receipts and payments in RMB totaled 12.1 trillion yuan, an increase of 22 percent year on year. In particular, RMB receipts and payments registered 6.19 trillion yuan and 5.91 trillion yuan respectively, resulting in a net inflow of 271.46 billion yuan and a receipt-to-payment ratio of 1:0.96. RMB cross-border receipts and payments under the current account posted 7.23 trillion yuan, up 10 percent year on year. In particular, settlements of trade in goods registered 6.39 trillion yuan, whereas settlements of trade in services and other items under the current account registered 843.22 billion yuan. Cross-border RMB receipts and payments under the capital account totaled 4.87 trillion yuan, an increase of 43 percent year on year.



Source: People's Bank of China.

Figure 1 Monthly RMB Settlements of Cross-border Trade

Box 1 Inclusion of the RMB into the SDR Currency Basket

On November 30, 2015, the Executive Board of the International Monetary Fund (IMF) decided to include the RMB into the currency basket of the Special Drawing Right (SDR) as a fifth currency, along with the US dollar, the euro, the Japanese yen, and the British pound. The weight of the RMB in the SDR basket is 10.92 percent, whereas the weights of the US dollar, the euro, the Japanese yen, and the British pound are 41.73 percent, 30.93 percent, 8.33 percent, and 8.09 percent respectively. The new basket will become effective on October 1, 2016.

The SDR is an international reserve asset created by the IMF in 1969 to supplement other reserve assets of member countries. It is a claim on freely usable currencies and is counted as part of international reserves, together with gold, foreign exchange, and

other reserve assets. The SDR also serves as a unit of account by the IMF and other international institutions. At its inception, the SDR was equal in value to the US dollar. Beginning in 1974, the value of the SDR was determined by a basket comprised of currencies of 16 countries whose exports of goods and services exceeded 1 percent of the world's total, such as the US dollar, the Deutsche mark, the Japanese yen, the British pound, the French franc, the Canadian dollar, the Italian lira, the Dutch guilder, the Belgian franc, the Swedish krone, the Australian dollar, the Norwegian krone, the Danish krone, the Spanish peseta, the South African rand, and the Austrian schilling. In 1980 the SDR currency basket was revised to include the currencies of the world's top five exporters, including the US dollar, the Deutsche mark, the British pound, the Japanese yen, and the French franc. In 2000 freely usable criteria were introduced, and the number of currencies in the SDR basket was reduced to four, including the US dollar, the euro, the British pound, and the Japanese yen. During the quinquennial SDR review in 2010, the RMB was judged to have met the export criterion; however, the RMB was not included in the SDR as it was not deemed to be freely usable.

The SDR review is usually conducted every five years, typically covering the composition of the SDR basket of currencies and their weights. The current criteria for inclusion state that the SDR basket comprises currencies that are issued by members or monetary unions whose exports had the largest values over a five-year period and have been determined by the IMF to be "freely usable." A "freely usable" currency is defined in the IMF's Articles of Agreement refer to a currency that the IMF determines (i) is widely used to make payments for international transactions, and (ii) is widely traded on the principal exchange markets. Several indicators are used as important factors to determine the free usability assessment: the shares of currencies in reserve holdings, the currency denominations of international debt securities, international banking liabilities, cross-border payments, trade financing, and the volume (turnover) of transactions in foreign-exchange markets. SDRs are allocated to IMF members from time to time to supplement their reserve assets. The IMF made SDR general allocations during the 1970–1972 and the 1978–1981 periods. After the outbreak of the global financial crisis, in order to better deal with the crisis, in 2009 SDR 182.6 billion were allocated. To date, a total of 204.1 billion SDRs (equivalent to USD 280.1 billion) have been allocated. The allocation for China is SDR 6.9897 billion.

Since the beginning of 2015, the PBC, the SAFE, and other government agencies, working closely with the IMF and building on existing work, successfully addressed data and operational issues concerning the SDR review. On November 30, 2015, the IMF Executive Board discussed and passed the Review of the Method of Valuation of the SDR, and decided to include the RMB in the SDR. According to the report, the RMB has met the freely usable criteria as revealed by the relevant indicators. Specifically, in 2014 38 respondents reported holding RMB-denominated assets equivalent to 1.1 percent of the world's total reserve assets and making the RMB the 7th largest reserve currency; as of the second quarter of 2015, RMB-denominated international banking liabilities accounted for 1.8 percent of the world's total, the 5th

largest in the world; as of the second quarter of 2015, RMB-denominated international debt securities ranked 9th in the world, accounting for 0.4 percent of the total; in the first six months of 2015, the issuance of international debt securities in RMB ranked 6th in the world, accounting for 1 percent of the total; from the third quarter of 2014 to the second quarter of 2015, the RMB's share of global cross-border payments reached 1.1 percent and ranked 8th, whereas the RMB's share of trade finance accounted for 3.4 percent, the third largest in the world; according to BIS data, the RMB trading volume rose to 1.1 percent of the total turnover, 9th in the world. Updated surveys of six global and regional foreign-exchange trading centers, such as London and Hong Kong, place the global turnover in RMB as the 8th largest in the world. Second, operational issues related to the RMB's inclusion were resolved. Specifically, in July 2015 the authorities liberalized access to onshore fixed-income markets for reserve managers of official institutions' agents acting on their behalf, and these investors are no longer subject to investment quotas in the fixed-income market; they can use fixed-income derivatives without restrictions and they can select their own settlement agent. Moreover, relevant processes for account, custodial, trading, and settlement services are being simplified and standardized. In late September, similar access to the onshore foreign-exchange market was granted to the same set of institutions. These investors can now negotiate and conduct both spot and derivative foreign-exchange trade at known rates and can deal directly with onshore commercial counter-parties. These institutions are also allowed to hedge foreign-exchange risks across all maturities, without any requirement that they hold an underlying RMB asset or that they demonstrate the need for using the instrument. Furthermore, the authorities have also taken steps to make onshore interest rates more market-determined. In October, the PBC announced the full liberalization of interest rates on deposits. In addition, in September the Ministry of Finance announced the initiation of weekly auctions of three-month securities according to a published calendar, with the first auction taking place in early October 2015, thus helping to establish a representative RMB interest rate for calculation of the SDR interest rate. Third, the Chinese authorities have made notable strides in enhancing data disclosures, including: announcing their subscription to the IMF's Special Data Dissemination Standard (SDDS) in October 2015; joining the COFER survey in September, and reporting for the first time on the currency composition of a representative portion of China's reserves; reporting data to the BIS on international banking liabilities and to the IMF Coordinated Portfolio Investment Survey in December. In addition, considering the growing role of international financial flows, the report proposed an adjustment to the weighting formula by increasing the weight of financial variables and adding new financial variables.

After the IMF's Executive Board decided to include the RMB in the SDR, Christine Lagarde, managing director of the IMF, stated in an interview that the decision represented an important milestone in the integration of China into the global financial system and was recognition of the progress by the Chinese authorities during the past several years to reform the monetary and financial systems. Continued reforms in these areas will contribute to more vibrant international monetary and financial systems and

in turn will support the development and stability of the Chinese and global economies.

In general, the inclusion of the RMB in the SDR basket will increase the representativeness and attractiveness of the SDR and will help improve the current international monetary system, which will be beneficial to both China and the rest of the world. This also means that the international community expects that China will play a greater role in the international economic and financial systems. Going forward, China will continue to deepen and accelerate its economic reforms and financial opening and will contribute to promoting world economic growth, safeguarding financial stability, and improving global economic governance.

Part 2 Monetary Policy Operations

Since 2015 the Chinese economy has faced extensive downward pressures, inflation has been moderate, and there has been a growing impact of uncertainties from abroad. In accordance with the overall arrangements of the Party Central Committee and the State Council, the PBC continued its sound monetary policy, with initiatives to adapt to the new normal and adhering to the tone of seeking progress while maintaining stability. Through flexible use of various monetary-policy tools, the PBC has strengthened preemptive adjustments and fine-tuning measures to maintain liquidity at a reasonably sufficient level, to guide the reduction of financing costs, and to promote economic restructuring. At the same time, the PBC has also firmly promoted market-oriented financial reforms and further improved the monetary-policy regulatory framework.

I. Flexible open market operations were conducted, and guidance and regulations for money-market rates were strengthened

In 2015, due to the effects of the Federal Reserve's interest-rate hike and changes in expectations about the RMB exchange rate and other factors, foreign-exchange inflows became outflows and liquidity demand in the banking system increased. At the same time, other factors including the issuance of a large volume of local government debts, stock market volatilities, initial public offerings, and financial regulatory assessments, also added to uncertainties about liquidity changes in the banking system, led to rising complexities and difficulties for liquidity management.

In accordance with the requirements for a sound monetary policy, the PBC closely monitored the influence of the Federal Reserve interest-rate hike and other factors related to liquidity of the banking system, conducted flexible open market operations mainly be repurchases based on changes in the liquidity supply and demand patterns. Coordinated with other monetary-policy tools such as RRR cuts, these operations have effectively hedged the impact on liquidity from declines in foreign exchange and other

factors, and achieved good results in maintaining total liquidity at a reasonably adequate level and balancing liquidity supply and demand. Meanwhile, against the background of heightened volatility in the domestic and international financial markets and the increasingly complex regulatory environment, the PBC strengthened preemptive adjustments and fine-tuning measures and on a timely basis reduced short-term fluctuations through the flexible use of Short-term Liquidity Operations (SLO) during intermittent conventional open-market operations. These measures have promoted the smooth operation of financial markets and have created a sound liquidity environment for the steady growth of credit. In 2015 the PBC conducted open market repurchasing operations that totaled 3.238 trillion yuan, and SLO that served 520 billion yuan of liquidity. By the end of 2015, the outstanding balance of open market repurchasing operations totaled 10 billion yuan, 0 for the SLO, and 422.2 billion yuan of central-bank bills.

In accordance with the general requirements of the interest-rate regulations, combined with the need to transform the monetary-policy framework, the PBC strengthened guidance and adjustments to the money-market interest rates, based on integrated use of quantity and price tools to guide the steady transmission of money-market interest rates, and implemented effective measures to reduce the volatility in the money-market interest rates and to optimize the maturity structures. In 2015, along with cuts in the benchmark deposit and lending interest rates, the market witnessed nine downward changes in the interest rates of 7-day open market repurchasing operations, with the repo interest rate at 2.25 percent by year-end, a drop of 160 basis points from early 2015. This has played a key role in guiding the downward movements of money-market interest rates. Meanwhile, the PBC further improved the continuity and stability of 7-day repurchasing operations in the open market, and effectively guided and stabilized market expectations through the continuous release of interest-rate signals in the open market, which not only enhanced the capability of open market operations to guide money-market interest rates but also contributed to reasonably narrow the spreads between 7-day and overnight interest rates in the money market and further optimized the maturity structure of interest rates.

Central treasury cash management operations were conducted. In 2015 a total of 510 billion yuan of treasury funds was deposited in banks in ten separate operations, including 270 billion yuan in 3-month funds, 210 billion yuan in 6-month funds, and 30 billion yuan in 9-month funds. The balance of treasury funds by the end of 2015 stood at 110 billion yuan, a reduction of 160 billion yuan from the end of the last year.

II. Standing lending facility and medium-term lending facility operations were conducted as appropriate

In early 2015, in order to implement the decisions of the Central Economic Work Conference, improve the channels for liquidity support to small and medium financial institutions, and facilitate smooth operations in the money market, based on the replicable experiences of the early pilot Standing Lending Facility (SLF) operations of

PBC branches in 10 provinces (municipalities), the PBC promoted SLF operations by branch offices throughout the country. In November, in order to explore the role of the SLF interest rates offered by branch offices to serve as the ceiling of the interest-rate corridor, based on the liquidity situation and the regulatory needs of monetary policy, the PBC decided to appropriately cut the SLF interest rates in branches, after which the interest rates of overnight and 7-day SLFs for local corporate financial institutions that met the macro-prudential requirements were cut to 2.75 percent and 3.25 percent respectively. In 2015 the PBC system conducted a total of 334.84 billion yuan in SLF operations, including 334.7 billion yuan, 0 yuan, 0 yuan, and 135 million yuan in each quarter, and with an outstanding balance of 40 million yuan by the end of 2015.

In 2015 the PBC provided mid-term base money to financial institutions through the medium-term lending facility (MLF) operations to facilitate and guide financial institutions to enhance support to key areas and weaknesses in the economy, including small and micro enterprises, and the agricultural sector, rural areas, and farmers. In 2015 the PBC conducted a total of 219.48 billion yuan in MLF operations, including 101.45 billion yuan, 51.45 billion yuan, 36 billion yuan, and 30.58 billion yuan in each quarter, and with an outstanding balance of 66.58 billion yuan by the end of 2015. The maturity of all MLF operations in the first half of the year was 3 months, with an interest rate of 3.5 percent. In the second half of the year, based on changes in the maturity structure of market liquidity and demand for mid-term base money by financial institutions, the PBC extended the maturity of MLF operations to 6 months, with an interest rate of 3.35 percent. In order for the MLF rates to serve as the mid-term policy interest rates and to guide financial institutions to lower their lending rates and social financing costs, in November the PBC cut the 6-month MLF interest rate by 10 basis points to 3.25 percent.

III. Targeted and universal RRR cuts were combined, and an averaging method for reserve assessments was adopted

Since 2015, the PBC has adjusted the reserve requirement ratio (RRR) on five occasions, including four universal cuts and five targeted cuts, resulting in a cumulative cut of 2.5 percentage points for the universal RRR and another 0.5 to 6.5 percentage points for the RRR cut for targeted deposit-taking financial institutions. First, in order to support key areas in the economy, including the agricultural sector, rural areas, and farmers, and small and micro enterprises, the RRR was cut by a cumulative of 0.5 to 1 percentage point for targeted commercial banks that had reached the prudential requirements or that had provided a certain share of loans to key areas in the economy, and by a total of 2 to 2.5 percentage points for targeted rural financial institutions (rural cooperative banks, rural credit cooperatives, and village banks). Second, to support major water conservancy projects and infrastructure construction, extra RRR cuts of 6.5 percentage points were applied to the Agricultural Development Bank. Third, to promote higher enterprise efficiency and expansion of consumption, targeted RRR cuts

of 4 to 4.5 percentage points were applied to finance companies, financial leasing companies, and auto finance companies. In general, institutions that enjoyed the targeted RRR cuts accounted for more than 98 percent of all financial institutions.

Meanwhile, in order to further improve the reserve mechanism, optimize the monetary-policy transmission mechanism, and provide a buffer mechanism for financial institutions to manage liquidity, since September 2015 the PBC prudently reformed the RRR assessments in a progressive manner, adopting the averaging assessment method combined with management of a ceiling limit for end-of-day overdrafts during the early stages. Specifically, during the maintenance period, the ratio of the arithmetic average of the end-of-day balance of reserves deposited by financial institutions to the base amount for the reserve assessment must be no less than the RRR, while at the end of each business day the ratio of the balance of the reserves deposited by financial institutions to the base amount for the reserve assessment may be lower than the RRR by a maximum of 1 percentage point. Since its implementation, the reform of the reserve assessment system has effectively improved the flexibility and convenience of liquidity management for financial institutions, helping to reduce the excess reserve needs of financial institutions for sudden and concentrated payments and smoothing money-market volatility.

IV. The macro-prudential policy framework was improved

The PBC further improved the macro-prudential policy framework and played a better role in counter-cyclical regulation. First, the dynamic adjustment of the differentiated reserve requirement mechanism was upgraded to a macro-prudential assessment system, which continues to focus on the macro-prudential capital adequacy ratio and expands the single indicator into one dozen indicators in seven aspects, covering both volume and price, both indirect and direct financing, turning prior guidance into in-process monitoring and post evaluation, and establishing a more comprehensive and more flexible macro-prudential policy framework to guide financial institutions to strengthen their self-discipline and self-management. Second, the PBC included the foreign-exchange liquidity and cross-border capital flows in the macro-prudential management, imposed risk reserves for foreign-exchange forward sales, expanded macro-prudential management for cross-border financing in both RMB and foreign currencies, and applied a normal deposit reserve ratio to funds deposited in domestic financial institutions by foreign financial institutions.

Box 2 The differentiated reserves and dynamic adjustment mechanism was "upgraded" to a macro-prudential assessment (MPA)

According to the relevant deployment by the Central Government, combined with a summary of the lessons from the global financial crisis by the G20 and the Financial Stability Board (FSB), beginning in 2009 the PBC began to study policies and measures to strengthen macro-prudential management, and in 2011 it formally introduced a

differentiated reserves and dynamic adjustment mechanism, with a core content whereby appropriate credit growth of financial institutions depends on the reasonable needs of economic growth and their own capital levels. In the five years since its implementation, the mechanism has played an important role in strengthening macro-prudential management, promoting steady credit growth, and maintaining stability in the financial system.

At present, the Chinese economy has reached a stage of having to deal simultaneously with the slowdown in economic growth, making difficult structural adjustments, absorbing the effects of the previous economic stimulus policies, and preventing financial risks in the more complicated environment. With the rapid development of financial innovation, the types of assets and liabilities have become more diversified and it has become increasingly difficult to effectively achieve macro-prudential policy objectives by only targeting narrow loans. In addition, continued efforts to promote the market-oriented interest-rate reform and the RMB exchange-rate formation mechanism reform have created higher requirements for macro-prudential management. Therefore, the macro-prudential policy framework must be further improved to make it more flexible, more comprehensive, and more effective in counter-cyclical regulation and systemic risks prevention. In view of this, effective as of 2016 the PBC established the Macro-Prudential Assessment (MPA) for financial institutions.

The MPA is not a new tool but rather a further improvement, or an "upgraded" version, of the existing differentiated reserves and dynamic adjustment mechanism. The MPA adopts the core concern of the macro prudential capital adequacy ratio and retains the concept of macro-prudential policies on counter-cyclical regulations. With international experience and adaptations to changes in the economic and financial situations, the MPA has expanded the single indicator into one dozen indicators in seven respects, expanding the target on narrow loans into broader credits, covering both volume and price for both indirect and direct financing, turning prior guidance into in-process monitoring and post evaluation, and establishing a more comprehensive and more flexible macro-prudential policy framework to guide financial institutions to strengthen their self-discipline and self-management.

The MPA will guide the behavior of financial institutions from numerous dimensions in seven respects. The first respect focuses on capital and leveraging, which restricts asset expansions of financial institutions through capital and strengthens risk prevention. This respect mainly focuses on the macro-prudential capital adequacy ratio and the leverage ratio, whereby the indicator for the macro-prudential capital adequacy ratio is decided by broad credit growth and target growth rates of GDP and CPI, reflecting the macro-prudential factors in the Basel III capital framework, including counter-cyclical capital buffers and additional capital requirements for systemically important institutions, while the leverage ratio should not be less than 4 percent with reference to the regulatory requirements. In the future after related management standards are defined, the total loss absorption capacity (TLAC) and other indicators will also be

considered for inclusion. The second respect focuses on assets and liabilities, which, as an adaptation of financial development and as a part of the trend of asset diversification, changed the practice of focusing on narrow loans to assessing broad credits (including loans, securities, investments, and repurchases), not only paying close attention to asset changes on the balance sheet but also establishing soundness requirements for the liability structure of financial institutions. The third respect focuses on liquidity, which encourages financial institutions to strengthen liquidity management, to use stable funding sources to develop asset businesses, to improve deposit reserve management, and to raise the requirements for liquidity coverage with reference to regulatory standards. The fourth respect focuses on pricing behavior, which assesses if the pricing behavior of financial institutions is in line with what is required by market competition, and identifies irrational interest-rate pricing, reflecting close attention to order in market competition and the pricing behavior of commercial banks during the early stages of removing the ceiling for the deposit rates. The fifth respect focuses on asset quality, which encourages financial institutions to improve asset quality and enhance risk prevention, including reviews of non-performing loans of the same type of financial institutions in the same area. The sixth respect focuses on cross-border financing risks, comprehensively reviewing the risk-weighted balance of cross-border financing and its structural features in terms of the currency and maturity in order to accommodate frequent cross-border capital flows and the growing trend of cross-border lending, and planning ahead and enhancing risk monitoring and prevention. The seventh respect focuses on implementation of credit policies, which adheres to the principle of mixed measures as necessary for support or control, encouraging financial institutions to support key areas and weaknesses in the economy and continuously optimizing the credit structure. According to the needs for macro-controls and assessments and implementation, the PBC will improve on a timely basis assessment methods and indicators in order to better evaluate the business of financial institutions and to guide financial institutions to strengthen their prudential operations.

Next, in accordance with the general requirement that a "prudent monetary policy should be flexible and appropriate to create a suitable monetary and financial environment for structural reforms," the PBC will earnestly implement the MPA, guide commercial banks to enhance liquidity and asset-liability management, guide the reasonable growth of monetary credit and social financing, strengthen systemic financial risk-prevention measures, and improve the efficiency of financial services for the real economy.

Box 3 Macro-prudential policies for foreign-exchange liquidity and cross-border capital flows were strengthened

In view of the situation in the domestic market and the lessons from international experiences, in 2015 the PBC included foreign-exchange liquidity and cross-border capital flows in macro-prudent management and further improved the macro-prudential policy framework.

First, the macro-prudential policy for foreign-exchange liquidity was improved. In August 2015 significant growth was recorded in the volume of forward sales of foreign exchange from banks on behalf of their customers and cross-border purchases and sales of RMB, which was apparently beyond the normal level and might reflect speculative arbitrage and pro-cyclical activities. In order to conduct counter-cyclical regulations on foreign-exchange liquidity, curb irrational differences in expectations, promote the sound management of financial institutions, and prevent macro-financial risks, by the end of August 2015 the PBC implemented macro-prudential management measures for forward sales of foreign exchange, and in the middle of September it implemented management measures for cross-border purchases and sales of RMB, requiring financial institutions to deposit 20 percent of the value of their forward sale contracts (including futures and swaps) as foreign-exchange risk reserves and raising the commission rates for squaring positions and purchase and sales of foreign exchange of specific banks that have exceeded a usual level in their cross-border purchases and sales of RMB, so as to curb speculation through the use of price instruments, on exchange rates of some enterprises and overseas entities. Remarkable success has been achieved since implementation of the relevant policies. The contract value of forward foreign-exchange sales and the amount of cross-border RMB purchases by financial institutions have returned to a normal level and short-term arbitrage activities have been curbed, while the real demand of banks and enterprises has been satisfied. Currently, the commission rates of some banks that earlier were raised have also returned to a normal level.

Second, the macro-prudential management pilot program for cross-border financing in both RMB and foreign exchange was expanded. In 2015 the PBC established a model of macro-prudential management for cross-border financing of economic entities in the Shanghai FTA, which tied the cross-border financing of financial institutions and enterprises to their capital strength and set leveraging and macro-prudential adjustment parameters for regulations. According to the spirit and decisions of the CPC Central Committee and the State Council whereby replicable experiences in the FTAs shall be promoted to other places as soon as possible, and based on the useful experiences from the Shanghai FTA, on January 25, 2016 the PBC expanded its pilot program to 27 banks and enterprises registered in the four FTAs, including Shanghai, Guangdong, Tianjin, and Fujian, tied the debt raising space for market players to their capital strength and then solvency, tailored the volume of cross-border financing to the macro-economic situation, the overall solvency conditions, and the balance of payments by adjusting macro-prudential parameters and controlling leveraging and currency mismatch risks.

Third, macro-prudential management of RMB cross-border capital flows has been strengthened. Since January 25, 2016, the PBC has applied the normal deposit reserve ratio to deposits of overseas financial institutions in domestic financial institutions. This not only constitutes a further improvement to the existing reserve system but also provides a long-term mechanism for counter-cyclical regulation of RMB cross-border

flows. It has helped curb pro-cyclical cross-border flows of RMB, guiding overseas financial institutions to enhance RMB liquidity management, promoting sound operations of foreign financial institutions, and preventing macro-financial risks, and maintained financial stability.

The main purpose of implementing a macro-prudential policy is to curb short-term speculative transactions from the perspective of preventing systemic financial risks, to prevent pro-cyclical activities, such as increased in leveraging and currency mismatch risks and maintaining financial stability. In general, the macro-prudential policy is market-oriented, price-based, transparent, non-discriminatory, and dynamic, and it does not involve administrative controls or capital controls. Next, the PBC will take measures in view of the economic and financial situations and the need for regulations, conduct follow-up evaluations of the implementation of the relevant policies, improve and optimize the macro-prudential policy framework for foreign- exchange liquidity and cross-border capital flows, prevent systemic financial risks, maintain financial stability, and safeguard the bottom line so as not to allow the emergency of any systemic and regional financial risks.

V. Policy tools for credit policy-supporting central-bank loans, discounts, and PLS were actively employed to increase credits to key areas and weak sectors in the economy.

The PBC actively employed credit policy-supporting central-bank loans, discounts, and Pledged Supplementary Lending (PLS) to guide financial institutions to increase support to key areas and weak sectors in the economy, including small and micro enterprises, the agricultural sector, rural areas, and farmers, and renovation programs for shantytowns. At the end of 2015, the outstanding agriculture-supporting loans of the central bank totaled 196.2 billion yuan, loans to support small and micro enterprises stood at 75.2 billion yuan, and central-bank discounts stood at 130.5 billion yuan. As approved by the State Council, effective from October 2015 the PBC expanded the coverage of PLS operations from the China Development Bank to include also the Agricultural Development Bank of China and the China Export-Import Bank to support bank lending to lend to shantytown renovation programs, major water conservancy projects, and RMB-denominated lending to overseas investment projects. Based on their progress, in 2015 the PBC provided a total of 698.1 billion yuan to the three banks in PLS, with an outstanding balance of 1.08 trillion yuan by the end of the year.

Box 4 A pilot program of central-bank loans against credit-asset pledges and internal ratings was promoted to improve the framework for PBC collateral management

In recent years, with the changes in the supply and demand of foreign exchange, base money provided through foreign-exchange channels was significantly reduced, and the PBC has become more inclined to supply base money through open market operations, loans against credit-asset pledges, supplementary collateral loans, MLFs, and other

channels. Based on international experience, liquidity supplied by the central bank through claims requires financial institutions to provide eligible collateral. Along with the increasing amount of liquidity supplied through central-bank initiatives, the problem of structural inadequacies of eligible collateral gradually emerged, especially the lack of high-grade bond holdings by local financial institutions, and it is difficult for local financial institutions to provide adequate eligible collateral when applying to the central bank for liquidity support. This has limited space for the central bank when moderate liquidity is required.

To ensure the safety of central-bank claims, to prevent moral hazards for financial institutions, and to solve the problem of inadequate eligible collateral for small and medium financial institutions, in April 2014 the PBC began a pilot program of loans against credit-asset pledges and internal ratings in Shandong and Guangdong provinces, where high-quality credit assets of financial institutions that have passed the PBC internal rating processes and that have met certain standards are included in the range of eligible assets that can be accepted as pledges, thus improving the eligible collateral management framework of the PBC. The pilot areas have established basic principles, operating procedures for central-bank loans against credit-asset pledges, and internal rating databases, and have conducted central-bank lending operations with credit assets as collateral. These experiences can be replicable and introduced to other areas.

In September 2015, based on the experiences in Shandong and Guangdong provinces, the PBC expanded the pilot program of loans against credit-asset pledges to nine other provinces (municipalities), namely Shanghai, Tianjin, Liaoning, Jiangsu, Hubei, Sichuan, Shaanxi, Beijing, and Chongqing. The PBC branches in the pilot areas have carried out internal ratings on some enterprises that received lending from local corporate financial institutions within their jurisdictions and included the credit assets that have met the criteria defined by the PBC as eligible assets that can be accepted as pledges.

The pilot program has been progressing smoothly. By the end of 2015, the PBC completed the internal rating processes of 3,022 enterprises that received loans from local financial institutions in the pilot areas, and have included the credit assets that met the criteria for the range of eligible assets that can be accepted as pledges. This has been helpful to resolve the problem of insufficient high-grade bonds as pledges for local corporate financial institutions, and it has made it convenient for the PBC to provide liquidity to those institutions. The branch offices of the PBC in the pilot areas have provided 4.97 billion yuan as loans against credit-asset pledges to thirty-one local financial institutions.

The pilot program of loans against credit-asset pledges is an important policy measure to improve the PBC's collateral management framework, to help improve the effectiveness and flexibility of monetary policies, to resolve the problem of insufficient eligible collateral assets held by local corporate financial institutions, to guide financial

institutions to increase support to the agricultural sector, rural areas, and farmers, and small and micro enterprises, to reduce social financing costs, and to support the real economy. The PBC will continue to promote the pilot program of loans against credit-asset pledges.

VI. Window guidance and credit policies have played an important role in structural guidance

The PBC has strengthened the prominent role of window guidance and credit policies and their effects on the credit structure, guiding financial institutions to make better use of new loans and to revitalize the stock of credit assets, exploring innovative organizational structures, eligible collateral, and product and service models, and allocating more credit resources to key areas and weak sectors in support of stabilizing economic growth, adjusting the economic structure, and improving the livelihood of the people. First, banking financial institutions have been encouraged and guided to provide full support for projects that will help build China into a strong manufacturing power, to provide financial services for strategic adjustments to the industrial structure, infrastructure construction, and development and reform in key areas, such as shipbuilding, railways, logistics, and the energy industries, to step up support for care of the elderly and the healthcare industries, and to strengthen innovations in consumer credit products so as to effectively meet the reasonable credit needs of the household sector in six areas of consumption. Second, banking financial institutions have been encouraged to provide quality financial services for the agricultural sector and for 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 operational rights for contracted land and property rights for rural housing. Support was given to qualified financial institutions to issue earmarked financial bonds and to use the proceeds to grant loans to micro and small enterprises. Third, banking financial institutions have been urged to implement policies to eliminate excess capacity, and a policy framework for green finance was established and improved. Fourth, financial support for the coordinated development of the Beijing-Tianjin-Hebei region and for the Yangtze River economic belt was provided to promote the quality of financial services for coordinated regional development. Fifth, financial services for poverty alleviation, employment, education, ethnic minorities, migrant workers, and college graduates-turned-village officials were further improved. Financial efforts targeted for poverty alleviation have been strengthened, such as financial inclusion, support for on-going and healthy economic and social development of poverty-stricken areas and the poor so as to eliminate poverty and to become better off. In addition, financial institutions have been 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, credit support for key areas, such as small and micro enterprises and the agricultural sector, rural areas, and farmers, was strong. At end-2015, outstanding RMB

loans to small and micro enterprises amounted to 17.4 trillion yuan, an increase of 13.9 percent year on year. The growth rate was 2.7 and 5.3 percentage points more 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 26.4 trillion yuan, up 11.7 percent year on year and accounting for 27.8 percent of the total loans issued during the same period.

VII. Benchmark deposit and lending rates were lowered and the ceiling on deposit rates was lifted

The role of interest-rate leveraging has been flexibly tapped to adjust and guide the downward movement of market rates in a stable and appropriate manner. Since the beginning of 2015, the PBC lowered the benchmark deposit and lending rates of financial institutions on five successive occasions in order to reduce social financing costs and to enhance financial support for the real economy. Among these, the one-year benchmark lending rate of financial institutions was reduced by a cumulative 1.25 percentage points to 4.35 percent, and the one-year benchmark deposit rate was cut by a cumulated 1.25 percentage points to 1.5 percent. As the effects of the policies gradually emerged, the interest rates on loans of financial institutions declined notably and money-market interest rates remained low, effectively reducing the financing costs of enterprises. In general, deposit interest rates also declined, and a tiered, differentiated, and competitive deposit-rate pricing mechanism was basically put in place.

Significant progress has been achieved in the market-based interest-rate reform. First, controls on interest rates have been basically removed. The ceiling on the deposit interest rate was removed as an adjustment and reform measure. The ceiling on the RMB deposit rate was expanded from 1.2 times that of the benchmark rate to 1.3 times and 1.5 times in March and May of 2015 respectively. The ceiling on the foreign-exchange retail deposit interest rate was removed in May 2015; the ceiling on the interest rate for time deposits with maturities of more than one year (excluding one year) was removed in August; and the ceiling on deposit interest rates for all commercial banks and rural cooperative financial institutions was removed in October, thus indicating the removal of all controls on interest rates. Second, the market interest-rate pricing self-regulatory mechanism has been improved. In 2015 the number of members of the self-regulatory mechanism grew to 643. Meanwhile, efforts were made to actively promote the establishment of and improvements in the self-regulatory mechanisms at the provincial levels, and industry self-regulation and guidance were enhanced for the interest-rate pricing of small and medium-sized financial institutions to maintain orderly market competition in different areas. Third, the benchmark interest-rate mechanism in financial markets has been improved through efforts to further strengthen the role of the Shanghai Inter-bank Offered Rate (Shibor) and the Loan Prime Rate (LPR). Fourth, innovation in financial products has been progressing. Issuances and transactions of inter-bank certificates of deposit (CD) have continued. With CDs being issued to retail depositors, a breakthrough has been achieved. As a

result, the range of market-priced liability products of financial institutions has been expanded. In 2015 issuances of inter-bank CDs and CDs for enterprises and individuals reached 5.3 trillion yuan and 2.3 trillion yuan respectively. With progress in market-based interest rates, enhancement of the pricing capability of financial institutions, improvements in the benchmark interest-rate mechanism in financial markets, and the strengthened adjustment capability of central-bank interest rates, the decisive role of the market in resource allocations has been enhanced.

VIII. Market-based RMB exchange-rate regime was improved

The market-based RMB exchange-rate regime has been further improved in a self-initiated, controllable, and gradual manner, and the RMB exchange rate has remained basically stable at an adaptive and equilibrium level. On August 11, 2015, the PBC decided to improve the quotation mechanism for the central parity of the RMB against the US dollar in order to strengthen the market orientation and the benchmark nature of the central parity of the RMB against the US dollar. Before the opening of the market, the market-makers provide quotes for the parity to the CFETS on each business day by referring to the closing rate in the inter-bank foreign-exchange market on the previous day and by taking into consideration the demand and supply situation in the foreign-exchange market and the exchange-rate movements of the major currencies. Improved quotes by market-makers help to strengthen the market orientation of the central parity of the RMB against the US dollar and to expand the floating range of market exchange rates so that the exchange rates will play an enhanced role in adjusting market demand and supply.

In 2015 the highest and lowest central parity of the RMB against the US dollar were 6.1079 yuan and 6.4936 yuan respectively. Among the 244 trading days, the RMB appreciated on 112 days and depreciated on 132 days. The biggest daily appreciation and the biggest daily depreciation were 0.54 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-2015, the central parity of the RMB against the euro and the Japanese yen was 7.0952 yuan per euro and 5.3875 yuan per 100 yen respectively, an appreciation of 5.08 percent and a depreciation of 4.65 percent respectively from the end of 2014. Between the start of the RMB exchange-rate regime reform in 2005 and end-2015, the RMB appreciated by 41.14 percent against the euro and by 35.61 percent against the Japanese yen.

In order to facilitate bilateral trade and investment, the PBC continued to adopt measures to promote direct trading of the RMB against foreign currencies. In 2015 direct RMB trading against the Swiss franc was launched in the inter-bank foreign-exchange market. Direct RMB trading against foreign currencies was brisk in the inter-bank foreign-exchange market and liquidity was improved. Exchange costs for market players were reduced.

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

Unit: 100 million yuan

Currency	USD	Euro	JPY	HKD	GBP	AUD	NZD	SGD	CHF	CAD	MYR	SUR	THB
Trading volume	290,645	4,257	3,370	1750	780	1,005	169	3,801	149	128	15	225	1.5

Source: China Foreign Exchange Trade System.

As of the end-2015, under the bilateral currency swap agreements with the relevant foreign monetary authorities, foreign monetary authorities used a total of 49.94 billion yuan, and the PBC used a total of USD 0.43 billion. The use of swap funds has played a positive role in promoting bilateral trade.

IX. A deposit insurance system was launched and reforms of financial institutions were deepened

A deposit insurance system was smoothly launched and implementation of the system was carried out in an orderly way. Effective from May 1, 2015, the *Regulations on Deposit Insurance* were implemented by the PBC in accordance with the arrangements and requirements of the State Council. More than 3,000 deposit-taking banking institutions completed the procedures for joining the deposit insurance scheme, and collection of the due premium from May 2015 through December was completed. In general, in more than the half-year since implementation of the *Regulations on Deposit Insurance*, there have been positive responses from all parties, the deposit landscape of large-, medium-, and small-sized banks remained stable, and operations of banking institutions have remained sound. As an important basic institutional arrangement, the deposit insurance system plays a very important role in improving the financial safety net, strengthening protection of depositors, promoting the formation of a market-based mechanism for financial risk prevention and resolution, and serving as a long-term mechanism to maintain financial stability.

Breakthroughs have been made in the reform of policy-based and development of financial institutions. After the deliberations of the State Council Executive Meeting and the approval of the Central Leading Group on Comprehensively Deepening the Reforms, the State Council approved the overall program of reform and implementation for the Agricultural Development Bank of China in December 2014, the program for deepening reform of the China Development Bank, and the overall program of reform and implementation for the Export-Import Bank of China in March 2015. 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 programs. Meanwhile, work to define the scope of business of the three banks, to improve their governance structure, and to revise their articles of incorporation has also

made steady progress.

The reforms of large banks continued. The reform program of the Rural Finance Business Division of the Agricultural Bank of China was deepened and expanded to the entire country to further improve financial services to the agricultural sector, rural areas, and farmers, and at the county level. Approved by the State Council in June, the proposal to deepen the reforms of the Bank of Communications includes measures to improve the ownership structure and corporate governance, to step up internal reforms, and to enhance external supervision. This will help the bank transform its operational mode, increase its competitiveness, and build a stronger capability to serve the real economy. In December the equity diversification of the China Postal Savings Bank made progress, with China Life Insurance, China Telecom, UBS, JP Morgan Chase, and other institutions becoming strategic investors. In August the State Council approved the transformation and restructuring programs of the Great Wall Asset Management Company and the China Orient Asset Management Company to further promote their business transformation.

Significant results have been achieved in the reform of the rural credit cooperatives (RCCs): their capacity for sustainable development has been enhanced, financial services to the rural economy have been improved, and the reform of property rights has made progress. In 2015 a total profit of 223.3 billion yuan was recorded from the RCCs throughout the country. At end-2015, the ratio of the NPLs of the RCCs was 4.3 percent; their capital adequacy ratio was 11.6 percent; their outstanding amount of agricultural-related loans and loans to farmers were 7.8 trillion yuan and 3.7 trillion yuan respectively, up 9.8 percent and 8.8 percent year on year. There were 859 rural commercial banks, 71 rural cooperative banks, and 1,299 RCCs with legal-person status at the county (city) level.

X. Deepening the reforms of foreign-exchange administration

New progress has been made in streamlining and decentralizing administrative procedures and in facilitating trade and investment. First, management reform measures have been "upgraded" to promote centralized operations of foreign-exchange funds by multinational companies, simplifying the requirements for opening accounts, payments and receipts, and the use of funds for the purpose of reducing the capital costs of enterprises. Second, the pilot program for payment institutions to provide cross-border foreign-exchange payment services has been expanded to the entire country as a measure to support the development of a new mode of services. A total of USD 5.4 billion of cross-border payments and receipts was processed during the entire year. Third, administration of the franchising retail foreign-currency exchange business has been improved. The pilot program of cross-border cash transfer business was introduced to facilitate the development of the foreign-currency exchange business. Fourth, the pilot program of foreign-exchange administration in the free trade zones proceeded in a steady manner. Initiatives were implemented in the free trade zones in

Shanghai, Tianjin, Guangdong, and Fujian, such as the voluntary settlement of foreign-exchange funds from external debts and direct receipts of foreign-exchange revenue from trade in goods of class-A enterprises.

New breakthroughs were made in RMB capital account convertibility. First, direct investments are now fully convertible, with the elimination of the annual foreign-exchange review and the record-filing requirement for reinvestment, the voluntary sale of capital by foreign-invested enterprises throughout the country, and the abolition pre-examinations and approvals for direct investments. Second, the policy for mutual recognition of funds between the Mainland and Hong Kong was implemented, and the guidelines for the mutual recognition of funds were released. Based on the quota of 300 billion yuan of net inflows for both northern bound and southern bound investments, the quota limits for individual agencies and products were abolished. Third, the domestic commodity futures market was further opened. Quota and registration requirements for exchange conversions were abolished for foreign investors to facilitate their participation in China's domestic crude oil futures market, with only the reporting obligation remaining.

The statistical and monitoring system for cross-border capital flows was improved. First, the PBC has subscribed to the Special Data Dissemination Standards (SDDS), joined the IMF Coordinated Portfolio Investment Survey (CPIS), and the BIS International Banking Statistics (IBS), and has participated in the Survey on Currency Composition of Foreign Exchange Reserves. Second, the *Balance of Payments and International Investment Position Manual* (Sixth Edition) are now fully implemented. Balance of payment statements and International Investment Position statistics were released in accordance with the new edition, and the corresponding statistical method and reporting and inspection mechanisms were improved. Third, the monitoring and analysis mechanism for cross-border capital flows was improved with the adoption of new functional modules, including data sharing, monitoring of abnormalities, and free trade zones, to provide technical support for routine monitoring and analysis.

The capacity of cross-border capital flow risk management has been enhanced. First, in-process and ex-post management was improved. Monitoring and management of cross-border capital flows were strengthened, with enhanced authenticity and compliance requirements, and cross-border speculative arbitrage activities were curbed through foreign-exchange verification and inspection measures. Second, management of overseas use of bank cards has been strengthened. An annual quota of overseas cash withdrawals and a limited range of overseas use of bank cards were introduced. Third, drastic measures were taken to crack down on all kinds of illegal activities and violations of the foreign-exchange regulations. In 2015 2,044 cases involving foreign-exchange irregularities were investigated, and 69 cases involving underground banks and illegal foreign-exchange transactions were cracked in a joint campaign with the public security agency.

Part 3 Financial Market Analysis

In 2015 the overall performance of the financial markets was stable. The money market traded briskly and market interest rates remained low. The issuance of bonds increased notably and the yield curve shifted downward. Stock market indices saw large fluctuations. The foreign-exchange market experienced greater turbulence and swap and forward transactions increased rapidly. Financial market reforms proceeded steadily, financial products were further diversified, the range of participants was widened, the infrastructure was constantly improved, and the opening-up made great progress.

I. Financial market analysis

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

Growth of repo transactions on the inter-bank market doubled, while the turnover of inter-bank borrowing increased rapidly. In 2015 the cumulative turnover of bond repos reached 457.8 trillion yuan on the inter-bank market, representing an average daily turnover of 1.8 trillion yuan, an increase of 104.8 percent year on year and representing an acceleration of 62.9 percentage points from the previous year. The cumulative turnover of inter-bank borrowing reached 64.2 trillion yuan, with an average daily turnover of 257.9 billion yuan, an increase of 71.2 percent year on year and representing an acceleration of 65.1 percentage points from the previous year. In terms of the maturity structure, transactions were more concentrated in overnight products, which accounted for 85.1 percent and 84.1 percent of the respective turnovers in bond repos and inter-bank borrowing transactions, representing an acceleration of 7.0 and 5.8 percentage points from the previous year. The turnover of bond repos on the stock exchanges rose 41.3 percent year on year to reach 128.2 trillion yuan.

In terms of financing among financial institutions, the flow of funds displayed the following characteristics. First, Chinese-funded large banks remained net fund providers and the amount of their net lending surged. In 2015 net lending of Chinese-funded large banks through repos and inter-bank borrowing increased 135.2 percent year on year to 207 trillion yuan, among which net lending through inter-bank borrowing experienced a larger increase of almost two times the amount during the previous year. Second, borrowing by foreign-funded banks and other financial institutions and vehicles surged. In 2015 net borrowing by foreign-funded banks increased 676 times year on year to 13.4 trillion yuan. Third, net lending of Chinese-funded small- and medium-sized banks through inter-bank borrowing declined to 2.4 trillion yuan, a decline of 42.7 percent year on year. Fourth, net borrowing of insurance institutions through repos and inter-bank borrowing declined to 7.9 trillion yuan, or a decline of 5.2 percent year on year.

Table 7 Fund Flows among Financial Institutions in 2015

Unit: 100 million yuan

	Repos		Inter-bank borrowing	
	2015	2014	2015	2014
Chinese-funded large banks ^①	-1,885,635	-816,890	-183,955	-63,213
Chinese-funded small- and medium-sized banks ^②	619,911	315,128	-23,790	-41,485
Securities institutions ^③	364,808	205,904	106,682	78,390
Insurance institutions ^④	79,014	83,257	58	180
Foreign-funded banks	104,578	13,272	29,785	4,035
Other financial institutions and vehicles ^⑤	717,324	199,329	71,221	22,094

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

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

③Securities institutions include securities firms and fund management companies.

④Insurance institutions include insurance firms and corporate 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, funds, wealth management products, trust plans, and other investment vehicles. Some of these financial institutions and vehicles do not participate in the inter-bank borrowing 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 and standard bond forwards began trading. In 2015 64,557 RMB interest-rate swap deals were reached in the market, an increase of 50 percent year on year. The notional principal volume totaled 8230.4 billion yuan, an increase of 104 percent year on year. In terms of the maturity structure, contracts with maturities of up to one year traded most briskly and their aggregate notional principal volume posted 7242 billion yuan, accounting for 88 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 repo fixing rate (FR007) and the Shibor, and their notional principal accounted for 89.5 percent and 10.2 percent of the total respectively. In 2015 standard bond forwards began trading, with a total of 83 deals and 1.96 billion yuan. A total of 994 deals of standard interest-rate derivatives was reached, with a notional principal amount of 501.4 billion yuan.

Table 8 Transactions of Interest-Rate Derivatives in 2015

	Interest-rate swaps	Standard interest-rate derivatives	Standard bond forwards
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	Transactions (lots)	Amount of notional principal (100 million yuan)	Transactions (lots)	Amount of notional principal (100 million yuan)	Transactions (lots)	Amount (100 million yuan)
2015	64,557	82,304.1	994	501,4	83	19.6
2014	43,019	4,0347.2	212	413.5	—	—

Source: China Foreign Exchange Trade System.

The issuance and trading of inter-bank certificates of deposits (CDs) continued to grow notably. In December 2015 observers of the market interest-rate pricing self-regulatory mechanism were eligible to issue inter-bank CDs. In 2015 283 financial institutions issued a total of 6,101 inter-bank CDs, raising 5.3 trillion yuan. The trading volume on the secondary market was 18.4 trillion yuan. The issuance and trading were both priced based on the Shibor. In December 2015 the weighted average interest rate for the issuance of 3-month inter-bank CDs was 3.23 percent, 17 basis points higher than that of the 3-month Shibor. On June 2, 2015 the PBC released the *Provisional Administrative Rules on Certificates of Deposits*, and the issuance of CDs was officially launched. In 2015 4,768 CDs were issued by financial institutions, with a total volume of 2.3 trillion yuan. The development of the CD market further expanded the scope of market-priced liability products, helped to build the independent pricing capability of financial institutions, and improved the market interest-rate mechanism.

Money-market interest rates remained low and stable. In general, money-market interest rates declined during the first half of the year and then went up a bit in Q3. In Q4, the PBC reduced the reserve requirement ratio and flexibly utilized various tools to provide timely liquidity so as to keep money-market interest rates low and stable. In December, the weighted average interest rate of inter-bank borrowing and pledged repos posted 1.97 percent and 1.95 percent respectively, a decline of 152 basis points and 154 basis points respectively year on year. At the end of 2015, the overnight and 7-day Shibor posted 1.99 percent and 2.36 percent, a decline of 154 basis points and 228 basis points respectively year on year. The 3-month and 1-year Shibor posted 3.09 percent and 3.35 percent respectively, a decline of 205 and 138 basis points respectively year on year.

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

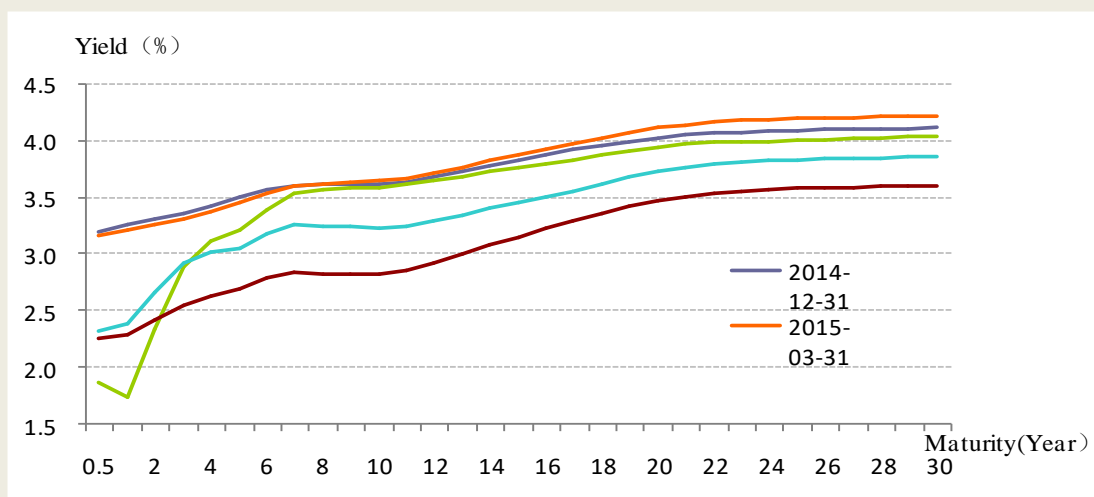
In 2015 the volume of spot bond trading on the inter-bank market posted 86.7 trillion yuan, representing an average daily turnover of 348.3 billion yuan, an increase of 115.8 percent year on year. In terms of the trading entities, Chinese-funded small- and medium-sized banks and securities institutions were mainly net bond sellers, with total net spot bond sales of 3.4 trillion yuan; net spot bond sales of Chinese-funded large banks increased in the second half of the year; other financial institutions and vehicles were mainly net bond purchasers, with total net spot bond purchases of 3.6

trillion yuan. In terms of the trading products, a total of 9.9 trillion yuan of spot government securities was traded, accounting for 11.1 percent of the total spot bond transactions on the inter-bank market; the turnover of spot financial bonds and corporate debenture bonds was 46.1 trillion yuan and 30 trillion yuan respectively, accounting for 53.2 percent and 34.6 percent of the total spot bond transactions on the inter-bank market respectively. The volume of spot bond trading on the stock exchanges totaled 3.4 trillion yuan, an increase of 21.9 percent year on year.

Bond indices on the inter-bank markets moved up. The China Bond Composite Index (net price) rose from 101.42 points at the beginning of the year to 104.83 points at the end of the year, up 3.4 percent; the China Bond Composite Index (full price) increased 4.2 percent, from 114.50 points at the beginning of the year to 119.29 points at the end of the year. The Government Securities Index on the stock exchanges increased 6.1 percent, from 145.60 points at the beginning of the year to 154.54 points at the end of the year.

The yield curve of government securities on the inter-bank market moved downward by a large margin. At end-2015, the yields of 1-year, 3-year, 5-year, 7-year, and 10-year government securities declined by 96, 82, 81, 77, and 80 basis points from the beginning of the year, while the spread between 10-year and 1-year government securities widened from the beginning of the year by 16 basis points to 52 basis points. In Q1 the yield of government securities first declined and then went up; in Q2, influenced by the decline in money-market interest rates, the increase in the supply of local government bonds, and improvements in the stock market, the yield of short-term government securities decreased sharply and the yield of medium- to long-term government securities decreased slightly, but with a steeper curve; beginning in Q3, the yield of medium- to long-term government securities decreased notably due to dramatic fluctuations in the stock market, large pressures from the economic downturn, and the growing demand for a safe haven.

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



Source: China Central Depository & Clearing Co., Ltd.

The volume of bond issuances expanded significantly. In 2015 a total of 22.9 trillion yuan of bonds was issued, an increase of 108.3 percent year on year, among which issuances of local government bonds, corporate bonds, and inter-bank CDs grew rapidly; with respect to corporate debenture bonds, issuances of enterprise bonds registered a year-on-year decrease. At end-2015, outstanding bonds of all kinds posted 48.8 trillion yuan, an increase of 38.1 percent year on year.

Table 9 Bond Issuances in 2015

Type of bonds	Issuances (100 million yuan)	Year-on-year growth (100 million yuan)
Government securities	21,058	3,311
Local government bonds	38,351	34,351
Central-bank bills	0	0
Financial bonds ^①	102,095	65,543
Of which: Financial bonds issued by the China Development Bank and policy financial bonds	26,051	2,851
Inter-bank certificates of deposits	53,024	44,827
Corporate debenture bonds ^②	67,205	15,709
Of which: Debt-financing instruments of non-financial enterprises	54,326	12,514
Enterprise bonds	5,031	-3,229
Corporate bonds	7,708	6,680
Bonds issued by international institutions	115	95
Total	228,824	119,009

Notes: ① 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 deposits, and so forth.

② 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 Central Depository & Clearing Co., Ltd.

Financial products diversified further on the bond market. First, insurance companies were allowed to issue supplemental capital bonds on the inter-bank market. This measure helped broaden the capital channels for insurance companies and enhanced their solvency and risk resilience. Second, a green financial bond was launched to provide a financing channel for financial institutions to support environmental protection, energy conservation, clean energy, clean transportation, and other green industry projects and to increase the supply of green credit, in particular medium- and long-term green credit. Third, debt financing instruments were further diversified for non-financial enterprises with the launch of perpetual bills, M&A bills, green bills, asset-backed bills, and "debt-loan combo" paper. The issuance registration system was improved through tiered management. A specialized institutional investor mechanism was introduced for the issuance of financing instruments for targeted investors. Furthermore, the bond market was opened up further, with RMB-denominated bonds issued by overseas financial institutions, including HSBC, Bank of China Hong Kong and Standard Chartered Hong Kong, and overseas governments, including the governments of British Columbia and the Republic of Korea.

The coupon rates of bonds declined notably. The coupon rate of 10-year government securities issued in December was 2.99 percent, a decline of 78 basis points from those of the same maturity issued in December 2014. The coupon rate of 10-year financial bonds issued by the China Development Bank in November was 3.47 percent, a decline of 90 basis points from those of the same maturity issued in December 2014. The average coupon rate of 1-year short-term financing bills (rated A-1) issued by AAA-rated enterprises was 3.78 percent, a decline of 152 basis points from the same period of the previous year. The average coupon rate of 5-year medium-term notes (rated AAA) issued by AAA-rated enterprises was 4.17 percent, a decline of 150 basis points from the same period of the previous year. The Shibor played a greater role in bond pricing. In 2015 a total of 4 floating-rate bonds were issued based on the Shibor, with a gross issuance volume of 17 billion yuan; 302 fixed-rate enterprise bonds were issued, with a gross issuance volume of 342.1 billion yuan, all based on the Shibor; and a total of 890.3 billion yuan of fixed-rate short-term financing bills was issued based on the Shibor, accounting for 91.6 percent of all fixed-rate short-term financing bills.

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

The bill acceptance business increased slightly. In 2015 commercial bills issued by

enterprises totaled 22.4 trillion yuan, an increase of 1.3 percent year on year; outstanding commercial bills posted 10.4 trillion yuan at end-2015, an increase of 5.4 percent year on year. In the first half of the year, the balance of bill acceptances increased slightly, reaching 10.9 trillion yuan at end-August. It then fluctuated within a narrow range, and by end-2015 it had increased by 0.5 trillion yuan from the beginning of the year. In terms of the industries of the issuing enterprises, outstanding bankers' acceptances were mainly issued by enterprises in the manufacturing, wholesale, and retail industries, with small- and medium-sized enterprises issuing about two-thirds of the total.

The outstanding balance of bill financing increased rapidly and the interest rates on the bill market revealed a downward trend. In 2015 commercial bills discounted by financial institutions totaled 102.1 trillion yuan, an increase of 68.2 percent year on year; the outstanding balance of bill discounts stood at 4.6 trillion yuan, an increase of 56.9 percent year on year. In general, the outstanding amount of bill financing increased rapidly, growing by 1.7 trillion yuan from the beginning of the year; the share of outstanding bill financing among the total outstanding loans was 4.9 percent, an increase of 1.3 percentage points year on year. In 2015, as overall liquidity in the banking sector was reasonable and sufficient, interest rates on the money market showed a downward trend. Due to the downward movement of discount rates as a result of the central-bank discount rate adjustment, movements of the money-market interest rates, and changes in the supply and demand in the bill market, interest rates generally declined amid fluctuations.

4. The stock indices rebounded while the volume of trading and equity financing increased notably

In the first half of 2015 the stock indices rose rapidly, fell sharply in the middle of the year, and then rebounded after hitting bottom in August and September. At end-2015, the Shanghai Stock Exchange Composite Index closed at 3,539 points, an increase of 9.4 percent from end-2014; the Shenzhen Stock Exchange Component Index closed at 12,665 points, an increase of 15.0 percent from end-2014; the Growth Enterprise Board (GEM Board) Index (Chinext Price Index) closed at 2,714 points, an increase of 84.4 percent from end-2014. The weighted average P/E ratio of the A-share market on the Shanghai Stock Exchange rose from 16 times at end-2014 to 17.6 times at end-2015, while during the same period that of the Shenzhen Stock Exchange rose from 34.6 times to 53.3 times.

Turnover on the stock markets increased rapidly. In 2015 the combined turnover of the Shanghai and Shenzhen Stock Exchanges reached 255 trillion yuan, with a daily turnover averaging 1 trillion yuan, an increase of 245 percent year on year; turnover on the GEM Board totaled 28.5 trillion yuan, an increase of 265.6 percent year on year. At end-2015 the combined market capitalization of the Shanghai and Shenzhen Exchanges posted 41.6 trillion yuan, an increase of 31.7 percent year on year; the market capitalization of the GEM Board posted 3.2 trillion yuan, an increase of 145.4 percent

year on year.

The amount of equity financing grew. In 2015 a total of 1.1 trillion yuan was raised by enterprises and financial institutions by way of IPOs, additional offerings, rights issuances, and warrant exercises on domestic and overseas stock markets, an increase of 60.4 percent year on year. Among this total, 851.8 billion yuan was raised on the A-share market, an increase of 75.9 percent year on year.

5. Insurance industry assets grew rapidly

In 2015 total premium income in the insurance industry amounted to 2.4 trillion yuan, representing year-on-year growth of 20.0 percent and an acceleration of 2.5 percentage points from the previous year; total claim and benefit payments amounted to 867.4 billion yuan, representing year-on-year growth of 20.2 percent. Specifically, total claim and benefit payments in the property-insurance sector increased 10.7 percent year on year, while those in the life-insurance sector increased 30.7 percent.

Insurance assets grew rapidly. At end-2015 total assets in the insurance industry posted 12.4 trillion yuan, representing year-on-year growth of 21.7 percent and a decline of 0.9 percentage point from the previous year. Among this total, bank deposits declined 1.3 percent year on year, whereas investment-linked assets increased 30.5 percent.

Table 10 Use of Insurance Funds, End-2015

	Outstanding balance (100 million yuan)		As a share of total assets (%)	
	End- 2015	End- 2014	End-2015	End-2014
Total assets	123,598	101,591	100	100
Of which: Bank deposits	24,350	25,233	19.7	24.8
Investments	87,446	66,997	70.8	65.9

Source: China Insurance Regulatory Commission.

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

In 2015 the turnover of spot RMB/foreign-exchange transactions totaled USD4.9 trillion, an increase of 17.9 percent year on year. The turnover of RMB/foreign-exchange swap transactions totaled an equivalent of USD8.3 trillion, an increase of 86.0 percent year on year, among which overnight RMB/USD swap transactions posted USD5.7 trillion, accounting for 68.3 percent of the total turnover in RMB/USD swap transactions. The turnover on the RMB/foreign-exchange forward market totaled USD37.2 billion, a decline of 29.7 percent year on year. The turnover of foreign currency pair transactions amounted to an equivalent of USD120.2 billion, an increase of 98.4 percent year on year. In particular, EUR/USD pairs were traded the most, accounting for 47.0 percent of the total.

The number of participants on the foreign-exchange market increased further. At end-2015, there were 518 members on the foreign-exchange spot market, 123 members on the foreign-exchange forward market, 123 members on the foreign-exchange swap market, 99 members on the currency swap market, and 61 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. The price of gold declined amid fluctuations

The price of gold continued to decline amid fluctuations. In 2015 the price of gold on the international market peaked at USD1,295.75 per ounce and reached a trough of USD1,059.40 per ounce, closing at USD1,062.25 per ounce at end-2015 and representing a decline of 11.4 percent from the end of the previous year. The movement of domestic gold prices kept pace with that on the international market. However, influenced by the depreciation of the RMB, the decline in domestic gold prices was less than that on the international market. The peak price of gold (AU9999) on the Shanghai Gold Exchange was 265 yuan per gram, and the lowest price was 210.79 yuan per gram. At end-2015, the price of gold closed at 222.86 yuan per gram, a decline of 7.4 percent from the end of the previous year.

In 2015 the trading volume of gold on the Shanghai Gold Exchange continued to surge. The trading volume of gold was 34,100 tons, an increase of 89.6 percent year on year, and the turnover posted 8.01 trillion yuan, an increase of 79.4 percent year on year. The trading volume of silver was 80.57 trillion tons, an increase of 61.2 percent year on year, and the turnover posted 2.76 trillion yuan, an increase of 44.9 percent year on year. The trading volume of platinum was 60.22 tons, a decline of 7.2 percent year on year, and the turnover posted 13.518 billion yuan, a decline of 28.0 percent year on year.

II. The development of institutional arrangements in the financial markets

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

First, qualified private equity funds are allowed to invest in the inter-bank bond market to further diversify the investor base and to improve the multi-layered bond market system. As of end-2015, five private equity funds had gained access to the inter-bank bond market. Second, the approval procedures were abolished for secondary market transactions of bonds on the inter-bank bond market. That is, all bonds legally issued can be immediately traded on the inter-bank bond market after the issuance is completed, and information disclosures and investor protection requirements have been enhanced to promote regulation and the sound development of the bond market. Third, RMB clearing banks and overseas participating banks in the clearing business are

allowed to conduct bond purchase transactions on the inter-bank bond market and they are provided with new RMB liquidity management instruments. Fourth, foreign central banks and monetary authorities, sovereign wealth funds, and other overseas institutional investors are allowed to conduct bond outright purchases, repurchases, bond lending, interest-rate swaps, and other transactions as allowed by the People's Bank of China to improve the efficiency of investments on the inter-bank market. At end-2015, 50 such institutions had gained access to the inter-bank bond market.

2. Institutional arrangements were improved for the equity market

First, public comments were solicited on the *Administrative Rules for the Securities Future Program Trading*. The Rules establish regulatory requirements for application and approval, access management, order examination, and fee management to regulate program trading and to ease the negative effects, as reflected in the increasing market volatility, the effect on fair markets, and pressures on the technical system. Second, new IPOs were resumed. On November 6, the China Securities Regulatory Commission (CSRC) decided to resume IPOs and it adopted reform measures to improve the IPO system, including abolishing advance payments for subscriptions of newly issued stocks, simplifying the approval requirements for stock issuances, strengthening the information disclosure requirements and the responsibility of intermediary institutions, establishing an investor protection mechanism, including compensation for diluted current returns and advance compensations. In order to implement these reform measures, the CSRC released the amended the *Administrative Rules on Securities Issuances and Underwriting*, the *Administrative Rules for Initial Public Offerings and Listings*, and the *Administrative Rules for Initial Public Offerings and Listings on the Growth Enterprise Board*, which entered into effect on the first day of 2016. Third, the *Administrative Rules on Regulation of Money-Market Funds* were released to replace the *Interim Administrative Provisions on Money-Market Funds*, further improving the regulatory requirements on the scope, terms, and ratios of investments, providing system-wide institutional arrangements for liquidity management on the money market and prescribing specific disclosure requirements for Internet-based sales of money-market funds.

3. Institutional arrangements were further improved for the insurance market

First, efforts were made to promote the insurance industry to support the people's welfare and the real economy. The State Council released the *Opinions on Nationwide Implementation of Critical Illness Insurance for Urban and Rural Dwellers*, requiring that critical illness insurance cover all the participants, both rural and urban, in the basic medical insurance scheme and a comprehensive critical illness insurance scheme be established nationwide by 2017. A preferential tax policy for commercial insurance policy holders was adopted to combine the efforts of the government and the market to improve the people's livelihood. Policies supporting major engineering projects and

small and micro-enterprises were adopted to provide services to the real economy. Second, the market-based reform was deepened. The rate reform of universal insurance and life insurance products that pay dividends was launched, and the reform of the latter was basically completed. The rate reform of commercial auto insurance was furthered, with the coverage of the pilot program expanding from six regions (including Heilongjiang and Shandong) to eighteen regions. The market-based reform of insurance fund investments continued, with the ratio of blue-cap investments raised, the scope of overseas investments enlarged, investments in asset-backed products better regulated, and provisions for the creation of PEs by insurance funds further clarified. The reform of the insurance intermediary market was deepened with a view to establishing an insurance intermediary system with clearly defined functions and a smooth access and exit mechanism that supports the orderly movement of factors. The recapitalization channels for insurance firms were broadened by allowing insurance companies to issue capital replenishment bonds on the inter-bank market. The State Council approved the establishment of the Shanghai Insurance Exchange as a market-based trading platform for the industry. Third, regulation of insurance was strengthened. Solvency regulations were enhanced with the release of the China Risk Oriented Solvency System and the start of the transitional phase of its implementation. The regulations for the use of insurance funds were strengthened by the release of internal control guidelines on the use of insurance funds, and improved regulation of information disclosures concerning trading with connected parties and purchases of more than 5 percent of the stocks of a listed company on the secondary market, enhanced prudential supervision of the asset allocation behavior of insurance firms, and the shift of soft constraints to hard constraints in asset and liability management to prevent investment risks. Supervision over corporate governance was beefed up with the release of comprehensive provisions for a corporate governance assessment system for legal-person insurance companies and comprehensive regulation of internal audits of insurance companies. Regulation of Internet insurance was improved with the release of basic rules on Internet insurance businesses and approval for the establishment of three Internet insurance companies.

4. Promoting development of the foreign-exchange market

First, foreign-exchange products were further diversified. Standard foreign-exchange swap products based on bilateral credit lines and automatic matching were launched. Second, the foreign-exchange market infrastructure was improved. An agent clearing service was launched on the inter-bank foreign-exchange market to reduce transaction costs for participants. Third, management of the comprehensive foreign-exchange purchase and sale position of commercial banks was optimized. The ceiling and floor on the position of national banks and market-makers were expanded to meet the demand of banks to manage exchange-rate risks and foreign-exchange market liquidity.

5. Development of the gold market was promoted

First, the Shanghai Gold Exchange launched the price-asking gold options business to further improve the product system on the gold market. Second, the Shanghai Gold

Exchange announced it would accept gold inventory as margin collateral to improve market efficiency and to reduce costs for investors. Third, the market-maker system made steady progress on the price-asking market and improved the liquidity of the market.

Part 4 Macro-economic Analysis

I. Global economic and financial developments

In 2015 the global economy was more complex, as the major economies faced further discrepancies in terms of their growth conditions and monetary policies, the international financial market and commodities prices faced intensified fluctuations, and non-economic disturbance factors such as geopolitics accumulated. The U.S. economic condition was relatively good. There were signs of a recovery in the euro area but obstacles still existed. Japan experienced increasing economic volatility and deflationary pressures. Overall growth in the emerging market economies slowed down.

1. Developments in the Major Economies

The U.S. economy continued to recover moderately. In the first quarter, real GDP grew by 0.6 percent quarter on quarter (annualized), but hurt by factors such as the cold weather, the strike at the ports on the west coast, and so forth. Since the second quarter, the U.S. economy displayed an obvious recovery, driven by expansion in the manufacturing and service industries, acceleration in consumption growth, and the warming of the real-estate market. Beginning in the fourth quarter, the economic condition has been stable. Momentum in the manufacturing and service industries slowed down, consumption showed a positive trend, and the labor market continuously improved as unemployment fell to its lowest level since May 2008. The inflation rate remained low during the year, below the target inflation rate set by the Fed. On December 16, the Fed raised the 2016 economic growth projections to 2.4 percent.

There were signs of a recovery in the euro area but obstacles still existed. Due to the stronger stimulus policies by the European Central Bank (ECB) and the depreciation of the euro, the economy showed a moderate recovery. GDP increased by 1.3, 1.6, and 1.6 percent respectively in the first three quarters of 2015. Beginning in the fourth quarter, the economy continued to grow moderately and the labor market saw continuous improvements, with the unemployment rate declining to 10.4 percent in December, a record low since November 2011. Inflation remained low and it faced downward pressures. Meanwhile, due to uncertainties related to the massive inflow of refugees and the negative impact of the terrorist attack in Paris, the economic recovery in the euro area still required monitoring.

The performance of Japan's economy experienced volatility and faced deflationary

pressures. During the first quarter, the growth rate rebounded substantially. However, affected by the sharp decline in private consumption and net exports, Japan's economy contracted and recovery was still relatively weak, with GDP increasing by negative 0.5 percent and 1.0 percent quarter on quarter (annualized) respectively during the second and third quarters. Since the fourth quarter, though the manufacturing PMI rallied and the unemployment rate improved to some extent, the risks of deflation remained due to the fall in international oil prices. The inflation rate was still well below the 2 percent target rate set by the Bank of Japan (BOJ).

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

Country	Index	2014Q4			2015Q1			2015Q2			2015Q3			2015Q4		
		Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
United States	Real GDP Growth Rate (annualized quarterly rate, %)	2.1			0.6			3.9			2.0			0.7 (preliminary estimate)		
	Unemployment Rate (%)	5.7	5.8	5.6	5.7	5.5	5.5	5.4	5.5	5.3	5.3	5.1	5.1	5.0	5.0	5.0
	CPI (YOY, %)	1.6	1.3	0.7	-0.2	-0.1	0	-0.1	0	0.2	0.2	0.2	0	0.1	0.4	0.7
	DJ Industrial Average (closing number)	17391	17828	17983	17165	18133	17776	17841	18010	17620	17689	16528	16285	17664	17720	17425
Euro Area	Real GDP Growth Rate (annualized quarterly rate, %)	0.4			0.5			0.4			0.3			...		
	Unemployment Rate (%)	11.6	11.5	11.4	11.3	11.2	11.2	11.1	11.0	11.0	10.8	10.8	10.6	10.6	10.5	10.4
	HICP (YOY, %)	0.4	0.3	-0.2	-0.6	-0.3	-0.1	0	0.3	0.2	0.2	0.1	-0.1	0.1	0.1	0.2
	EURO STOXX 50 (closing number)	2998	3076	3004	3198	3401	3435	3439	3444	3285	3432	3110	2976	3216	3288	3100
Japan	Real GDP Growth Rate (annualized quarterly rate, %)	1.8			4.4			-0.5			1.0			...		
	Unemployment Rate (%)	3.5	3.5	3.4	3.6	3.5	3.4	3.3	3.3	3.4	3.3	3.4	3.4	3.1	3.3	3.3
	Core CPI (YOY, %)	2.9	2.4	2.4	2.4	2.2	2.3	0.6	0.5	0.4	0.2	0.2	0	0.3	0.3	0.2
	NIKKEI 225 (closing number)	16414	17460	17451	17674	18847	19207	19983	20563	20236	20585	18890	17388	19083	19747	19033

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

Growth in some emerging market economies slowed down and some economies registered negative growth. Due to numerous factors, including the continued weakening of commodity prices, the reversal in global capital flows due to the expectation of a further rate hike by the Fed, and geopolitical shocks, financial market risks, in the emerging market economies increased. Due to domestic structural problems, some economies slowed down or even recorded negative growth. In 2015 the GDP in Brazil fell by 4.5 percent year on year during the third quarter, and the GDP in Russia fell by 3.7 percent year on year.

2. Developments in global financial markets

Most currencies depreciated against the US dollar. Affected by the expectation that the Fed would raise the interest rates, the dollar index continued to rise and most currencies depreciated to varying degrees against the US dollar. At the end of 2015, the exchange rates of the euro, the pound sterling, and the Japanese yen against the US dollar were 1.086 dollar per euro, 1.4738 dollar per pound, and 120.3 yen per dollar respectively, a depreciation of 10.23 percent, 5.36 percent, and 0.52 percent respectively from the end of 2014. At the same time, the currencies in most of the emerging markets depreciated by large margins. In particular, the Kazakhstan tenge lost almost 40 percent against the US dollar while the Argentine peso and the Brazilian real lost more than 30 percent. The South African rand and the Russian ruble depreciated by more than 20 percent. The Malaysia ringgit, the Mexican peso, and the Indonesian rupiah lost more than 10 percent.

Interest-rate movements in money markets diverged among countries. In 2015 the dollar Libor in the London inter-bank market climbed due to the expectation that the Fed intended to raise interest rates. The upward momentum was more obvious in November, with the 1-year dollar Libor registering 1.178 percent, an increase of 55 basis points from the end of 2014. Affected by the ECB's upgrading of its loose monetary policies, the euro Libor closed at 0.0593 percent, a decrease of 23 basis points. The Euribor continued last year's declining trend, registering 0.142 percent, a decrease of 27 basis points from the end of the last year.

The yields of government securities in the advanced economies increasingly fluctuated. The yields of government bonds in the advanced economies generally remained low, but with increasing fluctuations. At the end of 2015, the yield of 10-year government bonds in the United States, Germany, and the United Kingdom closed at 2.275 percent, 0.634 percent, and 1.961 percent respectively, up by 10, 14, and 21 basis points from the last year. The yield of 10-year government bonds in Japan closed at 0.272 percent, down by 6 basis points. Meanwhile, the yields of government securities in the emerging economies diverged. The yields of 10-year government bonds in Argentina, Russia, and Greece dropped by 840, 428, and 121 basis points, whereas those in Brazil, Turkey, South Africa, and Indonesia surged by 416, 238, 197, and 102 basis points respectively.

Global stock markets exhibited increasing volatility. During the first quarter of 2015, global stock markets performed well but in the second and third quarters they fluctuated as their stock indices plummeted, but they improved to some extent during the last quarter. At the end of 2015, the Dow Jones Industrial Average Index, the STOXX 50 Index, and the Nikkei 225 Index closed at 17,425, 3,100, and 19,034 respectively, down by 2.2 percent, and up by 3.2 percent and 9.1 percent. The stock markets in the emerging market economies generally declined. The drops in the stock indices in

Turkey and Indonesia were among the largest, losing 16.3 percent and 12.4 percent respectively.

3. Monetary policies in the major economies

Monetary policies in the major advanced economies diverged further. On December 16, 2015, the Fed hiked the interest rate, deciding to raise the target range for the federal funds rate to 1/4 to 1/2 percent, by 25 basis points; the interest rate paid on required and excess reserve balances was raised to 0.50 percent; the overnight reverse repurchase operations rate rose to 0.25 percent; and the discount rate increased by one-quarter of one percentage point to 1.00 percent. The Fed announced that after this increase its monetary policy would remain accommodative. The European Central Bank (ECB) upgraded its easing monetary policies. In January, it announced it would further enlarge the asset purchase scale to €60 billion and would expand the scope to euro area governments, institutions, and European companies. In March, it officially launched its public-sector purchase programme (PSPP), and in September it increased the issue share limit from the initial limit of 25 percent to 33 percent. On December 3, the ECB announced it would decrease the deposit facility by 10 basis points to negative 0.30 percent, while keeping the interest rates of the main refinancing operations (MROs) and the marginal lending facility unchanged. The ECB decided to extend the asset purchase programme (APP) to the end of March 2017 or beyond, if necessary, and also decided to continue conducting the main refinancing operations and the three-month longer-term refinancing operations as fixed rate tender procedures with full allotments for as long as necessary, and at least until the end of the last reserve maintenance period of 2017. The Bank of Japan (BOJ) continued to carry out its quantitative and qualitative monetary easing policies and promised to maintain injections of base money by 80 trillion yen per year. On January 29, 2016, the Bank of Japan (BOJ) decided to introduce a "Quantitative and Qualitative Monetary Easing (QQE) with a Negative Interest Rate" in order to achieve the price stability target of 2 percent by the earliest possible date. A negative interest rate of minus 0.1 percent will be applied to the outstanding balance of each financial institution's current account at the BOJ. The Bank of England (BOE) maintained the Bank Rate at 0.5 percent and the scale of asset purchases at GBP 375 billion. Meanwhile, in order to boost their economies, the central banks of Canada, Denmark, Norway, Australia, and New Zealand lowered their benchmark rates and some of them made several cuts. In addition to the ECB, the central banks of Denmark, Switzerland, and Sweden implemented a negative interest-rate policy. In addition, the central bank of Switzerland eliminated the upper limit of the SRF/EUR, while the central bank of Sweden expanded the scale of its asset purchase plan. Responding to inflationary pressures, in 2015 the central bank of Iceland raised the benchmark rate on three occasions by a total of 100 basis points to 6.50 percent.

The monetary policies in the emerging market economies also revealed some differences, as the complex external environment made policy making more difficult. On the one hand, some economies lowered their benchmark rates so as to boost their

economies and to reduce the external impact. In 2015 the Central Bank of Russia cut its benchmark rate on five occasions by a cumulative 600 basis points to 11.0 percent. The Reserve Bank of India lowered its repo rates on four occasions by a cumulative 125 basis points to 6.75 percent. Meanwhile, the central banks of South Korea, Thailand, Vietnam, Hungary, Indonesia, Ukraine, and Poland all reduced their policy rates. On the other hand, some economies tightened their monetary policies in response to domestic inflationary pressures and the shock caused by the Fed's adjustment of the interest rate. The Central Bank of Brazil increased its benchmark interest rate on five occasions by a cumulative 250 basis points to 14.25 percent. The Central Bank of Peru and of South Africa respectively raised their interest rates on two occasions by a cumulative 50 basis points to 3.5 percent and 6.25 percent. Following the Fed, countries such as Mexico, Chile, and Saudi Arabia raised their interest rates by 25 basis points to cope with the pressures of capital outflows; among them, Mexico increased its interest rate for the first time since 2008. To alleviate capital flight pressures and risks of capital outflows, Argentina lifted its foreign-exchange controls and allowed the exchange rate to float freely.

4. The global economic outlook and the major challenges

Looking ahead to 2016, the global economy will continue its major adjustments and may also face the following risks.

First, the rate hike by the Federal Reserve will cause further divergence in the monetary policies of the major advanced economies and will produce certain spillover effects. The divergence of the monetary policies in the major economies and their mutual influence will result in global adjustments of asset allocations and a re-pricing of risks, and will aggravate fluctuations in cross-border capital flows. The actual path for the Fed to raise the rate will be subject to numerous uncertainties and may increase volatilities in the economic and financial markets.

Second, some emerging market economies may face serious downward pressures. After the Fed raised the interest rates, the emerging market economies found it more difficult to coordinate macro-economic policies with the advanced economies, while some economies faces a dilemma of capital outflows and downward pressures on the domestic economy. In particular, economies that have large current account deficits and depend heavily on external debt or commodity exports and that peg their exchange rate to the US dollar either nominally or actually may face greater potential risks.

Third, international commodity prices remain at low levels, thus commodity exporters suffer from economic downward pressures and higher debt risks. Affected by geopolitical and other factors, changes in supply and demand relations and commodity prices still face large uncertainties. Those economies with simple structures that rely on primary commodity exports will continue to be on the receiving end of serious shocks.

Fourth, inflation will face global downward pressures. Due to various factors such as

low oil prices and weak domestic demand, the major advanced economies face downward inflation pressures, which are substantially lower than the policy targets. Given that the global economic recovery is relatively weak, the overall debt level remains high, and investment growth has slowed, the downward pressures will continue to weigh on inflation over the medium term.

Fifth, growth of global trade remains slow. Influenced by the weak global economic recovery, fewer imports of raw materials by the emerging market economies, the structural changes in global trade, the trend of value chain internalization, and the rising trade protectionism, growth of global trade is slowing and is likely to put a drag on world economic growth.

In addition, geopolitical risks have intensified. The terrorism situation has become more serious, and geopolitical tensions in the Middle East have become more complex, which probably will affect global financial markets, including international prices of crude oil. Meanwhile, it is difficult to find an immediate solution to the European migrant problem, and this may hinder recovery in the euro area.

II. Analysis of China's macro-economic performance

In 2015 the Chinese economy performed in a stable manner with positive developments in terms of structural adjustments. Final consumption contributed to more than 60 percent of GDP growth and the share of tertiary industry reached 50.5 percent. Emerging industries and new business models developed robustly. Consumer prices grew moderately and employment remained stable. GDP registered 67.7 trillion yuan in 2015, growing by 6.9 percent as compared to 2014 in comparable prices. GDP growth during the four quarters of 2015 grew by 7.0 percent, 7.0 percent, 6.9 percent, and 6.8 percent respectively year on year, and by 1.3 percent, 1.9 percent, 1.8 percent, and 1.6 percent respectively quarter on quarter. In 2015 the CPI increased by 1.4 percent year on year and the trade surplus posted 3.6865 trillion yuan.

1. Consumption contributed more to growth

Consumption contributed more to growth, and consumption via the new business models grew particularly rapidly. In 2015 per capita disposable income increased by 8.9 percent in nominal terms and by 7.4 percent in real terms year on year to reach 21,966 yuan. Broken down, per capita disposable income of urban residents registered 31,195 yuan, which was 8.2 percent more than that in the last year in nominal terms and 6.6 percent more than that in the last year in real terms; per capita disposable income of rural residents reached 11,422 yuan, increasing by 7.5 percent year on year in real terms. According to the Q4 Urban Depositors' Survey conducted by the People's Bank of China, residents' willingness to consume increased. The share of residents willing to consume more registered 20.8 percent, an increase of 0.4 percentage point from the previous quarter, which represented a new high since the second quarter of 2009. In 2015 total retail sales increased by 10.7 percent year on year in nominal terms

and by 10.6 percent in real terms to reach 30.1 trillion yuan. Broken down, retail sales in the urban areas gained 10.5 percent year on year to reach 25.9 trillion yuan, while retail sales in the rural areas grew by 11.8 percent year on year to reach 4.2 trillion yuan. Online retail sales continued to boom and reached a total of 3.9 trillion yuan, which was 33.3 percent more than the total in the previous year. The consumption structure was upgraded, with robust growth in smart and green products and rapid growth in consumption of services.

The growth of fixed-asset investments slowed down. Fixed-asset investments (excluding those by agricultural households) reached 55.2 trillion yuan, increasing by 10 percent year on year in nominal terms, representing a deceleration of 5.7 percentage points from the previous year, and growing by 12 percent in real terms. Broken down by regions, investment in the eastern, central, and western regions grew by 12.7 percent, 15.7 percent, and 9 percent year on year to 22.9 trillion yuan, 14 trillion yuan, and 13.7 trillion yuan respectively. Investments in the northeastern region fell by 11.2 percent to 4.0 trillion yuan. Broken down by industries, investments in the primary industry maintained rapid growth, while the growth of investments in the tertiary industry declined. Total investments in the primary, secondary, and tertiary industries grew by 31.8 percent, 8.0 percent, and 10.6 percent year on year to 1.6 trillion yuan, 22.4 trillion yuan, and 31.2 trillion yuan respectively. In 2015 investments in construction projects grew 4.3 percent year on year to reach 101.9 trillion yuan; planned investments in new projects increased by 5.5 percent to reach 40.8 trillion yuan.

The share of general trade increased and the new business models maintained rapid growth. In 2015 total exports and imports reached 24.6 trillion yuan, down 7.0 percent year on year. Among this total, exports fell by 1.8 percent year on year to 14.1 trillion yuan; imports declined by 13.2 percent to 10.4 trillion yuan; and the cumulative trade surplus registered 3.7 trillion yuan, which was 56.7 percent more than that in the previous year. The share of general trade increased to 54 percent of total trade, which was 0.3 percentage point more than that in the previous year. Broken down by categories, exports of machinery and electronics grew by 1.2 percent and accounted for 57.7 percent of total exports, which was 1.7 percentage points more than that in the previous year. Exports of labor-intensive products declined by 1.7 percent year on year and accounted for 20.7 percent of total exports. Imports of commodities, including crude oil and iron ore, continued to grow. New business models, including cross-border e-commerce and market procurements, emerged as a new engine of growth. In 2015 the growth of cross-border e-commerce grew by more than 30 percent, and exports in the form of market procurements increased by more than 70 percent.

The structure of foreign direct investments (FDI) improved further and outbound direct investments (ODI) registered rapid growth. In 2015 the total value of actually utilized FDI increased by 6.4 percent year on year to reach 781.35 billion yuan (or USD 126.27 billion). Non-financial ODI gained 14.7 percent year on year to reach USD 118.02 billion. In 2015 actually utilized foreign investments in the services sector went

up by 17.3 percent year on year to reach 477.05 billion yuan (or USD 77.18 billion), growing by 17.3 percent year on year and accounting for 61.6 percent of the total actually utilized foreign investments; actually utilized foreign investments in the manufacturing industry remained basically flat with the previous year at 245.23 billion yuan (or USD 39.54 billion), accounting for 31.4 percent of the total actually utilized foreign investments.

2. Industrial production stabilized amid a slowdown

The value-added of the tertiary industry grew more rapidly than the secondary industry and continued to take up a larger share of GDP. In 2015 the value-added of the primary, secondary, and tertiary industries were 6.1 trillion yuan, 27.4 trillion yuan, and 34.2 trillion yuan respectively, up 3.9 percent, 6.0 percent, and 8.3 percent year on year and accounting for 9.0 percent, 40.5 percent, and 50.5 percent of GDP respectively. The share of the tertiary industry was 2.4 percentage points higher year on year, which was 10 percentage points higher than that of the secondary industry.

In 2015 total grain production gained 2.4 percent year on year to reach 620 million tons. Among this total, the production of cereals grew 2.7 percent to reach 570 million tons. The combined output of pork, beef, mutton, and poultry declined 1.0 percent year on year to 84.54 million tons, among which the output of pork dropped by 3.3 percent to 54.87 million tons.

Industrial production stabilized amid slower growth. In 2015 the value-added of statistically large enterprises, if calculated at comparable prices, grew by 6.1 percent year on year. Broken down by sectors, the value-added in the mining industry, the manufacturing industry, as well as the electricity, heating, gas and water production and supply industries grew by 2.7 percent, 7.0 percent, and 1.4 percent respectively year on year. The sales to production ratio of statistically large enterprises reached 97.6 percent. Actual profits of statistically large enterprises posted 6.3554 trillion yuan, which was 2.3 percent less year on year. The profit margin of the major business lines of statistically large enterprises reached 5.76 percent. According to the Entrepreneurs' Survey conducted by the PBC during the fourth quarter, corporate production and operations were facing severe challenges, while the performance of the sales price index stabilized. The corporate performance index declined for six consecutive quarters to 48.4 percent. The sales price index was 39.2 percent, which was 0.1 percentage point higher than that in the previous quarter.

3. Consumer prices remained at a low level

Growth in consumer prices decelerated. In 2015 the CPI rose 1.4 percent year on year, which was 0.6 percentage point less than that in the previous quarter, and growth from Q1 through Q4 registered 1.2 percent, 1.4 percent, 1.7 percent, and 1.5 percent respectively. Specifically, the price of food increased by 2.3 percent, which was 0.8 percentage point less than that in the previous year, while the price of non-food items grew by 1.0 percent year on year, which was 0.4 percentage point less than that in the

previous year. The price of consumption goods went up by 1.2 percent year on year, which was 0.6 percentage point less than that in the previous year, while the price of services increased by 2.0 percent year on year, which was 0.5 percentage point less than that in 2014.

The decline in producer prices widened. In 2015 the PPI decreased by 5.2 percent year on year, which was 3.3 percentage points more than the decline during the previous quarter. The year-on-year decline during the four quarters stood at 4.6 percent, 4.7 percent, 5.7 percent, and 5.9 percent respectively. The price of capital goods declined by 6.7 percent year on year, which was 4.2 percentage points more than that in the previous year; the price of consumer goods fell by 0.3 percent year on year, which was 0.3 percentage point more than the decline in the last year. The Industrial Production Index (IPI) went down by 6.1 percent year on year, which was 3.9 percentage points more than the decline in the previous quarter, and the decline from Q1 through Q4 posted 5.6 percent, 5.5 percent, 6.5 percent, and 6.9 percent respectively. The price of agricultural capital goods gained 0.4 percent year on year, in contrast to a decline of 0.9 percent in the previous year. The producer prices of agricultural products gained 1.7 percent year on year, as compared to a decline of 0.2 percent in 2014. In 2015 the CGPI decreased by 6.4 percent year on year, and the year-on-year decline during the four quarters of 2015 registered 5.6 percent, 5.6 percent, 7.0 percent, and 7.5 percent respectively. The price of primary goods fell by a large margin, with the decline in the price of investment goods exceeding the decline in the price of consumption goods.

Due to the decline in international commodity prices, the fall in import prices widened. During the four quarters of 2015, the average price of Brent Crude oil futures on the Intercontinental Exchange increased by -28.5 percent, 15.2 percent, -19.2 percent, and -12.9 percent during the four quarter respectively, amounting to a cumulative decline of 42 percent. The average price of copper on the London Metal Exchange increased by -12 percent, 3.6 percent, -12.8 percent, and 7.3 percent from Q1 through Q4, amounting to a cumulative drop of 26.3 percent. In 2015 the year-on-year decline of import prices fell by 11.5 percent, which was 8.2 percentage points more than that in the previous year, and the decline from Q1 through Q4 stood at 9.8 percent, 11.6 percent, 13.2 percent, and 11.5 percent respectively. Export prices declined by 0.8 percent year on year, which was 0.2 percentage point more than that in the previous year, and the decline during the four respective quarters of 2015 stood at 1.1 percent, 1.1 percent, 1.0 percent, and 0.2 percent respectively.

The GDP deflator registered a year-on-year decline. In 2015 the GDP deflator (the ratio of nominal GDP to real GDP) fell by 0.5 percent year on year, as compared to a 0.8 percent year-on-year increase in the previous year.

Steady progress was made in terms of the price reform. The CPC Central Committee and the State Council issued *Several Opinions on Promoting the Pricing Mechanism*, deploying pricing reform for the current and future stages. They Opinions note that

pricing in competitive areas and links will be liberalized by 2017. Pricing by the government is to be limited to important public utilities, public services, and areas that have natural monopolies; by 2020, a market-based pricing mechanism will be put in place, scientific, well-regulated, and transparent pricing regulatory rules and an anti-monopoly system will be established, and the pricing adjustment mechanism will be set up. The National Development and Reform Commission (NDRC) released a revised version of the *Central Pricing Directory*,³ which entered into effect on January 1, 2016. The categories of pricing were reduced from 13 to 7, while the number of pricing items was cut from 100 to 20 as compared to in the 2001 version. In addition, pricing reforms in areas such as railway freight, medicine, and non-residential natural gas were also progressing.

4. Fiscal revenue grew slowly

In 2015 fiscal revenue rose 5.8 percent in comparable terms⁴ to reach 15.2 trillion yuan, a year-on-year deceleration of 2.8 percentage points. Fiscal expenditures reached 17.6 trillion yuan, up 13.2 percent year on year in comparable terms and an acceleration of 4.9 percentage points year on year. The fiscal deficit registered 2.4 trillion yuan, which was 1.2 trillion yuan more than that in the previous year. The major reasons for the slow growth in fiscal revenue include: 1.) The sharp decline in tax revenue from imports due to the much lower prices of imported commodities and smaller imports; 2.) The slow growth of the VAT as calculated by current prices due to the slower industrial production, in particular the sustained decline in the PPI; 3.) The drop in corporate profits and in the growth of profitability which contributed to the fall in the corporate income tax; 4.) The decline in fiscal revenue as a result of the structural tax cut and universal reductions of fees, which reduced the tax burden on the corporate and household sectors.

In terms of the structure of fiscal revenue, non-tax revenue rose 10.6 percent in comparable terms year on year to total 2.7 trillion yuan, and tax revenue went up 4.8 percent year on year to 12.5 trillion yuan. Among this total, the corporate and household income tax increased by 10.1 percent and 16.8 percent respectively, the domestic value-added tax, consumption tax, and turnover tax went up by 0.8 percent, 18.4 percent, and 8.6 percent respectively, and the value-added tax and consumption tax on imported goods declined by 13.2 percent year on year. Outlays for environmental protection, transportation, medical services and birth control, social security and employment rose fairly rapidly, by 26.2 percent, 17.7 percent, 17.1 percent, and 16.9 percent respectively year on year.

5. The employment situation was generally stable

³ Originally titled the *Pricing Catalogue of the State Planning Commission and the Relevant Departments of the State Council*.

⁴The Ministry of Finance adjusted the statistical standards for fiscal revenue and expenditures by moving 11 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 in the previous year, which is consistent with the statistical standard in the draft budget for 2015.

In 2015 newly created urban employment totaled 13.12 million, reemployment in the urban and rural areas reached 5.67 million, employment of job seekers with low employability was 1.73 million, and the registered urban unemployment rate remained at 4.05 percent. Statistical analysis by the China Human Resources Market Information Monitoring Center based on information provided by public employment service institutions in 97 cities indicated that the labor supply was short of demand in Q4 of 2015, and the ratio of job seekers to job vacancies was 1.10, an increase of 0.01 quarter on quarter and a decline of 0.05 year on year. Compared with the previous year and the last quarter, both supply and demand were declining. Broken down by industry, demand for labor in sectors such as information transmission, computer services, and software, warehousing and postal services, as well as leasing and commercial services increased year on year, while the demand for labor in other sectors fell. Demand for labor with technical and professional skills exceeded supply. Compared with the last year, demand for technicians rose slightly, while the need for labor with other technical and professional skills declined.

6. International payments and expenditures were generally balanced

In 2015 the current account surplus registered USD 293.2 billion, accounting for 2.7 percent of GDP during the period, which was within the internationally accepted reasonable range. The capital and financial account deficit stood at USD 161.1 billion, among which the capital account surplus was USD 300 million and the non-reserve financial account deficit was USD 504.4 billion, with a reduction of reserve assets by USD 342.9 billion. By end-2015, total reserve assets stood at USD 3.33 trillion.

By end-September 2015, the total outstanding external debt posted USD 1529.8 billion. Among this total, the outstanding value of medium- and long-term external debt registered USD 506.3 billion, accounting for 33 percent of the total external debt, and the outstanding value of short-term debt stood at USD 1023.5 billion, accounting for 67 percent of the total external debt. Among the short-term external debt, 49 percent was credit related to trade.

Box 5 The reserve requirement ratio, liquidity, and the central-bank balance sheet

The central bank balance sheet is closely related to the operations of monetary policy operations, as monetary policy will bring about adjustments in the size and structure of central-bank assets and liabilities. For example, open market operations by central banks selling Treasury bonds to absorb liquidity cause a reduction of *claims on the government* on the asset side and accordingly decrease under *deposits of other depositary institutions (excess reserves)* on the liabilities side. Base money injections by central banks via lending to commercial banks lead to increases under claims on other depositary institutions on the asset side, and accordingly to a rise under *deposits of other depositary institutions* on the liabilities side (Table One).

Table One Simplified Central-Bank Balance Sheet

Asset	Liabilities
Foreign Assets	Reserve currencies
Foreign exchange	Currency issuances
Monetary gold	Deposit of other depository institutions (including required reserves and excess reserves)
Claims on government	Bond issuances
Claims on other depository institutions	Foreign liabilities
Claims on other financial institutions	Government liabilities
Claims on non-financial institutions	Capital
Other assets	Other liabilities
Total assets	Total liabilities

During economic booms, the central banks in the advanced economies and some emerging economies conduct conventional monetary policies with short-term interest rates as targets and maintain the short-term market interest rate at the target range via open market operations. Under such a scenario, changes in the balance sheet of the central banks are mainly a by-product of daily operations, with no significant adjustments in the size or structure of assets and liabilities. After the outbreak of the Asian financial crisis in 1997, the monetary authorities in the Asian economies came to realize the importance of foreign-exchange reserves in their crisis response, which led to a surge in their reserve holdings. As a result, foreign assets (foreign-exchange reserves) soared on the asset side, and reserve currencies (base money) rose sharply on the liabilities side. In order to alleviate potential shocks from excessive liquidity brought about by equivalent RMB injections as a result of foreign-exchange purchases, the central banks usually enhance the reserve requirement ratio or issue central-bank bills for sterilization. A high reserve requirement ratio is essential to share the costs of foreign-exchange reserves. After this round of the global financial crisis, as short-term interest rate approached or reached the zero lower band, the central banks in many developed economies managed their balance sheets more actively in order to clear the monetary-policy transmission work, improve financial market liquidity, and enhance credit.

Similar to many Asian economies, China has experienced capital inflows for quite some time, and the central bank has sterilized the excessive liquidity via a higher reserve requirement ratio and central-bank bill issuances. On the balance sheet of the PBC, foreign assets took up a dominant share of 78 percent on the asset side, while reserves accounted for the largest share of 63 percent and currency issuances accounted for about 21 percent on the liabilities side. The shares of other items were comparatively low.

In an open economy, the making of monetary policy faces “hard constraints” from the exchange rate and also constraints from international comparisons of asset prices. An excessively easy domestic monetary policy may lead to downward pressures on the local currency. In cases of an excessively high CPI and high housing prices, a country

can divert investments outbound where asset prices are lower. Such developments take the form of capital outflows and reductions in the foreign-exchange reserves. Reflecting on the central-bank balance sheet, for example, a reduction in the reserve requirement ratio will transform part of the required reserves under *deposits of other depositary institutions* into excess reserves, and therefore will enhance the liquidity in the banking system and bring down the market interest rate. Given the strong easing signal of cutting the reserve requirement ratio, such a policy measure may enhance easing expectations, which then will lead to heightened depreciation pressures on the local currency, accelerated capital outflows, and declines in the foreign-exchange reserves. As a result of the double-entry bookkeeping system of the central-bank balance sheet, the decline in reserves on the liabilities side was matched by a decline in foreign-exchange reserves on the asset side. Therefore, in an open macro-economic environment, monetary policy makers should have an international view and carefully analyze the influences of asset allocations and the dynamic equilibrium of the economy, being aware that such influences may take the form of cross-border capital flows. Monetary policy should remain neutral and appropriate, preventing an entrenching decline of aggregate demand in the process of restructuring on the one hand, and avoiding the provision of excessive liquidity or hindering market clearing on the other hand. A mix of monetary policies should be adopted to provide a facilitating monetary and financial environment for restructuring.

7. Sectoral analysis

(1) The real-estate sector

Nationwide turnover of commercial real estate continues to improve. Among 70 large and medium-sized cities, many more reported a rise in housing prices. Investment in real-estate development, however, is still on a decline, while real-estate loans are growing stably.

Many more cities reported higher housing prices. In December 2015 the price of newly-built commercial residential housing increased month on month in 39 out of 70 large- and medium-sized cities, 37 more cities than in January 2015, and the rise in first-tier cities was comparatively larger. The price of pre-owned residential housing increased month on month in 37 cities, 31 more than in January 2015; housing prices grew year on year in 35 cities, 32 more than in January 2015.

The turnover of commercial real estate continued to recover. In 2015 the nationwide floor area of sold commercial real estate posted 1.28 billion square meters, up 6.5 percent year on year, which was 14.1 percentage points higher than that in the previous year. The turnover of commercial real estate nationwide gained 14.4 percent year on year to reach 8.7 trillion yuan, which was 20.7 percentage points higher than that in the previous year, thus reaching a historical peak. Among this total, the sold floor area and the sales value of commercial residential housing accounted for 87.5 percent and 83.4 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. In 2015 nationwide investment in real-estate development went up by 1.0 percent year on year to reach 9.6 trillion yuan, a deceleration of 9.5 percentage points compared with that in 2014. In particular, investment in residential housing posted 6.5 trillion yuan, up 0.4 percent year on year and a deceleration of 8.8 percentage points from 2014, accounting for 67.3 percent of the total investment in real-estate development. The floor area of newly started real-estate projects declined 14 percent year on year to 1.54 billion square meters, which was 3.3 percentage points more than the decline of 2014. The floor area of real-estate projects under construction grew 1.3 percent year on year to reach 7.36 billion square meters, representing a deceleration of 7.9 percentage points compared with that in 2014. The floor area of completed real-estate projects posted 1 billion square meters, representing a year-on-year decline of 6.9 percent, as compared to a year-on-year increase of 5.9 percent in 2014.

Real-estate loans rose steadily. By end-2015, outstanding real-estate loans of major financial institutions (including foreign-funded financial institutions) stood at 21 trillion yuan, up 21 percent year on year, which was 2.1 percentage points more than that in 2014. Outstanding real-estate loans accounted for 22.4 percent of total outstanding loans, which was 1.1 percentage points more than that at the end of 2014. In particular, outstanding housing mortgages rose 23.9 percent year on year to reach 13.1 trillion yuan, an acceleration of 6.3 percentage points from end-2014; outstanding housing development loans gained 18.6 percent year on year to reach 3.9 trillion yuan, a deceleration of 5.7 percentage points from end-2014; outstanding land-development loans rose 12.8 percent year on year to reach 1.5 trillion yuan, a deceleration of 12.9 percentage points from end-2014. During 2015 new real-estate loans registered 3.6 trillion yuan, an increase of 843.4 billion yuan, accounting for 30.6 percent of total new loans and representing 2.5 percentage points more than that at end-2014.

Welfare-housing loans continued to increase. By end-2015, outstanding loans for the development of welfare housing posted 1.8 trillion yuan, up 59.5 percent year on year, which was 2.3 percentage points more than that at end-2014; among this total, loans for the development of new welfare housings reached 676.13 billion yuan in 2015, accounting for 92.7 percent of the new real-estate development loans during the same period and 37.7 percentage points more than that in the last year. In addition, the pilot program of using housing provident fund loans to support the construction of affordable housing proceeded steadily. At end-2015, 369 welfare-housing projects in 84 cities were granted loan approvals, receiving 84.03 billion yuan in loan disbursements based on their construction progress, and 52.71 billion yuan of the principal was repaid.

(2) Steel industry

The steel industry is an important raw material industry for the national economy, playing a vital role in China's industrialization and urbanization. During the Twelfth Five-Year Plan period, China's steel industry developed in a stable manner, effectively

meeting demand for economic and social development, and the pace of reducing overcapacity and industrial restructuring picked up. The steel industry is now facing increasing resource and environmental constraints, acute structural mismatches, and the serious task of further restructuring and upgrading.

In 2015, amid a plunge in international commodity prices, heightened downward pressures in the domestic economy, and an acceleration in restructuring and upgrading, the steel industry continued to undergo the painful process of transformation, with a significant overcapacity problem, a sustained decline in the prices of products, and broad losses. First, total steel production was declining, but supplies still exceeded demand. In 2014 total production of crude steel declined 2.3 percent year on year to reach 0.8 billion tons, and output of steel products rose 0.6 percent year on year to reach 1.12 billion tons. Apparent consumption of crude steel fell by 5.5 percent year on year to reach 0.7 billion tons, and apparent consumption of steel products dropped by 1.4 percent year on year to reach 1.02 billion tons. The year-on-year growth of steel production was less than the year-on-year decline in steel consumption, and the overcapacity in the steel market was not significantly eased. Second, the prices of products continued to fall. By end-2015, the CSPI steel price index released by the China Iron and Steel Association stood at 56.4 points, declining by 32.2 percent year on year, which was 16 percentage points more than the decline in the previous year. This can be attributed to weak demand in the lower stream industries (real estate and infrastructure construction, machinery manufacturing, automobiles, shipping, and so forth) on the one hand, and the plummeting commodity prices on the other hand. Third, corporate profitability declined substantially. Sluggish demand and a sustained drop in steel products further squeezed the profitability of steel industry companies. From January through November, total sales of statistically large steel companies reached 2.6664 trillion yuan, declining by 19.3 percent year on year and registering a loss of 53.132 billion yuan.

The Thirteenth Five-Year Plan is a vital period for structural adjustments and transformation of the steel industry in China. The steel industry should translate challenges into opportunities. The opportunities of supply-side structural reforms should be seized to strengthen restructuring and upgrading. Active and prudent efforts should be made to resolve the overcapacity of steel by fully tapping into market mechanisms and economic and legislative measures in a lawful, well-customized, and thorough manner. Industrial upgrading should be promoted by facilitating the development of intelligent manufacturing, enhancing quality and brand building, researching and developing high-end products and green development. In addition, supporting policies should be put in place by improving fiscal and taxation support, resolving the issues of non-performing assets, worker replacements, and earmarked bonuses and subsidies, implementing credit policies with a carefully-designed incentive mechanism, and allowing the capital market to play a role in mergers and acquisitions of the steel industry.

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

I. Outlook for the Chinese economy

The global economy is at a profound rebalancing stage. The differences in economic performance and macro-economic policies among the economies are continuing and international financial markets have become increasingly volatile. Against the background of this complex global environment, China has maintained a medium-high level of growth and remains one of the fastest growing large economies. Growth has become more balanced and the economic structure has improved, as reflected by many positive developments. In 2015 urban employment increased by 13 million, and the contribution of consumption to economic growth increased 15.4 percent year on year. The tertiary industry as a percentage of GDP exceeded 50 percent, up 2.4 percentage points year on year. Consumption and services have become important engines for stable economic growth. The downward pressures on the Chinese economy are mainly from resources, energy, and other traditional industries and industries with excess capacity. New growth dynamics are in the pipeline. Supported by the policies of simplifying administrative procedures and delegating powers, a large wave of mass innovations and mass entrepreneurship has begun, and new business models and new industries have emerged. In some industries, endogenous drivers are gaining momentum. Enterprise profits in some provinces and sectors have maintained double-digit growth. In the short run, the cumulative effects of the macro-economic management policy measures adopted in the previous period are being felt. Relatively abundant liquidity, the stable and low level of market interest rates, and the fairly rapid growth of money and credit will all contribute to stable growth. In the long run, healthy fundamentals and features such as strong resilience, large potentials, and policy space remain unchanged. With the progress in supply-side reform, total-factor productivity is expected to go up further and to promote higher-quality and more sustainable growth of the economy.

It is worth noting that the current external and domestic environments remain complex and present numerous challenges to growth and structural adjustments. Looking at the international environment, there are uncertainties in the pace and the level of the interest-rate hikes by the Federal Reserve, the spillover of which will have a major impact on cross-border capital flows, asset allocations, emerging financial markets, and even on macro-economic policies. The global value chain and trade and investment flows are undergoing changes. Recovery in the advanced economies may have a weaker pull effect on the Chinese economy. The geopolitical landscape is becoming more complex with many uncertainties and destabilizing factors. Recently, some international organizations and institutions made downward revisions to their global growth projections. The World Bank lowered its projection of the global growth rate in 2016 from 3.3 percent to 2.9 percent. On the domestic front, the structural imbalances

in supply and demand are acute, with oversupply coexisting with a lack of supply, an excess structural capacity, and a large inventory in real estate and other industries. The growth potentials in some new areas are yet to be fully tapped and market clearing is not yet completed. These factors have affected the vitality of economic activities. The costs for the corporate sector and for the overall economy have been rising rapidly. In some industries, the cost of growth has exceeded that of productivity, undermining the competitiveness of the economy. The downward pressures remain formidable and the debt level is rising relatively rapidly. Risk exposure in the real economy and in the financial sector is on the rise. These imbalances are mainly structural. The key to solving them is to advance supply-side reform while reasonably expanding aggregate demand. The five major tasks of removing excess capacity, reducing inventories, reducing leverages and costs, and shoring up weak spots will be implemented to enable markets to play a decisive role in resource allocations. The top-down institutional design and grass-root innovations will be combined to allow the localities to take more initiatives in the new mechanism. Measures will be adopted to nurture and strengthen new growth points, beef up the quality and efficiency of growth, improve the incentive mechanism for financial institutions, preserve the sustainability of financing, and explore room for effective resource allocations.

In terms of prices, price inflation has been modest and stable, and it has continued to exhibit structural features. The prices of oil and other commodities have remained low. Given the downward pressures in the domestic economy and the existence of structural excesses, and now that the catch-up effect of non-tradable prices of the Balassa-Samuelson effect has continued for some period and may decelerate, it is likely that price inflation may be kept at a low level during the structural adjustments. However, current price levels are not low and continue to display structural features. The gap between the PPI and the CPI remains large. The PPI has been in negative ground for more than 40 months, indicating the continued existence of excess capacity in traditional industries and the impact of the decline in commodity prices on the international market. The CPI has been positive and low, indicating relatively stable consumer demand and rigidity in labor costs and service prices. At the same time, housing prices are still on the rise and might be transmitted to other sectors. According to the Urban Depositors' Survey conducted by the PBC in Q4 2015, the future price expectation index was up 0.3 percentage point quarter on quarter, the share of respondents regarding overall price levels and housing prices as high was up 3.1 and 2.4 percentage points respectively from Q3. Going forward, price movements will be closely watched and a comprehensive variety of differentiated measures will need to be adopted and prioritized when necessary to respond to such developments.

Box 6 Supply-Side Structural Reforms and Aggregate Demand Management

It was emphasized during the Central Economic Work Conference that just concluded that efforts will be enhanced in the field of supply-side structural reforms in addition to implementing measures to expand aggregate demand. Currently, there are both cyclical and structural factors at work. But the key to enhancing endogenous drivers and

preserving stable and sustainable growth is to facilitate structural reforms and adjustments since the major problems are due to the structural imbalances and the growth pattern. However, the focus on supply-side reforms does not mean demand management will be ignored. It is of vital importance to conduct research on management of aggregate demand that is consistent with the supply-side structural reforms.

In the framework of mainstream economic theory, aggregate supply is separate from aggregate demand. In the short term, due to sticky prices, the supply curve is horizontal and national income is determined by aggregate demand. This is also at the core of Keynesian theory. The expansion of aggregate demand is reflected in the growth of output, and the short-term stimulus of demand expansion is most obvious. In the medium term, the supply curve will be a slope in which the expansion of aggregate demand will push up output and cause prices to rise as well. The strength of the two effects is determined by the angle of the slope. In the long run, the supply curve will become a vertical line, in which the expansion of demand will only lead to price hikes (neutrality of money) and output will be fully determined by aggregate supply. Thus, capital, labor, and technology are critical to promote long-term growth. As such, mainstream theory does not deal with demand and the implicit assumption is that supply creates its own demand, i.e., the so-called Say's law.

The framework of mainstream economics has introduced price rigidity to study demand and supply separately in the short run and in the long run to make it clearer and to include them in models. However, subsequent problems may arise. For example, such an approach does not involve the interactions between the demand curve and the supply curve, whereas in reality they have impacts on each other and thus cannot be separated. Investment is regarded as demand when it is being implemented and it becomes supply after it is completed. Mainstream theory generally does not touch upon excess capacity and the supply gap because the assumption is that the free movement of prices leads to market clearing. But the reality is more nuanced. For example, prices in some fields cannot freely float; even if prices fluctuate widely, effective clearing sometimes is not possible due to the soft constraints (a good example is excess capacity and zombie enterprises); where there is limited access, it is difficult for the market to provide effective supply in some areas (for example in medical care and education); and protectionism in some localities has hindered the nurturing of a centralized market. Hence, the structural problem of oversupply coexisting with undersupply emerges on the supply side, while the lack of demand and unsatisfied demand coexist on the demand side. This is the structural imbalance we usually see in observations of country-specific studies.

Due to the above factors, we need to fully consider the interactions between supply and demand. The focus of supply-side structural reform is to eliminate excess capacity and oversupply, while at the same time working to make up for the lack of supply in certain fields. The core is to have the market play a decisive role in resource allocations. In the

process of supply-side structural reforms, it is even more desirable to recognize the meaning of aggregate demand management. It not only includes traditional fiscal and monetary policies and supply-side reform, such as streamlining administrative procedures, delegating powers to lower-level governments, and encouraging competition.

In the short run, supply-side structural reforms might exacerbate downward pressures, and thus it is necessary to properly manage aggregate demand to maintain economic performance at a reasonable range. However, it is worth noting that over-reliance on demand stimulation, fixed-asset investments, and real-estate investments will further push up the debt level and the leverage ratio. Therefore, supply-side reforms will be necessary to release effective demand. For example, in the mid- and late 1990s, the boom in the real-estate and auto industries as a result of the reforms helped to bring the economy out of its downward cycle after the Asian financial crisis. After the housing reform in 1998, growth of investment in real-estate development was up from -1.2 percent in 1997 to 13.7 percent; over the next five years, the growth averaged 24.5 percent per annum. With the adoption of policy measures to boost the auto industry, output grew 22.8 percent per annum between 1999 and 2003, far exceeding the growth of 2.9 percent in 1998. This is a vivid example of the importance of policy dividends and the size of the potential demand that can be tapped. After the rapid development of the heavy and chemical industries and as a result of the gradual increase in the level of household income, consumer demand will tilt more toward medical and health care, education, culture, and other service sectors. It is thus necessary to tap into the vitality of private investments, shore up the weak spots, and release the effective demand. Much can be done in this regard.

In some areas where there is large demand potential, effective supply is suppressed. For example, the inadequacy of social security and the lack of upgrading in consumer goods have constrained the expansion of household consumption; the service sector is underdeveloped due to overregulation; the role of the market mechanism to replace bad players with good players has not come into full play, thus hampering efficient resource allocations and the introduction of new drivers; development of the private sector and endogenous growth drivers is not solid. Progress in structural reforms in targeted areas is needed to unleash effective demand. Under the new circumstances, a new mechanism will be used to encourage local governments to take an initiative; the problems of institutional arrangements that delay the new type of urbanization will be resolved; ownership and market access restrictions will be lifted to support the development of the services industry; the social security system will be improved to provide a long-term mechanism to support the expansion of consumption; excess capacity will be reduced and capital will be replenished to provide a basis for sustainable financing; and development of the financial market will be accelerated and reform will be continued to provide better services to the real sector.

II. Monetary policy during the next stage

The PBC will earnestly implement the decisions of the 18th CPC National Congress, the Third, Fourth, and Fifth Plenary Sessions of the 18th CPC Central Committee, and the Central Economic Work Conference, and will follow the strategic decisions of the Party Central Committee and the State Council to continue the reform and opening up. The PBC will adhere to the guideline of seeking progress while maintaining stability and the overall principle of maintaining stable macro-economic policies and adopting flexible micro policies. Efforts will be made to adapt to the new normal in the economy, maintain policy consistency and stability, and continue to implement a sound monetary policy that is neither too tight nor too loose. Fine-tunings and preemptive adjustments will be adopted as necessary and with proper strength, while policy measures will be better targeted and will be more flexible in order to conduct aggregate demand management for the ongoing supply-side structural reforms, to create a neutral monetary and financial environment for structural adjustments, and to support sustainable 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. In view of the financial deepening and innovations, the monetary-policy framework will be improved to strengthen pricing tools and the transmission mechanism, to bring about the smooth transmission of monetary policy to the real economy, to resolve 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, and the policy mix will be optimized. Macro-prudential regulation will be improved and the macro-prudential assessments will be conducted to keep liquidity at an appropriate volume and to bring about reasonable growth of money, credit, and all-system financing aggregates. In view of developments in the economic and financial market situations at home and abroad, the PBC will flexibly use various monetary-policy tools, improve the central-bank collateral management framework, maintain liquidity and market interest rates at appropriate levels, maintain the stability of the money market, and cultivate a sound, neutral, and proper monetary environment from the perspectives of both price and volume. Continued efforts will be made to guide 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.

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. The direction and structure of liquidity provisions will be optimized, and the relevant measures of the targeted reserve requirement ratio will be implemented properly. The credit policy supporting central-bank lending, central-bank discounts, and Pledged Supplementary Lending will be used to guide

financial institutions to optimize the credit structure. For the purpose of supporting the market to play a decisive role in financial resource allocations and to support the government to play a better role, financial sector reform and development will be facilitated and the decisions of the CPC Central Committee and the State Council on reducing overcapacity, the leverage ratio, inventories, and costs, and the shoring up of the weak spots will be implemented in earnest to beef up support to upgrade the economy and to provide services to the real economy. Banking financial institutions will be encouraged to support the transformation and upgrading of the manufacturing sector, to provide good services for strategic adjustments of the industrial structure, the building of infrastructure, shipping and railways, logistics and energy, and other key industries, and to step up financial support for elderly care and health care. The banking industry will be encouraged to properly implement various financial-support policies to remove excess capacity and to provide support for a reduction of excess capacity and for an upgrading of the iron and steel industry and the coal mining industry, and to improve a policy system for green finance. There will be proper financial support for the coordinated development of Beijing, Tianjin, and Hebei and the Yangtze River Economic Belt. The sustainable and sound development of a credit asset-backed securities market will be promoted. Financial services to the new type of business operators in the agricultural sector will be improved, the pilot program for loans pledged with operation rights for contracted farmland and rural home property rights will be prudently advanced, and financial institutions will be guided to gear up support to key fields, including water conservancy projects, agricultural infrastructure, integration of the primary, secondary, and tertiary industries, and external cooperation with the agricultural sector, modern plantations, new urbanization, and so forth. Financial services for poverty alleviation will be improved and financial inclusion will be energetically advanced to guide financial institutions to increase credit inputs to rural areas. Evaluations of the effects of the agriculture-supporting and the small- and micro-enterprise credit policy will be improved, and an evaluation mechanism for poverty alleviation credit-related financial services will be explored to enhance credit support to weak links. The financial industry should tap its functions to increase support to important fields in the national economy, including startups of businesses and innovation, science and technology, the cultural industries, information consumption, and strategic and emerging industries. Job creation for and businesses started by women, the disabled, rural migrant workers, college graduates-turned-village officials will become the focus for the financial sector so as to break new ground for financial services related to the people's livelihood, including employment and education.

Third, the market-based interest-rate reform and the RMB exchange-rate regime reform will be further 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 capability for interest-rate pricing and risk management, develop market benchmark interest rate and yield curves, and improve the market-based interest-rate mechanism. The PBC will explore an interest-rate corridor mechanism, enhance the interest-rate adjustment

capability, and improve the mechanism for the transmission of central- bank policy rates to the financial market and the real economy. Oversight of the irrational pricing behavior by financial institutions will be intensified. The important role of the self-regulatory mechanism for market interest-rate pricing will be tapped, effective incentives for interest-rate pricing will be adopted, and industry self-regulation and risk prevention will be reinforced to maintain fair pricing. 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 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 reflow 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 flows will be improved.

Fourth, there will be continued efforts to improve the system of financial markets, to support the role of financial markets in preserving stable economic growth, supporting economic structural adjustments and transformation, deepening reform and opening, and preventing financial risks. Financial market innovations will be promoted to diversify products and layers on the bond market in order to meet investor demand. The infrastructure, institutional arrangements, and supervision of financial markets will be intensified to prevent financial risks. Information disclosures, credit ratings, and other market discipline mechanisms will be established and improved, the rating practices of credit-rating agencies will be regulated, and an incentive mechanism will be nurtured for good-faith performance by intermediary agencies. Over-the-counter bond products will be diversified, the trading mechanism for bonds and bond derivatives will be optimized, and innovations in the centralized clearing mechanism will be facilitated. There will be studies on increasing market access for additional qualified institutional investors, both domestic and foreign, to diversify the investor base and to improve the efficiency of investment management on the inter-bank bond market. The inter-bank bond market will be opened up further so that a larger contingent of qualified foreign issuers will be able to issue RMB bonds and a wider range of foreign institutional investors will gain access. The overall design of the bond-market infrastructure will be improved in the context of opening up for the compatibility of the domestic market with overseas markets in terms of trading arrangements and institutional designs.

Fifth, the reform of financial institutions will be deepened to improve financial services by increasing supply and enhancing competition. A reform program for policy

and development financial institutions will be implemented to establish a proper capital restraint mechanism, to improve the governance structure, and to improve fiscal and tax policies and to turn them into sustainable development and policy financial institutions with Chinese characteristics that provide adequate services for economic development. The reform of large commercial banks will be deepened to improve corporate governance, to build effective mechanisms for decision making, execution, and checks and balances, and to translate the principles of corporate governance into daily operations and risk-control behavior. The Agricultural and Rural Financial Service Division of the Agricultural Bank of China will continue to improve its capacity to provide services at county levels and to agricultural sectors, rural areas, and farmers. The program of deepening reform will be implemented by the Bank of Communications. The shift to market-based operations of asset-management companies will be further promoted.

Sixth, effective measures will be adopted to prevent and eliminate 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, to deepen reforms, and to build a risk-control capacity. Monitoring and early warnings of financial risks will be enhanced to screen sources of potential risks on a dynamic basis. There will be intensified monitoring and analysis of corporate-debt risks, the quality of credit assets in the banking sector, Internet finance, financing activities via informal channels, illicit fund-raising, and cross-border fund flows. Financial institutions and various parties will be urged to draft contingency plans for different scenarios and to eliminate credit default risks. Local government debt risks will be effectively handled and government debt management will be improved. The Financial Regulatory Coordination Joint Ministerial Conference will play a role in enhancing risk monitoring and regulatory coordination of cross-sector and cross-market products. Supervision will be strengthened across the board to better regulate various kinds of financing activities. The special rectification program designed to enhance supervision of financial risks of Internet finance will be carried out to tap the role of local governments in preventing and mitigating financial risks, cracking down on financial crime, and preserving local financial stability and social stability. The cases of risk will be properly handled to contain the spread of illegal fund raising and to safeguard the bottom line for preventing systemic and regional financial risks.