

China Monetary Policy Report Quarter Two, 2015

(August 7, 2015)

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

Executive Summary

In the first half of 2015 the performance of the Chinese economy was within a reasonable range and structural adjustments were vigorously being driven ahead, leading to increased economic vitality. The contribution of consumption to economic growth increased. Infrastructure investments grew rapidly and the trade surplus continued to expand. There were also positive developments in terms of industrial performance. The proportion of tertiary industry continued to increase. Employment remained stable and consumer prices picked up moderately. In the first half of the year, GDP growth was 7.0 percent year on year and the consumer price index was up 1.3 percent year on year.

In accordance with the decisions and overall arrangements of the Party Central Committee and the State Council, the PBC continued its sound monetary policy, focusing on implementing a policy that is neither too tight and nor too loose and conducting timely and appropriate fine-tunings and preemptive adjustments. Measures were taken to use various monetary policy tools, including open market operations, medium-term lending facility, and a standing lending facility. The reserve requirement ratio was cut on two occasions and the PBC branches were authorized to carry out standing lending facility operations so as to retain an adequate volume of liquidity in the banking system. Benchmark lending and deposit interest rates were cut on three occasions and repo interest rates were lowered on seven occasions in order to bring down market rates, to keep the real interest rate stable, and to create a neutral and sound monetary environment. Management of desirable lending was improved, the parameters of the policy management system were properly adjusted, and a targeted reduction in the deposit reserve requirement ratio was implemented on three occasions. Financial institutions were encouraged to beef up support to small and micro enterprises, agriculture-related sectors, the construction of major water conservancy projects, and the central/western regions. Pledged Supplementary Lending (PSL) was utilized to help development financial institutions provide long-term, stable, and low-cost funding for shantytown renovations. The market-based interest-rate reform was further promoted. The upper limit of the floating band of deposit rates was raised to 1.5 times the benchmark level, the upper limit on foreign-currency deposit rates was removed, and large-scale certificates of deposit (CDs) to individual and institutional investors were launched. The securitization of credit assets progressed. The volume of debt-financing instruments of non-financial enterprises issued by micro, small, and medium-sized enterprises was expanded. Policy and development banks continued to strengthen their capital bases

and the building of a deposit insurance mechanism achieved breakthroughs.

The sound monetary policy gradually produced effects, as reflected in adequate liquidity in the banking system, stable and rapid growth of money and credit, a continuous improvement in the loan structure, a notable decline in market interest rates, and a basically stable exchange rate. At the end-June 2015, broad money M2 was up 11.8 percent year on year. Outstanding RMB loans were up 13.4 percent year on year, registering an increase of 6.6 trillion yuan from the beginning of 2015, 537.1 billion yuan more than the increase during the corresponding period of the last year. All-system financing aggregates grew by 11.9 percent compared with the same period of the last year. In June, the weighted average loan interest rate offered to non-financial enterprises and other sectors was 6.04 percent, a reduction of 0.92 percentage point from the last year. At the end of June, the central parity of the RMB against the US dollar was 6.1136 yuan per US dollar, an appreciation of 0.09 percent from end-2014.

The global economy is still recovering. As important features of the recovery, complications and divergent performances will have a lasting influence on near-term global activities. In general, resilient economies, which underwent rapid market clearing and structural adjustments, revealed a stronger growth momentum. Under the background of global rebalancing, the Chinese economy has entered a new normal state. In essence, this involves transformation of the economic development pattern and structural adjustments. For the short term, structural adjustments may result in downward pressures. However, they will inject energy for sustainable growth for the medium and long-term. During this process, it is important to strike a balance among promoting steady growth, facilitating reform, making structural adjustments, improving the people's livelihood, and preventing risks. Innovations in macro-economic management methods will be combined with the structural reforms.

The PBC will follow the strategic arrangements of the Party Central Committee and the State Council, adhere to the guidelines of seeking progress while maintaining stability, take initiatives to adapt to the new normal in the economy, continue to implement a sound monetary policy, maintain policy consistency and stability, pay more attention to continuing a policy stance that is neither too tight nor too loose, conduct timely and appropriate fine-tunings and preemptive adjustments, create a neutral and proper monetary and financial environment for the adjustment, transformation, and upgrading of the economic structure, and facilitate sustainable and scientific development. Both quantitative and price-based monetary policy instruments will be employed, the macro-prudential policy framework will be improved, and a combination of policy measures will be further optimized to keep liquidity at an appropriate volume and to realize an appropriate growth of money, credit, and all-system financing aggregates. There will be continued efforts so that finance will better serve the real economy, mobilize the stock of credit assets, optimize the structure of new loans, and improve the financing and credit structures.

Numerous coordinated measures will be taken to address both the symptoms and the root causes of the high financing costs. At the same time, reform innovations will be emphasized and reform measures will be integrated with macro-economic management policies. The market will play a more decisive role in resource allocations. In view of the financial deepening and the innovations, the macro-economic management system, including that of its transmission channels to the real economy, will be further improved. The efficiency and capacity of the financial sector to provide services to the real sector will be improved. A comprehensive set of measures will be put in place to safeguard the bottom line in order to avoid the emergence of both systemic financial risks and regional financial risks.

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Part 1 Money and Credit Analysis

In the first half of 2015 liquidity in the banking sector was sufficient. Money, credit, and all-system financing aggregates grew in a stable and relatively rapid manner. There was a marked fall in interest rates.

I. Growth of monetary aggregates picked up

At the end of June 2015, outstanding M2 stood at 133.3 trillion yuan, up 11.8 percent year on year, representing an acceleration of 0.2 percentage point from end-March. Outstanding narrow money (M1) stood at 35.6 trillion yuan, up 4.3 percent year on year, representing an acceleration of 1.4 percentage points from end-March. Cash in circulation (M0) grew by 2.9 percent year on year to 5.9 trillion yuan. On a net basis, in the first half of the year the central bank withdrew 166.5 billion yuan of cash from the economy, an increase of 3.5 billion yuan year on year. In recent months growth momentum in the monetary supply was strengthened, and the growth of M2 was close to the full-year target. It is expected that going forward growth of M2 will continue to accelerate. In terms of the sources of monetary creation, the year-on-year accelerations of loans and securities investments are the two major reasons for the pickup of M2 growth, with the impact of securities investments becoming more pronounced. Purchases of local government bonds by deposit-taking financial institutions and substantial increases in equities and other investments resulted in an acceleration of securities investments in year-on-year terms. In addition, the year-on-year deceleration in the traditional inter-bank businesses, including foreign-exchange purchases, the buying back of the sale of assets, and inter-bank lending, to some extent slowed M2 growth.

At end-June, outstanding base money registered 28.9 trillion yuan, up 3.2 percent year on year. The money multiplier stood at 4.62, which was 0.31 and 0.44 higher than that at end-March and at the end of 2014 respectively. The excess reserve ratio of financial institutions was 2.5¹ percent and that of rural credit cooperatives was 5.9 percent.

II. Stable growth of deposits in financial institutions

At the end of June, outstanding deposits of domestic and foreign currencies in all financial institutions posted 136.0 trillion yuan, up 10.6 percent year on year and at par with that at end-March. This was an increase of 11.5 trillion yuan from the beginning of the year and a deceleration of 749 billion yuan year on year. Outstanding RMB deposits registered 131.8 trillion yuan, up 10.7 percent year on year and an acceleration of 0.6 percentage point from end-March. This was an increase of 11.1

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,” based on which the reserve requirement should be calculated in line with the applicable legal reserve requirement ratio of 0. The excess reserve requirement ratio as calculated based on the expanded coverage is not comparable to the previous data. If calculated based on the previous coverage, the excess reserve requirement ratio should be higher than 2.5 percent.

trillion yuan from the beginning of the year and a deceleration of 375.6 billion yuan year on year. Outstanding deposits in foreign currencies registered USD 681.5 billion, up 8.8 percent year on year. This was an increase of USD 71 billion from the beginning of the year and a deceleration of USD 55.2 billion year on year.

Broken down by sector, growth of household and non-financial corporate-sector deposits grew at a relatively slow pace, whereas deposits of non-deposit-taking financial institutions grew rapidly. At end-June, outstanding household deposits posted 53.3 trillion yuan, up 6.2 percent year on year and a deceleration of 2.8 percentage points from end-March. This represented an increase of 3.1 trillion yuan from the beginning of the year. Outstanding deposits in the non-financial corporate sector registered 39.8 trillion yuan, up 3.8 percent year on year, an acceleration of 0.6 percentage point from end-March, and an increase of 2.1 trillion yuan from the beginning of the year. Outstanding fiscal deposits registered 4.1 trillion yuan, an increase of 10.7 percent year on year, and growth of 524.4 billion yuan from the beginning of the year. Outstanding deposits of non-deposit-taking financial institutions registered 13.5 trillion yuan, up 64.2 percent year on year. This represented an increase of 4.0 trillion yuan from the beginning of the year and an acceleration of 1.7 trillion yuan year on year. Among this total, in connection with the brisk trading on the stock market in the first half of the year the margins of securities firm clients grew 2.7 trillion yuan from the beginning of the year, an increase of 2.6 trillion yuan year on year. Deposits of special purpose vehicles (including off-balance-sheet wealth management, securities investment funds, trust plans, and so forth) grew by 784.8 billion yuan from the beginning of the year, a deceleration of 972.4 billion yuan year on year.

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

At end-June, outstanding loans in domestic and foreign currencies of all financial institutions posted 94.4 trillion yuan, up 12.5 percent year on year. This was an increase of 6.8 trillion yuan from the beginning of the year and an acceleration of 27.8 billion yuan year on year. At end-June, outstanding RMB loans stood at 88.8 trillion yuan, representing growth of 13.4 percent year on year. This was an increase of 6.6 trillion yuan from the beginning of the year and an acceleration of 537.1 billion yuan year on year. New RMB loans extended during the first half of the year accounted for 67 percent of the amount for the entire year of 2014.

Broken down by sectors, RMB loans to the household sector and to non-financial businesses and other sectors grew in a stable manner, whereas bill financing increased by a large margin. At end-June, outstanding RMB loans to the household sector posted 25.1 trillion yuan, up 15.5 percent year on year. Beginning in the second quarter, RMB loans to the household sector maintained a steady pace. The end-June figure represented an increase of 2.0 trillion yuan from the beginning of the year and

an acceleration of 75.1 billion yuan year on year. In particular, growth of home mortgage loans gathered pace and reached 18.2 percent at end-June, the highest level during the past 11 months. This represented an increase of 1.1 trillion yuan from the beginning of the year and an acceleration of 189.5 billion yuan year on year. At end-June, outstanding loans to non-financial businesses and other sectors posted 63.0 trillion yuan, up 13.1 percent year on year. Loans experienced steady growth from the beginning of the second quarter and increased by 4.6 trillion yuan from the beginning of the year. In terms of the maturity brackets of RMB loans, new medium- and long-term RMB loans increased 3.7 trillion yuan from the beginning of the year, an acceleration of 384.7 billion yuan year on year. The share of new medium- and long-term RMB loans in total new loans was 55.8 percent. Outstanding short-term loans (including bill financing) increased by 2.7 trillion yuan from the beginning of the year. Among this total, bill financing grew by 869.2 billion yuan from the beginning of the year, representing an acceleration of 625.6 billion yuan year on year. Broken down by institutions, Chinese-funded large-sized banks and small- and medium-sized banks registered a larger year-on-year acceleration in their loan growth.

Table 1 RMB Loans of Financial Institutions in H1 2015

Unit: 100 million

| | New loans | Acceleration |
|--|-----------|--------------|
| Chinese-funded large-sized banks ① | 31549 | 1111 |
| Chinese-funded small- and medium-sized banks ② | 32558 | 6046 |
| Small-sized rural financial institutions ③ | 9109 | -505 |
| Foreign-funded financial institutions | 38 | -392 |

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 moderated. At end-June, outstanding foreign-currency loans of financial institutions posted USD 921.1 billion, up 0.7 percent year on year. This was an increase of USD 40.5 billion from the beginning of the year and a year-on-year deceleration of USD 74.5 billion. In terms of the loan structure, outward loans increased by a large margin of USD 33.4 billion from the beginning of the year, accounting for 82.4 percent of the new

foreign-currency loans during the same period.

IV. Stocks of all-system financing aggregates grew steadily

According to preliminary statistics, at end-June stocks of all-system financing aggregates reached 131.58 trillion yuan, representing an increase of 11.9 percent year on year. Flows of all-system financing aggregates during the first half of the year posted 8.81 trillion yuan, a deceleration of 1.46 trillion yuan year on year. With regard to the composition of the flows, off-balance-sheet financing, including trust loans, entrusted loans, and undiscounted bankers' acceptances, foreign-currency-denominated loans and enterprise bonds registered a large year-on-year deceleration. It is worth noticing that new issues of local government bonds posted 863.8 billion yuan during the first half of the year, an increase of 731.5 billion yuan year on year, most of which was used for the replacement of debt stocks borrowed through local government financing vehicles (such as bank loans, trust loans, and so forth). Since local government financing vehicles belong to the non-financial corporate sector in the statistics of all-system financing aggregates, whereas local governments are not covered in all-system financing aggregates, the replacement of local government debt in effect reduces all-system financing aggregates. If this is factored in, the financial system's support of the real economy has not declined.

The growth of all-system financing aggregates during the first half of the year was characterized by the following: first, RMB loans to the real economy grew markedly, and their share of all-system financing aggregates increased significantly. In the first half of the year, RMB loans posted 6.59 trillion yuan, up by 874.2 billion yuan from the same period of the last year. During the same period, new RMB loans accounted for 74.8 percent of all-system financing aggregates, an increase of 19.2 percentage points from the same period of 2014. Second, foreign-currency-denominated loans decelerated notably from the same period of the last year. New loans denominated in foreign currencies were equivalent to 43.6 billion yuan during the first half of the year, a deceleration of 325.1 billion yuan year on year. New loans denominated in foreign currencies accounted for 0.5 percent of the increment in all-system financing aggregates, down by 3.1 percentage points from the same period of the previous year. Third, the considerable growth of equity financing by non-financial enterprises pushed up the share of direct financing. The combined amount of bond and equity financing on the domestic market by non-financial enterprises posted 1.35 trillion yuan during the first half of the year, accounting for 15.3 percent of the increment in all-system financing aggregates during the same period and an acceleration of 0.8 percentage point from the same period of the last year. Fourth, the growth of off-balance-sheet financing, including trust loans, entrusted loans, and undiscounted bankers' acceptances, decelerated year on year. As supervision and regulation over the inter-bank business of financial institutions were strengthened, off-balance-sheet financing, including trust loans, entrusted loans, and bankers' acceptances, were gradually regulated, resulting in slower growth. During the first half of the year, the

combined amount of new entrusted loans,² trust loans, and undiscounted bankers' acceptance bills registered 593.3 billion yuan, a decrease of 1.83 trillion yuan year on year, accounting for 6.7 percent of the increment in all-system financing aggregates, down by 17.0 percentage points from the same period of the last year.

Table 2 The Increment in All-system Financing Aggregates in H1 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 domestic stock markets | |
| H1 2015 ^② | 88068 | 65860 | | 436 | 5324 | 309 | 300 | 9286 | 4245 |
| Y-o-y change | -14570 | 8742 | | -3251 | -6475 | -4292 | -7576 | -3751 | 2372 |

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.

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.

² Starting from January 2015, the statistical coverage of entrusted loans was adjusted and divided into two categories, entrusted loans under cash management operations and general entrusted loans. In the statistics of 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 specified volumes on specified terms with money provided by companies, organizations, individuals, and other principals.

Table 3 Stocks of All-system Financing Aggregates in H1 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 domestic stock markets |
| End-June 2015 ^② | 131.58 | 88.07 | 3.50 | 9.87 | 5.38 | 6.94 | 12.61 | 4.16 |
| Y-o-y change | 11.9 | 13.8 | -6.2 | 18.4 | 1.7 | -10.4 | 19.1 | 17.3 |

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.

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

In June the weighted average loan interest rate offered to non-financial companies and other sectors was 6.04 percent, down 0.51 percentage point from March. In particular, the weighted average loan interest rate was 6.46 percent, down 0.32 percentage point from March; the weighted average bill financing rate was 4.01 percent, down 1.39 percentage points from March. The mortgage loan interest rate generally fell, with the weighted average home mortgage interest rate posting 5.53 percent in June, down 0.49 percentage point from March.

The share of loans with interest rates lower than the benchmark rate increased, whereas the share of loans offered at or above the benchmark rate dropped. In June, the share of loans with interest rates lower than the benchmark rate was 17.43 percent, up 6.13 percentage points from March, whereas the share of loans offered at and above the benchmark rate was 15.77 percent and 66.80 percent respectively, down

4.01 and 2.12 percentage points respectively from March.

Table 4 Shares of Loans with Rates at, above, or below the Benchmark Rate, January through June 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] | Above 2.0 |
| 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 |

Source: The People's Bank of China.

The deposit and lending rates of foreign currencies edged down due to fluctuations in the interest rates on international markets and changes in supply and demand for foreign currencies on the domestic market. In June, 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 0.63 percent respectively, up 0.01 percentage point and down 0.08 percentage point respectively from March. The weighted average interest rates of US dollar loans with maturities within 3 months and of those with maturities between 3 to 6 months (including 3 months) posted 1.56 percent and 1.73 percent respectively, down 0.17 percentage point and up 0.55 percentage point respectively from March.

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

Unit: %

| Month | Large-value deposits | | | | | | Loans | | | | |
|----------|----------------------|-----------------|---------------------------------|----------------------------------|--------|------------------|-----------------|---------------------------------|----------------------------------|--------|------------------|
| | Demand deposits | Within 3 months | 3–6 months (including 3 months) | 6–12 months (including 6 months) | 1 year | 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 |

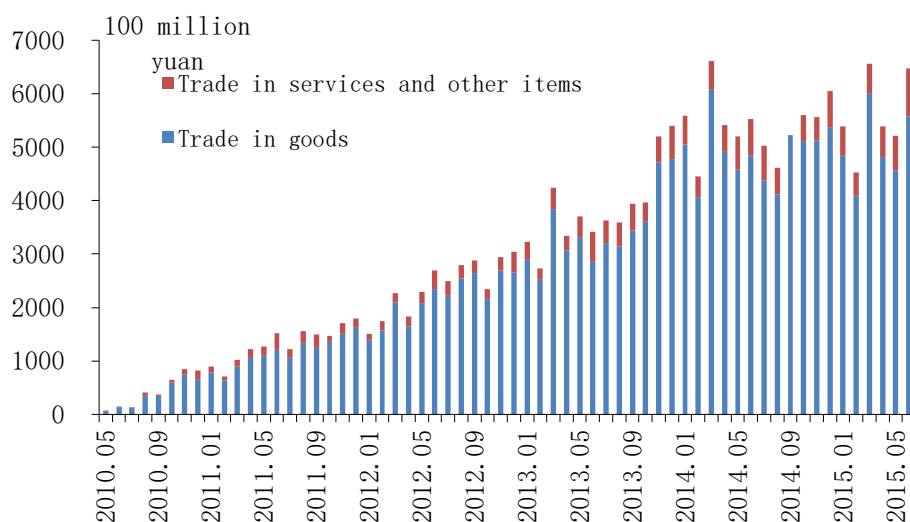
Source: The People's Bank of China.

VI. The RMB exchange rate remained basically stable

Beginning in 2015, the RMB appreciated slightly. The exchange rate was basically stable while experiencing two-way fluctuations. At the end of June, the central parity of the RMB against the US dollar was 6.1136 yuan per US dollar, representing an appreciation of 54 basis points, or 0.09 percent, from the end of 2014. From the reform of the RMB exchange-rate regime in 2005 to the end of June 2015, the RMB registered a cumulative appreciation of 35.38 percent against the US dollar. According to calculations by the Bank for International Settlements (BIS), in the first half of 2015 the NEER and the REER of the RMB appreciated by 3.64 percent and 2.95 percent respectively, and from the RMB exchange-rate regime reform in 2005 to June 2015, the NEER and REER of the RMB exchange rate appreciated by 45.62 percent and 55.73 percent respectively.

VII. Cross-border RMB businesses developed steadily

Cross-border RMB businesses continued to grow in a stable manner. During the first half of 2015, cross-border receipts and payments in RMB totaled 5.67 trillion yuan, an increase of 18 percent year on year. In particular, RMB receipts and payments registered 3.02 trillion and 2.65 trillion yuan respectively, resulting in a receipt-to-payment ratio of 1:0.088. RMB receipts and payments under the current account posted 3.37 trillion yuan. In particular, settlements of trade in goods registered 3 trillion yuan, up 2 percent year on year, whereas settlements of trade in services and other items under the current account registered 371.1 billion yuan, up 14 percent year on year. RMB receipts and payments under the capital account totaled 2.3 trillion yuan, an increase of 50 percent year on year.



Source: The People's Bank of China.

Figure 1 Monthly RMB Settlements of Cross-border Trade

Part 2 Monetary Policy Operations

Since the beginning of 2015, the PBC has continued its sound monetary policy. Facing increased uncertainties, including mounting downward pressures on growth, moderating price levels, and an uncertain trend in the RMB equivalent of foreign-exchange purchases, the PBC focused on implementing a monetary policy that was neither too tight nor too loose and conducted timely and appropriate fine-tunings and preemptive adjustments. The PBC used a number of monetary-policy tools to increase the supply of liquidity, which effectively filled the liquidity gaps caused by the dwindling inflows of foreign exchange and the increased willingness of market participants to hold foreign exchange, and maintained total liquidity at an adequate level. At the same time, benchmark deposit and lending rates and interest rates of repo operations were lowered to guide down market rates and to keep real interest rates stable. A neutral and stable monetary environment was achieved by utilizing both quantitative and pricing tools. Financial institutions were guided to optimize the structure of their loans and to support the development of the real economy and to make structural adjustments.

I. Flexible open market operations were conducted

In line with changes in the supply and demand of liquidity, the PBC conducted flexible open market operations and used repo operations as a major tool to ensure an

adequate volume and a balanced distribution of liquidity in the banking system. Meanwhile, to smooth out liquidity fluctuations and to offset the impact of short-term disruptions on the money market, such as initial public offerings, the PBC reduced the term of repo operations from 14 days to 7 days so as to further increase the flexibility of operations, enhance fine-tunings and preemptive adjustments, and stabilize the liquidity level and the money market. During the second quarter of 2015, a total of 165 billion yuan of liquidity was injected into the system through repo operations, bringing the total volume provided during the first half of the year to 958 billion yuan. In addition, a total of 180 billion yuan of liquidity was provided via SLO operations during the first half of the year.

Considering the comprehensive economic and financial conditions as well as the inflation level, when appropriate the PBC enhanced the flexibility of open market operations. During the first half of the year, 7-day repo rates dropped on 7 occasions by a cumulative 135 basis points. Among these reductions, four were made in Q2 to supplement the other policy measures, such as the cuts in the benchmark deposit and lending rates, to guide down money market rates, to stabilize market expectations, and to promote the proper growth of money, credit, and all-system financing aggregates. At end-June, the 7-day repo rate stood at 2.50 percent.

Central treasury cash management operations were conducted at appropriate times. In the first half of the year, a total of 230 billion yuan of treasury funds was deposited in commercial banks on five separate operations, including 50 billion yuan in three-month deposits, 150 billion yuan in six-month deposits, and 30 billion yuan in nine-month deposits.

Box 1 Open Market Operations and Liquidity Management

As an important responsibility of a central bank, liquidity management is a primary means of conducting monetary policy. In the toolkit of a central bank, apart from the traditional tools of open market operations, the reserve requirement ratio, and central bank lending and discounts, new tools have been added for the purpose of better managing liquidity. These policy tools differ in terms of eligible targets, operational methods, maturities, and collateral requirements, and therefore they are applicable in different liquidity environments and deliver liquidity management in different ways. Taking into consideration factors such as the economic and financial conditions, the requirements for monetary adjustments, and changes in overall liquidity levels, a central bank uses a combination of various liquidity management tools to properly adjust short-, medium-, and long-term liquidity so as to keep the aggregate volume of liquidity at a proper level, smooth out short-term interest-rate fluctuations, and realize monetary-policy goals.

Open market operations (OMOs) are transactions conducted by a central bank to provide or withdraw short-term funds. By adjusting the volume of overall liquidity in

the banking system, OMOs eventually adjust the money supply and interest rates. The major types of operations include reverse repos and repos, purchases and sales of government bonds, and the issuance of central bank bills. Compared with other liquidity management tools, OMOs have the following features: first, the central bank takes the initiative in the operations; second, operations via a market auction mechanism ensures the transparency of information; third, with a comparatively fixed frequency (daily or weekly), OMOs become a regular and routine measure for liquidity adjustments; fourth, the central bank can change the type, direction, and intensity of the operations in a timely and active manner, making the OMOs highly flexible. Most major central banks in the advanced economies today regard OMOs as a regular tool to manage liquidity.

To deal with various liquidity conditions, a central bank may use OMOs with different frequencies and intensities, sending different signals to the market. When there is a long-term trend of a mismatch in the supply and demand of liquidity in the banking system, OMOs may be used in combination with other policy tools to make effective adjustments to the long-term liquidity level. For example, from 2003 to 2013 the PBC successfully sterilized the excess liquidity caused by foreign-exchange inflows through the use of central bank bills, reverse repos, and adjustments to the reserve requirement ratio.

In addition to being capable of continuously injecting or absorbing liquidity, OMOs are also highly flexible, thus they are ideal tools for two-way fine-tunings. By properly choosing the type, maturity, and size of the OMOs, a central bank can make balanced fine-tunings and precisely manage the liquidity. For example, when seasonal factors, such as the collection of tax payments to the treasury and the large demand for cash in the run-up to the holidays lead to a short-term liquidity gap and upward pressures on money-market interest rates, open market repos can be used to pump liquidity into the system. By matching the maturity of repos and the timeline of fiscal expenditures or cash withdrawals after the holidays, the central bank can keep the aggregate volume of liquidity stable and maintain a balance in the demand and supply of capital. In another example, factors such as a cut in the reserve requirement ratio may cause a one-time surge in the liquidity level. Meanwhile, the liquidity demand of banks as a result of a lending boom rises gradually and slowly, leading to a short-term surplus in the liquidity supply. At such a time, reverse repos can be used to freeze the excess and can gradually release the frozen funds as the liquidity level in the market wanes. Thus, a large amount of funds from the rate cut can be evenly released within a period of time and financial market risks from excessive liquidity in the banking system will be mitigated.

A central bank decides on the stance of its monetary policy in view of the economic and financial conditions, the inflation level, and other macro-economic factors. Thus, over a period of time the monetary policy stance of a central bank is relatively stable. Under a given policy stance, the direction and intensity of OMOs mainly depend on

the supply and demand of liquidity as well as on the requirements for liquidity management. Based on past experience, two-way fine-tunings of liquidity through operational changes in direction do not indicate a change in the monetary-policy stance. Instead, they are meant to improve liquidity management and to help realize the goals of monetary adjustments. This is a norm for central banks to manage liquidity.

II When necessary, lending facilities were carried out appropriately

In order to keep the volume of liquidity in the banking system at an appropriate level and to meet the commercial banks' liquidity demand, during the first half of the year the PBC provided a total of 1529 billion yuan through the Medium-term Lending Facility (MLF). However, due to the maturity of 1659 billion yuan, there was a net reduction of 130 billion yuan in MLFs, leading to an outstanding amount of 514.5 billion yuan. To ensure the supply of base money in the medium term, in June the PBC for the first time carried out six-month MLF operations, offering an interest rate of 3.5 percent, which served to guide medium-term rates and to help lower social financing costs. While providing MLFs, the PBC also guided financial institutions to beef up support to small and micro firms, the agricultural sector, rural areas, farmers, and other key areas and weak links in the economy.

In line with the overall liquidity level in the money market, during the first half of year the PBC carried out a total of 334.7 billion yuan of standing lending facilities (SLFs) operations and recollected all of the funds upon maturity. At the end of Q2, the outstanding amount of SLFs registered zero.

III. Targeted and universal cuts in the reserve requirement ratio were combined

On two occasions, in February and April 2015, the PBC announced a combination of targeted and universal cuts in the RMB deposit reserve requirement ratio (RRR) for financial institutions. First, the RRR for financial institutions was reduced by a total of 1.5 percentage points; second, the RRR for some targeted financial institutions was cut. The ratio for the Agricultural Development Bank of China was reduced from 18 percent to 10.5 percent. Based on the results of dynamic evaluations of financial institutions whose RRRs were lowered in June 2014, the PBC cut the RRR an additional 0.5 percentage point for city commercial banks and non-county-level rural commercial banks that had extended a specific share of loans to small and micro companies. The RRRs for rural cooperative banks, rural credit cooperatives, village and township banks, financial companies, financial leasing companies and auto financing companies were lowered by 1 to 1.5 percentage points to a uniform rate of

11.5 percent.

In June 2015, the PBC decided to further cut the deposit RRR for targeted financial institutions. First, the RRR was lowered by 0.5 percentage point for city commercial banks and non-county-level rural commercial banks that had reached the targeted RRR reduction standard in terms of the share of loans to the agricultural sector, rural areas, and farmers in total lending. Second, a reduction of 0.5 percentage point was applied to the RRR of large state-owned commercial banks, joint-stock commercial banks, and foreign-funded banks that had reached the targeted RRR reduction standards in lending to the agricultural sector, rural areas, and farmers, and to micro and small enterprises. Third, the RRR was reduced by 3 percentage points for finance companies to further motivate them to do their part in increasing the efficiency of enterprise fund use. After this cut, commercial banks (not including county-level commercial banks) that had operated in a prudent way and that had extended a certain share of loans to micro and small enterprises were eligible for a RRR that was 1 percentage point lower than that of their counterparts.

IV. The dynamic adjustment mechanism of the differentiated reserve requirements continued to play an active role

Macro-prudential regulation was strengthened. The dynamic adjustment mechanism of the differentiated reserve requirements was further improved to play an active role in counter-cyclical management and structural adjustments. The parameters of the dynamic adjustment mechanism were calibrated according to the performance of financial institutions in five respects, including: the amount of loans for micro enterprises and agriculture-related enterprises, the capital adequacy ratio, internal risk controls, the launch of new branch offices, and regional development, so that the mechanism could be more differentiated and targeted. Financial institutions were encouraged to keep the pace of credit extensions in line with real and seasonal demands and to increase the proportion of lending to small and micro enterprises, the agricultural sector, rural areas, and farmers, businesses in the central/western and underdeveloped regions, and other key areas and weak links in the economy, so as to support the appropriate growth of credit and development of the real economy.

V. Multiple measures were taken to guide financial institutions to optimize their loan structures

Monetary policy, macro prudential management tools, and credit policy were used to coordinate credit and industrial policies and to guide financial institutions to optimize their loan structures.

The PBC actively employed credit policy–related central-bank lending, discounts and

Pledged Supplementary Lending (PLS) in guiding financial institutions to step up credit support to key areas in the economy, such as small and micro enterprises, the agricultural sector, rural areas, and farmers, and shantytown renovation projects. The interest rates of credit policy-related central-bank lending and PLS were timely cut to help reduce social financing costs. At end-June, the central bank's outstanding loans to support agriculture reached 218 billion yuan, up 33.8 billion yuan from the same period of the last year; outstanding loans to support micro enterprises registered 59.6 billion yuan, an increase of 34 billion yuan year on year; and the outstanding amount of central bank discounts was 130 billion yuan, up 18 billion from the same period of the last year. In accordance with the timeline of the shantytown renovation projects, the PBC issued PLS in the amount of 420.4 billion yuan to the China Development Bank during the first half of the year; as a result, the bank received a total of 803.5 billion yuan in PSL.

Financial institutions were guided to properly handle new loans, mobilize the stock of credit assets, innovate their organizational structures, collaterals, and product and service modes, and to provide more credit and loans to important areas and to weak links in the economy so as to improve the efficiency of growth and to ensure the sustainable and sound development of the economy. Financial services for poverty alleviation, employment, education, ethnic minorities, migrant workers, and college-graduates-turned village officials were further improved. Commercial, policy, and development financial institutions were urged to provide support to investment projects in seven large categories, to consumption programs in six areas, to three kinds of key projects with strategic importance, and to “going global” projects. The reasonable funding needs of key ongoing and follow-up projects were met and efforts were made to support major infrastructure and livelihood projects, such as railway construction, irrigation systems, and underground pipe networks that both enhance the people's livelihood and help improve the quality and efficiency of economic growth. With respect to financial services for industries with excess capacity, in line with the principle of the “differentiated treatment and no one-size-fits-all” approach, the PBC urged financial institutions to strengthen and improve credit management by absorbing, relocating, consolidating, and eliminating excess capacity. The home mortgage credit policy was further improved to facilitate the purchase of owner-occupied or improvement-oriented homes. Financial institutions were encouraged to revitalize their stocks of credit assets through credit asset securitization and by properly using recollected funds, optimizing fund allocations, and increasing the amount of loanable funds.

As a result, the credit structure was further optimized and credit inputs played a greater role in promoting stable growth, transformation of the growth model, and improving the people's livelihood. At end-June 2015, outstanding RMB and foreign-exchange agriculture-related loans issued by financial institutions registered 25.1 trillion yuan, an increase of 11.5 percent year on year and accounting for 27.7 percent of total loans; outstanding RMB loans to SMEs posted 16.2 trillion yuan, registering a

year-on-year increase of 14.5 percent, which was 5.2 percentage points and 3.3 percentage points higher than the growth of loans for large and medium-sized enterprises respectively, and 1.1 percentage points higher than the growth of total loans during the same period.

VI. Benchmark deposit and lending rates were cut successively and the market-based interest-rate reform was accelerated

In order for the benchmark interest rates to continuously guide market interest rates, cut social financing costs, and provide support for the sustainable and healthy development of the real economy, in 2015 the PBC lowered benchmark deposit and lending rates for financial institutions on March 1, May 11, and June 28. As a result, the one-year benchmark loan interest rate was lowered by a cumulative 0.75 percentage point to 4.85 percent, and the one-year benchmark deposit interest was reduced by a cumulative 0.75 percentage point to 2 percent. Due to numerous measures, including the successive reductions of the benchmark interest rates, the interest rates of loans offered by financial institutions declined notably. In June 2015, the weighted average interest rate on new loans granted by financial institutions was 6.04 percent, down 0.92 percentage point from the same period of the last year, reaching an unprecedented low since 2011. Meanwhile, deposit rate pricing by financial institutions tended to be more rational, deposit interest rates generally declined, and a tiered, differentiated, and competitive deposit-rate pricing mechanism was basically put in place. As the policy measures gradually took effect, the interest rates on the monetary market and the bond market declined substantially, as did the social financing costs.

The market-based interest-rate reform was accelerated. First, control over interest rates continued to be loosened in an orderly manner. In March and May 2015, the PBC expanded the upper limit of the floating band of the deposit interest rates from 1.2 times the benchmark deposit rate to 1.3 and 1.5 times the benchmark deposit rate respectively. Furthermore, nationwide the upper limit of interest rates on small-value deposits in foreign exchange was removed. Second, the interest-rate pricing mechanism continued to be improved, reflected in the expansion of membership in the national pricing mechanism and the establishment of a self-regulatory market interest-rate pricing mechanism at the provincial level, which established a sound basis for progress in the market-based interest-rate reform. Third, new products were launched in an orderly manner. In June, the *Implementation Rules for the Management of Certificates of Deposit* were published, allowing financial institutions to issue certificates of deposit to enterprises and individuals based on market pricing. With the launch of certificates of deposit and the gradually active trading of inter-bank certificates of deposit, financial institutions enjoy more pricing autonomy. In addition, their capability to manage liabilities and price making has been enhanced.

Box 2. The Issuance of Certificates of Deposit to Enterprises and Individuals

A certificate of deposit (CD) is a book-entry large denomination certificate of deposit issued by a deposit-taking banking financial institution to non-financial institution investors. International experience shows that many countries during their move to market-based deposit interest rates introduced certificates of deposit as an important measure to promote reform. In China, as the market-based interest-rate reform has progressed in recent years, interest-rate controls have been lifted, with the exception of those on deposits. As the upper limit of the floating band of deposit rates has been enlarged to 1.5 times the benchmark, financial institutions have enhanced their independent pricing capacity. The pricing of deposit interest rates has become increasingly differentiated and there has been orderly pricing competition. Meanwhile, the rapid development of the inter-bank certificate of deposit market has established a solid foundation for introducing certificates of deposit to enterprises and individuals. The conditions and timing are both good for the launch of certificates of deposit.

On June 2, 2015, the PBC announced the *Provisional Rules on Management of Certificates of Deposit* and on June 15, the core members of the self-regulatory mechanism issued the first batch of CDs. Since the launch of CDs, issuance has proceeded smoothly, with a growing size, various maturities, an increasing number of issuers, and positive market feedback. By end-July, 554 batches of CDs had been issued, with a total size of 681.6 billion yuan. There were eight different maturities, including: 1-month, 3-month, 6-month, 9-month, 1-year, 18-month, 2-year, and 3-year. Among all maturities, 1-year and 1-month CDs were the most popular in the market, accounting for 44.4 percent and 18.5 percent of the total issuance respectively. In terms of the subscribers, the majority of buyers were enterprises. A total of 573 billion yuan of CDs were issued to enterprises, accounting for 82.9 percent of all issuances. Meanwhile, CDs were less favored by individuals due to their limited understanding and knowledge about the product. However, individual subscribers also exceeded expectations. A total of 118.6 billion yuan of CDs were issued to individuals, accounting for 17.1 percent of all issuances. Interest rates of the issued CDs were close to 1.4 times deposit rates of the same maturities, and they were lower than the yields of guaranteed principal wealth management products of the same maturities. On July 30, the issuers of CDs were expanded from core members of the market interest-rate pricing discipline mechanism to the base members of national financial institutions, and local corporate financial institutions and foreign banks that had experience in issuing inter-bank certificates of deposit. The total number of issuers increased from 9 to 102.

In general, the issuance of CDs is an important measure for the market-based interest-rate reform. It will promote the orderly expansion of the scope of market-priced liability products and the development of the market-based interest-rate mechanism; facilitate financial institutions to further improve their pricing capacities,

accelerate business transformation and sustainable development, and help market players such as enterprises and individuals better understand the market-based interest-rate pricing. The issuance of CDs also represents effective progress toward market pricing of deposit interest rates and will provide valuable experience. Furthermore, certificates of deposit, as a well-regulated and market-based product, will gradually replace high interest-rate liability products, such as wealth management products.

During the next stage, the PBC will continuously promote the development of the CD market by gradually expanding the range of issuers and facilitating trading in the secondary market so as to promote the market-based interest-rate reform in an orderly manner.

VII. The RMB exchange-rate regime was further improved

The market-based RMB exchange-rate regime was further improved in a self-initiated, controllable, and gradual manner. The RMB exchange rate was kept basically stable at an adaptive and equilibrium level based on market supply and demand and with reference to a basket of currencies. In the first half of 2015, the highest and lowest central parity of the RMB against the US dollar were 6.1079 and 6.1617 respectively. Among the 119 trading days, the RMB appreciated on 57 days and depreciated on 62 days. The largest daily appreciation was 0.17 percent (105 basis points) and the largest daily depreciation was 0.16 percent (96 basis points).

The RMB fluctuated in both directions against other major international currencies, including the euro and the Japanese yen. At end-June, the central parity of the RMB against the euro and the Japanese yen was 6.8699 yuan per euro and 5.0052 yuan per 100 yen respectively, an appreciation of 8.53 and 2.64 percent respectively from the end of the last year. From the start of the reform of the RMB exchange-rate regime in 2005 until end-June, the RMB appreciated against the euro and the yen by 45.77 percent and 45.97 percent respectively. Direct trading between the RMB and foreign currencies in the inter-bank foreign-exchange market was active and market liquidity increased notably, thus helping to lower the costs of currency conversion in the economy.

Table 6 The Trade Volume of the RMB against Foreign Currencies in the Inter-bank Foreign-Exchange Spot Market in H1 2015

Unit: 100 million yuan

| Currency | USD | Euro | Japanese yen | HKD | GBP | Australian dollar | New Zealand dollar | Singapore dollar | Canadian dollar | Malaysian ringgit | Russian ruble | Thai baht |
|----------------|--------|------|--------------|-----|-----|-------------------|--------------------|------------------|-----------------|-------------------|---------------|-----------|
| Trading volume | 120254 | 2298 | 1728 | 832 | 546 | 533 | 99 | 1988 | 15.0 | 6.8 | 19.3 | 0.7 |

Source: China Foreign Exchange Trade System.

In the first half of 2015, under the bilateral local currency swap agreements signed by the PBC and the relevant foreign monetary authorities, the PBC conducted swaps with counterparty monetary authorities in a total amount of 89.65 billion yuan. The amount of actual utilization of RMB was 35.105 billion yuan; the PBC conducted transactions equivalent to USD 1.185 billion, with actual utilization of foreign currency equivalent to USD 1.185 billion. At end-June, the outstanding amount of RMB used by foreign monetary authorities stood at 24.602 billion yuan, whereas the amount used by the PBC equaled USD 890 million. These swaps have played an active role in facilitating bilateral trade and investment.

VIII. Deepening of the reforms of financial institutions

The reforms of the Bank of Communications and the Agricultural Bank of China proceeded steadily. Approved by the State Council in June, the Bank of Communication's proposal to deepen the reforms includes measures to improve corporate governance, step up internal reforms, and enhance external supervision. This will help the bank change its operational mode, increase its competitiveness, and improve its capability to serve the real economy. The reform program of the Rural Finance Business Division of the Agricultural Bank of China was deepened and expanded to include the entire nation. Approved by the State Council, in April the PBC published the *Notice of the People's Bank of China on Expanding the Reform of the Rural Finance Business Division of the Agricultural Bank of China*, which expanded the coverage of the reform to county-level branches of the Agricultural Bank of China. This will improve the bank's services to the agricultural sector, rural areas, and farmers, and at the county level.

The reforms of the rural credit cooperatives (RCCs) proceeded smoothly, with the achievements including an improved capital adequacy level, an increased share of agriculture-related loans, and the introduction of private and strategic investors. At the end of June, the outstanding amount of NPLs and the average NPL ratio of the RCCs throughout the country stood at 483.3 billion yuan and 4.2 percent respectively. Their capital adequacy ratio was 10.8 percent, up 0.3 percentage point year on year. Total

deposits and outstanding loans of the RCCs throughout the country stood at 17.7 trillion yuan and 11.6 trillion yuan respectively, up 12.7 percent and 15.3 percent respectively from the same period of the last year; outstanding agro-linked loans and loans to farmers posted 7.5 trillion and 3.6 trillion yuan, up 11.5 percent and 9.9 percent respectively year on year. At end-June, there were 728 rural commercial banks, 80 rural cooperative banks, and 1,424 RCCs with legal-person status at the county (city) level.

IX. Deepening of the reforms of foreign-exchange administration

Efforts were made to facilitate trade and investment. First, centralized operations and management of the foreign-exchange funds of multinational companies were promoted to better serve the export-oriented economy. By the end of June, 570 companies were participating in the pilot program. The program enables good companies, especially private companies, to optimize their use of capital. Second, management of cross-border foreign currency banknotes was improved to meet the demand for banknotes. In May, franchised institutions were allowed to engage in the transport of foreign currency banknotes into or out of the territory of China and in the foreign currency wholesale business, which contributed to the diversification of the domestic supply of foreign currency banknotes. Third, quotas for institutional investors were properly allotted to support the development of the capital market. In the first half of 2015, the PBC granted USD 8.62 billion in QFII to 34 institutions, RMB 91.2 billion in RQFII to 38 institutions, and USD 6.67 billion in QDII to 44 institutions. This helped to open up the domestic capital market as well as to connect to the overseas market.

The capital account has become more convertible. First, the voluntary settlement scheme of foreign-exchange capital funds by foreign-invested enterprises was expanded. It provides enterprises with more decision-making power and the right to choose the foreign-exchange capital settlement for enterprises, enables them to avoid the risks of exchange-rate fluctuations, reduce financial costs, and make direct investments fully convertible. Second, preparations for the Mainland–Hong Kong Mutual Fund Recognition Scheme is fully under way. Quotas will be assigned to all participating institutions and to all products. The scheme will facilitate cross-border issuances and sales of funds both in mainland China and in Hong Kong, and will open a new channel for investment.

The surveillance and management system for cross-border foreign-exchange receipts and payments was strengthened. First, the monitoring, early-warning, and management system for the flow of foreign-exchange funds was improved. Monitoring and analysis of short-term fluctuations of cross-border funds were enhanced, while analysis was accurate and scientific. At the same time, emergency response plans were amended and the range of policy tools was expanded. Second, special inspections of key areas and channels were carried out, including those for the

collection of export proceeds, foreign-exchange banknotes carried by individuals, entrepôt trade, and the forward settlement of foreign exchange. Special actions were taken to crack down on using offshore companies or underground banks to transfer illegal gains and income, such as bribes, and to prevent the abnormal flow of cross-border capital. Third, the State Administration of Foreign Exchange clamped down on activities in violation of the foreign-exchange laws and regulations. The *Circular on the Detailed Rules for the Implementation of the Declaration of the Balance of Payments Statistics through Banks* (Huifa No. 27 [2015]) was published to standardize the declaration of the balance-of-payments statistics for foreign-related receipts and payments by the declarer through domestic banks; and the *Circular on the Reform of the Administrative Approach for the Settlement of Foreign Exchange Capital Funds of Foreign-Invested Enterprises* (Huifa No.19[2015]) was issued to promote foreign-exchange management reform and to facilitate the operation and fund management of foreign-invested enterprises.

Part 3 Financial Market Analysis

In the first half of 2015 (H1 2015), the overall performance of the financial markets was stable. The money market traded briskly and market interest rates declined notably. The issuance of bonds increased. The stock indexes of the Shenzhen and Shanghai markets continued to rally and trading volume surged.

I. Financial market analysis

1. The money market traded briskly and market interest rates declined notably

Growth of repo transactions on the inter-bank market surged and the turnover of inter-bank borrowing increased rapidly. During the period under review, the cumulative turnover of bond repos on the inter-bank market reached 175.1 trillion yuan, representing an average daily turnover of 1.4 trillion yuan, up 85.7 percent year on year. The cumulative turnover of inter-bank borrowing reached 24.5 trillion yuan, with an average daily turnover of 200.6 billion yuan, up 37.7 percent year on year. In terms of the maturity structure, overnight products still dominated bond repos and inter-bank borrowing transactions, accounting for 81.4 percent and 79.4 percent of their respective turnovers, an acceleration of 0.8 percentage point and a deceleration of 3.3 percentage points respectively from the same period of the last year. The turnover of bond repos on the stock exchanges rose 40.6 percent year on year to 56.2 trillion yuan.

The flow of funds among financial institutions exhibited the following characteristics. First, the volume of trading increased by a large margin year on year. Net lending of large commercial banks increased 151.6 percent year on year to reach 83.6 trillion yuan. Net borrowing of Chinese-funded small- and medium-sized banks was almost four times the amount during the corresponding period of 2014. Second, large banks became the major fund providers, with foreign-funded institutions changing from fund suppliers to fund borrowers. Third, borrowing by other financial institutions and vehicles surged by 141 percent year on year to reach 25.8 trillion yuan.

Table 7 Fund Flows among Financial Institutions in H1 2015

Unit:100 million yuan

| | Repos | | Inter-bank borrowing | |
|---|----------|----------|----------------------|---------|
| | H1 2015 | H1 2014 | Q1 2015 | Q1 2014 |
| Chinese-funded large banks ^① | -766,013 | -302,247 | -69,873 | -29,964 |
| Chinese-funded small- and medium-sized banks ^② | 304,201 | 91,888 | -25,204 | -20,890 |
| Securities and fund management companies | 153,314 | 85,322 | 49,915 | 37,604 |
| Insurance companies | 38,656 | 36,632 | 38 | 99 |
| Foreign-funded financial institutions | 41,900 | -3,071 | 14,604 | -2,576 |
| Other financial institutions and vehicles ^③ | 227,943 | 91,477 | 30,520 | 15,727 |

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

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

③Other financial institutions and vehicles include urban credit cooperatives, rural credit cooperatives, finance companies, trust and investment companies, financial leasing companies, asset-management companies, social security funds, mutual funds, wealth management products, trust plans, and other investment vehicles. Some of these financial institutions and vehicles do not participate in the inter-bank funding market.

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

Source: China Foreign Exchange Trade System.

Interest-rate swap transactions boomed. In H1, 34,229 deals were reached on the RMB interest-rate swap market, with the total notional volume of the principal reaching 3561.62 billion yuan, up 109.7 percent year on year. In terms of the maturity structure, contracts with maturities of within one year traded most briskly

and their aggregate notional principal posted 3008.18 billion yuan, accounting for 84.5 percent of the total. In terms of the reference rates, the base rate of the floating leg of the RMB interest-rate swaps mainly included the 7-day fixing rate (FR007) and the Shibor, and their notional principal accounted for 90.6 percent and 8.9 percent of the total respectively. In H1 2015, the trading volume of standard interest-rate derivatives reached 274.5 billion yuan, and the most traded product was SS011M, accounting for 95.3 percent of the total trading volume.

Table 8 Transactions of Interest-Rate Derivatives in H1 2015

| | Interest-rate swaps | | Bond forwards | | Forward-rate agreements | | Standard interest-rate derivatives | |
|---------|------------------------|---|---------------------|---------------------------|-------------------------|---|------------------------------------|---|
| | Number of deals (lots) | Amount of notional principal (100 million yuan) | Transactions (lots) | Amount (100 million yuan) | Transactions (lots) | Amount of notional principal (100 million yuan) | Transactions (lots) | Amount of notional principal (100 million yuan) |
| H1 2014 | 18,180 | 16,982.9 | — | — | — | — | — | — |
| H1 2015 | 34,229 | 35,616.2 | — | — | — | — | 640 | 1,295.5 |

Source: China Foreign Exchange Trade System.

The issuance and trading of inter-bank certificates of deposit (CD) continued. By the end of June, 101 financial institutions had disclosed CD issuance plans, among which 88 institutions executed issuance plans on the inter-bank market. In H1, 2205 CDs with a total amount of 1.67 trillion yuan were issued on the inter-bank market. The trading volume on the secondary market was 2.5 trillion yuan. The issuance and trading are both priced based on the Shibor. The rapid development of the CD market has helped enhance the role of the Shibor at the medium to long ends. In June, the weighted average interest rate for the issuance of 3-month CDs was 3.27 percent, 25 basis points higher than the 3-month Shibor.

Interest rates on the money market declined. In June, the weighted average interest rate of inter-bank borrowing and pledged repos posted 1.44 percent and 1.41 percent respectively, a decline of 225 and 220 basis points respectively from March 2015, and a decline of 141 and 148 basis points respectively year on year. At end-June, the overnight and 7-day Shibor were 3.23 percent and 3.39 percent respectively, a decline of 190 and 134 basis points respectively from the beginning of 2015.

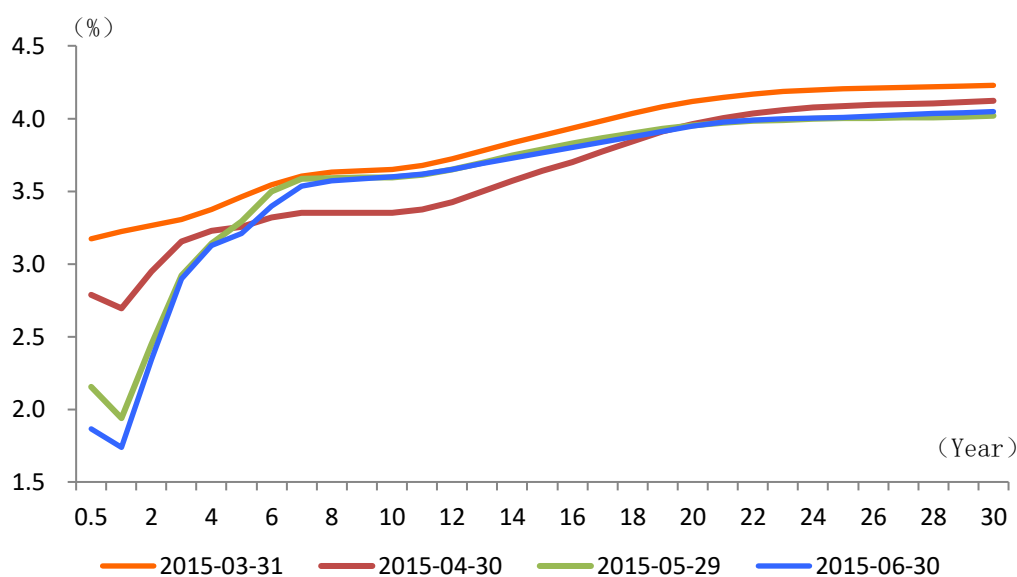
2. Spot bond trading became increasingly brisk and bond issuances expanded rapidly, whereas coupon rates generally declined.

In Q1, the volume of spot bond trading on the inter-bank market posted 33 trillion yuan, with the daily trading volume averaging 270.1 billion yuan, up 88 percent year

on year. In terms of the trading entities, Chinese-funded small- and medium-sized banks were mainly net bond sellers, with total net spot bond sales of 1.3 trillion yuan during the period under review; other financial institutions and vehicles were net bond purchasers, with net spot bond purchases of 1.2 trillion yuan. In terms of the traded products, a total of 3.4 trillion yuan of spot government securities was traded, accounting for 10.2 percent of the total spot bond transactions on the inter-bank market; the turnover of spot financial bond transactions and corporate debenture bond transactions were 17.2 trillion yuan and 12.2 trillion yuan respectively, accounting for 52.2 percent and 36.9 percent respectively. A total of 1.5 trillion yuan of spot bonds was traded on the stock exchanges, an acceleration of 458.7 billion yuan year on year.

Bond indices on the inter-bank markets moved up slightly. In H1, the China Bond Composite Index (net price) increased from 101.42 points at the end of 2014 to 102.21 points at end-June, up 0.78 percent; the China Bond Composite Index (full price) grew 1.20 percent, from 114.50 points at end-2014 to 115.87 points at end-June, up 1.20 percent. The Government Securities Index on the stock exchanges rose 2.77 percent, from 145.60 points at end-2014 to 149.64 points at end-June.

The yield curve of government securities on the inter-bank market moved downward, and the yield curve became steeper. At end-June, the yields of 1-year, 3-year, 5-year, 7-year, and 10-year government securities declined by 152, 47, 30, 7, and 2 basis points respectively from the end of 2014, with the spread between 10-year and 1-year government securities widening by 186 basis points, an expansion of 150 basis points from the end of 2014. During the first half of the year, liquidity in the money market was ample and the economy faced large downward pressures. However, the supply of local government bonds expanded. As these factors worked together, the yield of government securities generally declined, with the yield of medium- and long-term bonds declining by a small margin.



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

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

The volume of bond issuances expanded significantly. In H1, a total of 8.6 trillion yuan of bonds was issued. This represented an increase of 3.2 billion yuan year on year, among which the year-on-year increase in the issuance of central government securities was 850.7 billion yuan (largely due to the progress in local government debt conversions), the year-on-year increase in the issuance of local government bonds was 731.5 billion yuan, the year-on-year increase in the issuance of inter-bank certificates of deposit (a component of financial bonds) was 1.5 trillion yuan, and the year-on-year increase in the issuance of non-financial company debt financing instruments was 307.9 billion yuan, while there was a year-on-year decrease of 272.5 billion yuan in the issuance of enterprise bonds. At end-June, the total volume of outstanding bonds posted 39.9 trillion yuan, up 22.7 percent year on year.

Table 9 Bond Issuances in H1 2015

| Type of bond | Issuances (100 million yuan) | Year-on-year growth (100 million yuan) |
|---|------------------------------|--|
| Government securities ^① | 17,227 | 8507 |
| Central bank bills | 0 | 0 |
| Financial bonds ^② | 40,956 | 22,713 |
| Of which: Financial bonds issued by the China Development Bank and policy financial bonds | 15,275 | 1,750 |
| Corporate debenture bonds ^③ | 16,655 | 15,286 |
| Of which: Debt-financing instruments of non-financial enterprises | 27,387 | 518 |
| Enterprise bonds | 2,471 | -2,726 |
| Corporate bonds | 529 | 174 |
| Total | 85,570 | 31,738 |

Notes: ①Including municipal bonds.

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

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

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

At end-June, the coupon rates of government securities, financial bonds, and corporate debenture bonds all declined. The coupon rate of 10-year government securities was 3.64 percent, a decline of 0.13 percentage point from December 2014.

The coupon rate of 10-year financial bonds issued by the China Development Bank was 4.08 percent, down 0.29 percentage point from those of the same maturity issued in December 2014. The coupon rates of corporate debenture bonds declined. The average coupon rate of short-term financing bills (rated A-1) issued by AAA-rated enterprises was 3.98 percent, down 1.32 basis points from end-2014; the average coupon rate of 7-year corporate bonds was 4.8 percent, down 1.2 percentage points from end-2014. The Shibor played an increasingly larger role in bond pricing. In H1 2015, 43 floating-rate bonds and inter-bank certificates of deposits were issued based on the Shibor, with a gross issuance volume of 19.4 billion yuan; 166 fixed-rate enterprise bonds were issued based on the Shibor, with a gross issuance volume of 181.1 billion yuan; and a total of 432.2 billion yuan of fixed-rate short-term financing bills was issued based on the Shibor, accounting for 93 percent of all fixed-rate short-term financing bills.

Box 3 Good Momentum in the Development of the Credit Asset Securitization Business

Credit asset securitization (asset-backed securities) is a structural financing activity in which a banking financial institution transfers credit assets and trusts to a separate institution to issue asset-backed securities to investors, and the yield of the securities are paid with the cash flow of the assets. Simply put, it is a structural financing activity that sells credit assets in the form of securities. The asset-backed security business began in the 1970s as a result of the development of the housing market in the United States. As they have helped meet the numerous demands of various kinds of investors, in many parts of the world asset-backed securities have developed into a fairly mature financial product.

In March 2005, with the approval of the State Council, the PBC and several other agencies established a pilot credit asset securitization coordination group, thus initiating the credit asset securitization program. In 2009, due to the subprime mortgage crisis, the pilot program stalled. However, in 2011, with the consent of the State Council, the pilot program was resumed. In August 2013, the State Council decided to further expand the pilot program. At the May 13, 2015, Executive Meeting of the State Council it was decided to promote credit asset securitization through the following measures: expanding the pilot by 500 billion yuan, further improving the institutional arrangements, simplifying the procedures, encouraging one-off registration and independent and phased issuances, and regulating information disclosures. By the end of June 2015, a total of 127 credit asset backed securities were issued, with a cumulative volume of 409 billion yuan and an outstanding volume of 359.1 billion yuan. In particular, between May 13 and end-June, 14 credit asset backed securities were issued, with a cumulative volume of 59.6 billion, up 29.5 billion yuan year on year.

After ten years of experimentation, an institutional framework for credit asset

securitization, commensurate with the Chinese situation, is now in place. A market system for asset backed securities has also taken form and is developing with a good momentum. First, there is an increasingly larger group of originators. At end-June 2015, there were almost 70 originators, including various kinds of banks, auto financing companies, asset-management companies, financial leasing companies, and so forth. Second, the underlying assets have been expanded to include the major components of loans, such as company loans, mortgage loans, auto loans, credit card loans, and financing leasing assets. Third, the investor base has been diversified. At end-June 2015, the number of securities companies, insurance companies, mutual funds, and other non-legal person investors accounted for 56.4 percent of the total number of investors. Credit asset securitization is playing an increasingly noteworthy role in credit risk diversification.

Compared with the mature markets, the asset backed securities market is at a nascent stage. The outstanding volume of asset backed securities accounts for only 0.3 percent of all outstanding loans. There remains vast room for its development. As the Chinese economy is in a new normal state, the sound development of the asset backed securities market will help revitalize the stock of credit assets, free more credit sources, optimize the credit structure, and improve the efficiency of fund use. It will play a significant role in promoting development of a multi-tiered capital market, transformation of commercial banks, optimization of the allocation of financial resources, and enhancement of support of the financial sector to the real economy.

As the next step, the PBC will work together with the relevant agencies to implement the decisions of the State Council, continue the market-oriented reforms, follow the principle of authentic sales of credit assets, insulation of bankruptcy, a single set of standards, information sharing, regulation enhancement, and risk prevention, and allowing no re-securitization, improving the market mechanism, giving full play to the role of information disclosures, credit ratings, and other market instruments, expanding the pilot, educating the investors, preventing risks, and promoting the sustained and sound development of the asset backed securities market.

3. Bill financing increased rapidly and interest rates declined

The bill acceptance business increased slightly. In H1, commercial bills issued by enterprises totaled 11.3 trillion yuan, up 3.2 percent year on year; outstanding commercial bills posted 10.8 trillion yuan at the end of H1, up 5.8 percent year on year. At end-June 2015, the balance of bill acceptances increased 916.6 billion yuan from the beginning of 2015, with decelerated growth year on 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. Small- and medium-sized enterprises issued about two-thirds of all commercial bills issued by enterprises.

The outstanding balance of bill financing increased rapidly and interest rates on the bill market showed a downward trend. In Q1, commercial bills discounted by financial institutions totaled 47.9 trillion yuan, up 87.0 percent year on year; the outstanding balance of bill discounts stood at 3.8 trillion yuan, up 71.7 percent year on year. At end-June, the outstanding amount of bill financing increased by 869.2 billion yuan from that at the beginning of 2015, accelerating every month; the share of outstanding bill financing in the total outstanding loans was 4.26 percent, up 1.42 percentage points year on year. In Q1, as liquidity in the banking system was adequate, interest rates on the bill market showed a downward trend; moreover, supply and demand on the bill market was fairly balanced, and bill interest rates were mainly affected by interest-rate movements on the money market.

4. Stock indices continued to rally. while the trading volume and financing increased sharply

The stock indices continued to rally. Since the beginning of 2015, the stock indices rose rapidly. At one point, the Shanghai Stock Exchange Composite Index exceeded 5000 points. However, starting from the third week of June, stock indices experienced large swings and declined sharply. At end-June, the Shanghai Stock Composite Index and the Shenzhen Stock Exchange Component Index closed at 4,277 points and 14,338 points respectively, up 32.2 and 30.2 percent from the end of 2014; the Growth Enterprise Board (GEB) Index (Chinext Price Index) closed at 2,859 points, up 94.2 percent from the end of 2014. The weighted average P/E ratio of the A-share market on the Shanghai Stock Exchange rose from 16.0 times at end-2014 to 21 times at end-June, while during the same period that of the Shenzhen Stock Exchange rose from 35.0 times to 55 times.

Turnover on the stock markets surged. In H1, turnover on the Shanghai and Shenzhen Stock Exchanges totaled 139 trillion yuan, with daily turnover averaging 1.2 trillion yuan, up 542.4 percent year on year. Turnover on the GEM Board totaled 13 trillion yuan, up 301.8 percent year on year. At end-June, the combined market capitalization of the Shanghai and Shenzhen Exchanges posted 47.2 trillion yuan, up 132.4 percent year on year; the market capitalization of the GEM Board posted 3.1 trillion yuan, up 180.4 percent year on year.

The amount of equity financing increased rapidly. In H1, a total of 599.4 billion yuan was raised by enterprises and financial institutions by way of IPOs, additional offerings, rights issuances, and warrant exercises, representing an increase of 342.9 billion yuan year on year.

5. Assets in the insurance industry grew rapidly

In Q1, total premium income in the insurance industry amounted to 1.4 trillion yuan, representing year-on-year growth of 19.3 percent and a deceleration of 1.5 percentage

points compared to the last year; total claim and benefit payments amounted to 420.4 billion yuan, representing year-on-year growth of 19 percent. Specifically, total claim and benefit payments in the property insurance sector increased 7.1 percent, while those in the life insurance sector increased 30.3 percent.

The growth of insurance assets accelerated. At end-June, total assets in the insurance industry posted 11.4 trillion yuan, representing year-on-year growth of 21.9 percent and an acceleration of 3 percentage points year on year. Among this total, bank deposits increased 4.6 percent year on year, while investment-linked assets increased 27.5 percent.

Table 10 Use of Insurance Funds, End-June 2015

| | Outstanding balance (100 million yuan) | | As a share of total assets (%) | |
|-------------------------|--|---------------|--------------------------------|----------------|
| | End-June 2015 | End-June 2014 | End-June 2015 | End-March 2014 |
| Total assets | 114,297 | 93,737 | 100 | 100 |
| Of which: Bank deposits | 26,791 | 25,618 | 23.4 | 27.3 |
| Investments | 76,894 | 60,288 | 67.3 | 64.3 |

Source: China Insurance Regulatory Commission.

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

In Q1, the turnover of spot RMB/foreign-exchange transactions totaled USD 2.1 trillion, down 0.5 percent year on year. The turnover of RMB/foreign-exchange swap transactions totaled an equivalent of USD 3.1 trillion, up 51.8 percent year on year, among which overnight RMB/USD swap transactions posted USD 1.9 trillion, accounting for 60.9 percent. Turnover on the RMB/foreign-exchange forward market totaled USD 17.3 billion, down 33.3 percent year on year. In Q1, turnover of foreign currency pair transactions amounted to an equivalent of USD 51.3 billion, up 80 percent year on year. In particular, EUR/USD transactions accounted for the lion's share, or 41.7 percent, of the total.

The number of participants on the foreign-exchange market increased further. At end-March, there were 492 members on the foreign-exchange spot market, 105 members on the foreign-exchange forward market, 104 members on the foreign-exchange swap market, 91 members on the currency swap market, and 49 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 price remained low and turnover on the gold market surged

The price of gold declined after a small rally and thereafter remained low, with small fluctuations. In H1, the price of spot gold on the international market peaked at USD 1,298.00 per ounce and reached a trough of USD 1,147.25 per ounce, closing at USD 1,171.00 per ounce at end-June, representing a decline of 2.36 percent from the end of the last year. The peak price of gold (AU9999) on the Shanghai Gold Exchange was 265.00 yuan per gram, and the lowest price was 230.40 yuan per gram. At end-June, the price of gold closed at 234.94 yuan per gram, representing a decline of 5.65 yuan per gram, or 2.35 percent, from the end of the last year. The differential between domestic and international gold prices declined sharply, averaging 0.68 yuan per gram on a daily basis in H1, a decline of 24.44 percent year on year.

The gold market on the Shanghai Gold Exchange operated smoothly and the volume of transactions surged. In H1, the trading volume of gold was 17,520.1 tons, an increase of 166.3 percent year on year, and the turnover posted 4.2 trillion yuan, an increase of 150.7 percent year on year. The trading volume of silver was 38.9 trillion tons, an increase of 151.0 percent year on year, and the turnover posted 1.4 trillion yuan, up 115.3 percent year on year. The trading volume of platinum was 27.9 tons, a decline of 14.4 percent year on year, and the turnover posted 68.3 billion yuan, down 29.8 percent year on year.

II. Institutional building in the financial markets

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

The *Notice of the People's Bank of China's Financial Market Department on Access of Private Equity Funds to the Inter-bank Bond Market* was released to further diversify investor base support for the sound development of the bond market and to improve the multi-layered bond market system. The PBC released *Public Notice [2015] No.17*, to abolish the approval requirements for trading to allow all kinds of bonds issued in accordance with the laws and regulations to be traded directly on the inter-bank bond market after the issuance is completed, and to strengthen information disclosures and investor protection requirements, for the purpose of further promoting the sound development of the bond market. The *Notice of the People's Bank of China on Participation of Clearing Banks and Participating Banks for Cross-border RMB Business in Bond Repos on the Inter-bank Bond Market* was released to allow these banks to conduct bond repo transactions on the inter-bank bond market, providing another tool for RMB liquidity management.

2. Institutional arrangements for the equity market were improved

The one account per investor limit was lifted for the A-share market. On April 12, the China Securities Depository Clearing Corporation Limited released the *Notice on Lifting the Limit of One Securities Account Per Natural Person* to allow natural person investors to open multiple A-share accounts and close-end fund accounts on the Shanghai and Shenzhen Stock Exchanges starting from April 13, 2015.

The futures market was further opened up to overseas participants. On June 26, the China Securities Regulatory Commission released the *Provisional Rules on Trading Certain Domestic Future Products by Overseas Traders and Overseas Brokerage Firms*, which was to enter into effect on August 1, 2015. The *Provisional Rules* defined the major business procedures involved in the trading of certain domestic products and provided a variety of modes for overseas traders and brokerage firms to participate in the trading, facilitating the orderly access to the futures market by overseas traders and promoting the opening-up of the futures market.

Public opinion was solicited on the *Provisional Rules on Regional Equity Market Regulation*. On June 26, the China Securities Regulatory Commission released the *Exposure Draft of the Provisional Rules on Regional Equity Market Regulation* to define the status and functions of regional equity markets, the regulatory framework, the bottom-line of regulation, and market rules and supporting measures for regional equity markets. The *Rules* are important to improve the multi-tiered capital market system, expand the direct financing of medium, small, and micro enterprises, and facilitate mass innovation and entrepreneurship.

3. Institutional arrangements were further improved for the insurance market

Related party transactions were regulated. In order to further regulate the related party transactions of insurance companies, prevent the risks of transfer of benefits and of cross transfers, and prevent the spread of risks, the China Insurance Regulatory Commission released the *Notice on Further Regulating Related Party Transactions of Insurance Companies*, which places limits on an insurance company's total assets, total investment volume on major categories of assets, outstanding volume of investments in a single related party, and so forth, steps up requirements for internal reviews of related party transactions by insurance companies, strengthens the roles of non-associated directors and independent directors, and further clarifies information disclosure requirements. On May 13, the China Insurance Regulatory Commission released the *Notice on Strengthening Information Disclosures of Related Party Re-insurance Transactions* to require insurance companies that operate in the territory of China, both Chinese-funded and foreign-funded, to disclose information on related party re-insurance transactions.

Regulation of the capital reserve has been enhanced. On April 27, the China Insurance

Regulatory Commission released the *Administrative Rules on the Capital Reserve of Insurance Companies*, which abolishes the administrative capital reserve approval requirements, replaces all ex-ante approval requirements with ex-post filings, adjusts certain requirements on the amount of reserve deposits, relaxes the requirements on deposit banks by providing a larger variety of banks to be eligible under the precondition of ensuring fund safety, and makes it clear that the nature of the reserve fund should not be altered during the duration of the deposits.

A pilot tax concession program for commercial health insurance has been introduced. On May 6, the State Council executive meeting adopted a decision on preferential personal income tax treatment for commercial health insurance to combine government efforts with market forces to improve the people's livelihood. On May 12, the Ministry of Finance, the General Administration of Taxation, and the China Insurance Regulatory Commission jointly released the *Notice on the Launch of the Pilot on Commercial Health Insurance Personal Income Tax Policy* to make it clear that individuals who purchase commercial health insurance policies can enjoy up to 2400 yuan of tax credits annually. The four municipalities directly under the central government, i.e., Beijing, Shanghai, Tianjin, and Chongqing, will begin the pilot program in all of their jurisdictions, while other provinces and autonomous regions will each choose a city within their respective jurisdictions that has a large population and has a good capacity for comprehensive management to be a pilot city. The development of commercial health insurance will complement the basic health insurance, reduce the medical costs for consumers, improve the level of medical insurance coverage, and promote the development of a modern service sector, the expansion of domestic consumption, and adjustments in the economic structure.

On June 29, the State Council approved the Program for Establishing the China Insurance Investment Fund. The Fund will operate on a market basis as a professional, limited partnership fund with a total volume of 300 billion yuan. It will tap the advantages of long-term investments of insurance revenue, move in line with national strategies and market demand, and increasing the supply of public goods and services.

4. Promoting the sound development of the foreign-exchange market

Bank management of foreign-exchange purchases and sales has been improved. The upper and lower limits of the foreign-exchange surrender position of national banks and market-maker banks have been expanded to better enable banks to provide foreign-exchange liquidity to the market. The agent foreign-exchange settlement business has been launched. The establishment of a multi-layered settlement system aims to provide net settlement services to small and medium banks, reduce transaction costs, and promote active trading on the foreign-exchange market.

Part 4 Macro-economic Analysis

I. Global economic and financial developments

The global economy was in generally good shape, but the situation still remained complex and divergent. During the second quarter, the U.S. economy continued its moderate recovery with some economic indicators improving. Growth in the euro area showed more positive signs, but the Greek debt problem was still affecting economic and financial stability in the euro area. The Japanese economy was recovering, but the outlook still requires watching. Growth in some emerging market economies slowed down and financial market volatility increased.

1. Developments in the Major Economies

The momentum for recovery was steady in the United States, with several economic indices improving. Negatively affected by factors such as the cold weather, the port strike on the west coast, the appreciation of the USD, and the sluggish oil prices, GDP in the United States during the first quarter grew by only 0.6 percent quarter on quarter (annualized), but it increased by 2.9 percent year on year due to the relatively low base number during last year. Since the second quarter, the U.S. economy has displayed a firm recovery, with the manufacturing and service industries continuing to expand and consumption growth accelerating. In June, the Michigan Consumer Sentiment Index (MCSI) reached 96.1, the highest reading since 2008. The real estate market performed well, as data on new housing sales and housing starts remained high. The labor market continued to improve. In June, the unemployment rate dropped to its lowest level since the financial crisis and the problem of idle labor was relieved. The subdued level of the inflation rate may affect the process of normalization in the monetary policy of the Federal Reserve (Fed).

Economic recovery in the euro area was in good condition, but the Greece debt problem added uncertainty and instability. In the first half of 2015, the euro area was recovering. The main countries were experiencing a high growth rate. The labor market improved constantly, with a declining unemployment rate. Meanwhile, the Harmonized Index of Consumer Prices (HICP) regained its positive growth and the decline in the PPI narrowed. However, the Greek debt problem continued to be a potential risk factor for an economy recovery in the euro area. Dragged down by the debt crisis, Greece once again faced a recession. The risk of deflation was exacerbated and the unemployment rate reached 26 percent, exceeding that of the other members in the euro area.

Japan's economy was recovering, but prospects still required watching. In the first quarter, Japan's GDP increased by 3.9 percent quarter on quarter (annualized), recording positive growth for two successive quarters. Since the beginning of the second quarter, though the unemployment rate remained low, many other economic indicators revealed some instability. Important indices like the manufacturing PMI

data, the industrial production index (IPI), year-on-year growth of commercial retail sales, and year-on-year growth of foreign trade all declined. Given the depressed level of corporate investments, the challenges of the aging population, and the indebtedness and destocking pressures in the corporate sector, the prospects for Japan's economy need to be watched.

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

| Country | Index | 2014Q2 | | | 2014Q3 | | | 2014Q4 | | | 2015Q1 | | | 2015Q2 | | |
|---------------|---|--------|-------|-------|--------|-------|-------|--------|-------|-------|--------|-------|-------|------------------------|-------|-------|
| | | Apr. | May | June. | Jul. | Aug. | Sep. | Oct. | Nov. | Dec. | Jan. | Feb. | Mar. | Apr. | May | Jun. |
| United States | Real GDP Growth Rate (annualized quarterly rate, %) | 4.6 | | | 3.9 | | | 2.2 | | | 0.6 | | | 2.3 (primary estimate) | | |
| | Unemployment Rate (%) | 6.2 | 6.3 | 6.1 | 6.2 | 6.1 | 5.9 | 5.7 | 5.8 | 5.6 | 5.7 | 5.5 | 5.5 | 5.4 | 5.5 | 5.3 |
| | CPI (YOY, %) | 2.0 | 2.1 | 2.0 | 2.0 | 1.7 | 1.6 | 1.6 | 1.3 | 0.7 | -0.2 | -0.1 | 0 | -0.1 | 0 | 0.2 |
| | DJ Industrial Average (closing number) | 16581 | 16717 | 16852 | 16563 | 17098 | 17043 | 17391 | 17828 | 17983 | 17165 | 18133 | 17776 | 17841 | 18010 | 17620 |
| Euro Area | Real GDP Growth Rate (annualized quarterly rate, %) | 0.3 | | | 0.6 | | | 0.9 | | | 1.0 | | | ... | | |
| | Unemployment Rate (%) | 11.6 | 11.6 | 11.6 | 11.6 | 11.5 | 11.5 | 11.5 | 11.5 | 11.4 | 11.2 | 11.3 | 11.2 | 11.1 | 11.1 | 11.1 |
| | HICP (YOY, %) | 0.7 | 0.5 | 0.5 | 0.4 | 0.4 | 0.3 | 0.4 | 0.3 | -0.2 | -0.6 | -0.3 | -0.1 | 0 | 0.3 | 0.2 |
| | EURO STOXX 50 (closing number) | 2978 | 3033 | 3228 | 3115 | 3044 | 3067 | 2998 | 3076 | 3004 | 3198 | 3401 | 3435 | 3439 | 3444 | 3600 |
| Japan | Real GDP Growth Rate (annualized quarterly rate, %) | -6.7 | | | -1.9 | | | 1.5 | | | 3.9 | | | ... | | |
| | Unemployment Rate (%) | 3.6 | 3.5 | 3.7 | 3.8 | 3.5 | 3.6 | 3.5 | 3.5 | 3.4 | 3.6 | 3.5 | 3.4 | 3.3 | 3.3 | 3.4 |
| | Core CPI (YOY, %) | 2.3 | 2.2 | 2.3 | 2.3 | 2.3 | 2.3 | 2.2 | 2.1 | 2.1 | 2.1 | 2.0 | 2.1 | 0.4 | 0.4 | 0.6 |
| | NIKKEI225 (closing number) | 14304 | 14632 | 15162 | 15621 | 15425 | 16174 | 16414 | 17460 | 17451 | 17674 | 18847 | 19207 | 19983 | 20563 | 20236 |

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

Growth in the emerging market economies slowed down and their financial markets experienced volatile fluctuations. Due to numerous factors including their domestic economic structural problems, the tightening external financial conditions, the re-balancing in the global economy, and the increasing geopolitical risks, the growth momentum in the emerging market economies generally weakened. With the USD strengthening and the sharp decline in international commodity prices, countries that had heavily relied on natural resources and energy exports experienced a moderation in economic growth. Countries with strong manufacturing industries have benefited from the declining commodity prices. In particular, growth of GDP in India during the

first quarter was 7.5 percent year on year. Given the uncertainties in the timing of the Fed rate hike, and higher geopolitical tensions, the investors' risk-aversion sentiment increased and some emerging market economies experienced large volatility in their financial markets. The yields of 10-year government bonds in Argentina, Turkey, and Indonesia rose by a large margin.

2. Developments in global financial markets

In the first half year of 2015, the USD was generally strong. On June 30, the exchange rate of the euro, pound sterling, and Japanese yen against the US dollar was 1.1135 dollar per euro, 1.5705 dollar per pound, and 122.49 yen per dollar respectively, a depreciation of 7.95 percent, an appreciation of 0.85 percent, and a depreciation of 2.29 percent respectively from the end of 2014. At the same time, most of the emerging market currencies depreciated. Among them, the Brazilian real lost more than 10 percent against the USD.

The USD Libor in the London Inter-bank Market rose slightly, while the Euribor continued to decline. On June 30, the 1-year dollar Libor posted 0.7715 percent, an increase of 7.7 basis points from the end of March. The 1-year Euribor registered 0.164 percent, a decrease of 3.4 basis points from the end of March.

Government bond yields in the developed economies and in several emerging market economies increased. On June 30, 10-year government bond yields in the United States, Germany, and Japan closed at 2.33 percent, 0.802 percent, and 0.458 percent respectively, up by 39.9, 61.7, and 5.8 basis points from the end of March. Affected by the worsening crisis, the yield of Greek government bonds fluctuated sharply, soaring from a quarter trough of 10.603 percent on June 24 to 15.406 percent six days later, an increase by 480.3 basis points within one week. Meanwhile, the yield of 10-year government bonds in some emerging market economies continued to rise, with those in Argentina, Turkey, and Indonesia surging by 332, 98, and 97 basis points respectively.

Global stock markets showed both ups and downs. On June 30, the Dow Jones Industrial Average Index closed at 17619.51, down by 0.9 percent from the end of the last quarter. The Nikkei 225 Index closed at 20235.73 points, up by 5.4 percent from end-March. The stock markets in the emerging market economies had mixed movements. The stock indices in Russia, Argentina, Brazil, and Turkey surged by 6.8 percent, 7.6 percent, 3.8 percent, and 1.7 percent respectively, but the stock index in Indonesia dropped by 11.0 percent. Starting from June 29, Greece closed its stock market, and on the same day the stock indices in countries like Germany and France generally declined because investors feared that the run on Greek banks could spread to other countries in the euro area.

3. Monetary policies in the major economies

The monetary policies in the major advanced economies diverged, with interest rates generally remaining at a low level. At its regular meetings in March, April, and June the Federal Open Market Committee (FOMC) of the Fed maintained the current 0 to one-quarter percent target range for the federal funds rate, reiterated that it would be appropriate to raise the target range for the federal funds rate when it saw further improvements in the labor market, and stated that it was reasonably confident that inflation would move back to its 2 percent objective over the medium term. But during the Congressional hearings, Fed Chairman Yellen said that “If the economy evolves as we expect, economic conditions likely will make it appropriate at some point this year to raise the federal funds rate target.” The Bank of England (BOE) maintained the Bank Rate at 0.5 percent and the scale of asset purchases at GBP375 billion. The Bank of Japan (BOJ) regarded its monetary easing policy as functioning. It promised to increase injections of base money by 80 trillion yen per year and to carry out its quantitative and qualitative monetary easing policy until the inflation target of 2 percent is reached.

The European Central Bank (ECB) continued to maintain the main refinancing operations (MROs), the marginal lending facility, and the deposit facility at 0.05, 0.3, and -0.2 percent respectively. In January, it announced it would expand asset purchases to €60 billion per month and would include bonds issued by governments and institutions in the euro area. Meanwhile, some small-sized developed economies, such as Sweden, Norway, Iceland and New Zealand, continued their monetary easing policies by lowering their benchmark rates.

Some emerging market economies relaxed their monetary policies in order to boost economic growth. In the first half of the year, the Reserve Bank of India lowered its policy rates three times to 7.25 percent, by a total of 75 basis points. The Central Bank of Russia lowered its benchmark rate on five occasions, by a total of 550 basis points to 11.5 percent. The Bank of Korea lowered its benchmark rate on two occasions, by a total of 50 basis points to 1.5 percent. On April 29, the Bank of Thailand lowered its policy rate by 25 basis points to 1.5 percent. Despite the moderation in the growth rate, some countries tightened their monetary stance in response to inflationary pressures and depreciation pressures. In the first half of 2015, the Central Bank of Brazil increased its benchmark interest rate on five occasions, by a total amount of 250 basis points to 14.25 percent.

4. The global economic outlook and the major challenges

In its *World Economic Outlook (WEO)* released in July 2015, the International Monetary Fund (IMF) revised downward the projection for global growth in 2015 by 0.2 percentage point to 3.3 percent, compared with that in the April edition of the *WEO*. Projections for growth in the United States were revised downward from 3.1 percent to 2.5 percent; projections for growth in the euro zone remained unchanged, and those for Japan were revised downward by 0.2 percentage point to 0.8 percent;

growth in the emerging market and developing economies was revised downward to 4.2 percent. Overall, the global economy still faces the following challenges.

As the rate hike by the Fed is drawing near, global interest rates and cash flows may be affected. Though the minutes of the Fed's meeting in June have been considered dovish and the market expects a delay in the Fed's increase in the rate due to the developments in Greece, the probability of a rate hike during this year remains high. On the one hand, the Fed's rate hike may push up interest rates globally and drive capital back to dollar assets, thereby creating shocks to those emerging market economies that have a fragile balance-of-payments position or that have debt problems. On the other hand, if the timing or strength of the policy adjustments surprise the market, they may also trigger sharp volatility in international financial markets.

Prospects regarding the Greek debt issues still remain uncertain, which continues to impact the euro area and even international financial markets. Since 2015, efforts to resolve the Greek debt problem have experienced ups and downs. The outcome of the Greek referendum in early July revealed that over one-half of Greek citizens were opposed to the rescue plans provided by international creditors. This caused large disturbances in the euro area and global financial markets. At present, the Euro Summit has reached a consensus on an aid program for Greece, and the Greek parliament has voted to adopt the structural reforms and fiscal consolidation proposed by international creditors. As the next step, international creditors will discuss the details of the aid program and continue to urge Greece to carry out domestic reforms as soon as possible. However, considering the strong opposition against the reform within Greece, future prospects for resolution of the Greek debt problem are still not clear.

International commodity prices fluctuated at a low level, with the risk of deflation still existing in some economies. Commodity prices bottomed out in Q2, but the rebound was short-lived. Commodity prices continued to fluctuate at low levels due to sluggish demand in international markets and the strong US dollar. Since July, with the impact of expectations of a Fed rate hike and a strong US dollar, capital has fled in large volumes from commodity and financial assets, resulting in a sharp decline in international commodity prices. At the end of July, the Bloomberg Commodity Index, which tracks 22 kinds of raw materials, fell by nearly 60 percent from its 2008 high. To some extent, the decline in international commodity prices may stimulate consumer demand. However, at the same time, it may increase the risks of deflation in some economies and further complicate the international economic environment.

II. Analysis of China's macro-economic performance

In the first half of 2015, the Chinese economy continued to perform within a reasonable range, with positive developments in terms of structural adjustments. Expansion of consumption was steady and growth of online retail sales remained strong. Growth of

investments stabilized, and investments in infrastructure grew quite rapidly. The trade surplus continued to grow. Industrial production remained basically stable and the share of tertiary industry expanded further. The employment situation was generally stable and consumer prices increased moderately.

According to preliminary statistics, China's GDP registered 29.7 trillion yuan in the first half of 2015, up 7.0 percent year on year in comparable terms. Consumption contributed more to growth, reaching 60 percent in the first two quarters of 2015. The GDP in both Q1 and Q2 grew by 7 percent year on year. Quarter-on-quarter GDP growth was 1.7 percent in Q2. In the first half of 2015, the CPI rose 1.3 percent year on year and the surplus in trade in goods posted 1612.8 billion yuan.

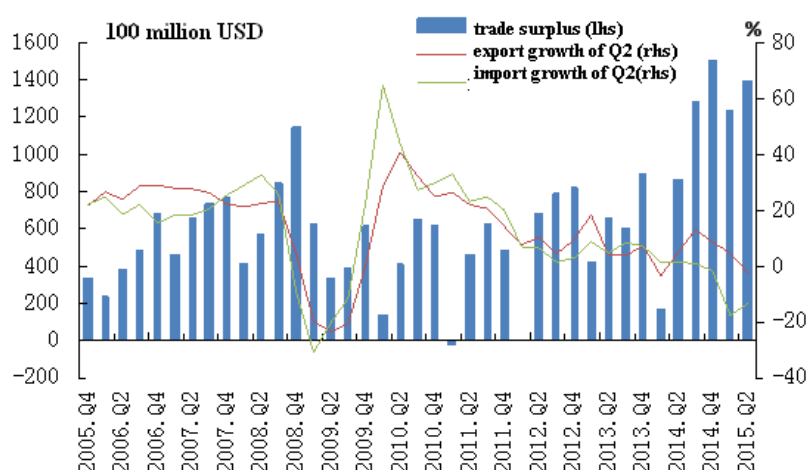
1. Consumption registered steady growth, investment growth stabilized, and the trade surplus continued to grow

Income and consumer demand among urban and rural residents registered stable growth. In H1 2015, per capita disposable income averaged 10931 yuan, gaining 9.0 percent year on year in nominal terms and 7.6 percent in real terms. In particular, the per capita disposable income of urban residents averaged 15699 yuan, up 8.1 percent in nominal terms and 6.7 percent in real terms; the per capita income of rural residents averaged 5554 yuan, up 9.5 percent year on year in nominal terms and 8.3 percent in real terms. According to the Q2 Urban Depositors' Survey conducted by the People's Bank of China, the share of residents willing to consume more registered 16.9 percent, a decline of 1.6 percentage points from the end of Q1, while the share of residents willing to invest more stood at 43.2 percent, 7.3 percentage points higher than that at the end of Q1, indicating the crowd-out effect of asset investments on short-term consumption by residents. Resident sentiment for travel during the following three months was 31.6 percent, which was 2.6 percentage points higher than that during the previous quarter. In the first half of 2015, retail sales totaled 14.2 trillion yuan, up 10.4 percent year on year in nominal terms and 10.5 percent in real terms. Growth of retail sales in the rural areas continued to exceed that in the urban areas, with urban retail sales posting 12.2 trillion yuan, up 10.2 percent year on year, and rural retail sales registering 2.0 trillion yuan, up 11.6 percent year on year. Online retail sales maintained a strong momentum, with the combined value of sales of goods and services reaching 1645.9 billion yuan, up 39.1 percent year on year. The consumption structure has been upgraded, with rapid sales growth in telecommunications and new-energy automobiles, and enhanced demand for sports and entertainment and high-value consumer goods.

Growth of fixed-asset investments stabilized, while infrastructure investments registered relatively rapid growth. In H1 2015, fixed-asset investments (excluding those by agricultural households) reached 23.7 trillion yuan, up 11.4 percent year on year in nominal terms, representing a deceleration of 2.1 percentage points from Q1 and up 12.5 percent in real terms. It is worth noting that the growth of fixed-asset investments rebounded in May and June. Private fixed-asset investments increased by 11.4 percent and accounted for 65.1 percent of the total. Broken down by industries, investments in the

primary, secondary, and tertiary industries grew 27.8 percent, 9.3 percent, and 12.4 percent respectively. In the tertiary industry, infrastructure investments (excluding investments in the electric power industry) posted 4.1 trillion yuan, representing growth of 19.1 percent year on year, which was 7.7 percentage points higher than the growth of total investments. Broken down by regions, year-on-year growth in the eastern, central, and western regions registered 10.1 percent, 14.9 percent, and 9.9 percent respectively. Growth of investments in on-going and new projects posted 3.7 percent year on year, which was 3.3 percentage points less than that in the previous quarter; planned investments for new projects totaled 19.4 trillion yuan, up by 1.6 percent year on year, which was 4.5 percentage points less than the growth in Q1.

The decline in export growth narrowed and the fall in import prices had a major impact on imports. Private enterprises made substantial contributions to exports. In the first half of 2015, total exports and imports reached 11.5 trillion yuan, down 6.9 percent year on year. Exports increased by 0.9 percent year on year to reach 6.6 trillion yuan during the first half of 2015. Exports registered negative growth for the three consecutive months from March to May, but the decline in the margin narrowed month on month. Exports resumed positive growth in June. In Q2, imports dropped by 15.5 percent year on year to total 5.0 trillion yuan, but the decline was 1.8 percentage points less than that during the first quarter. In the first half of the year, the average price of imported goods fell by 10.9 percent, dragging down import growth by 10.3 percentage points. The trade surplus posted 1.6 trillion yuan in H1, gaining by 1.5 times year on year. Exports by private enterprises increased by 6.8 percent, contributing 2.8 percentage points to the growth of total exports. General trade exports grew relatively rapidly, increasing by 6.3 percent year on year and exceeding the growth of total exports by 5.4 percentage points. Broken down by destinations, exports to the United States and the ASEAN countries grew rapidly, by 9.3 percent and 9.5 percent respectively year on year, while exports to the EU and Japan dropped significantly, by 2.5 percent and 10.5 percent year on year.



Source: General Administration of Customs.

Figure 3 The Growth of Exports and Imports and the Trade Balance

Structural adjustments in foreign direct investments (FDI) were still underway and outbound direct investments (ODI) registered fairly rapid growth. In the first half of 2015, utilized FDI totaled 402.5 billion yuan, up 8.3 percent year on year. ODI by domestic non-financial investors totaled 343.2 billion yuan, up 29.2 percent year on year. Utilized foreign investments in the services sector rose 23.6 percent year on year to reach USD 43.43 billion, accounting for 63.5 percent of the national total, while utilized foreign investments in the manufacturing industry declined 8.4 percent year on year to reach USD 20.86 billion.

2. Agricultural production was in a good shape and industrial production remained basically stable

In the first half of 2015, the value-added of the primary, secondary, and tertiary industries were 2025.5 billion yuan, 12964.8 billion yuan, and 14696.5 billion yuan respectively, up 3.5 percent, 6.1 percent, and 8.4 percent year on year, with the growth of the tertiary industries notably exceeding that of the secondary industries. The value-added of the primary, secondary, and tertiary industries accounted for 6.8 percent, 43.7 percent, and 49.5 percent of GDP respectively, and the share of the tertiary industries was 2.1 percentage points higher than that during the same period of the previous year and 5.8 percentage points higher than the share of the secondary industries.

Agricultural production was in a good shape. The production of summer grain totaled 141.07 million tons, growing by 4.47 million tons, or 3.3 percent, year on year. Total production of summer rapeseed registered 13.88 million tons, increasing by 160,000 tons, or 1.2 percent, year on year. In the first half of 2015, the combined output of pork, beef, mutton, and poultry declined 2.4 percent year on year to 39.06 million tons, among which the output of pork dropped by 4.9 percent to 25.74 million tons.

The performance of industrial production remained basically stable. In the first half of 2015, the value-added of statistically large enterprises, if calculated at comparable prices, grew by 6.3 percent year on year, among which growth in June registered 6.8 percent year on year, representing the third consecutive month of growth, and the month-on-month increase in June stood at 0.64 percent. Broken down by sectors, the growth of computers, telecommunications, and other electronic machinery manufacturing industries, non-ferrous metal refining and rolling industries, and the pharmaceutical industry registered 10.8 percent, 10.5 percent, and 10.1 percent respectively, all of which were relatively rapid compared with other industries. In the first half of 2015, the sales-to-output ratio of statistically large enterprises reached 97.3 percent, and the share cost and profit margins of their main businesses were 86 percent and 5.49 percent respectively. Actual profits of statistically large enterprises posted 2844.2 billion yuan, which was 0.7 percent less year on year and 2.0 percentage points narrower than the decline during the first quarter. Among the 41 industrial categories, 32 earned more profits than they did during the same period of the previous year. In particular, the gross profits of petroleum processing, the coking and nuclear fuel processing industry, the water production and supply industry, the comprehensive use of the waste resources industry,

and the chemical fiber manufacturing industry grew relatively rapidly, standing at 78.7 percent, 56.3 percent, 53.4 percent, and 50.6 percent respectively. The corporate performance index remained above the break-even point, the order index rebounded, and the profit index turned for the better. According to the Entrepreneurs' Survey conducted by the PBC during the second quarter, the corporate performance index stood at 51.8 percent, which was 1.0 percentage point lower than that during the previous quarter; the domestic order index rose by 3.7 percentage points to reach 46.3 percent; the export order index increased by 4.5 percentage points to 48.7 percent; the corporate profit index stood at 52.8 percent, which was 1.8 percentage points higher than that during the previous quarter.

3. Consumer prices rose moderately

Growth in consumer prices increased slightly. In the first half of 2015, the CPI rose 1.3 percent year on year, and growth from April through June was 1.5 percent, 1.2 percent, and 1.4 percent respectively, averaging 1.4 percent, an acceleration of 0.2 percentage point from the previous quarter. Specifically, the prices of food and non-food items both increased by a larger margin. In the second quarter, the price of food gained 2.1 percent year on year, an acceleration of 0.2 percentage point from that in the previous quarter, contributing 0.7 percentage point to CPI growth, and the price of non-food items rose by 1.0 percent year on year, an acceleration of 0.2 percentage point from the previous quarter and contributing 0.7 percentage point to CPI growth. Meanwhile, the price of consumer goods went up by 1.1 percent year on year, an acceleration of 0.2 percentage point from the previous quarter, and the price of services grew 2.1 percent year on year, an acceleration of 0.3 percentage point from the previous quarter.

The decline in producer prices widened. In the first half of 2015, the PPI dropped by 4.6 percent year on year, and the decrease from April through June registered 4.6 percent, 4.6 percent, and 4.8 percent respectively, averaging a decline of 4.7 percent, which was 0.1 percentage point more than the decline in the previous quarter. Among this total, the fall in consumer goods and capital goods both fell by a larger margin. In Q2, the price of consumer goods edged down by 6.0 percent year on year, which was 0.1 percentage point more than that during the previous quarter, dragging the PPI down by 4.6 percentage points. The producer purchasing prices decreased by 0.2 percent year on year, accelerating by 0.1 percentage point compared with the decline during the previous quarter, dragging down the PPI by 0.1 percentage point. During the first half of 2015, the CGPI went down by 5.6 percent year on year, which was 3.8 percentage points more than the decline during the same period of the last year. The decline in the prices of primary goods was more substantial, with a deeper drop in the price of investment goods than in the prices of consumer goods. In Q2, the producer prices of agricultural products fell by a larger margin than the prices of agricultural capital goods. The producer prices of agricultural products rose by 1.5 percent year on year as compared to a decline of 0.7 percent in Q1; the prices of agricultural capital goods rose 0.6 percent year on year, in contrast to a decline of 0.9 percent during the previous quarter.

Commodity prices in international markets were on a general decline, but they rebounded in the second quarter. In Q2, the average price of Brent Crude oil futures on the Intercontinental Exchange plunged 42.1 percent year on year, but rose by 15.2 percent quarter on quarter. The average price of copper on the London Metal Exchange plummeted by 10.9 percent year on year but increased by 3.9 percent quarter on quarter. The average price of spot aluminum fell by 1.8 percent year on year in Q2 and by 1.9 percent quarter on quarter. As there is a time lag in the effects of the plunge in commodity prices, the decline in import prices widened further. In the first half of 2015, import and export prices fell by 10.7 percent and 1.1 percent respectively. From April through June, import prices fell by 12.8 percent, 12.8 percent, and 9.3 percent respectively, averaging 11.6 percent. This was 1.8 percentage points more than the fall during the previous quarter. Export prices grew by -1.5 percent, -2.3 percent, and 0.5 percent respectively, averaging -1.1 percent, which was flat with that in the previous quarter.

The decline in the GDP deflator narrowed. In the first half of 2015, the GDP deflator (the ratio of nominal GDP to real GDP) was -0.5 percent, down by 1.5 percentage points from the same period of the last year and down by 0.6 percentage point from the previous quarter.

The price reform continued. On May 4, the National Development and Reform Commission (NDRC) issued a joint notice with other relevant departments, stipulating that beginning on June 1 2015, price controls on drugs, except for those on anesthetics and first-category psychiatric medications, would be lifted; the drug purchase mechanism would be improved and payments under the national insurance would be subject to guidelines, so that the trading prices of medicines would be formed based on market competition. On May 22, the NDRC and the State Postal Bureau jointly issued a notice stating that, beginning on June 1 2015, the pricing of some domestic postal services, including special express services, would be market-based rather than controlled by the government. On June 3, the NDRC issued a joint notice with other relevant authorities, providing that from the date of issuance of the notice, the price standards for textbooks, notarial services, and judicial identifications would be subject to provincial variations. On June 7, the NDRC issued a joint notice with other relevant departments to further liberalize price controls over mobile phone testing, bar code services, and the testing of ships and products for marine services so that the specialized service providers would have discretion to price such services.

4. Fiscal revenue and expenditures posted low growth

In the first half of 2015, fiscal revenue rose 4.7 percent in comparable terms³ to 8.0 trillion yuan, decelerating by 4.1 percentage points year on year. The growth of fiscal revenue remained subdued mainly due to the decline in the growth of tax revenue as a result of the

³The 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. Growth of other items refers to growth in the absolute value of revenue and expenditures in 2015, as compared with the same period of the previous year.

slowdown in industrial growth, shrinking imports, and the drop-off in the growth of corporate profits. Fiscal expenditures reached 7.7 trillion yuan, up 10.6 percent year on year in comparable terms, a deceleration of 5.2 percentage points year on year. Fiscal revenue exceeded expenditures by 231.2 billion yuan, a decline of 317.2 billion yuan year on year.

In terms of the structure of fiscal revenue, non-tax revenue rose 11.5 percent in comparable terms year on year to total 1.3 trillion yuan, and tax revenue went up 3.5 percent year on year to 6.7 trillion yuan. Among this total, the domestic value-added tax, consumption tax, and turnover tax went up by 2.4 percent, 16.5 percent, and 6.0 percent respectively year on year, while the value-added tax, consumption tax, and turnover tax increased by 2.4 percent, 16.5 percent, and 6.0 percent year on year respectively; the value-added tax of imported goods and the consumption tax declined by 14.5 percent year on year, and the corporate income tax and the personal income tax gained 4.9 percent and 16.8 percent respectively year on year. Outlays for social security and employment, energy conservation and environmental protection, urban and rural communities, and transportation rose fairly rapidly, by 20.9 percent, 19.9 percent, 19.1 percent, and 18.7 percent respectively.

5. The employment situation was basically stable

In the first half of 2015, new urban employment was 7.18 million, fulfilling 71.8 percent of the target for the year. By end-Q2, the urban registered unemployment rate stood at 4.04 percent, a slight decline year on year and quarter on quarter. In Q2, a statistical analysis by the China Human Resources Market Information Monitoring Center, based on market supply and demand information provided by public employment service institutions in 101 cities, indicated that market demand slightly exceeded market supply and the ratio of job seekers to job vacancies was 1.06, a decline of 0.05 year on year and 0.06 quarter on quarter. Broken down by industry, demand for labor in sectors such as transportation, warehousing and postal services, and financial services increased by a relatively large margin compared with that during the same period of the previous year, while the demand for labor in industries such as construction, the agricultural, forestry, animal husbandry, and fishery industries, and wholesale and retail services declined more significantly. Broken down by professional or technical qualifications, demand for labor with beginning or intermediate professional levels exceeded supply. Demand for labor of various professional or technical qualifications fell year on year, while it increased quarter on quarter.

6. International payments and expenditures were generally balanced

The balance of payments registered a small surplus. In Q1, the current account surplus registered USD 75.6 billion, accounting for 3.3 percent as a share of GDP during the period, which was within the internationally accepted reasonable range. The capital and financial account deficit stood at USD 17.9 billion, among which the capital account surplus was USD 200 million and the financial account deficit was at USD 18.1 billion. By end-June, total reserve assets reached USD 3.69 trillion.

By end-March 2015, the total outstanding external debt posted USD 1673.2 billion, among which USD 804.7 billion, or 48.1 percent, was denominated in domestic currency, and USD 868.5 billion, or 51.9 percent, was denominated in foreign currency (including SDR allocations). Among this total, the outstanding value of the medium- and long-term external debt registered USD 494.2 billion, accounting for 29.5 percent of the total, and the outstanding value of the short-term debt stood at USD 1179 billion, accounting for 70.5 percent of the total. Among the short-term external debt, 50.5 percent was credit related to trade.

7. Sector analysis

(1) The real-estate sector

Nationwide turnover of commercial real estate stabilized and rebounded, and more cities reported higher real-estate prices. The growth of investment in real-estate development continued to decline, while real-estate loans continued their stable growth.

More cities reported higher housing prices. In June, the price of newly-built commercial residential housing increased quarter on quarter in 27 out of 70 large- and medium-sized cities, 15 more cities than in March 2015; and housing prices rose year on year in 2 cities, 2 more than in March 2015. The price of pre-owned residential housing increased quarter on quarter in 42 cities, 30 more than in March 2015, and grew year on year in 4 cities, 3 less than in March 2015.

The turnover of commercial real estate stabilized and rebounded, and the floor area and value of commercial real-estate sales increased year on year. In the first half of 2015, the nationwide floor area of sold commercial real estate posted 500 million square meters, up 3.9 percent year on year, as opposed to a decline of 0.2 percent in January and May; the sales value of commercial real estate rose 10.0 percent year on year to 3.4 trillion yuan, which was 6.9 percentage points more than the increase from January to May of 2015, and it registered positive growth for the two consecutive months of May and June; the sold floor area and the sales value of commercial residential housing accounted for 88.3 percent and 84.5 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 the first half of 2015, nationwide investment in real-estate development went up by 4.6 percent year on year to reach 4.4 trillion yuan, a deceleration of 3.9 percentage points compared with the growth in the first quarter of 2015. In particular, investment in residential housing posted 3.0 trillion yuan, up 2.8 percent year on year and a deceleration of 3.1 percentage points from Q1 2015, accounting for 67.1 percent of the total investment in real-estate development. The floor area of newly started real-estate projects declined 15.8 percent year on year to 670 million square meters, which was 2.6 percentage points less than the growth during the first quarter of 2015. The floor area of real-estate projects under construction grew 4.3 percent year on year to 6.38 billion square meters, representing a deceleration of

2.5 percentage points compared with the previous quarter. The floor area of completed real-estate projects posted 0.33 billion square meters, representing a year-on-year decline of 13.8 percent, which was 5.6 percentage points more than the decline during the previous quarter.

Growth in real-estate loans rose relatively rapidly. As of end-June 2015, outstanding real-estate loans of major financial institutions (including foreign-funded financial institutions) stood at 19.3 trillion yuan, up 19.4 percent year on year, which was flat with that at end-March 2015. Outstanding real-estate loans accounted for 21.7 percent of the total outstanding loans, which was 0.3 percentage point higher than that at the end of March 2015. In particular, outstanding mortgage loans rose 18.2 percent year on year to 11.7 trillion yuan, an acceleration of 0.3 percentage point from end-March 2015; outstanding housing-development loans gained 21.9 percent year on year to 3.7 trillion yuan, a deceleration of 2.3 percentage points from end-March 2015; outstanding land-development loans rose 32.8 percent year on year to 1.5 trillion yuan, an acceleration of 2.2 percentage points from end-March 2015. During the first half of 2015, new real-estate loans registered 1882.9 billion yuan, accounting for 28.7 percent of total new loans, which was 1.7 percentage points higher than that in Q1 2015.

Welfare-housing loans grew quite rapidly. By end-June 2015, outstanding loans for welfare-housing development posted 1.5334 trillion yuan, up 58.2 percent year on year, which was 6.1 percentage points lower than that at end-March 2015; among this total, new welfare-housing development loans reached 389.5 billion yuan in the first half of 2015, accounting for 68.6 percent of new real-estate development loans during the same period, which was 24.8 percentage points more than that in the first quarter. In addition, the pilot program of using housing provident fund loans to support the construction of affordable housing proceeded steadily. At end-June 2015, 362 welfare-housing projects in 83 cities were granted loan approvals and received 81.05 billion yuan in loan disbursements based on the construction progress, and 36.46 billion yuan of the principal was repaid.

(2) Shipping industry

The shipping industry is a comprehensive industry of strategic importance, providing technologies and equipment for maritime transportation, resource development, and national defense in the modern age, and it can drive the development of key industries, such as the steel, chemical, textile, machinery manufacturing, and electronic information industries. The shipping industry is a vital component of high-end manufacturing industry in China, and it also provides the foundation and significant support for the implementation of maritime strategy.

As a result of its rapid development since the beginning of the new century, China is already among the major ship manufacturers in the world, with strong international competitiveness. However, impacted by the international financial crisis, demand in the international shipping industry has plunged and there has been a significant lack of new orders, imposing downward pressures on the shipping industry in China. Recently, amidst

the moderate recovery of the global economy, China's shipping industries began to show signs of recovery. In the first half of 2015, a total of 185.3 thousand DWT (deadweight tonnage) was completed by the Chinese ship manufacturing industry, rising 6.3 percent year on year; among this total, 167.1 thousand DWT of ships were exported, a year-on-year increase of 8.5 percent. The 88 key enterprises in the shipping industry had a main core turnover of 141 billion yuan, which was 4.5 percent more year on year; and their gross profits stood at 2.47 billion yuan, which represented a decline of 3.5 percent year on year. Compared with its major global competitors, the shipping industry in China is recovering relatively slowly. According to the statistics of Clarkson, new orders of global shipping enterprises reached 13.28 million CGT in the first half of 2015, among which 5.92 million were acquired by companies in the Republic of Korea (ROK), accounting for 45 percent of the world's total; 2.68 million were acquired by Japanese enterprises, which accounted for 20 percent of the world's total; and the ranking of newly acquired orders by Chinese enterprises for the first time was number two in the world; the number of orders acquired by Chinese companies was 2.56 million, ranking number three worldwide, accounting for 19 percent of the total. However, by end-June 2015 the number of holding orders in the shipping industry posted 40.96 million CGT, still ranking number one worldwide. This was followed by the ROK and Japan, with holding orders of 32.8 million CGT and 19.79 million CGT respectively.

Currently, the world shipping industry has entered a new round of profound adjustments, and competition has become fiercer in terms of technology, products, and the market. Though large in size, the shipping industry in China is yet to be more competitive, and the lag in recovery also exposed the medium- and long-term problems faced by the industry during its development, including its excessive low-end capacity and its lack of high-end capacity, amounting to an outstanding structural overcapacity; the core equipment of key parts have an inadequate brand image and scale of production, and their comprehensive technological capacity is yet to improve; the supporting industries lag behind in their development, and there is a dire need for higher efficiency in production. During the next stage, in order to facilitate the maritime development strategy and promote the maritime silk road in the twenty-first century, the shipping industry should accelerate its structural adjustments and upgrading, enhance self-initiated innovations, expand the high-end market of shipping and maritime engineering equipment, and promote its international capacity and equipment manufacturing cooperation. Efforts should be made to diversify the ownership structure, encourage key shipping manufacturing enterprises to carry out mergers and acquisitions, encourage large shipping enterprises to form strategic alliances with companies on the upper and lower streams, and guide business structural adjustments of medium and small shipping enterprises. Meanwhile, policy measures should be launched to provide financial support for the restructuring of the shipping industry by encouraging financial institutions to provide credit and financing support based on commercial rules and to channel more funds to export buyer credits for ships.

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

I. Outlook for the Chinese economy

As the global economy is still recovering, complexities and divergences will remain important features of the global economy for a period to come. In general, economies that are flexible, have reached market clearing and have moved rapidly in structural adjustments have displayed a stronger recovery momentum. Against the backdrop of global adjustments, the Chinese economy has entered a new normal. In essence, this is about the transformation of the development pattern and the adjustment of the economic structure. A period of structural adjustments may bring downward pressures for the short run, but for the medium and long term it will inject vitality for sustainable growth. During this process, it is important to strike a balance among seeking stable growth, promoting reforms, adjusting the structure, improving welfare, and preventing risks, and to combine innovation in macro-economic management with promoting structural reforms. Though the external environment remains complex, there are favorable conditions for the Chinese economy to maintain steady and fairly rapid growth. In the short run, macro-economic management experiences have been accumulated. The effect of a series of growth-supporting policies is gradually unfolding. Monetary policy is focusing more on preemptive adjustments and fine-tunings as well as the need to adopt a stance that is neither too tight nor too loose. The conduct of monetary policy seeks to implement the aggregate policy and give more weight to a structural optimization. The liquidity situation is generally adequate, market interest rates remain low, and the financing costs of the real economy are declining. These factors provide a good basis for the financial sector to beef up support for the real economy and to support job creation and economic growth. The Enterprise Survey conducted by the PBC in Q2 shows that the export order index and the domestic order index were 4.5 percentage points and 3.8 percentage points higher respectively than in the previous quarter. The quarterly Urban Depositors' Survey conducted in Q2 shows that the future income confidence index was 0.1 percentage point higher than in the previous quarter, while the future employment index remained stable. Expectations have remained steady. Looking at the medium term, economic growth will not be driven by strong stimulus measures. Rather, it will be

buttressed by the vitality released by reform and innovation. As measures to delegate power to lower levels of government, streamline administrative procedures, and optimize services are being implemented, the number of newly registered companies has grown rapidly amidst an emerging wave of massive entrepreneurship. These measures will strengthen the internal drivers of growth. The implementation of the maritime and land silk road initiative, the integrative development strategy of Beijing, Tianjin, and Hebei and the development of the Yangtze River Belt, the ongoing railway, water conservancy, shanty town renovation, and other major projects also contribute to stable investment and economic growth. The twin engines of massive entrepreneurship and innovation as well as the increased supply of public goods and services will support economic growth. In the long run, the good fundamentals in the economy will remain unchanged, and resilience, potential, and large room for further development will continue to exist. In particular, with the progress of structural adjustments and service-sector growth, the boom in investment in IT, leasing and business services, science and technology services, health services, the agricultural, forestry, animal husbandry, and fishery sectors, and the new growth points such as the Internet economy and the various sectors providing services to consumers, the growth potential will be released as the structural adjustments and reform are further implemented. The reform dividends will push up the productivity of factors and promote sustainable economic growth with higher quality.

Of course, it is worth noting that there are deep-rooted problems and challenges. The worldwide recovery has experienced twists and turns, and uncertainties and destabilizing factors will emerge while the structural adjustments are proceeding. As the market expects that the Fed interest hike is drawing close, the exchange rates of the major currencies might experience large swings and uncertainties in cross-border capital flows might increase, further complicating domestic efforts for macro-economic management. Looking at the domestic front, the economy is heavily dependent on policies aimed at stabilizing growth and government-led investments, hence the endogenous growth drivers need to be further strengthened. The tasks of reform and structural adjustments remain arduous. Due to the relative lack of new growth points and investment areas, the effective transmission of monetary policy is affected. As a result of financial innovation and technology development, funds will flow and easily accumulate, and asset prices will see larger fluctuations. These factors, combined with the continued build-up of debt, may create potential risks in the real sector and the financial system. The key to resolving these problems and challenges is to promote structural adjustments, deepen the reforms, further open up, build a stronger basis, seek breakthroughs in key areas, and let the market play its role in terms of equal access, promoting competition, and allocating resources to unleash the growth potentials. It is necessary to foster and strengthen new growth points, encourage economic activities, improve the quality and efficiency of growth, and expand the areas for the effective allocation of financial resources.

Price levels remain low and stable. Future price movements should be watched. The

global economy is gradually recovering while it is undergoing a process of structural adjustments. Commodity prices are diverging and fluctuating. The Chinese economy is changing gears and experiencing structural adjustments. The supply capacity is adequate, but the overcapacity problem is noteworthy in certain sectors. Against this background, there are good conditions for price inflation to remain low. Monetary policy does not respond to price movements of individual goods, but rather it looks at overall price levels. As the series of policy measures recently adopted to preserve stable growth are producing results, demand has recovered mildly and support of price levels remains stable. According to the Entrepreneurs' Survey conducted by the PBC in Q2, the product selling price index and the raw material purchase price index were 1.8 percentage points and 1.9 percentage points higher respectively than in the previous quarter. The Q2 Urban Depositors' Survey showed that the future price expectation index rebounded mildly from the previous quarter to 60.4 percent, and the household price expectation index remained stable. Future price movements will hinge on the domestic and external economic environment and on the macro-economic situation. There will be continued monitoring.

Box 4 Several Issues regarding Monetary-Policy Transmission

In recent years, in response to the economic performance, the central bank has used a combination of various monetary-policy instruments to adjust the price and quantity of liquidity in the banking system in order to create a neutral monetary environment for economic growth, structural adjustments, and the upgrading of the growth model. Overall, the sound monetary policy has produced positive results, as indicated by the stable performance of the real economy and the financial system. Yet there are problems in the transmission of monetary policy, such as the steepening of the yield curve and the structural problems of the high financing costs and the lack of access to financing.

The effectiveness of monetary policy depends on both policy formulation and policy transmission, on both the central bank and the economic agents, and on both the internal and external environments. In general, credit and interest rates are the most important channels of monetary-policy transmission

The credit channel includes the bank credit channel and the balance sheet channel. Monetary policy has an impact on the supply and demand of credit through the bank credit channel, eventually affecting consumption and investment; monetary policy has an impact on the balance sheet of the corporate sector, affecting investment activities in the sector. Transmission of the credit channel hinges on the balance sheet situation of the corporate sector, the lending capacity of the banking sector, the level of the risk premium, and so forth. Presently, the indebtedness of the corporate sector is high. The build-up of NPL risks has increased the risk premium and has eroded the profit-making capacity of banks. Thus, the efficiency of monetary-policy transmission has been reduced. In addition, for the credit channel to play a role, credit resources

should be allocated efficiently by the credit market. This requires a well-established market exit mechanism and a NPL disposal mechanism to allow inefficient enterprises to exit the market and for banks to dispose of NPLs promptly so that the released funds can be channeled to efficient companies. Take the experience of quantitative easing in the US and Japan as examples. Japan was the first country to adopt a quantitative easing policy. However, after the asset bubble burst in the 1990s, Japan's economy remained sluggish for many years. One important reason for this was the absence of an effective market exit mechanism. In contrast, in the aftermath of the global financial crisis, financial institutions, the household sector, and the corporate sector in the US experienced painful but relatively swift adjustments through default and bankruptcy. The number of bank failures reached 140 and 157 in 2009 and 2010 respectively, while the application of business bankruptcies totaled 420,000 cases in Q2 2010. Against this background, the QE policy produced relatively good results. Nevertheless, it is not realistic to expect the credit market to do all of the work in allocating credit resources. Small and micro enterprises have difficulties in accessing the credit market due to their inability to meet capital and collateral conditions. Such a situation exists in many countries. Therefore it is necessary for governments to provide credit enhancements and other public goods for these enterprises and to develop a multi-tiered capital market to create multiple financing channels.

The interest-rate channel refers to the transmission from short-term interest rates to medium- and long-term rates, and from money market rates to bond and credit market rates. In general, the central banks in the developed economies adjust the short-term interest rates. Such movements are then transmitted to medium- and long-term interest rates through maturity arbitrage in the market. The functioning of the interest-rate channel depends to a large extent on the stable expectations of market participants regarding the future path of policy rates. In China, the monetary-policy framework is in transition from being based on a quantitative instrument to being based on price instruments. We are using price instruments such as short-term and medium-term rate adjustments, and adjustments of the benchmark deposit and loan interest rates to transmit price signals to the market. The combination of quantitative and price instruments plays an important role in the conduct of monetary policy. Of course, as a result of financial innovation and market development, it will be increasingly difficult for monetary policy to combine quantity and price objectives. The mechanism is being improved for better transmission of the interest-rate channel and for stable expectations. In addition, the effective transmission of interest-rate signals requires well-developed financial markets. It is necessary to promote infrastructure building for the financial markets.

For the above-mentioned channels to work effectively, it is essential for market participants to respond promptly to signals. For example, the existence of soft financial constraints, which are cost insensitive, tend to crowd out hard constraints and result in adverse selection. The behavior of local governments also has an important impact as large fluctuations in the supply of local government bonds will

affect the yield curve. Furthermore, the freezing of a massive amount of funds by mechanisms such as new stock issuances, the interest rates of the major economies, and other external factors may also affect the domestic interest-rate level and the shape of the yield curve.

Overall, in order for monetary policy to be effective, it is necessary to adopt policy measures at the proper timing and with the appropriate strength, and to improve the transmission mechanism through reform. On the one hand, the monetary-policy framework should be improved to move gradually from being based on quantitative instruments to being based on prices, to improve the yield curve, and to enhance the capacity of the financial sector to provide services to the real sector. On the other hand, multiple measures should be taken to promote financial market development, improve the yield curve, the market exit mechanism, and the NPL disposal mechanism, and to develop a multi-tiered capital market. Meanwhile, structural adjustments and reform will be furthered to nurture endogenous growth points to provide good opportunities for profitable and sustainable investments and for the financial sector to have good interactions with the real sector.

II. Monetary policy during the next stage

The PBC will earnestly implement the decisions of the 18th CPC National Congress, the 3rd and 4th Plenary Sessions of the 18th CPC Central Committee, the Central Economic Work Conference, and the Report on the Work of the Government, and will follow the strategic arrangements of the Party Central Committee and the State Council. The PBC will adhere to the guideline of seeking progress while maintaining stability and the overall principle of maintaining stable macro-economic policies while adopting flexible micro policies, take initiatives to adapt to the new normal in the economy, maintain the consistency and stability of policies, continue to implement a sound monetary policy that is neither too tight nor too loose, and conduct timely and appropriate fine-tunings and preemptive adjustments in order to create a neutral monetary and financial environment for the structural adjustments and the upgrading and transformation of the economy and to promote sustainable and balanced development of the economy. There will be an increased focus on reform and innovation and more measures to integrate reform and macro-economic management, to combine monetary-policy adjustments with continued reform, and to enable the market to play a decisive role in resource allocations. Measures will be adopted in view of the deepening of financing and innovation to improve the monetary-policy framework, to support the smooth transmission of monetary policy to the real economy, to resolve outstanding issues, and to improve the efficiency of the financial system and services to the real sector.

First, a combination of various monetary-policy instruments will be employed, macro-prudential regulation will be enhanced and improved, and the combination of

policy measures will be optimized to keep liquidity at an appropriate volume and to realize the opportune growth of money, credit, and all-system financing aggregates. In view of the changes in the domestic and international economic and financial conditions, we will flexibly utilize various monetary-policy tools, improve the central bank collateral management framework, maintain liquidity at an appropriate level, and preserve the stability of the money market. 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. Taking into consideration the five major factors of the recipients of agro-supporting and small enterprise supporting lending, the level of the capital adequacy ratio, the risk and internal control situation, the establishment of new outlets and subsidiaries, and regional development, the central bank will decide on and adjust the policy parameters to realize differentiated treatment and to guide financial institutions to manage the pace and structure of lending based on real demand and seasonal features to support the real economy. The mechanism and approach of macro-prudential regulation will be improved.

Second, the stock of credit assets will be revitalized and the use of new loans will be optimized to support the structural adjustments, the transformation of the growth model, and the upgrading of the economy. In accordance with the basic principle of the financial sector providing services to the real sector, efforts will be made to optimize the structure and direction of liquidity, implement measures for a targeted reserve requirement ratio reduction, make good use of credit policy supporting central bank lending, central bank discounts, and pledged supplementary lending to guide financial institutions to optimize the credit structure. There will be efforts to promote innovation in financial services and products, to continue the policy measures to support small and micro-enterprises, to expand the financing channels for small and micro-enterprises, and to support their sound development. Assessments of the effects of the credit policy guidance will be further improved and the results of such assessments will be closely linked with the utilization of monetary policy and financial market tools to guide financial institutions to increase credit to the agricultural sector, rural areas, farmers, and small and micro enterprises. Better financial services will be provided to support the strategy of innovation-driven development, financing products tailored to the needs of enterprises in technology innovation will be designed, and financial institutions will be encouraged to enhance support to science and technology, culture, the strategic emerging industries, and other key areas. Efforts will be made to provide financial services for the removal of excess capacity, to develop green financing, to provide financial services for the integrated development of Beijing, Tianjin, and Hebei, and to improve the quality of financial services. Efforts will be made to provide financial services for development-oriented poverty reduction and to facilitate the development of micro-credit for poverty alleviation, and to strengthen coordination of financial services for large and extremely poverty-stricken areas. Financial inclusion will be actively promoted and financial support and services related to the people's livelihood

will be enhanced, such as those supporting employment, education, ethnic minorities, migrant workers, and college-graduate-turned village officials. The differentiated housing mortgage policy will be implemented to support the building of welfare housing and to support rational home buying by households, and to further expand normal and market-based financing channels. Development and policy-related financing will continue to play a role in major and large construction projects, such as reconstruction of shantytowns, water conservatory projects, and railways in the mid-west regions. A number of measures will be taken to reduce the costs of financing in the entire economy, such as maintaining the reasonable growth of money and credit, improving the corporate governance of banks, cleaning up the unreasonable financial service charges, improving a multi-tiered capital market, increasing the supply of financial services, deepening the reforms and structural adjustments, and so forth.

Third, the market-based interest-rate reform and the RMB exchange-rate regime reform will be deepened to improve efficiency in the allocation of financial resources and to improve the monetary-policy framework. The self-regulatory market interest-rate pricing mechanism will be improved to build the independent pricing capacity of financial institutions. The issuance and trading of inter-bank certificates of deposit will be promoted and we will explore the introduction of certificates of deposit to corporate and individual customers to gradually increase the range of market-priced liability products of financial institutions. Efforts will be made to develop the Shibor and the Loan Prime Rate to build a fairly complete market interest-rate system. The central bank interest-rate adjustment framework will be improved to guide stable expectations and to improve the transmission mechanism. The RMB exchange-rate regime will be further improved to allow market demand and supply to play a greater role, to enhance 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 demand. 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 settlement of cross-border trade activities. The impact of the changing international situation on capital flows will be carefully watched and effective monitoring of cross-border capital movements will be strengthened.

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 up, and preventing financial risks. The financial infrastructure and the institutional arrangements will be strengthened to provide a more efficient investment and financing market for economic structural adjustments and upgrading. Market

innovations will be encouraged to diversify the products and layers in the bond market and to better meet investor demands. The market-making mechanism will be improved to enhance liquidity in the bond market and to lay a solid foundation for an effective yield curve. The investor base will be expanded and market participants will be diversified. The diversity of financial markets, financial products, investors, and financing intermediaries will be further promoted. Qualified overseas and domestic institutional investors will be welcomed to invest in the inter-bank bond market. The risk-sharing and market-discipline mechanisms will be strengthened. The sound development of the credit asset securitization market will be encouraged. We will implement measures to promote direct financing and to develop a multi-tiered capital market. Market supervision and the role of the corporate debenture bond joint ministerial coordination mechanism will be enhanced. We will further strengthen regulatory coordination and facilitate the development of market discipline mechanisms, such as information disclosures and credit ratings, to regulate the trading behavior of market participants, to prevent financial risks, and to promote the efficient operation and sound development of financial markets.

Fifth, the reform of financial institutions will be deepened to improve financial services by increasing supply and enhancing competition. The reform of large commercial banks and other large financial institutions will be furthered to continue to improve corporate governance, to build effective mechanisms for decision making, execution, and checks and balances, and to translate the principle of corporate governance into daily operations and risk-control behavior. The program of deepening reform will be implemented by the Bank of Communications. The Agricultural and Rural Services Division of the Agricultural Bank of China will continue to improve its capacity to provide services to the agricultural sector, rural areas, farmers and customers at county levels. A reform program for policy and development financial institutions will be implemented to establish capital constraint mechanisms, improve the governance structure, and improve the fiscal supporting policy in order to foster policy financial institutions with Chinese characteristics that operate on a sustainable basis and provide good services to support economic development. The shift to market-based operations of asset-management companies will be further promoted. Under the precondition of stronger supervision, the development of various kinds of financial institutions, financial service organizations, and intermediary agencies will be encouraged to build a financial eco-environment for fair competition with participation by all kinds of market participants. The various concerned departments will work together based on their division of labor to implement the *Guidelines on Promoting the Sound Development of Internet Financing*, to encourage innovation, to prevent risks, to strengthen regulation and industry self-regulation, and to guide Internet financing to provide services to the real sector.

Sixth, effective measures will be adopted to mitigate systemic financial risks and to preserve stability in the financial system. Macro-prudential regulation will be enhanced to guide financial institutions to operate on a sound basis and to encourage

them to strengthen internal controls, improve credit and liquidity management, and improve their risk control capabilities. The financial risk early-warning mechanism and the identifying and resolution mechanism will be improved with a focus on maintaining stable market expectations. The monitoring and analysis of local government debts, the real-estate sector, industries suffering from overcapacity, shadow banking businesses, and mutual guarantees and joint peer guarantees of enterprises will be enhanced to identify potential risks on a continual basis and to urge financial institutions to draft response plans for various scenarios. The Financial Regulatory Coordination Joint Ministerial Conference will play a role in enhancing risk monitoring and in regulating coordination of cross-sector and cross-market products, in coordinating development of various financial markets and instruments, and in establishing a system of comprehensive financial statistics and an information-sharing mechanism. Earnest efforts will be made to establish a deposit insurance regime. A comprehensive set of measures will be taken to preserve financial stability and to safeguard the bottom line of preventing systemic and regional financial risks.