2014 CHINA FINANCIAL MARKET DEVELOPMENT REPORT

PBC Shanghai Head Office
China Financial Market Development Report Committee

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Part I Overview

In 2014, in the face of complicated and volatile international environment and the tough task of promoting domestic reform, development and stability, China deepened reform comprehensively and conducted pre-emptive adjustment and fine-tuning in macro regulation. As a result, China's economy operated within a reasonable range and economic structure underwent positive changes, providing real economic basis for sustained financial market innovation and regulated development. Full-year performance showed that the size of financial markets grew substantially, market structure was further improved, innovations were launched continuously, institution building was increasingly strengthened, opening up went ahead stably, and the capacity of financial markets for supporting the real economy was further enhanced.

1. Analysis of the macro environment for China's financial market development in 2014

1.1 Analysis of international economic and financial conditions

In 2014, world economy as a whole continued slow recovery, divergence among different economies in the degree of recovery and macroeconomic policies became more obvious, and international financial markets witnessed larger swings and further divergence.

1.1.1 Recovery of advanced economies diverged while emerging market economies were under downward pressure

In 2014, recovery of advanced economies started to diverge. In the US, economy regained speed amid decreasing unemployment rate; in the euro area, economic recovery was anemic, with unemployment rate remaining at a relatively high level; and in Japan, economic output slumped. Emerging market economies saw a broad slowdown, and growth of global trade and cross-border direct investment missed the expectation.

1.1.1.1 Recovery of advanced economies diverged

In the US, economic recovery continued to take hold, and macroeconomic policy was back to normal. In early 2014, severe cold, which was rare in the US, caused the economic output to contract 2.9% quarter-on-quarter in the first three months, a five-year low. As the impact of harsh weather receded, the economy started to rebound in the second quarter, as industrial production and fixed asset investment picked up, while household consumption expenditures rose moderately. The annualized quarter-on-quarter growth of real gross domestic product (GDP) increased to 4.6% in the second quarter, while the annual growth rate was 2.2%. Sustained improvements were reported in job market. In December, the unemployment rate in the

US dropped to 5.6%, the lowest since the outbreak of global financial crisis. Inflationary pressure was modest. In the first half of the year, the year-on-year growth of monthly consumer price index (CPI) increased slightly, reaching the highest of 2.1%, but fell in the second half of the year to 0.8% in December, which was within the 2% target set by the US Federal Reserve (Fed). At the end of October in 2014, the Fed stopped buying long-term US treasury bonds and mortgage-backed securities (MBS), but kept federal funds rate unchanged at a low level of 0-0.25%.

In the euro area, economic recovery was sluggish. In 2014, economy in the euro area maintained the growth rate seen in 2013, as the annualized quarter-on-quarter growth of real GDP for each quarter posted 0.3%, 0.1%, 0.2% and 0.1% respectively. Inflation remained subdued. In December, the year-on-year growth of CPI in the euro area was -0.2%, the lowest level in recent five years. Unemployment rate stayed elevated at 11.4% in December. To channel bank credit to the real economy and, in particular, boost credit to small and medium-sized enterprises (SMEs), the European Central Bank (ECB) announced a package of accommodative monetary policy on June 5, 2014, which included introducing the targeted longer-term refinancing operations (TLTRO), preparing asset-backed securities (ABS) buying program, extending the conducting of main refinancing operations (MROs) as fixed rate tender procedures with full allotment to the end of 2016, and suspending the operation sterilizing the liquidity injected under the Securities Markets Program (SMP).

In Japan, the economic output dropped substantially. In April 2014, the Japanese government increased the consumption tax from 5% to 8%, which delivered immediate negative effects, as the year-on-year growth of CPI which had been increasing for 14 months suddenly reversed in May, decreasing persistently to 2.5% in December. The economic output slumped, with the annualized quarter-on-quarter growth of real GDP falling from 5.8% in the first quarter to -6.7% in the second quarter and -1.9% in the third quarter, putting the economy on the verge of recession. Given this, the Bank of Japan (BOJ) decided on October 30 to further expand the size of quantitative easing (QE). Then the Japanese government announced on November 18 that another consumption tax hike would be delayed by 18 months to April 2017.

1.1.1.2 Emerging market economies saw a broad-based slowdown

In 2014, the growth of emerging market economies moderated broadly, with countries experiencing a slowdown accounting for about 80% of the total, including such BRIC (Brazil, Russia, India and China) countries as Russia and Brazil. Emerging markets and developing countries were projected to grow 4.4% in 2014 by the International Monetary Fund (IMF), sinking 0.3 percentage points from 2013. In addition, the IMF estimated that the potential growth of emerging market economies would slide 1.5 percentage points as compared with 2011.

1.1.1.3 Growth of global trade and cross-border direct investment was weaker than expected

Growth of global trade and cross-border direct investment missed expectations due to anemic growth in such advanced economies as the euro area and Japan as well as the economic slowdown in emerging market economies. Statistics by the World Trade Organization (WTO) showed that the volume of global goods trade went up 1.8% year-on-year in the first half of 2014, 0.3 percentage points lower than the annual growth in 2013. In particular, exports in developed countries added 1.6%, while that in developing countries gained 2.1%. The WTO expected a growth of 3.1% in global trade volume for 2014, slightly higher than 2013. Worldwide cross-border direct investment was projected to be USD1.6 trillion in 2014 by the United Nations Conference on Trade and Development (UNCTAD), jumping 10.34% over the USD1.45 trillion recorded in 2013, moderately higher than 7.41% in 2013, but still below the pre-crisis average since 1980.

1.1.2 Market risk increased as large swings occurred in international financial markets

In 2014, the US tapering, adoption of QE in Europe, expansion of QE in Japan, and geopolitical tensions all affected the movement of international financial markets. The euro funding rate began to fall from previous hikes, and the yield on government bonds declined broadly in advanced economies, while that in emerging market economies diverged due to country-specific reasons. The US dollar strengthened against most currencies whereas the Russian ruble tumbled. The US stocks jumped, while those in Europe and Japan fell to varying degrees, and most emerging market economies saw an uptick in stock markets. The price of oil dropped substantially whereas that of agricultural products and metals weakened broadly.

1.1.2.1 Eurodollar lending rate remained low and the euro funding rate reversed previous upward trend

After tapering which started from January 2014, the Fed announced at the end of October that it would stop asset-buying program, but keep the federal funds rate unchanged at a low level of 0-0.25%. Consequently, Eurodollar lending rate remained low across the year, while the three-month US dollar London Interbank Offered Rate (Libor) fluctuated mildly around 0.23%. In early 2014, the euro funding rate moved up steadily, with the three-month euro Libor reaching 0.32% on April 28, a two-year high. In June, the ECB cut deposit facility rate from 0% to -0.1% which was also applied to excess reserves, and lowered rates on main refinancing operations and marginal lending facility by 10 and 35 basis points (bps) respectively to 0.15% and 0.4%. At the end of June, the three-month euro Libor plummeted to 0.18%. It stayed as low as 0.06% after September as the ECB adopted TLTRO.

1.1.2.2 Yields on European, US and Japanese government bonds dropped while those on emerging market sovereign bonds diverged

In 2014, there was a widespread decline in government bond yields in Europe, the US and Japan. On December 31, the five-year government bond yields in the US, Germany, France, the UK and Japan closed at 1.65%, 0.01%, 0.18%, 1.2% and 0.02% respectively, losing 10, 91, 104, 80 and 21 bps from the start of the year. The five-year government bond yields in heavily-indebted countries from the euro area dropped continuously. The European Stability Mechanism (ESM) financial assistance program for Spain expired in January; international assistance jointly provided by the European Commission, the ECB and the IMF to Portugal ended in May; and Greece was still receiving assistance, but regained market access as it issued in April the first sovereign bond since 2010. As of end-December, the five-year government bond yields in Ireland, Spain and Italy had already eased to less than 1%.

Yields on government bonds of emerging market economies diverged. As the US exit from QE became clearer in strategy and steps, panic among global investors diminished somewhat, driving down substantially government bond yields in some emerging markets as compared with 2013. For instance, the five-year Turkish government bond yield which rose most markedly in 2013 due to the US tapering announcement slid 214 bps throughout 2014. Government bond yields in some countries remained stable, for example, the five-year Indonesian government bond yield stayed as high as 8% recorded in 2013. However, some countries' government bond yields increased by a large margin, such as the five-year Russian government bond yield which went up 824 bps over the beginning of the year.

1.1.2.3 The US dollar strengthened against most currencies while the Russian ruble slumped

In 2014, the US dollar index appreciated 11% at end-December as compared with early July, while the euro, the British pound, and the Japanese yen depreciated 10.4%, 8.6% and 12.27% respectively against the US dollar. With regard to emerging markets, most currencies appreciated against the US dollar in the first half of the year, but as the US dollar strengthened, many currencies weakened vis-à-vis the dollar in the second half of the year and, at the year-end, were almost back to the level recorded earlier in the year. The Russian ruble depreciated sharply against the US dollar. On December 31, the central parity rate of RUB/USD was 55.4, depreciating about 40% as compared with the beginning of the year.

1.1.2.4 Stock markets in advanced economies diverged while those in emerging markets saw widespread gains

The US Dow Jones Industrial Average fluctuated upwards, gaining 9% across the year. Stock markets in euro area economies fluctuated and diverged, while European markets tumbled followed by a rally between September and mid-October. The full-year gain of the British FTSE100, German DAX30 and French CAC40 was -6%, 6% and 3.5% respectively. Japanese stock market saw gains amid fluctuations. It fell sharply between September and mid-October, but rallied as the BOJ expanded QE and another consumption tax hike was postponed, adding 12.6% in 2014, the highest among advanced economies. Stocks in emerging markets jumped broadly, with the Indian CN5X, Indonesian JKSE, Thailand's SET, Brazil's BOVESPA and South Africa's stock market index climbed 40.17%, 20.82%, 29.81%, 3.8% and 4.9% respectively in 2014.

1.1.2.5 Oil price collapsed while prices of agricultural products and metals weakened in general

In 2014, international oil price began to fall sharply in July. As of December 31, the Brent crude oil price had already dropped to less than USD60 from USD100 in early July. The price of rubber, wheat, soybeans and cotton declined. As of December 31, the price of these commodities retreated 30.41%, 7%, 22.52% and 27.68% respectively during the year. In contrast, cocoa price maintained the upward trend, as it kept rising during the year, gaining 6.7% in 2014. Metal price diverged as the price of aluminum, nickel and zinc at the London Metal Exchange (LME) increased 4%, 9% and 5.6% respectively as of December 31, while that of copper, lead and tin dropped 13.7%, 15.86% and 13% respectively. After a rise in the first quarter, precious metal price kept falling, down 0.05% and 19.19% respectively across the year.

1.2 Domestic economic and financial conditions

In 2014, faced with complex situations at home and abroad, China adhered to the general guideline of seeking progress while ensuring stability and promoting reform and innovation. As a result, the national economy progressed and achieved quality growth amid stability under the new normal. In relation to financial sector development, the People's Bank of China (PBC) and other competent authorities held fast to seeking progress on the basis of stability and promoting reform as well as innovation, and continued to adopt prudent monetary policy. Financial environment was comfortable, while financial reform and opening up fully deepened, which boosted the sustained and steady economic and financial development, providing a stable macro environment for financial market development.

1.2.1 China's economy performed stably within a reasonable range

In 2014, the Chinese economy continued to perform within a reasonable range, as consumption grew steadily, exports and imports improved mildly, job market conditions were stable, growth of investment and prices moderated somewhat, and pace of economic restructuring quickened.

1.2.1.1 Economic development achieved progress and improvement amid stability

Economic output growth maintained medium-high speed. In 2014, China's GDP posted 63.6 trillion yuan, jumping 7.4% over the previous year. Breakdown by quarter revealed that the year-on-year GDP growth for four quarters was 7.4%, 7.5%, 7.3% and 7.3% respectively.

Price growth slowed down marginally. In 2014, the CPI rose 2% year-on-year, down 0.6 percentage points as compared with the growth in 2013. In particular, food price went up 3.1% from a year earlier, retreating 1.6 percentage points from the growth in the previous year, which was a major contributor to the big drop in CPI. The decline in the producer price index (PPI) widened slightly, as producer selling price dropped 1.9% from last year, while producer purchasing price slid 2.2% from a year earlier, slightly higher than the decline in 2013 by 0.2 and 0.3 percentage points respectively.

Job market conditions were basically stable. In 2014, 10.70 million new jobs were added in urban areas. At the end of 2014, the urban registered unemployment rate was 4.09%. Residents' income grew steadily. In 2014, the per capita disposal income of rural residents was 10,489 yuan, a year-on-year nominal growth of 11.2%, and the inflation-adjusted real growth was 9.2%. The per capita disposal income of urban residents was 28,844 yuan, surging 9.0% over the previous year in nominal terms and 6.8% in real terms.

Aggregate demand continued to grow steadily. First, consumption growth was stable. In 2014, social retail sales of consumer goods soared 12% year-on-year to 26.2 trillion yuan, a real growth of 10.9% after being adjusted for inflation. Consumption growth of new business patterns was relatively faster. The online retail sales of units above designated size was 440 billion yuan, jumping 56.2% over last year. Second, exports and imports conditions improved. In 2014, exports and imports added up to USD4.3 trillion, gaining 3.4% over a year ago, with growth accelerating quarter by quarter. In particular, exports advanced 6.1% year-on-year to USD2.3 trillion, while imports edged up 0.4% over the previous year to USD2 trillion. The netting of exports and imports resulted in a surplus of USD382.5 billion. Due to large declines in international commodity prices, imports of energy and resource products increased in volume, but decreased in price. Trade structure was improved continuously, as general trade grew steadily and processing trade increased marginally. Third, growth of fixed asset investment moderated. In 2014, fixed asset investment (excluding rural households) surged 15.7% over 2013 to 50.2 trillion yuan, 3.9 percentage points lower than the growth in 2013. Breakdown by industry showed that investment in the primary industry soared 33.9%, that in the secondary industry went up 13.2%, and that in the tertiary industry climbed 16.8%. The planned total investment in construction projects was 96.9 trillion yuan, a year-on-year increase of 11.1%, while that in newly started projects gained 13.6% over the previous year to 40.6 trillion yuan. In 2014, investment in property development registered 9.5 trillion yuan, up 10.5% from a year earlier, losing 9.3 percentage points from the growth in 2013. Floor space of housing starts slid 10.7% from last year. In particular, floor space of residential housing starts slumped 14.4% from 2013.

1.2.1.2 Economic structure was further optimized

In 2014, positive progress was made in China's economic restructuring as well as transformation and upgrading. First, industrial structure became more optimized. In 2014, the value-added of the tertiary industry as a percent of the GDP was 48.2%, up 2.1 percentage points over last year. With the transformation of economic growth pattern, new business patterns, such as mobile Internet, electronic information and online sales, grew at a faster pace while traditional drivers of growth run out of steam, such as infrastructure investment and real estate sector. Growth of fixed asset investment in information technology, science and technology service, leasing and business service sector remained at a high level of about 40%. Second, demand structure continued to improve. In 2014, the contribution of final consumption expenditure to the GDP growth was 51.2%, up 3 percentage points over last year. The growth gap between fixed asset investment and social retail sales of consumer goods was 3.7 percentage points, narrowing by 2.5 percentage points as compared with that in 2013. Third, income inequality between rural and urban residents was reduced further. In 2014, real growth of per capita disposable income of rural residents was 2.4 percentage points higher than that of urban residents. The per capital disposable income ratio of urban residents to rural residents was 2.75, edging down 0.06 from that in 2013. Fourth, regional development was more balanced.

During the year, investment in eastern, central and western regions rose 14.6%, 17.2% and 17.5% respectively over the previous year, while statistically large industrial value-added in eastern, central and western regions went up 7.6%, 8.4% and 10.6% respectively over last year. Regional development became better coordinated, with a smaller gap between central and western regions and the eastern region. Fifth, new progress was made in energy conservation. In 2014, energy consumption per unit of GDP dropped 4.8% year-on-year.

1.2.2 Monetary and financial conditions were basically stable

1.2.2.1 Monetary environment was generally sound and stable

In 2014, the PBC continued to adopt prudent monetary policy, constantly innovated guidelines for and means of macro control, adopted a richer range of policy tools, optimized policy mix, targeted prominent issues in economic performance, and conducted preemptive structural adjustments and fine-tuning at the right time with the right intensity so as to create a stable monetary and financial environment, which would in turn promote economic restructuring as well as transformation and upgrading. Flexible open market operations were conducted, supplemented by short-term liquidity operation (SLO), to effect two-way adjustment as necessary. Medium-term lending facility (MLF) was created and used to guide market rates and lower social financing cost while overall liquidity was kept at a moderately adequate level. Efforts were made to properly adjust macro prudential policy parameters, allow credit policy to play a bigger role in supporting central bank lending and discount, and give full play to credit policy in guiding the shift towards better credit structure by encouraging financial institutions to channel more credit resources to key and weak sectors, such as agriculture, farmers and rural areas, as well as micro and small enterprises (MSEs). Interest rate liberalization and RMB exchange rate regime reform were promoted in a well-sequenced manner, while reform of foreign exchange administration system was deepened.

First, growth of monetary aggregates decelerated. At end-2014, broad money supply (M2) stood at 122.8 trillion yuan, up 12.2% year-on-year, 1.4 percentage points lower than the growth at the end of 2013; narrow money supply (M1) posted 34.8 trillion yuan, climbing 3.2% from a year earlier, down 6.1 percentage points from the growth at the end of last year; and currency in circulation (M0) went up 2.9% year-on-year to 6 trillion yuan.

Second, deposits at financial institutions grew at a slightly slower pace. At the end of 2014, outstanding RMB and foreign currency deposits at all financial institutions (including foreign-funded financial institutions, the same below) stood at 117.4 trillion yuan, jumping 9.6% from a year earlier. In particular, outstanding RMB deposits registered 113.9 trillion yuan, adding 9.1% over last year, 4.7 percentage points lower than that at the end of 2013.

Third, loans provided by financial institutions grew steadily. At the end of 2014, outstanding RMB and foreign currency loans of all financial institutions amounted to 86.8 trillion yuan, surging 13.3% over last year. In particular, outstanding RMB loans increased 13.6% year-on-year to 81.7 trillion yuan, edging down 0.5 percentage points as compared with growth at the end of 2013. Breakdown of RMB loans by maturity distribution indicated that medium and long-term loans grew faster whereas short-term loans grew less rapidly. At end-2014, outstanding medium and long-term loans increased 6.1 trillion yuan over the start of the year, 1.5 trillion yuan more than the growth over the same period of last year, while outstanding short-term loans added 2.5 trillion yuan over the beginning of the year, 1.7 trillion yuan less than the growth over the same period of 2013. Bill financing saw a big rise. At end-2014, outstanding bill financing went up 957.4 billion yuan over the beginning of the year, 1,047.1 billion yuan more than the growth over the corresponding period of 2013.

Fourth, size of social financing stayed modest. In 2014, social financing reached 16.5 trillion yuan, decreasing 859.8 billion yuan from last year. Financing structure indicated that RMB loans saw a relatively big jump with its share rising markedly. In 2014, RMB loans took up 59.4% of total social financing, up 8.1 percentage points over last year. Trust loans and undiscounted banker's acceptances shrank remarkably, while growth of off-balance sheet financing dropped substantially over the previous year. In 2014, entrusted loans, trust loans and undiscounted banker's acceptances comprised 17.5% of total social financing, down 12.3 percentage points over the corresponding period of last year. Bond and equity financing both jumped by a large margin, pushing the volume and share of direct financing to new record highs. In 2014, bond and equity financing by non-financial enterprises on domestic market accounted for 17.3% of total social financing, a year-on-year increase of 5.5 percentage points.

Fifth, financing costs for enterprises were lowered. At the end of 2014, fixed rate enterprise bonds were issued with a weighted average interest rate of 5.52%, decreasing 148 bps over the end of last year, while yields on five-year AAA and AA+ enterprise bonds dropped 148 and 141 bps respectively relative to the end of 2013. In December, the weighted average interest rate for loans to non-financial enterprises and other sectors was 6.77%, sliding 0.42 percentage points over the beginning of the year.

1.2.2.2 Financial reform advanced steadily

Market-based interest rate reform was accelerated. On November 21, the PBC announced to cut RMB benchmark lending and deposit rates for financial institutions, effective from November 22. The one-year RMB benchmark lending and deposit rates were lowered by 0.4 percentage points to 5.6% and by 0.25 percentage points to 2.75% respectively. At the same time, the upper limit of the floating range for deposit rates was raised from 1.1 to 1.2 times the benchmark; benchmark interest rates on loans and deposits of other maturities were adjusted accordingly; and the benchmark rate structure was properly simplified. The further lifting of the floating ceiling of deposit rates not only allows the market mechanism to play a bigger role in determining interest rates, but also lays a solid foundation for fully liberalizing deposit rates in the future. Simplifying benchmark rate structure is also helpful for financial institutions to adapt to interest rate liberalization, as well as to foster and build pricing capacity, which would further allow the market to play a decisive role in resource allocation.

The RMB exchange rate formation regime was improved further. In 2014, the PBC further improved the RMB exchange rate formation regime by sticking to the principle of proceeding in a self-initiated, controllable and gradual manner. It focused on making market supply the basis for adjustment with reference to a basket of currencies in order to increase the RMB exchange rate flexibility and keep it basically stable at a reasonable and equilibrium level. To promote bilateral trade and investment, China and the UK launched direct exchanges between the RMB and the British pound both on China's interbank foreign exchange market and London foreign exchange market starting from June 19, 2014. Direct trading of the yuan and the euro was available on China's interbank foreign exchange market starting from September 30, 2014. In general, direct trading of the yuan and other currencies on the interbank foreign exchange market was brisk with the liquidity level increased markedly and bid-ask price spread narrowed, which lowered transaction costs for microeconomic agents and promoted the use of local currency in bilateral trade and investment.

Development of a deposit insurance scheme saw major breakthroughs. To put in place and regulate deposit insurance, exercise law-based protection of the legal rights and interests of depositors, prevent and mitigate financial risk in time, and safeguard financial stability, the PBC formulated the *Regulations on Deposit Insurance (Consultation Draft)*, which was released along with explanatory notes on November 30, 2014 by the Legal Affairs Office of the State Council to solicit public comments. The *Regulations on Deposit Insurance (Consultation Draft)* stipulated that deposit-taking banking financial institutions established within the People's Republic of China, such as commercial banks, rural cooperative banks and rural credit cooperatives, should have deposits insured. Deposit insurance follows a limited claim which is up to 500,000 yuan. The development of a deposit insurance scheme would help better protect depositors, maintain the confidence of financial markets and the general public in China's banking system, promote the development of a market-based risk prevention and mitigation mechanism, put in place a long-term mechanism for safeguarding financial stability, and promote the healthy development of China's financial system.

Reform of foreign exchange administration regime was pushed forward actively. First, focus was put on promoting trade facilitation. Efforts were made to further deepen reform of foreign exchange administration in relation to trade by implementing in-depth reform of foreign exchange administration regime for goods and service trade, optimizing administrative measures for border trade, and regulating as well as providing convenience to foreign exchange receipts and foreign currency settlements in border trade via export agents. The pilot program of foreign exchange payment services for cross-border e-commerce provided by payment institutions was expanded to meet the needs for cross-border foreign exchange payments and receipts as well as foreign exchange purchase and surrender of domestic institutions and individuals shopping online. A pilot program was launched in Zhejiang and Fujian provinces to simplify document verification requirements for foreign exchange receipts and surrender in personal trade in a bid to provide convenience to individuals engaged in foreign trade. Second, the convertibility of capital account was promoted steadily. Efforts were made to fully conduct centralized operation and management of foreign currency-denominated funds of multinationals on a trial basis to allow centralized management of foreign currency funds at home and abroad, net settlements, conversion of foreign currency capital funds into the RMB at own discretion, and shared foreign debt quota, which would in effect reduce the financial cost for enterprises. Investment facilitation was further promoted by relaxing the approval of upfront fees in overseas direct investment and the administration of overseas lending, and streamlining the verification of profits remitted abroad. The scheme of qualified institutional investors was advanced steadily. Foreign debt management was improved by further simplifying the administration of cross-border guarantee and removing the quantity control on domestic guarantee for overseas borrowing, prior approval and restrictions on eligibility. Foreign exchange administrative procedures for converting foreign debts to loans were streamlined through delegating such business processes as principal and interest payments to banks. The development of policies on foreign exchange administration in the China (Shanghai) Pilot Free Trade Zone (hereinafter referred to as the Shanghai FTZ) was sped up with several innovative measures for foreign exchange administration launched on a trial basis in an attempt to explore the convertibility of capital account.

Major progress was made in the institution building of multi-tiered capital market. On May 9, the State Council published the *Several Opinions on Further Promoting the Healthy Development of Capital Market* (State Council Document [2014] No.17), which identified the direction for next steps in capital market development from such aspects as developing a multi-tiered stock market, promoting regulated bond market, fostering private equity market, advancing the development of futures market, enhancing the competitiveness of securities and futures sector, further opening up capital market, preventing and mitigating financial risk, and creating a favorable environment for capital market development. Capital market's fundamental institution building was improved continuously. First, the PBC and other relevant regulators unveiled administrative rules and regulations, which further diversified issuance and trading on the bond market. On March 5, the PBC released the third announcement of 2014, according to which commercial banks offering book-entry government bond business over the counter could add bonds issued by the China Development Bank (CDB), policy bank bonds and bonds issued by government-sponsored agencies like the China Railway to their bond business conducted over the counter in addition to existing book-entry government bonds. On January 26, the Financial Market Department of the PBC published the *Notice on Issues Concerning the Access of Commercial Banks' Wealth Management Products to the Interbank Bond Market* (PBC Financial Market Department Document [2014] No.1), specifying requirements for banks opening bond accounts for and the custody of wealth management products. On November 3, the National Association of Financial Market Institutional Investors (NAFMII) released the *Notice of the Financial Market Department of the People's Bank of China on Issues Concerning the Access of Qualified Non-Financial Institutional Investors to the Interbank Bond Market*, allowing qualified non-financial institutional investors to engage in bond investment via the trading platform for qualified non-financial institutional investors. Second, further efforts were made to promote the connectivity between Shanghai and Hong Kong stock exchanges, known as Shanghai-Hong Kong Stock Connect. On June 13, the China Securities Regulatory Commission (CSRC) issued the *Several Regulations on the Pilot of Shanghai-Hong Kong Stock Connect* (CSRC Decree No.101), which set out principles for domestic securities companies engaging in Shanghai-Hong Kong Stock Connect, clarified the business scope, the share of foreign shareholders, means of clearing and delivery, and delivery currency in Shanghai-Hong Kong Stock Connect, and spelt out requirements for investor protection, supervision and regulation, and record-keeping. On September 26, the Shanghai Stock Exchange (SSE) released the *Measures of the Shanghai Stock Exchange for the Pilot of Shanghai-Hong Kong Stock Connect*, clearly specifying the basic model and requirements pertaining to Shanghai-Hong Kong Stock Connect. Third, market making arrangements on the New Third Board were officially announced. On June 5, the *Administrative Rules for Market Making by Market Makers on the National Equities Exchange and Quotations (Provisional)* was released, specifying five requirements that securities companies should meet when applying for market making. Fourth, regulatory measures for private equity funds were announced. On August 21, the CSRC issued the *Provisional Measures for the Supervision and Regulation of Private Equity Funds* (CSRC Decree No.105), which clarified full coverage registration and file-keeping as well as qualified investors scheme, and set down regulations on the fund-raising and investment by private equity funds. Fifth, opinions on promoting innovation-driven development of the futures sector were unveiled. On September 16, the CSRC published the *Opinions on Further Promoting the Innovation-Driven Development of Futures Institutions*, which specified development objectives for futures sector in the next phase along with supporting policy measures from eight aspects, including enhancing the competitiveness of futures institutions, lowering market access threshold when appropriate, gradually promoting opening up among futures institutions, and strengthening investor protection.

Fundamental institution building of the insurance market gained speed. First, top-down design of the insurance sector was intensified. On August 10, the State Council promulgated the *Several Opinions on Expediting the Development of Modern Insurance Services* (State Council Document [2014] No.29), proposing to foster competitive, creative and dynamic modern insurance services by focusing on improving the economic compensation mechanism, strengthening the core function of risk management, and increasing the efficiency in allocating insurance funds. Second, efforts were made to reform market access and exit mechanisms for insurance institutions. The China Insurance Regulatory Commission (CIRC) regulated mergers and acquisitions (M&A) of insurance companies by setting down requirements with regard to acquiring parties, procedures, corporate governance, information disclosure and accountability for non-compliance, and put in place a period of transition for acquisitions and an equity lock-up period, in an attempt to protect the legal rights and interests of consumers, insurance companies and shareholders. In the meantime, restrictions on sources of funds and shareholder qualifications were relaxed moderately by no longer forbidding horizontal acquisition and encouraging the investment of high-quality capital from home and abroad, especially private capital, in the insurance sector, which would contribute to the optimized resource allocation in the insurance market. Third, the insurance sector was encouraged to support the new type of urbanization. On March 25, the CIRC published the *Guiding Opinions on Allowing the Insurance Sector to Service the Development of New Type of Urbanization* (CIRC Document [2014] No.25), pointing out that insurance should be given full play in providing financing and social security, innovation should be sped up on products and services, market entities as well as supervision and regulation of insurance, and that the initiative of allowing insurance sector to service the development of new type of urbanization should be promoted from six aspects, such as coordinating the development of commercial pension insurance and health insurance, innovating ways to utilize insurance funds, and improving the agricultural insurance service system. Fourth, supervision and regulation of the use of insurance funds was tightened. Regulation of investment in collective trust schemes by insurance institutions was further strengthened by stipulating that insurance funds should not be invested in a standalone trust or trusts with underlying assets from sectors or industries that are clearly forbidden by the state. Regulatory authorities would evaluate insurance institutions' internal control and compliance regarding uses of funds each year and assign a score accordingly, which would classify them into four tiers. Those falling into the last two tiers would be classified as the focus of regulation, and the CIRC would adopt regulatory measures that limit their channels, scope or proportion of use of funds.

1.2.2.3 The financial sector saw stable development and positive changes

Performance of the financial sector was stable in general. Assets of banking financial institutions continued to grow, while profitability and capital adequacy ratio (CAR) rose steadily. As of end-2014, total local and foreign currency assets of China's banking financial institutions reached 168.16 trillion yuan, a year-on-year increase of 13.6%, while local and foreign currency liabilities totaled 155.92 trillion yuan, surging 13% over last year. In 2014, commercial banks reaped cumulatively 1.55 trillion yuan in net profits, jumping 9.65% over the same period of last year. Outstanding non-performing loans (NPL) posted 842.6 billion yuan, while the NPL ratio was 1.25%. The CAR was 13.18% and the core tier-one CAR was 10.56%. The overall size of securities and futures institutions expanded rapidly amid an obvious hike in profitability. As of end-2014, total assets, net assets and net capital of 120 securities companies stood at 4.09 trillion, 920.519 billion and 679.16 billion yuan respectively. The annual operating revenues reached 260.284 billion yuan, while net profits hit 96.554 billion yuan, with 119 securities companies making a profit. Premium income of the insurance sector grew steadily with the size of net assets expanding substantially. As of end-2014, the cumulative direct written premium income of the insurance sector posted 2.02 trillion yuan, rising 17.49% from a year earlier, while the cumulative claim payments jumped 16.15% over the previous year to 721.621 billion yuan. Total assets of the insurance sector hit 10.16 trillion yuan, up 22.57% over the start of the year, while net assets soared 56.41% over the beginning of the year to 1,325.526 billion yuan.

Reform of financial institutions deepened. In July, a housing finance unit within the CDB was put into operation after approval. At the same time, development finance was given a bigger role in shanty town renovation, which would provide legal, convenient, appropriately-priced and stable funding channels to shanty town renovation. The plan for reforming the Agricultural Development Bank of China was endorsed in principle at the 63rd Executive Meeting of the State Council, which specified reform's overall objective and major policy measures. Reform of the CDB and the Export-Import Bank of China (China EximBank) was accelerated so as to further enhancing their functions of and roles in servicing national strategies. The transformation and institutional change of asset management companies was pushed further. On August 28, the China Huarong Asset Management Co., Ltd. officially signed the strategic cooperation agreement with eight strategic investors to replenish 14.54 billion yuan in total, which took up 21.0% of total shares after the replenishment. Reform of rural credit cooperatives achieved significant desired results as their financial profile continued to improve and agro-linked credit supply grew substantially. At the end of 2014, the NPL ratio of rural credit cooperatives across China was 3.8%, down 0.3 percentage points from last year, the CAR went up 2.8 percentage points from a year earlier to 13.2%, the provision coverage ratio added 8.7 percentage points over last year to 135.2%, and the annual profits reached 233.9 billion yuan. Outstanding loans to agriculture and rural households posted 7.1 trillion and 3.4 trillion yuan respectively, surging 13.4% and 12% year-on-year. The ownership system reform of nationwide rural credit cooperatives was advanced steadily, as some desired effects were achieved in clarifying ownership, improving corporate governance structure and beefing up the institution building of internal control. The level of operation and management was increased somewhat, as the corporate governance structure consisting of shareholders' meeting, board of directors, board of supervisors and senior management as well as rules and regulations were broadly put in place and in initial operation. As of end-2014, 1,484 rural credit cooperatives, 665 rural commercial banks and 89 rural cooperative banks were established across China with a single legal entity at the county (city) level.

2. Main features of China's financial market performance in 2014

In 2014, international economic and financial developments and policy environment diverged amid high volatility. China overcame the difficulty in simultaneously dealing with the slowdown in economic growth, making difficult structural adjustments, and absorbing the effects of previous economic stimulus policies, with the economy performing steadily within a reasonable range and positive changes taking place in structural adjustments. Financial markets mirrored economic and financial conditions at home and abroad, strongly propped up the development of the real economy, and was also characterized by progressing amid stable performance with regard to market development, improvement, innovation, regulation and opening up.

2.1 Size of financial markets expanded markedly

In 2014, the overall size of trading on China's financial markets continued to grow steadily. During the year, trading volume on money market, including interbank funding, pledged repurchase agreements (repos) and outright repos, posted 261.83 trillion yuan, surging 35.19% year-on-year. Custody size continued to maintain steady growth, as bond custody soared 18.09% over last year to 34.98 trillion yuan. Among it, total bond custody on the interbank bond market hit 31.79 trillion yuan, adding 16.8% over the same period of last year, which represented 90.09% of total tradable bonds under custody. Trading volume on stock market surged 58.71% over 2013 to 74.39 trillion yuan, while that on futures market reached 2.506 billion lots unilaterally, involving a total amount of 291.99 trillion yuan, jumping 21.48% and 9.17% respectively compared with last year. Among it, trading of commodity futures hit 2.283 billion lots, totaling 127.97 trillion yuan, a year-on-year increase of 22.54% and 1.16% respectively. Trading of stock index and government bond futures amounted to 218 million lots, with a total value of 164.02 trillion yuan, up 12.37% and 16.32% respectively from last year. Cumulative trading of gold on the Shanghai Gold Exchange (SGE) reached 18.5 thousand tons with a turnover of 4.59 trillion yuan, surging 59.17% and 42.81% respectively from a year earlier.

2.2 Financial market structural adjustment gained momentum

With financial market development, market participants became increasingly diversified. Moreover, market players, products and trading patterns in emerging markets showed stronger growth momentum, which contributed to a more balanced market.

2.2.1 Non-bank financial institutions played a more important role on money market

In 2014, a total of 56 non-bank financial institutions gained market access to the national interbank funding market, which brought the total number of non-bank financial institutions to 322 as of end-2014, accounting for 26% of the total membership. In terms of trading on the interbank funding market, total trading volume of non-bank financial institutions was 13.12 trillion yuan in 2014, soaring 53.27% year-on-year, far higher than 6.04% growth of the overall trading on the interbank funding market during the corresponding period. The share of non-bank financial institutions in total market trading reached 17.42%, up 5.37 percentage points from a year earlier.

2.2.2 The development of commercial bank OTC bond market helped improve bond investor structure

In May and December 2014, the CDB issued financial bonds over the counter of the Industrial and Commercial Bank of China (ICBC) and the Bank of China (BOC). In June, the China EximBank also issued financial bonds to individuals and non-financial institutions over the counter of the ICBC.

A richer range of bond products over the counter of commercial banks not only created a new channel for the public to invest in financial bonds, but also helped improve market liquidity and efficiency in the use of social funds.

2.2.3 More structural changes took place

New types of financial products presented a strong growth momentum. In 2014, the annual cumulative issuance of interbank certificates of deposit (CDs) was 897.562 billion yuan, which was 26.4 times the 34 billion yuan in 2013. Momentum of changes in market investor structure increased. Thanks to combination with emerging Internet-based business pattern, some fund companies increased 18.6 and 2 times in size in 2013 and 2014 respectively, much higher than the 4.78% and 51.96% growth of public fund during the corresponding period. Overseas investors got more deeply engaged in bond market. As of end-2014, outstanding bonds held by overseas institutional investors on the interbank bond market accounted for 1.77% of total custody on bond market, adding 0.58 percentage points over the 1.19% in 2013. New types of trading patterns like bond borrowing and lending saw a hike in trading volume. In 2014, the volume of bond borrowing and lending posted 401.99 billion yuan, surging 507% year-on-year, which was another rapid increase over the growth as high as 226% in 2013, pointing to an obviously stronger momentum of shifts in trading pattern. Turnover of outright repos added up to 11.75 trillion yuan, advancing 89.93% when compared with the same period of last year, which was 2.26 times the growth of pledged repo transactions during the corresponding period.

2.2.4 The stock market became a more multi-tiered system

First, listing requirements diverged further among different boards. The threshold of listing on the Growth Enterprise Board was lowered further, even without profitability requirement. Second, listing on the National Equities Exchange and Quotations (NEEQ) became commonplace, as the number of listed companies grew from 347 at the beginning of the year to 1,579 for the time being. Third, development of China's regional equity markets presented a fast growth momentum with progress made in multiple places. As of end-2014, there were about 20 regional equity markets officially put into operation across China, with the number of listed companies exceeding 15,000 cumulatively, an increase of over 9,000 from last year, which was five times the number of listed companies combined in the exchange market. Fourth, the Securities Association of China (SAC) published guidelines to further regulate business conducted over the counter of securities companies, which would help rebuild the fundamental functions of securities companies and further improve the tiers of stock market.

2.2.5 Membership structure of interbank foreign exchange market became more balanced

In 2014, the number of Chinese banking financial institutions, non-bank financial institutions, foreign-funded banks and overseas banks on foreign exchange market grew by 40, 10, 7 and 3 respectively. The market share of non-bank financial institutions and foreign-funded banks edged up 0.2 and 1.5 percentage points respectively over last year, whereas that of Chinese banking financial institutions dipped 1.6

percentage points. The balance among this wide variety of members in relation to their institutional strength improved slightly.

2.3 Financial market innovations were launched continuously

In 2014, pace of financial market innovation quickened, as financial products and instruments became more diversified. Financial products with different maturities and varying risk and return profiles were launched on submarkets, which had met the distinct demands of market participants through varying forms and channels. Meanwhile, market efficiency increased gradually, as market operation and trading mechanisms were improved continuously.

2.3.1 Product innovations

In terms of financial derivatives, the China Foreign Exchange Trade System (CFETS) launched the standardized interest rate derivative, spanning a range of terms and underlying interest rates. It differs from the original interest rate swap (IRS) mainly in that it has a fixed term for accruing interest and a pre-determined delivery date, which provides a good hedging tool for market participants. In terms of bond market, first, the CGN Wind Energy Limited issued the first floating-rate note linked to the carbon offset price with the floating-rate component adding an additional 5 to 20 bps to the yield, depending on the carbon offset price. Second, the first private placement bond by a financial leasing enterprise was issued through non-public offering and listed for trading on the Tianjin Equity Exchange. With regard to stock market, some listed companies that could meet relevant requirements were allowed to issue preferred shares, which boosted the capital of listed companies, but also provided equity investment options with more diverse risk profiles to investors.

In foreign exchange market, direct trading of the RMB against the New Zealand dollar, the British pound, the euro and the Singapore dollar became available on the interbank foreign exchange market, bringing the total number of directly traded foreign currencies to 8, which effectively promoted China's bilateral trade with and investment in some countries and regions, and facilitated the cross-border use of the RMB.

In gold market, the SGE launched the Mini gold deferred contract, which adjusted the trading unit of Au99.99 contract from 100 grams per lot to 10 grams per lot.

In terms of product innovation on futures market, first, new types of underlying assets were added to futures contracts. In 2014, five new commodity futures contracts were added, including hot rolled coils, iron alloy, late long-grain non-glutinous rice, polypropylene, and corn starch, which further enriched the contract series of black metals, agricultural products and chemicals. Second, the Shanghai Futures Exchange (SFE) was given the green light to introduce crude oil futures contract on its International Energy Exchange, which pushed product innovation on China's commodity futures market to a new phase in the process of internationalization. Third, active preparations were made to launch stock exchange-traded fund (ETF) options. Fourth, simulated trading of a variety of futures contracts was conducted. The China Financial Futures Exchange (CFFEX) conducted a market-wide simulated trading of such futures contracts as the EUR/USD, AUD/USD, SSE 50 Index, CSI 500 Index and ten-year government bonds. Fifth, the SFE, the Zhengzhou Commodity Exchange (ZCE) and the Dalian Commodity Exchange (DCE) prepared for launching commodity options on a trial basis by conducting simulated trading, improving trading systems, and strengthening institution building as well as investor education and training.

2.3.2 Mechanism innovations

With regard to the issuance mechanism, first, the commonly used tender offer and book building were improved by reducing restrictions on the tender offer for corporate debenture bonds, along with widening the scope of corporate debenture bond issuers and bidders. Relevant regulatory authorities further regulated the book building and tender offer for enterprise bonds in a bid to protect the legal rights and interests of all parties involved. Second, innovation was extended to the issuance of local government bonds. The pilot program of autonomous issuance and repayment of local government bonds was kicked off in Shanghai, Zhejiang, Guangdong, Shenzhen, Jiangsu, Shandong, Beijing, Jiangxi, Ningxia and Qingdao, which would further tighten market constraints and promote the healthy development of local government bond market. Third, enterprises seeking initial public offerings (IPOs) were allowed to choose to go public either on the Shanghai stock exchange or the Shenzhen stock exchange regardless of the offering size.

In terms of market operation mechanism, first, the CFETS launched the X-Swap, a price matching trading platform based on bilateral credit, which was first of its kind in China and could also provide more market information to clients. Second, innovation of operation mechanisms on foreign exchange market was sped up. The exchange rate floating range of the RMB vis-à-vis the US dollar was broadened from 1% to 2%. Banks were allowed to list the exchange rate of the RMB against other currencies at their own discretion by taking into account market demand and pricing capacity and to price autonomously in line with market supply and demand. Market access requirements for spot foreign exchange (FX) purchase and surrender as well as FX derivatives were relaxed, some administrative approvals and qualifications were removed, and the focus on ex ante approval was shifted onto ex post regulation. Third, all commodity futures exchanges fully promoted the development of night trading. The SFE started night trading one hour earlier so as to more widely capture important information releases around the globe. The DCE introduced the night trading of palm oil and coke.

With regard to market clearing and delivery mechanisms, first, the Shanghai Clearing House (SCH) introduced RMB central counterparty clearing to iron ore and steam coal swaps. Second, the DCE was allowed to introduce bonded delivery of futures contracts on a trial basis, and had already received and were processing the applications for futures bonded warehouse receipts.

2.4 Financial market regulations were further improved

The State Council published guidelines to promote capital market development. In May 2014, the State Council issued the *Several Opinions on Further Promoting the Healthy Development of Capital Market*, which specified general requirements for developing a healthy capital market and corresponding tasks from nine aspects. The new nine measures introduced top-down design for current and longer-term development of a healthy capital market and spelt out overall arrangements. In line with requirements of the Central Committee of the Communist Party of China (CPC) and the State Council, regulatory authorities concerned all intensified regulation of financial markets so as to promote sound market development.

With regard to money market, the self-regulatory body established in September 2013 for pricing money market rates issued a notice, stating that 93 eligible financial institutions including the China Everbright Bank were accepted as members based on prudential assessment results. It would enable the Shanghai Interbank Offered Rate (Shibor) to play a bigger role in guiding market rates, which would create favorable conditions for advancing market-based interest rate reform in a well-sequenced manner.

With regard to bond market, first, bond accounts for banks' wealth management products (WMP) were identified as type B. The PBC published a notice, clarifying that banks investing WMP funds in bonds traded on the interbank bond market must establish separate accounts for each product. Second, the State Council released the *Guidelines for Distinguishing Financial Liabilities from Equity Instruments and Relevant Accounting Treatment*, which regulated the accounting treatment of perpetual bonds and preferred stocks, and provided enterprises with less costly long-term financing instruments.

With regard to stock market, first, a fresh round of IPO reform was completed. The IPO resumed after more than one year. Second, supervision over non-compliance was tightened with higher penalties. In 2014, the CSRC imposed regulatory punishments on individuals and institutions that violated rules and regulations in underwriting IPOs. It opened an investigation into non-compliant information disclosure by several listed companies and closed several cases on stock trading using undisclosed information. Third, the de-listing of listed companies became a market-based common practice governed by law.

With regard to futures market, the CSRC issued the *Measures for the Supervision and Regulation of Futures Companies* in 2014, which expanded the scope of trading venues accessible by futures companies, and allowed them to engage in derivatives and relevant businesses at legal trading venues like the securities exchange. The China Futures Association (CFA) published the *Guidelines for the Pilot Program of Futures Companies Establishing Subsidiaries to Focus on Providing Risk Management Services*, stipulating that the pilot program should follow a market-based principle as well as the principle of pilot first, step-by-step implementation and steady promotion, which would be driven and regulated by the CFA through self-regulation.

With regard to financial derivatives market, the PBC released the *Notice on Issues Concerning the Establishment of Central Counterparty Clearing for Over-the-Counter Financial Derivatives and Introducing Central Counterparty Clearing to RMB Interest Rate Swaps*. The RMB interest rate swaps represented the first step in introducing compulsory central clearing to China's over-the-counter (OTC) financial derivatives. Netting and multilateral netting in central clearing would effectively reduce clearing cost, lift market efficiency, stave off systemic risks, and expedite interest rate liberalization.

2.5 Opening up proceeded stably

Pace of opening up the interbank funding market quickened. First, the ICBC Singapore Branch and the BOC Taipei Branch acquired membership, after which the number of overseas RMB clearing banks on the interbank funding market increased to four. Second, size of trading on the interbank funding market by overseas RMB clearing banks rose steadily, from 17.74 billion yuan in 2009 to 478.86 billion yuan in 2014, a growth of 27 times. On the one hand, the interbank funding market provided overseas RMB clearing banks with RMB liquidity management channels and a platform for communicating with domestic members of the interbank market; on the other hand, it bolstered the cross-border use of RMB and promoted the opening up of financial markets.

Opening up of bond market was pushed forward steadily. First, the scope of overseas institutional issuers was broadened to include non-financial enterprises. In March, Daimler AG issued 500 million yuan of RMB debt financing instruments on the interbank bond market. Debt capital market created a channel for overseas non-financial enterprises to raise funds on domestic market. Second, size of RMB bonds issued offshore expanded substantially. As of end-2014, RMB bonds issued on offshore market amounted to about 219.942 billion yuan, which was 2.18 times the full-year issuance of 109.055 billion yuan in 2013, and the overseas affiliates of domestic financial institutions constituted the bulk of issuers. Third, overseas investors became more active on China's bond market. As of end-2014, the number of overseas institutional investors on the interbank bond market reached 211, 73 more than that at the end of 2013, while their outstanding bond holdings on the interbank bond market jumped 73.24% over the end of 2013, hitting 572 billion yuan. Fourth, market intermediaries strengthened international exchange and cooperation. In 2014, the SCH signed cooperation documents with such overseas institutions as the Chicago Mercantile Exchange (CME) and the Euroclear Bank in a bid to further enhance communication and explore possibilities of cooperation.

With regard to the opening up of stock market, first, efforts were made to promote the connectivity between stock markets on the Chinese mainland and in Hong Kong. Second, cross-border regulatory cooperation was stepped up. The CSRC and the Financial Supervision Commission of the Isle of Man signed the *Memorandum of Understanding on Securities and Futures Regulatory Cooperation* to further enhance the securities and futures regulatory cooperation and communication between the two sides. Third, overseas investors gained wider access to securities issued on domestic market.

With regard to the opening up of futures market, first, the drive of going global gained speed. GF Financial Markets (UK) Ltd., a subsidiary of the GF Securities, was approved by the LME for Ring dealing membership, the LME's first Chinese-owned Ring dealing member company. Second, scope of international cooperation and communication was broadened. In 2014, the CFFEX and the

CME entered into the *Cooperative Agreement on Futures Market Data Exchange*, according to which both parties would share market data and the CFFEX authorized the CME as its overseas agent that would license and distribute CFFEX market data outside of the Chinese mainland.

China officially introduced the international board for gold transactions. On the evening of September 18, 2014, the international board was launched on the SGE during the night trading session, attracting nearly 30 members from home and abroad on its debut day with a trading volume of 243.44 kilograms, which added up to 61.3033 million yuan in value. The international board for gold transactions would increase the global influence of China's gold market and improve China's gold pricing capacity, which would in turn provide better services to the gold industry and enterprises in China.

The Shanghai FTZ actively encouraged enterprises to both attract foreign funds and make outbound investment. Foreign investment restrictions were relaxed progressively, as foreign ownership restrictions were reduced from 190 to 139 on the revised Shanghai FTZ negative list released in June 2014. Besides, foreign-invested projects, related contract and charter in sectors outside the list are no longer subject to government approval – only a filing procedure is required. On September 2, 2014, the platform for outbound investment services was established in the Shanghai FTZ to provide comprehensive consulting, filing for outbound investment, investment project recommendation, introduction to investment destination, industry analysis, and specialized outbound investment services, which would offer guidance and help to enterprises in the Shanghai FTZ when they seek to go global.

2.6 Capacity for supporting the development of the real economy was further enhanced

In 2014, financial markets played a bigger role in bolstering the real economy, which was its core function. It not only provided a richer range of financing options to enterprises, which lowered their funding costs and shored up the growth of MSEs, but also created favorable conditions and safeguards for the reform of state-owned enterprises (SOEs).

2.6.1 Financing channels for enterprises were broadened and funding costs reduced

In 2014, bond and equity financing increased by a large margin, which drove both the value and share of direct financing to all-time highs. Bond and equity financing by non-financial enterprises on domestic market posted 2.87 trillion yuan when combined, an increase of 827.3 billion yuan over last year, and accounted for 17.3% of total social financing during the corresponding period, up 5.5 percentage points as compared with 11.8% in 2013, making a new record high. In particular, cumulative net financing through corporate debenture bonds was 2.4 trillion yuan, representing 14.7% of total social financing in the same period, adding 3.2 percentage points over the previous year. Bond financing had grown into a major source of funds for enterprises from real sector, only second to loans. Meanwhile, the interest rate on bond issues had dropped persistently and sharply since 2014. The yield-to-maturity on typical three-year and seven-year AA enterprise bonds on the interbank market slid 150 and 127 bps respectively from the end of last year, obviously more substantial than the decline of 42 bps in the interest rate of loans to non-financial enterprises in the same period. As debt capital market had already become the second largest financing channel for enterprises from real sector, after loans, bond market obviously played an effective role in slashing enterprises' funding costs.

2.6.2 Financing strains on SMEs and MSEs were eased effectively

The share of bond financing in total financing by large enterprises went up gradually, especially for SOEs supervised by the central government whose share of bond financing approximated 30%. Financing through bond market by large enterprises reduced their reliance on credit accordingly. The freed-up credit resources increased the availability of funds for SMEs. In 2014, the growth of loans to MSEs, which was higher than that of last year, outperformed the average growth of all types of loans. At the end of 2014, outstanding loans to MSEs stood at 15.26 trillion yuan, surging 15.5% over last year, 1.3 percentage points higher than the growth at end-2013 and 1.9 percentage points higher than the growth of all loans during the corresponding period. In 2014, new loans to MSEs posted 2.13 trillion yuan, 128.5 billion yuan more than that in 2013, and took up 41.9% of new loans to all enterprises, 18.1 percentage points higher than the share of new loans to large enterprises in the same period.

2.6.3 Efforts were made to promote SOE reform

In 2014, SOE reform continued. Pilot reform was implemented in SOEs supervised by the central government, covering four work streams, namely, supervision of state-owned assets, mixed ownership, improvement of corporate governance structure, and discipline inspection and supervision. 19 provinces and municipalities including Shanghai also announced a roadmap for state-owned assets and SOE reforms, focusing on three major areas: first, improving the state-owned assets supervision and administration system centering upon capital administration; second, setting up two types of companies, one invested with and the other operated by state-owned capital; and third, developing mixed ownership, including introducing professional managers, employee shareholding and incentive mechanisms. Capital market development, such as stock market, had laid a solid foundation for accomplishing these reforms.

3. Outlook for China's financial market development in 2015

In 2015, China's economy entered the new normal and would move towards a new phase featuring a more advanced economic pattern, more complex division of labor and a more reasonable structure. Financial market development would adapt to and reflect the new normal with possible improvements in market regulation, innovation and internationalization, which is expected to provide support to economic growth under the new normal.

3.1 Rule-based financial market administration will be further strengthened

First, the Fourth Plenary Session of the 18th CPC Central Committee proposed that rule of law should be upheld fully, in line with which the institution building and regulation of China's financial markets would continue to intensify. With regard to market development, it may be embodied mainly in the following aspects: focusing more on encouraging market players to comply with rules and regulations in business operation and fulfill information disclosure obligations, and regulating disclosure processes, the integrity of information disclosed and compliance of market players; giving full play to market constraints and risk sharing mechanisms by mainly relying on information disclosure and due diligence as the major risk control approach; and attaching importance to the role of industry self-regulation and putting in place regulations on connected transactions along with punishments for non-compliance. Second, according to the arrangements by the CPC Central Committee and the State Council, market is to play a decisive role in resource allocation. In this process, relevant regulators are expected to reduce direct intervention in micro market behaviors and are more inclined to strengthen day-to-day and ex post regulation. Third, when efforts are made to actively promote innovation, relevant regulatory authorities are required to beef up financial market regulation in line with laws while lessening administrative intervention so as to ensure no systemic risks would arise.

3.2 Financial market reform and innovation will continue to deepen

In 2015, China's economic growth would enter the new normal characterized by the trinity of growth shifting gears, optimized structure and innovation-driven growth. At this stage, growth pattern would be more intensive, which would generate high quality and efficient growth, economic structure would undergo a deep adjustment that focuses on fine-tuning existing capacity and optimizing added capacity, and the driving force for economic growth would move to new sources of growth. All this is expected to improve significantly the foundation and environment for financial market reform and innovation, but also put forward new requirements regarding providing financial support to the real economy, which would in turn contribute to profound changes in financial market administrative institutions and participants in market investment and financing. With regard to financial market administration, the relationship between market and government would be further clarified, along with improved new day-to-day and ex post regulatory arrangements, which would further enable market players to make discretionary moves. For instance, market-based interest rate reform will accelerate, the RMB exchange rate formation regime will continue to improve, the *Securities Law of the People's Republic of China* is under revision, and the stock market reform which is expected to change the approval-based IPO system into a market-oriented registration system is on the horizon. As the Internet and financial markets become further integrated in a regulated way, better conditions and stronger incentives can be provided for financial market innovation, which will in turn advance financial market reform and innovation. With regard to financial market performance, new market players, products and trading patterns will emerge as China's financial markets continues to develop, which will contribute to a full sequence of submarkets and boost the growth of each submarket. In this process, each submarket may expand its product and investor boundaries, and promote the interconnectedness among submarkets, which may increase market investors' demand for financial derivatives that could hedge against risks in certain areas and secure profits. This will in turn promote market innovation.

3.3 Financial market internationalization will be intensified

First, the new normal in China's economic growth has resulted in a new two-way opening up requirement for China's financial markets. China will further promote reform-enhancing opening up of its financial markets and allow it to play a bigger role in servicing China's economy in global competition by making good use of both domestic and overseas markets and promoting the drive of inviting foreign investors and encouraging outbound investment. Second, the cross-border use of the RMB, whose international status has grown markedly since 2009, will facilitate financial market opening up. As of end-2014, the PBC had signed bilateral local currency swap agreements with 26 overseas central banks or monetary authorities, with the size of swap facilities approximating 3 trillion yuan. The RMB has already grown into the second largest currency for cross-border payments in China and the seventh largest reserve currency in the world. In 2015, China will steadily push forward the use of the yuan around the globe, a move deemed to continuously increase the yuan's overseas stock. Returns on cash holdings tend to be negative in the long run given the nature of credit money. Thus, those holding the yuan need to find investment channels. Looking at the motive for holding foreign currencies, they hold the yuan mainly to meet trade settlement and foreign debt repayment needs and favor safer and more liquid financial market products when seeking investment channels, which would facilitate financial market opening up. Third, with the implementation of such economic strategies as "One Belt, One Road", China will probably provide financial services to more countries, such as loans to finance infrastructure construction. The development of going-global initiative will potentially speed up the internationalization of China's financial markets. Fourth, as the economy develops further, all economic sectors in China will get more broadly involved in the development of international market, which would also in turn facilitate the internationalization of China' financial markets.

Part II Money Market

In 2014, the money market's scale maintained growth momentum with interest rate falling down on the whole. In particular, the interbank funding market enjoyed stable performance and non-bank financial institutions continued to boast brisk trading. The bond repo market witnessed gradually expanding trading volume and the trading term became shortened. The short-term financing bill market saw noticeably growing issuance volume with much diversified market participants. The bill market enjoyed rapid development with the market's awareness of risk control on the rise.

1. Interbank funding market

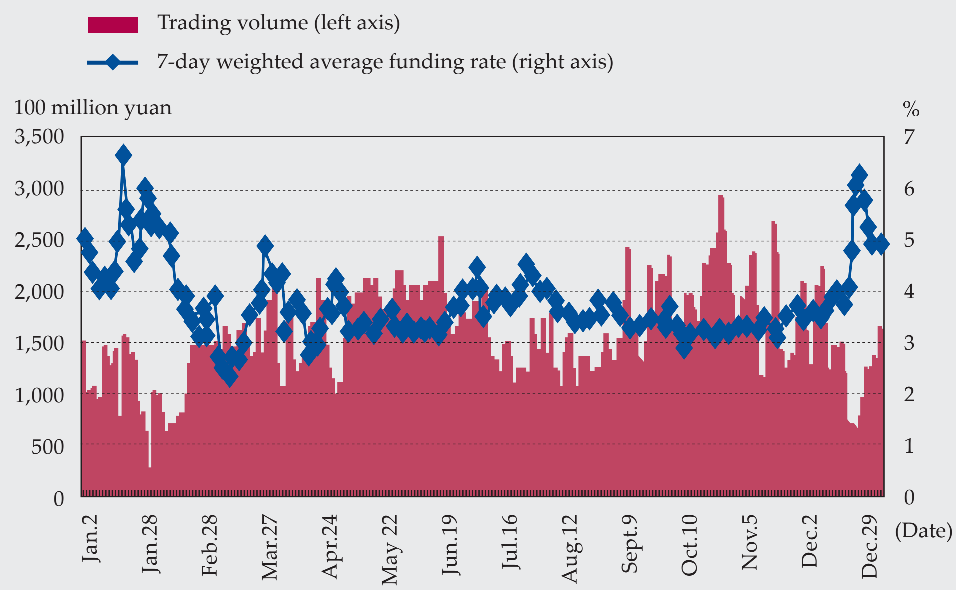
1.1 Performance of interbank funding market

In 2014, the role of open market operations in pre-setting and fine-tuning continued to be brought into play. In light of changing demand and supply conditions of market liquidity, the People's Bank of China (PBC) conducted open market operations with appropriate strength and frequency so as to meet the short-term liquidity fluctuations triggered by various factors. The annual cumulative turnover of repo transactions and reverse repo transactions hit 3,026 billion yuan and 525 billion yuan respectively, with a cumulative net injection of 84 billion yuan.

In terms of the instruments of open market operations, on the basis of maintaining an appropriate level of market liquidity, the PBC employed standing lending facilities and mid-term lending facilities in a bid to provide liquidity support for commercial banks that meet macro prudential requirements. In the meanwhile, stepped-up efforts have been made by the PBC in providing refinancing in support of the development of agriculture as well as long-term and fair-cost funds to the renovation of shantytowns by development financial institutions by means of pledged supplementary lending (PSL). Macro prudential management indexes were improved, loosening the credit supply restrictions on small and medium-sized regional incorporated financial institutions and financial institutions that generously supported the renovations of shantytowns and foreign trade.

In 2014, the cumulative turnover of the interbank funding market reached 37.66 trillion yuan with an average daily turnover of 150.651 billion yuan, increased 6.04% as compared with 2013. The weighted average interbank funding rate of 2014 was 2.96%, 71 bps lower than 2013. Take the 7-day rate for example, the maximum and minimum rates were 6.64% on January 20 and 2.34% on March 12, 561 bps and 21 bps lower than those of 2013 respectively. The annual spread was 430 bps, 540 bps lower than that of 2013.

Figure 2.1 Turnover and Interest Rates of the Interbank Funding Market in 2014



Source: National Interbank Funding Center.

In 2014, most of the interbank funding transactions remained short-term. The trading volume of transactions within 7days hit 35.6 trillion yuan, tanking a lion's market share of 94.53%, 0.6 percentage points higher as compared with the previous year. Specifically, overnight trading represented 78.32% of the overall market transactions, a modest decline of 3.78 percentage points as compared with 2013. The trading volume of transactions with a term between 7 days and 1 month stood at 1.77 trillion yuan, accounting for 4.6% of the total or 0.6 percentage points lower than 2013. As for transactions with a term of three months and plus, the trading volume amounted to 325.196 billion yuan, posting 0.86% of the overall market transactions and up 0.01 percentage points over the previous year.

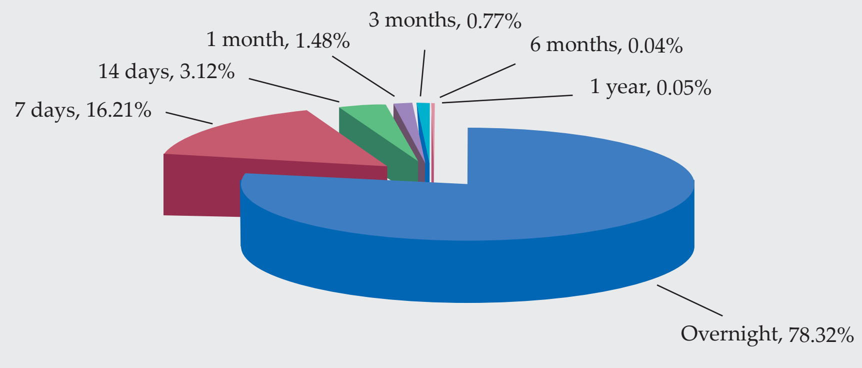
In 2014, banking institutions still dominate the interbank funding market. Specifically, joint-stock commercial banks, urban commercial banks, policy banks, foreign-funded banks and big-four state-owned commercial banks took up 36.33%, 13.58%, 8.89%, 8.8% and 8.02% of the overall market trading volume respectively. The above-mentioned institutions represented a market share of 82.58% accumulatively. The market share of non-bank institutions remained small. Nonetheless, securities companies and finance companies of conglomerates were also active market participants, taking up a market share of 10.84% and 4.88% respectively.

1.2 Main features of interbank funding market performance

1.2.1 Trading volume saw mild recovery

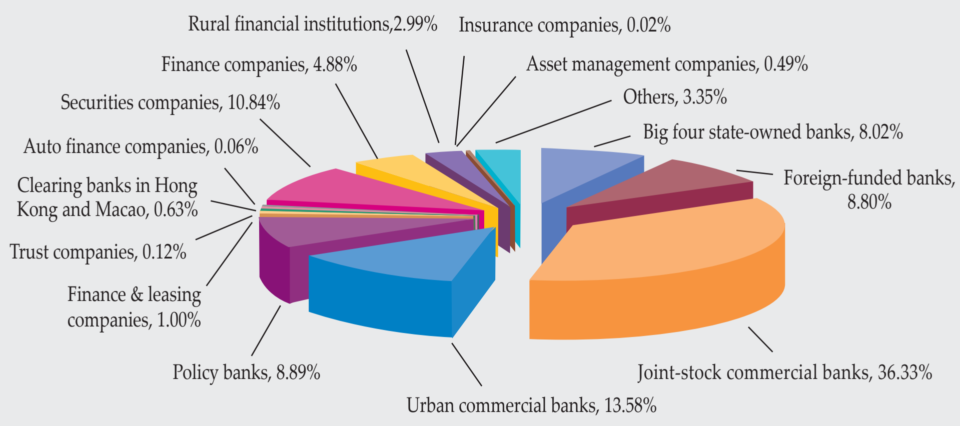
In 2014, the trading volume of the interbank funding market climbed up after a decline

Figure 2.2 Terms of Interbank Funding Market Transactions in 2014



Source: National Interbank Funding Center.

Figure 2.3 Interbank Funding Market Participants in 2014



Note: *Others* includes China Bond Insurance Co., Ltd..
Source: National Interbank Funding Center.

in 2013. The trading volume remained stable across the year with a monthly volume lingering between 3 trillion yuan to 4 trillion yuan. The monthly trading volume declined to around 2 trillion yuan at the beginning and end of the year due to seasonal and cross-year factors. The annual cumulative trading volume witnessed a mild year-on-year increase of 6.04%.

1.2.2 Interbank funding rate followed a U-shape movement with gradually narrower fluctuation band

In 2014, the annual weighted average interbank funding rate stood at 2.96%, 71 bps lower than that of the previous year. The interest rate followed a U-shape movement. Take the 7-day funding rate for example, during the holiday season of the Spring Festival, due to the changing conditions of market liquidity, the market rate soared from the mid of January and reached its annul maximum of 6.64% on January 20. After that, the rate descended unilaterally to its annual minimum of 2.34% in the mid of March. The rate fluctuated between 3% and 4% from April on with a gradually narrower fluctuation band. At the year-end, the rate climbed up to 6.26%, the second-highest level of the year, on December 22, and declined modestly afterwards to close at 4.89% on December 31.

The annual fluctuation band of the interest rate grew narrower. Take the 7-day rate for example, the maximum and minimum rates were 6.64% on January 20 and 2.34% on March 12, 561 bps and 21 bps lower than those of 2013 respectively. The annual spread was 430 bps, 540 bps lower than that of 2013.

The narrower fluctuation band of the rate could be explained by the following two reasons. For one thing, the continuity and stability of the presetting and fine-tuning of the monetary policy played a positive role in maintaining the equilibrium of market conditions and stabilizing market expectation. For another, financial institutions have stepped up their efforts in asset and liabilities management and greater importance has been attached to liquidity risk management. Therefore, the effects of seasonal factors on market price have been reduced due to financial institutions' preparation in meeting the market's liquidity demand on special occasions beforehand.

1.2.3 Lending from banking institutions was generally on the rise

The interbank funding market was continuously featured by net lending from banking institutions and net borrowing from non-bank financial institutions. Specifically, joint-stock commercial banks were the most important net lenders with a cumulative annual net lending of 6.06 trillion yuan, a year-on-year increase of 91.17% or 37.01% of the year's total. Policy banks and postal savings banks were the second and third largest market lenders and contributed an annual net lending of 6 trillion yuan and 2.13 trillion yuan, up 6.57% and 233.83% over 2013 and constituting a market share of 36.64% and 13.01% respectively. The big-four state-owned commercial banks, after contributing a net borrowing of 200 billion yuan in 2013, transformed into net lenders again in 2014, with an annual net lending of 1.61 trillion yuan or a market share of 9.81%.

1.2.4 Non-bank financial institutions witnessed fast growing number and greater borrowing amount

In 2014, non-bank financial institutions became more important players on the interbank funding market with growing number, greater trading volume and ever-increasingly brisker trading. In 2014, a total of 56 non-bank financial institutions got access to the interbank funding market, including 33 finance companies of conglomerates, 12 trust companies, 5 securities companies, 2 finance & leasing companies, 1 auto finance companies and 1 asset management companies of insurance companies, bringing the number of market players of non-bank financial institutions to 322, taking up 26% of the market.

In terms of the transactions, non-bank institutions contributed a cumulative trading volume of 13.12 trillion yuan, taking up a market share of 17.42%, a year-on-year increase of 53.27% or 5.37 percentage points higher as compared with the previous year. Non-bank institutions composed the most important borrowers of the market. In particular, securities companies and finance companies of conglomerates were the top 2 borrowers with a net borrowing of 784 million and 277 million yuan, up 95.51% and 22.57% over 2013 respectively.

1.2.5 Opening up picked up pace

In 2014, following the footsteps of the Bank of China (Hong Kong) Limited and Bank of China Macao Branch which got access to the interbank funding market in 2009 and 2010 respectively, Industrial and Commercial Bank of China (ICBC) Singapore Branch and Bank of China (BOC) Taipei Branch were granted the market's membership in 2014 as well, making a total number of 4 overseas RMB clearing banks on the interbank funding market.

In recent years, the trading volume of overseas RMB clearing banks on the domestic interbank funding market grew steadily. The trading volume grew 27 times from 17.74 billion yuan in 2009 to 478.86 billion yuan 2014. The interbank funding market not only provided a channel for liquidity management of RMB funds for overseas RMB clearing banks but also served as a communication platform for market participants. Moreover, the market promoted the cross-border use of RMB and the opening-up of the financial market as a whole.

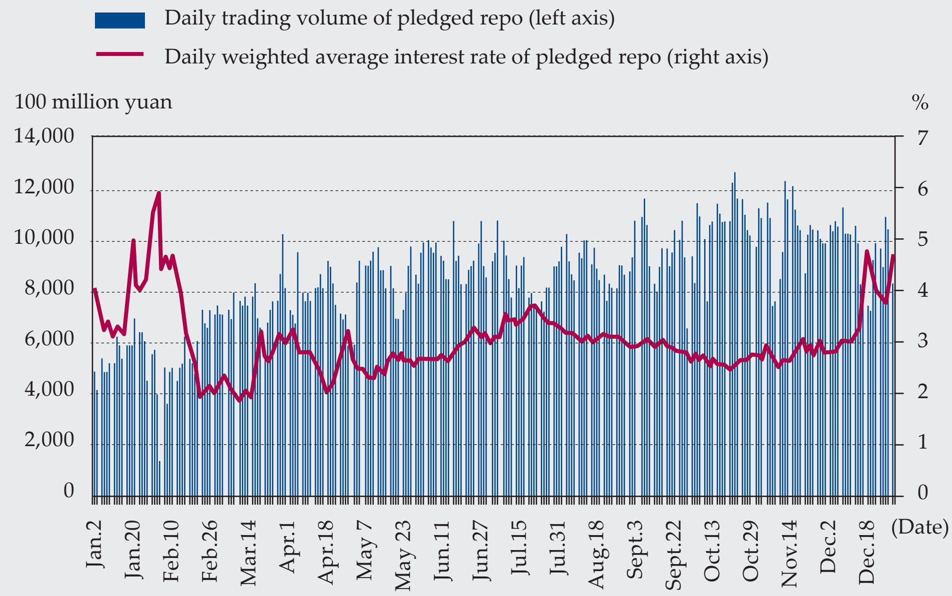
1.3 Outlook for interbank funding market development

After years of development, the interbank funding market has established a sound legal system and complete infrastructure with an appropriate layered structure and efficient operation. With the development of the market and the grow-up of market participants, administration of the interbank funding market will be transformed from ex ante administrative approval to ex post regulation. Efforts will be made in strengthening the market transparency management and ex post monitoring and inspection so as to promote the sound and stable development of the market.

2. Bond repo market

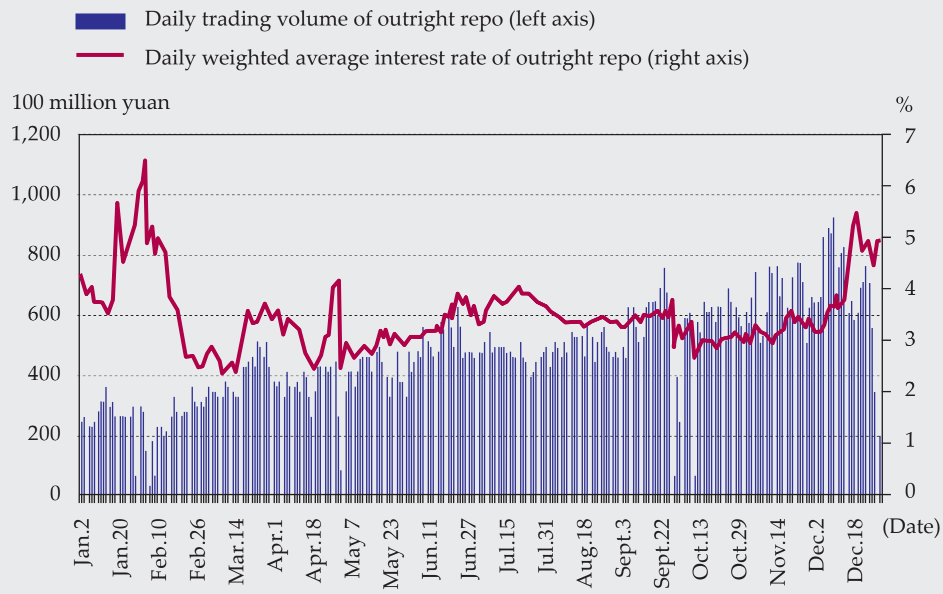
In 2014, the trading size of the bond repo market maintained stable growth momentum. The average transaction terms shortened as compared with the previous year and the repo rate substantially fell down. Policy financial bonds became the most important

Figure 2.4 The Turnover and Interest Rates of Pledged Repo in 2014



Source: www.chinamoney.com.cn.

Figure 2.5 The Turnover and Interest Rates of Outright Repo in 2014



Source: www.chinamoney.com.cn.

underlying assets of bond repo transactions. Large-scaled commercial banks and policy banks were net lenders of the market.

2.1 Performance of bond repo market

In 2014, the cumulative turnover of the repo transactions on the interbank bond market hit 224.42 trillion yuan, a year-on-year increase of 41.89%. In particular, the cumulative turnover of the pledged repo grew 39.77% to 212.42 trillion yuan, while the cumulative turnover of the outright repo reached 12 trillion yuan, an increase of 93.86% over that of 2013. The cumulative turnover of exchange bond market standard coupon amounted to 90.72 trillion yuan, up 37.2% over the previous year.

In 2014, the repo rate declined with narrower fluctuation band. The weighted average interest rate of the pledged repo descended 56 bps year-on-year to 2.98%. The maximum and minimum rates reached 5.9% on January 29 and 1.93% on March 11 respectively with an annual spread of 397 bps, 570 bps lower as compared with 2013. The weighted average interest rate of the outright repo fell 52 bps to 3.44% with an annual spread of 399 bps. In 2014, the interest rate of the pledged repo maintained the same movement with that of the outright repo. Generally speaking, the market rate was lower than that of 2013.

2.2 Main features of bond repo market

2.2.1 The size of the bond repo market grew steadily

In 2014, market size of the interbank bond repo market witnessed steady expansion. The market's turnover increased by 41.73% over the previous year, 30.12 percentage points higher than that of 2013. Specifically, turnover of the outright repo enjoyed the fastest growth with an annual growth rate of approximately 90%.

2.2.2 The maturity structure of bond repo transactions shortened

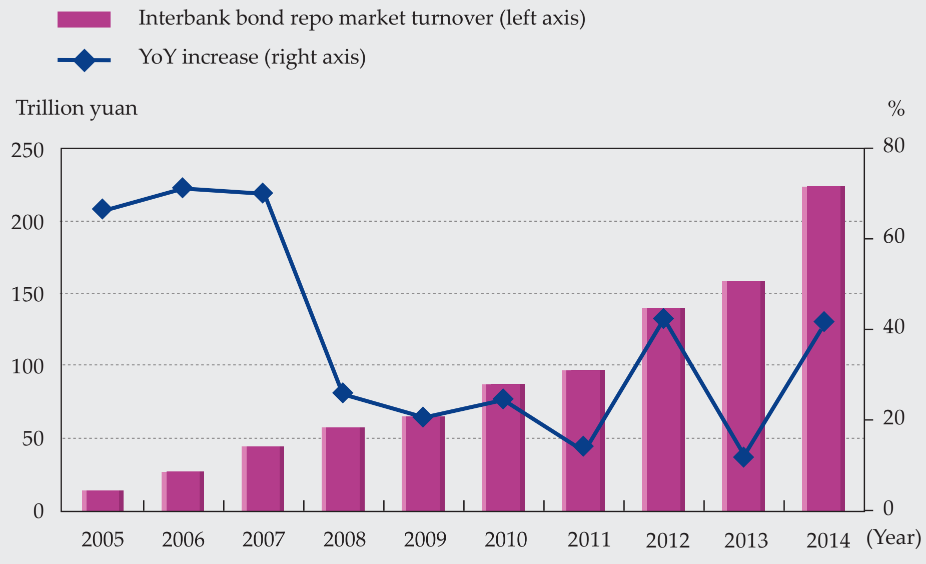
In terms of the term structure, less-than-7-day products accounted for 92.72% of the overall pledged repo transactions, 0.71 percentage points higher than that of 2013. Specifically, overnight products continued to trade briskly with an annual turnover of 166.91 trillion yuan, 78.57% of the total and 0.5 percentage points lower than that of 2013. 7-day products represented 14.14% of the total, down 1.2 percentage points over that of the previous year. 14-day-and-plus products saw a modest decline in market share. In particular, turnover of 14-day products accounted for 4.52% of the overall pledged repo transactions, up 0.26 percentage points over that of 2013,while the proportion of the turnover of 21-day-and-plus products declined 0.96 percentage points from 2013 to 2.76%.

The maturity of outright repo transactions shortened after prolonging in the previous year. Less-than-7-day products took up 87.31% of the total outright repo transactions, growing 4.29 percentage points over 2013.

2.2.3 Policy bank bonds became the most important underlying assets for bond repo transactions

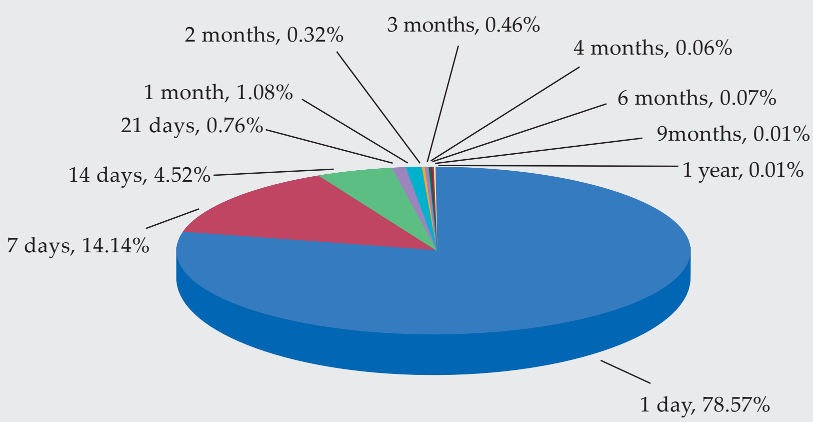
In 2014, treasury bonds, central bank bills and policy financial bonds accounted for 79.09% of the underlying bonds for pledged repo, up 1.13 percentage points over that of 2013. Specifically, the proportion of central bank bills as underlying assets for repo

Figure 2.6 The Size and Growth of Bond Repo Market, 2005—2014



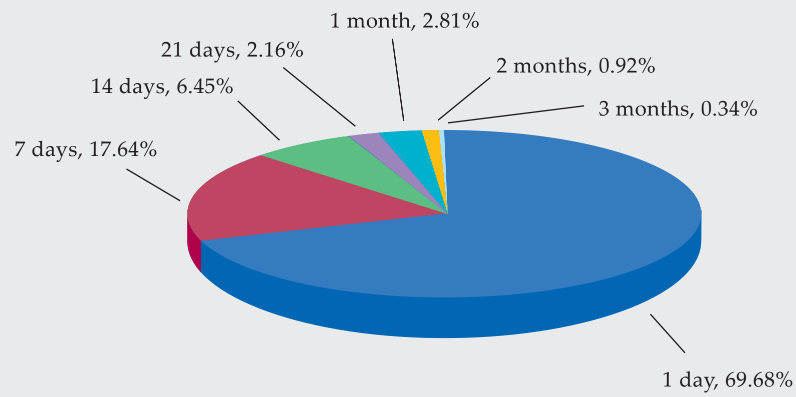
Source: www.chinamoney.com.cn.

Figure 2.7 Term Structure of Pledged Bond Repo Transactions in 2014



Source: www.chinamoney.com.cn.

Figure 2.8 Term Structure of Outright Bond Repo Transactions in 2014



Source: www.chinamoney.com.cn.

transactions decreased from 4.11% in 2013 to 0.76%, maintaining the declining trend that started from 2009, whereas the proportion of policy financial bonds grew from 36.15% in the previous year to 40.7%, up 4.55 percentage points. Besides, the proportion of commercial papers (CPs), super short-term commercial papers (SCPs), medium-term notes, collection notes and corporate bonds amounted to 15.86% altogether, 0.79 percentage points lower than that of 2013.

In 2014, the added-up proportion of treasury bonds, central bank bills and policy financial bonds as the underlying assets for outright repo transactions stood at 45.44%, 0.28 percentage points higher than that of 2013. Specifically, the proportion of treasury bonds as the underlying assets for outright repo transactions climbed up 5.76 percentage points over the previous year, whereas that of policy financial bonds and central bank bills declined 5.22 percentage points and 0.25 percentage points respectively. The proportion of CPs, SCPs, mid-term notes, collection notes and corporate bonds as the underlying assets for outright repo transactions grew from 49.28% in 2013 to 51.3%, 2.02 percentage points higher than that of 2013. In particular, the trading volume of CPs as underlying bonds for outright repo transactions witnessed a substantial increase, growing from 3.87% in 2013 to 8.81%.

2.2.4 Large commercial banks and policy banks were net lenders

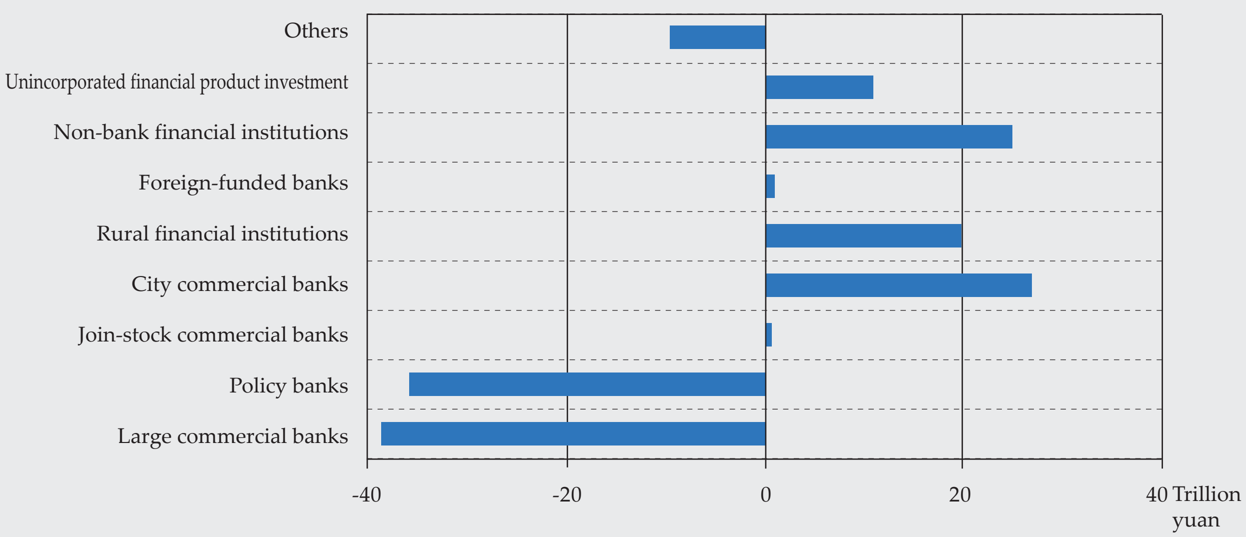
In terms of the fund flow of the repo market in 2014, the top three borrowers were urban commercial banks, rural commercial banks and rural cooperative banks as well as joint-stock commercial banks with a turnover of repo transactions of 67.54 trillion yuan, 33.37 trillion yuan and 32.29 trillion yuan respectively and accounted for 30.13%, 14.89% and 14.4% of the market respectively. Large-scaled commercial banks, policy banks and urban commercial banks were the top three lenders, which contributed a reverse repo turnover of 48.33 trillion yuan, 42.78 trillion yuan and 38.18 trillion yuan respectively, representing a market share of 21.56%, 19.08% and 17.03%.

As for the net fund flow, the top three lenders were large-scaled commercial banks, policy banks and the financial products of trust companies, which contributed a net lending of 42.01 trillion yuan, 41.4 trillion yuan and 3.76 trillion yuan respectively, whereas urban commercial banks, securities companies as well as rural commercial banks and rural cooperative banks made the top three market borrowers with a net borrowing of 29.36 trillion yuan, 19.48 trillion yuan and 12.35 trillion yuan.

2.2.5 The repo rate and the interbank funding rate were highly synchronized

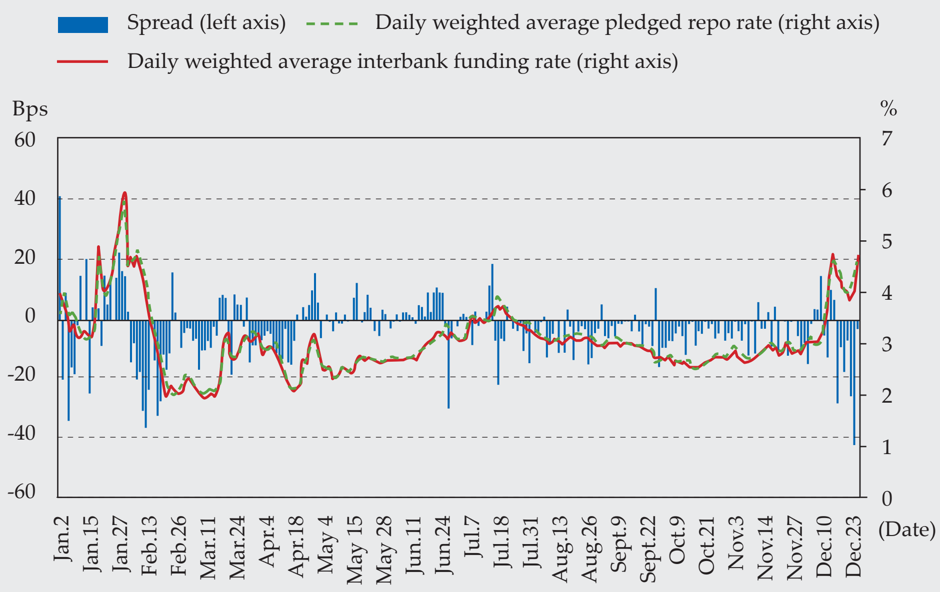
In 2014, the correlation coefficient between the daily weighted average rate of pledged repo and the interbank funding rate was 0.9870. The repo rate and the funding rate

Figure 2.9 Bond Repo Market Trading by Institutional Investors in 2014



Notes: 1. The numbers illustrated in the figure were net turnovers, which equal to the turnovers of repo transactions minus those of reverse repo transactions.
2. Large-scaled commercial banks include Industrial and Commercial Bank of China, Construction Bank of China, Agricultural Bank of China, Bank of China, Bank of Communications and Postal Savings Bank.
3. Policy Banks still include China Development Bank.
4.Joint-stock commercial banks exclude Bank of Communications.
5. Rural financial institutions include rural commercial banks, rural cooperative banks, rural credit unions and village banks.
6. Non-bank financial institutions include securities companies, fund companies, finance companies, insurance companies, asset management companies affiliated to insurance companies, asset management companies and trust & investment companies.
7. Non-incorporated financial products investment include funds, asset management businesses for designated clients of fund companies, securities asset management businesses of securities companies, insurance products of insurance companies, social insurance funds, pension funds, asset management businesses of commercial banks, financial products of trust companies and other investment products.
Source: www.chinamoney.com.cn.

Figure 2.10 Bond Repo Rate and Interbank Funding Rate Movement and the Spread in 2014



Source: www.chinamoney.com.cn.

were highly synchronized in movement. In terms of the spread, the average spread of the two rates was 8 bps, 1 bp higher than that of the previous year. 69.6% of the 250 trading days across the year saw a spread narrower than 10 bps.

In 2014, the repo rate followed a V-shape movement. In terms of the weighted average daily pledged repo rate, the rate soared in mid-January to hit its annual maximum of 5.9% on January 29 and crawled back afterwards to reach its annual minimum of 1.93% on March 11. The rate fluctuated within a narrow band before going up again in the final quarter of the year, closing at 4.68% at year-end.

2.3 Outlook for bond repo market development

Since its establishment in 1997, the interbank bond market, centered on the interbank bond repo market, has enjoyed rapid development for over ten years with expanding market scope and depth. Turnover of the interbank bond repo market exceeded 200 trillion in 2014 after hitting 100 trillion yuan for the first time in 2011. The market not only plays a key role in assets and liabilities management of financial institutions and financing channel expansion of market participants but also becomes an important reference for the central bank's open market operations and the formation of short-term rate on the money market. For the year of 2014, the PBC conducted a total of 83 repo transactions and 4 reverse repo transactions on the open market with a cumulative turnover of 3.55 trillion yuan. Specifically, on July 31, September 18, October 14 and November 25, the 14-day repo rate was cut by 10 bps, 20 bps, 10 bps and 20 bps to reach 3.7%, 3.5%, 3.4% and 3.2% respectively, effectively reducing the social financing cost.

Looking into 2015, with the advancement of interest rate liberalization and financial market opening up, the interbank bond rep market will enjoy sound and rapid development with enriched product portfolio and improved institutional arrangement. The interbank bond repo market, an importance platform for the PBC's open market operations, will provide beneficial conditions for the government and macro management departments to lead the movement of money market rate and adjust market liquidity.

3. Commercial paper market

In 2014, the CP market maintained stable and sound growth momentum. On the primary market, the issuance volume witnessed a substantial growth and the market stock continued to expand. The secondary market boasted stable operation with the turnover of spot trading increasing month-on-month. The yields on the secondary climbed up after an initial decline, driving down the overall yield level across the year.

3.1 Performance of commercial paper market

In 2014, non-financial enterprises issued cumulatively 1,506 Commercial papers[1], a year-on-year increase of 39.83%, with the face value growing 34.15% year-on-year to 2,154.35 billion yuan. Over the year, a total of 1,732.51 billion yuan was redeemed. At end-2014, the outstanding CPs amounted to 1,739.16 billion yuan, a year-on-year increase of 32.02%. In 2014, the average issuance volume of each CP hit 1.431 billion yuan, 61 million yuan less as compared with 2013.

In 2014, a total of 40 securities companies issued 252 CPs altogether, 123 more than that of the previous year, with a cumulative issuance value of 411.49 billion yuan, 43.58% more than that of 2013. In 2014, more and more securities companies with relatively low credit ratings became qualified issuers. The issuance of securities companies with a credit rating of AA and AA+ accounted for 8.91% and 16.31% of the market total respectively, 4.58 and 6.32 percentage points higher than that of the previous year respectively. Besides, China Securities Finance Corporation Limited launched 5 issuances of CPs with a cumulative value of 13.2 billion yuan, 2 more issuances or 4.2 billion yuan higher than those of 2013.

The operation of the secondary market of CPs remained stable with spot trading climbing up month-on-month. For the year of 2014, the monthly spot trading volume of non-financial institutions increased from 202.81 billion yuan to 641.96 billion yuan, an annual growth rate of 216.53%. The annual spot trading volume accumulated to 5.32 trillion yuan over the year, 8.82% higher than that of the previous year.

Yields of CPs on the secondary market followed a downward path, climbing up after an initial decline. Yields on the secondary market of short-term financing bills witnessed a substantial decline from

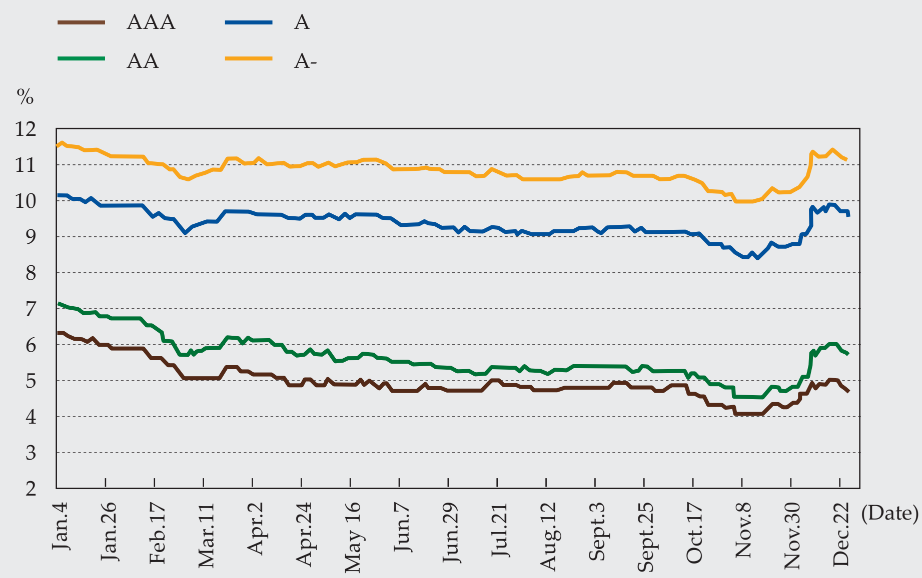
1 The commercial papers include commercial papers (CPs) and super short-term commercial papers (SCPs) issued by non-financial enterprises.

Figure 2.11 Issuance and Redemption of CPs

Source: National Association of Financial Market Institutional Investors (NAFMII).

January to February and recovered only in late March. From the beginning of April, the yields started to descend again and fell into a sharper decline after the National Day Holiday. From November to mid-December, the yields picked up fast and declined at the year-end. The overall yields on the secondary market fell down across the year. As of end-December, the yields of one-year AAA, AA and A short-term financing bills posted 4.7192%, 5.6292% and 9.5392% respectively, 156 bps, 144 bps and 53 bps lower than at the start of the year respectively.

Figure 2.12 One-Year CP Yields on the Secondary Market in 2014



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

3.2 Main features of CP market performance

3.2.1 SCPs witnessed rapid development

In 2014, interest rates of short-term bonds witnessed a substantial decline, attracting both issuers and investors. The NAFMII incorporated the AA enterprises into qualified issuers of SCPs so as to meet the enterprises' practical demand. In 2014, the proportion of the issuance of SCPs was noticeably raised. In terms of the issuance number, SCPs took up 28.88% of the total CPs issued by non-financial enterprises (including SCPs), up 8.83 percentage points over 2013. As for the issuance value, SCPs represented 50.34% of the total, 3.42 percentage points higher than that of 2013. The rapid growth of the market size of SCPs helps meet the super short-term liquidity demand of issuers, promote the flexibility of the enterprises' financial arrangement and cut the financing cost of enterprises. Moreover, SCPs also provide an important investment product for investors.

3.2.2 Change in issuance rates effectively transmitted monetary policy stance

In 2014, the PBC went to great lengths to guide the movement of market rat while maintaining sufficient liquidity on the market, driving down the social financing costs. Since the registration-based issuance of CPs by non-financial institutions was highly market-oriented, the issuance rates were sensitive to the change of movement or expectation of market rates. Since the beginning of 2014, the issuance rates of CPs has followed a downward path and were highly synchronized with the money market rates, which showed the transmission effects of debt financing instruments to interest rate policies. In terms of the interest rate level, CP yields on the secondary market were continuously declining across the year. On November 11, 2014, yield on the secondary market of one-year AAA CPs reached its annual minimum of 4.0387%, down 224 bps as compared with the start of the year. As for the credit spread, the credit spread of AAA and AA CPs with the same maturity of one year dropped from around 80 bps at the beginning of the year to about 45 bps in mid-November. The credit spread expanded further at the end of the year when the yields climbed up fast.

3.2.3 CP Investor structure was further optimized

Such collective investment institutions as funds increased their holdings of CPs, contributing to the establishment of a diversified investor structure. For one thing, funds and other collective investors, together with such non-bank financial institutions as the credit unions and securities companies, substantially increased their holdings of CPs (including SCPs) issued by non-financial enterprises. As of end-2014, the amount of CPs held by collective investors stood at 774.936 billion yuan, taking up a market share of 44.63%, 5.22 percentage points higher as compared with that at the end of the previous year. The holdings of credit unions and securities companies amounted to 34.34 billion yuan and 33.177 billion yuan, accounting for 1.98% and 1.91% of the market total, 0.25 percentage points and 0.37 percentage points higher than that at end-

Table 2.1 CP holdings by Institutional Investors

Units: 100 million yuan, %

	Holding balance (Oct. 2014)	Percentage	YoY change (over 2013)	Holding balance (2013)	Percentage	YoY change (over 2012)
Policy banks & China Development Bank	454.30	2.62	-0.98	458.80	3.54	2.66
Commercial banks	7,854.47	45.23	22.57	6,408.17	49.40	19.99
Nationwide commercial banks[1]	6,896.62	39.71	18.94	5,798.18	44.69	25.11
Foreign-funded banks	121.19	0.70	32.02	91.80	0.71	-35.98
Urban commercial banks	509.77	2.94	39.48	365.47	2.82	27.56
Rural commercial banks & rural cooperative banks	324.59	1.87	117.09	149.52	1.16	-1.16
Non-bank institutions	1,077.56	6.21	29.16	834.29	6.43	13.64
Credit Unions	343.40	1.98	52.86	224.65	1.73	-3.14
Securities companies	331.77	1.91	66.33	199.47	1.54	-20.85
Insurance institutions	350.86	2.02	1.56	345.48	2.66	75.80
Funds & other collective investors	7,749.36	44.63	51.58	5,112.44	39.41	-1.78
Non-financial institutions	1.50	0.01	-60.53	3.80	0.03	-82.65

Source: Shanghai Clearing House.

1 Nationwide commercial banks include state-owned and state-controlled commercial banks and joint-stock commercial banks. Specifically, state-owned and state-controlled commercial banks include Industrial and Commercial Banks of China, Agricultural Bank of China, Bank of China, China Construction Bank, Bank of Communications, Postal Savings Bank of China and their branches. Joint-stock commercial banks include CITIC Bank, Everbright Bank, Huaxia Bank, China Guangfa Bank, Shenzhen Development Bank, China Merchants Bank, Shanghai Pudong Development Bank, Industrial Bank Co., Ltd., China Minsheng Banking Co., Ltd., Evergrowing Bank, China Zheshang Bank, China Bohai Bank and their branches.

2013 respectively. For another, the proportion of commercial banks' holdings declined. As of end-2014, commercial banks cumulatively held 785.447 billion yuan worth of CPs. Although commercial banks still remain the most important holders of CPs, their market share has dropped from 49.4% in 2013 to 45.23%.

3.3 Outlook for CP market development

3.3.1 Market size will continue to grow steadily

In 2015, the Chinese economy will enter into a New Norm, i.e. the economic operation will be maintained with a proper range while transformation of economic growth mode and structural adjustment will be continuously advanced. New-type industrialization, informationization, urbanization and agricultural modernization will be pushed forward simultaneously. It is expected that the strategic emerging industries, the service industries and mid-and-high-end manufacturing industries will play a bigger role in supporting economic development. The conference on Economic Work of the Central Government, held at the end of 2014, emphasized the general principle of the economic work, i.e. adhering to prudent macro policies, flexible micro policies and social policies that safeguard the bottom line of social development, indicating the continuous implementation of proactive fiscal policies and prudent monetary policies. It is foreseeable that short-term financing demand of non-financial institutions will continue to thrive in 2015, driving the steady growth of the CP market, which will, in turn, effectively meet the demand for short-term funds of the real economy.

3.3.2 The investor structure will undergo further optimization

On November 2014, the trading platform for qualified non-financial institution investors was put into operation, granting market access to qualified non-financial institution investors. From December 1, part of the qualified non-financing institution investors could trade on the interbank bond market including such rural financial institutions as rural commercial banks, rural cooperative banks, rural cooperative unions and village banks, trust products, asset management scheme of securities companies, fund companies and the asset management schemes of their subsidiaries as well as asset management products of insurance companies. The above-mentioned qualified investors participated in the market of debt-instrument, actively involved in the trading of CPs, which will help enrich the variety of investors and optimize the holding structure of CPs.

4. Bill market

In 2014, financial institutions nationwide were actively involved in bill acceptance and bill discounting so as to meet the bill financing demand of SMEs. Meanwhile, major commercial banks attached greater importance to the risk control of bill businesses and the bill market enjoyed stable operation on the whole. Both the discounted bill balance and the proportion of discounted bill balance to loans crawled up. The interbank discounting businesses boasted brisk trading and interbank discounting rate tumbled across the year, climbing up at the year-end after declining at a slower pace quarter-on-quarter. In 2014, the internet bill businesses emerged on the bill market, shedding light on commercial banks' innovation regarding cross-market and diversified bill businesses.

4.1 Bill market performance

In 2014, the central government adopted micro stimulus policies in tackle with the downward pressure on economic growth. The central bank implemented presetting and fine-tuning of targeted loose monetary policy, providing a beneficial market environment for the bill businesses of financial institutions. Financial institutions went to great lengths to conduct the acceptance businesses of commercial drafts, bringing into full play the role of acceptance businesses in supporting credit increment and bill financing of SMEs. Bank acceptance businesses enjoyed continuous growth. In 2014, 22.1 trillion yuan worth of commercial drafts were issued, a year-on-year increase of 8.9%. The balance of undue commercial drafts reached 9.9 trillion yuan at the year-end, up 9.3% year-on-year. As of end-September, bill acceptance balance was 0.8 trillion yuan more than that at the beginning of the year. In terms of the industrial structure, most of the bank acceptance was issued by manufacturers, wholesalers and retailers. Specifically, bank acceptance issued by SMEs took up 2/3 of the total. In 2014, commercial banks were actively involved in adjusting assets and liabilities structure. Bill financing was promoted amid insufficient credit injection. From January to February, banks released credit funds by reducing bill businesses so as to support the growth of loans. However, ever since March, stepped-up efforts had been made by banks to beef up bill financing in a bid to support credit injection and bill financing had been climbing up after an initial decline in the first two months. The second and third quarters witnessed an accelerating growth of bill financing with major commercial banks increasing their holdings of bill assets for eight consecutive months. The growth of bill financing declined again at the year-end when major commercial banks cut their holdings of bill assets. As of end-December, bill financing balance held by financial institutions amounted to 2.92 trillion yuan, 957.4 billion yuan or 48.86% more than that at the end of the pervious year, taking up 3.57% of the total loans, 0.84 percentage points higher as compared with that at the end of 2013.

In 2014, bill financing aggregate continued to grow amid the central banks' moderately loose monetary policy stance. The interbank discounting businesses continued to boast brisk trading with financial institutions making profits from the spread. In 2014, the cumulative discount volume stood at 60.7 trillion yuan, a year-on-year increase of 33%. In 2014, due to the high market expectation for the promulgation of new regulatory policies regarding interbank businesses, commercial banks adopted prudent operating strategies in terms of the bill repurchase businesses. The bill repurchase market enjoyed relatively brisk trading in the midst of ongoing adjustment.

In 2014, the interbank discount rate made by the PBC, the money market rate and the supply and demand conditions on the bill market influenced the movement of bill market rate, which tumbled across the year and recovered at the end of each quarter. The rate saw a quarter-on-quarter decelerating decline and climbed up at year-end.

4.2 Main features of bill market performance

4.2.1 Bank acceptance businesses continued to expand with noteworthy fluctuations in its year-on-year growth rate

In 2014, mounting downward pressure on the economy aggravated the credit risks of bank loans. Based on client base expansion and credit risk control, banks went to great lengths to conduct the acceptance business of commercial drafts issued by enterprises. For the year, bank acceptance witnessed a stable quarter-on-quarter growth. The cumulative amount of commercial drafts issued by enterprise posted 5.7 trillion yuan, 5.3 trillion yuan, 5.2 trillion yuan and 5.9 trillion yuan in the four quarters respectively.

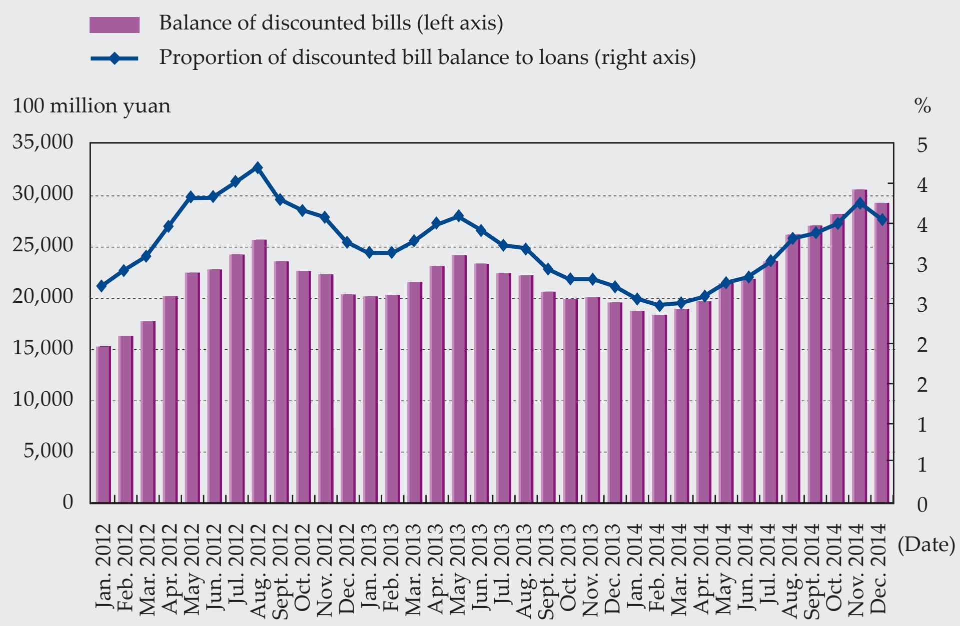
4.2.2 Discounted bill balance surged after an initial decline and the bill financing scale had been on the rise since March

At the beginning of 2014, against the backdrop of relative sufficient credit injection, major commercial banks cut back on bill financing scale so as to support the loan injection. The first two months witnessed a decline of 116.3 billion yuan of bill financing, whereas bill financing amount increased by 39.6 billion yuan month-on-month, ending the downward fluctuation that started in the second half 2013. Ever since March, commercial banks had stepped up efforts in supporting credit injection by means of bill financing. The bill financing scale saw a consecutive growth for months with the growth rate picking up in the middle of the year. The second and third quarters witnessed a quarter-on-quarter growth of bill financing sale of 319.4 billion yuan and 495 billion yuan respectively, or a quarter-on-quarter growth rate of 16.95% and 22.47% respectively. The monthly average growth rate of the two quarters represented 5.37% and 7.04% respectively. The growth rate of bill financing scale started to fall down in the fourth quarter, with a quarter-on-quarter growth of 219 billion yuan or a quarter-on-quarter growth rate of 7.78%. In December, major financial institutions started to reduce their holdings of bill assets again, resulting in a month-on-month decline of 140 billion yuan or a month-on-month decrease rate of 4.59% of bill financing scale (See Figure 2.13).

4.2.3 Interbank discounting business enjoyed brisk trading and bill repurchase market underwent adjustment amid reinforced interbank regulation

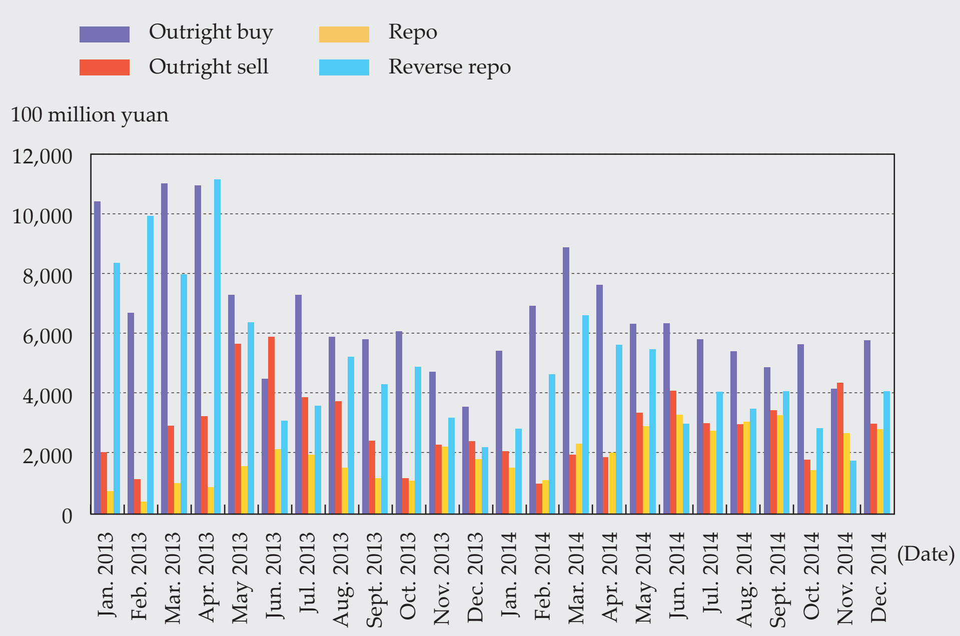
Ever since the beginning of the year, the bill discounting volume has been crawling up. Market liquidity released by the central bank's targeted loose monetary policy provided beneficial market conditions for the interbank discounting business. Meanwhile, regulations on the interbank businesses were expected to be reinforced, encouraging major commercial banks to conduct bill repurchase transactions in a stable manner. The second quarter witnessed the consecutive promulgation of the *PBC Document No.127* and the *CBRC Document No.140*. Bill market participants made adjustment in accordance with regulatory requirements, triggering fluctuations on the bill repurchase market. According to the data on www.chinacp.com.cn, in 2014, the cumulative quotation value of bill repurchase and reverse repurchase transactions hit 7.78 trillion yuan, a year-on-year decrease of 0.92 trillion yuan or 10.6%. In particular, the quotation value of reverse repurchase transactions stood at 4.86 trillion yuan, 2.17 trillion yuan of 27.02% less than that of the previous year. Adjustments

Figure 2.13 Balance of Discounted Bills As Percentage of Loans, 2012—2014



Source: www.chinacp.com.cn.

Figure 2.14 Monthly Quotation Value, 2013—2014



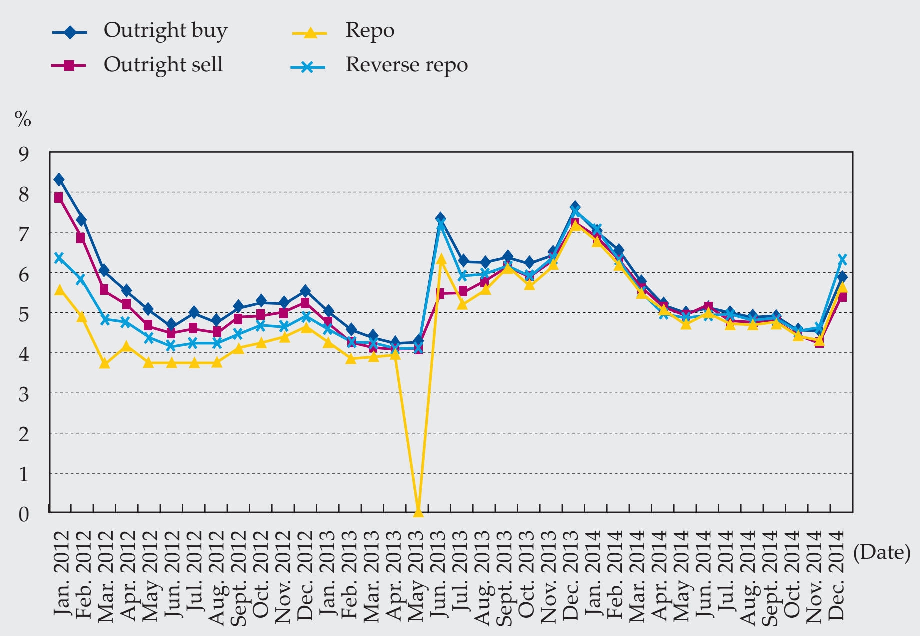
Source: www.chinacp.com.cn.

had been taking place in bill repurchase transactions (See Figure 2.14).

4.2.4 Interbank discounting rate climbed up at year-end after declining at a slower pace amid fluctuation across the year

In the first quarter, abundant bank credit and liquidity, together with the peak season of bank businesses at the beginning of the year, pushed down the interbank discounting rate, except for the Spring Festival and the end of each quarter when the rate surged temporarily. In the second quarter, the central bank cut the required reserve ratio to targeted financial institutions twice, pumping the liquidity into the market, which drove down the interbank discounting rate. In June, due to the structural liquidity crunch and reinforced market regulation, the interbank discounting rate surged while the interest rates of various bill businesses declined by a substantially smaller margin. In the third quarter, market liquidity tightened after an initial liquidity sufficiency due to the restart of the IPOs and the central bank's targeted loose monetary policy operations. The interbank discounting rate dipped again after rebounding in July. The rate surged slightly at the end of the quarter, giving a much smaller decline of the rate as compared with the previous quarters. In the fourth quarter, the interbank discounting rate climbed up after an initial decline. Ample liquidity on the market pushed down the rate at the start of the quarter. The rate stabilized and surged at the year-end amid balanced market liquidity conditions albeit the interest rate cuts of the central bank (See Figure 2.15).

Figure 2.15 Monthly Quotation Rates, 2012—2014



Source: www.chinacp.com.cn.

4.2.5 Financial institutions attached greater importance to the risk control of bill businesses and the bill market enjoyed stable operation as a whole

In 2014, the downward pressure on macro economy aggravated the operating risks of bill businesses. The banking sector strengthened the credit risk control in the midst of growing default risks. Commercial banks were actively involved in bill acceptance and discounting under the circumstances that the operating risks of bill businesses were prevented and controlled in a prudent manner. Centered on the credit risk control of enterprises, the risk control endeavor of banks was aimed at enhancing the qualification inspection of clients and verification of bills. Both the advance rate of bank acceptance and the overdue rate of bills were maintained at a low level. Besides, commercial banks also made efforts in compliant operation, prudent conductions of such businesses as bill repurchase and made business innovation based on regulatory regulations against the backdrop of an increasingly strict regulatory environment so as to insure the regulated and orderly development of the bill businesses and the stable operation of the bill market.

4.2.6 The cross-sector development of internet bills advanced the bill business innovation

In 2014, sufficient market liquidity pushed down the yields of such internet asset management products as Yu'ebao while internet bills attracted the market's attention for their higher yields and relative stability. Internet bills, based on the investment and fundraising information provided by the internet and the technical platform of telecommunications, provide financing services of commercial drafts for enterprises by raising the investment funds from the public through selling asset management products. Internet bills have been a brand new P2B mode in which earning rights of bills are transferred to the mass investors. Internet bills, boasting higher yields and lower threshold amount for investment, have been recognized and purchased by the public. Commercial drafts with more stable yields and controllable risks were made underlying assets for asset management products on various e-commerce platforms, giving rise to the mushrooming of asset management products of internet bills, which aroused the interest of the market. The concepts of internet finance were adopted by major commercial banks in their exploration of the new business mode of internet bills. Stepped-up efforts were also made in bill business innovation, which was focused on the proxy access to the electronic commercial draft system. Some of the small-and-medium-sized banks, in collaboration with the internet bill platforms, launched the intermediary services of agent verification, trust and collection of bills. The development of bill businesses was featured by diversified innovations. In line with the future development of electronic bill businesses, the bill agency of the ICBC reinforced its construction of the trust system of bills and the trading platform of electronic bills, laying a solid foundation for future business innovation.

4.3 Outlook for bill market development

In 2015, with the economic development entering a new normal, the bill market is expected to take on the following characteristics.

4.3.1 Growth of bill issuance by enterprises slowed down while bank acceptance surged by a small margin

In the recent two year, with the deceleration of GDP growth rate, the growth rate of cumulative issuance of commercial drafts, slowing down year-on-year, remained in the double-digits. The large number of newly-added issuance of commercial drafts signaled that the mid-to-high economic growth rate and economic restructuring will continuously push up the growth of bill financing demand of enterprise. Moreover, against the backdrop that the downward pressure on the economy is mounting and the acceptance rate of commercial drafts become market-based, the financing demand of clients may be met by bank acceptance instead of loans and banks will control credit risks and advance profitability by means of charging a margin deposit or deferential commission rate for acceptance. In 2015, the mid-to-high growth under the economic new normal and acceleration of structural adjustment will create beneficial external conditions for enterprises to use commercial drafts as a payment instrument or financing channel. Commercial banks are expected to be actively involved in bill businesses. Therefore, the cumulative issuance of bills will continue to grow year-on-year with the growth rate slowing down.

4.3.2 Bank discounting will be strengthened so as to support credit injection and the role of bill financing will be brought into full play

In terms of bank credit in 2014, major commercial banks have reinforced bill discounting businesses since March so as to support the loan injection, making up for insufficient credit on the market. In 2015, under the economic new normal, the driving force of investment for credit injection is expected to fall. Major commercial banks will expand credit provision by means of increasing bill discounting. The proportion of bill discounting to loans will remain at a high level. At the same time, the policy of stabilizing growth will stimulate the investment willingness of enterprises and manufacturing activities. It is expected that the potential bill financing demand of industries and SMEs that adjust their structures in line with policies will warm up. Bank acceptance issued by the above-mentioned industries and SMEs as well as the related discounting businesses will surge by a small margin year-on-year. The industrial structure of bill financing is expected to be optimized.

4.3.3 Banks are willing to purchase bills and the interbank discounting market continued to trade briskly

In 2015, the central bank will continue to implement prudent monetary policy, flexibly implement the toolkit of policy instruments, keep the liquidity of the banking system at an appropriate level and maintain the stable and proper growth of credit and social financing aggregate. Since the central bank's monetary policy has created a relatively loose market environment for financial institutions, the market rate will follow a U-shape track that is featured by limited decline during market tumbling and recovery afterwards, encouraging commercial banks to adopt the operating strategy of buy and sell and increasing the holding of bill assets. Besides, banks are more actively involved in making bill transactions based on bill rate fluctuations so as to adapt to the requirements of supervisory regulations on the interbank market and maximize profit margins under beneficial market conditions. The bill interbank discounting and repurchase market will continue enjoy brisk trading.

4.3.4 The bill rate witnessed a limited decline and followed a U-shape movement with phased fluctuations

When the central bank cut the interest rate an end-November 2014, the bill discounting rate surged by a small margin instead of falling down as the result of relatively stable credit injection and approximately equilibrium of market conditions. In 2015, it is expected that the bill discounting rate will be influenced by interest rate cuts and therefore the annual averages of bill discounting and interbank discounting rates will be lowered. Nonetheless, the bill rate has been at a low level after the continuous market tumbling in 2014. With the acceleration of financial reforms such as financial disintermediation, the cost of bank liabilities will go up, effectively bolstering the bill rate. Besides, with the interest rate liberalization speeding up and the IPOs restarted, financial reform measures will exert ever-increasingly complicated influence on market liquidity, triggering small phased fluctuations of the bill rate, which will surge slightly due to the structural liquidity crunch at the year-end.

Part III Bond Market

In 2014, with emphasis on both regulation and innovation, China's bond market maintained sound development momentum. Overall, the bond market continued its growth in size, with substantial increase in the issuance of corporate debenture bonds; the bond prices trended upward, with rates on the whole fluctuating downward; the bond market saw continuous product innovation and introduction of new regulations, and opening up of the market made progress.

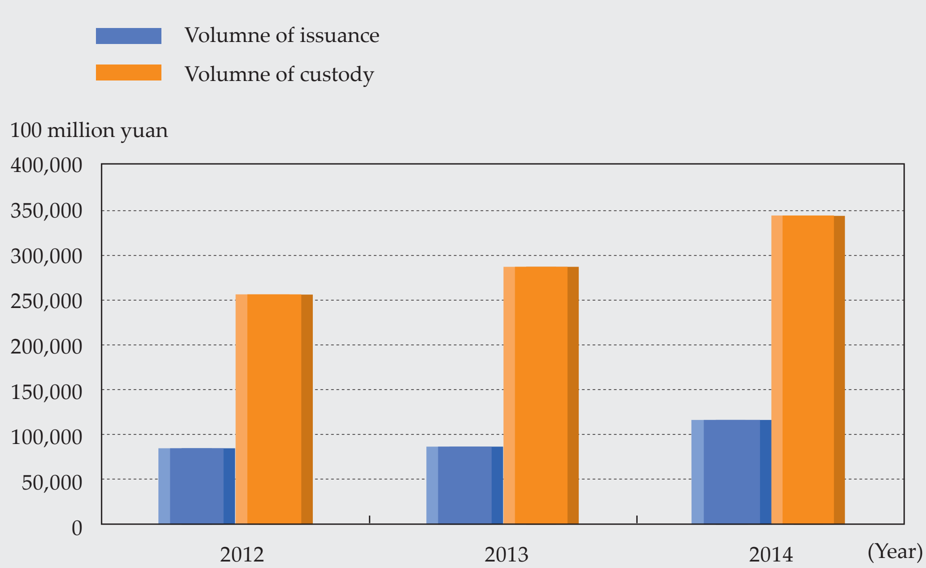
1. Overview of bond market performance

1.1 Performance of bond issuance market

1.1.1 Bond issuance expanded slightly and market stock grew steadily

In 2014, bonds issued on national bond market totaled 11 trillion yuan, a gain of 2 trillion yuan over last year, or 22.26%. The number of new bond issues registered with interbank bond market was 6,156 with a total value of 1.04 trillion yuan, rising 20.91% year-on-year, and accounting for 94.26% of the total issuance. The number of corporate bonds and privately-placed bonds by small and medium-sized enterprises (SMEs) issued on the exchange stood at 589 in total with the value reaching 363.96 billion yuan, taking up 5.74% of the total.

Figure 3.1 Change in the Size of Issuance and Custody on the Interbank Bond Market, 2012—2014



Sources: China Central Depository & Clearing Co., Ltd. and Shanghai Clearing House.

1.1.2 Bond market custody continued to increase steadily

By end-2014, bond market custody nationwide reached 34.98 trillion yuan, adding 5.34 trillion yuan from the end of previous year, or 17.99%. Among it, bond custody on the interbank market went up 16.8% year-on-year to 31.79 trillion yuan, accounting for 90.9% of the total, while that on the exchange-traded market surged 33.93% compared with last year to 2.6 trillion yuan, comprising 7.4% of the total, and custody on the over-the-counter (OTC) market soared 21.37% from last year to 593.613 billion yuan as of end-December 2014, taking up 1.7% of the total.

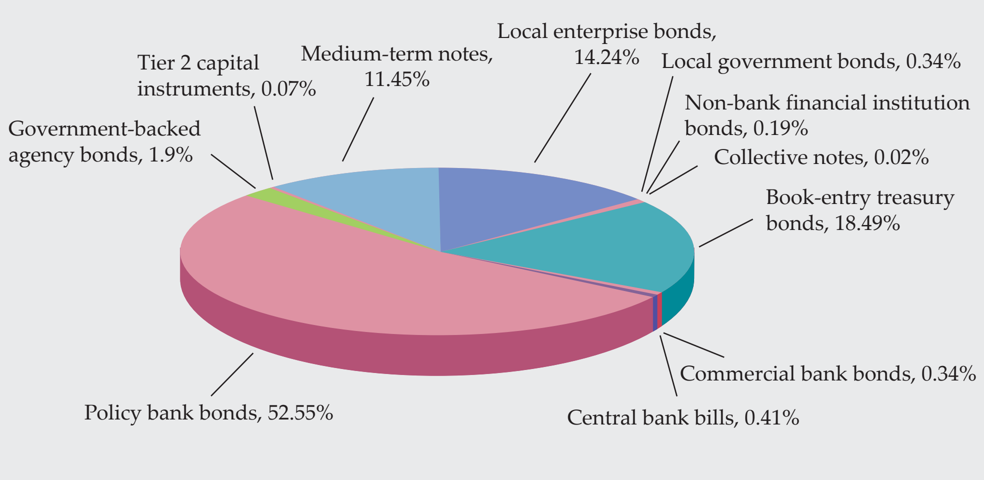
1.2 Performance of bond trading market

1.2.1 The size of spot bond trading declined slightly while repurchase trading became markedly more active

In 2014, settlement of spot bond trade on bond market added up to 43.15 trillion yuan, sliding 0.46% year-on-year. Volume of spot bond trade on the interbank bond market posted 40.36 trillion yuan, sinking 3.01% from last year. Settlement of spot bond trade on the exchange-traded market totaled 2.79 trillion yuan, jumping 60.31% compared with a year earlier. OTC trading surged 283.42% year-on-year to reach7.17 billion yuan.

Breakdown of spot bond trade on the interbank bond market by types of bonds showed that debenture bonds continued to take the biggest share of 41.6%, although the settlement volume retreated 9.31% from a year earlier; settlement of policy bank bonds[1] increased 9.91% from last year, boosting its share in total spot bond trade up to 40.15%; settlement of central bank bills dropped 2.14% from last year and accounted for 0.31% of the total; and settlement of treasuries and local government bonds slid 0.97% year-on-year, taking up 14.39% of the total.

Figure 3.2 Breakdown of Spot Bond Trade on the Interbank Bond Market by Bond Type in 2014



Sources: China Central Depository & Clearing Co., Ltd. and Shanghai Clearing House.

1 Policy bank bonds include financial bonds issued by the China Development Bank (CDB), the Agricultural Development Bank of China (ADBC) and the Export-Import Bank of China (China EximBank).

1.2.2 Bond market price index rose continuously while the yield curve fluctuated downward

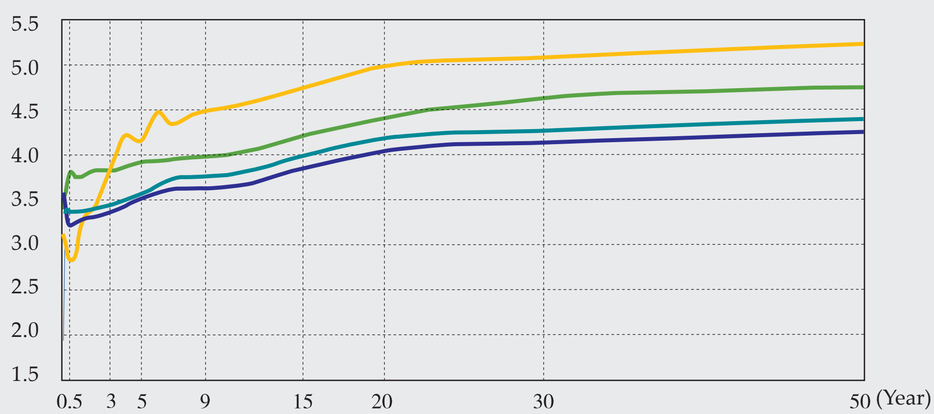
In 2014, domestic economic fundamentals witnessed weakness, with economic upward expectation cooling down gradually. In addition, the People's Bank of China (PBC) took a pre-emptive and fine-tuning monetary policy stance to keep total liquidity in appropriate adequacy while guiding the downward movement of market interest rates. Therefore, funding conditions were generally stable while slightly tilted toward loosening, and the bond market was showing an obvious bull market status, with the ChinaBond Index increasing constantly and the bond yield curve declined downward in fluctuation.

As of end-December 2014, the ChinaBond New Composite Index (Net Price Index) was 99.4821 points, up 5.54% from 94.2616 points at end-December 2013, while the ChinaBond New Composite Index (Wealth) was 157.0586 points, up10.34% compared with the 142.3383 points at end-December 2013. This has been the second largest yearly increase since 2002. The average yield on ChinaBond fixed rate treasury bonds, policy bank bonds, enterprise bonds (AAA), and short and medium-term notes (AAA) declined 100, 152, 136 and 144 bps respectively compared with the start of the year.

1.2.3 New bonds on the OTC market saw active trading

In 2014, bonds issued by the CDB, policy banks and government-backed institutions such as the China Railway Corporation greatly promoted the activities of the OTC bond market. The trade of new bonds counted for 73.07% of the total OTC trade of 2014. The number of book-

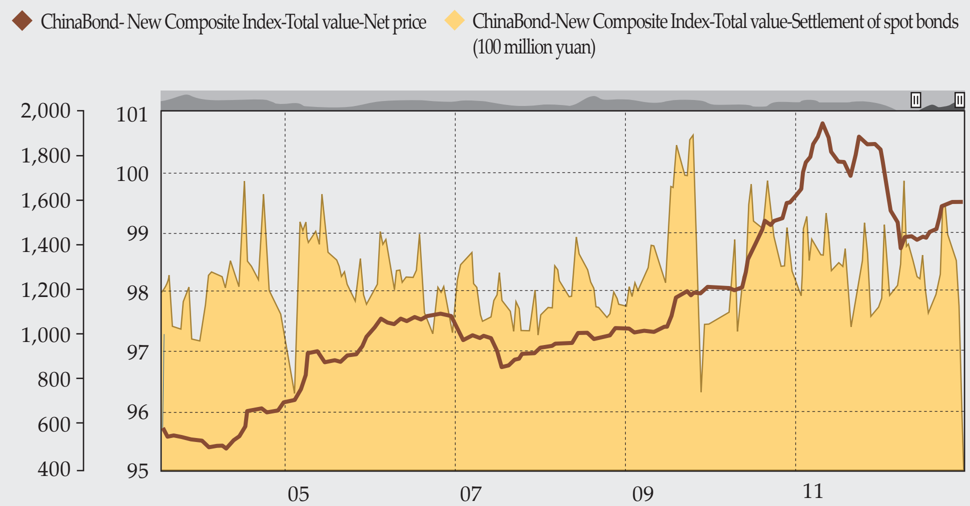
Figure 3.3 Yield Curves of Interbank Fixed Rate Treasury Bonds in 2014



Color	Date	Remaining maturity (year)	Yield (%)
	Mar.31,2014	0.0	1.8467
	Sept.30,2014	0.0	2.1392
	Oct.31,2014	0.0	2.1287
	Dec.31,2014	0.0	2.7937

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

Figure 3.4 Movement of ChinaBond Composite Index (Net Price) in 2014



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

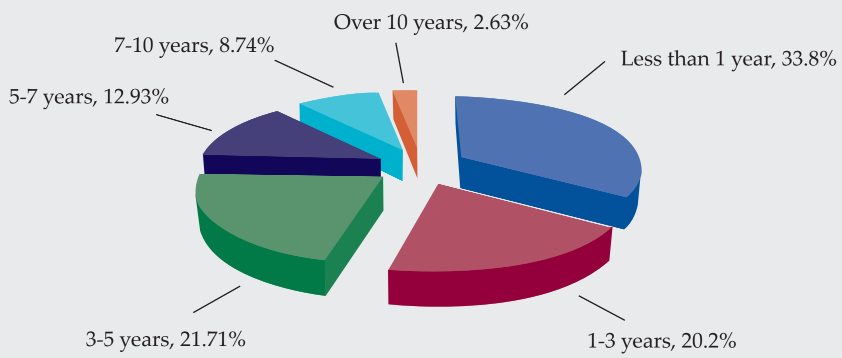
entry treasury bonds, the original major trading bonds on the OTC market, reached 123, 9 more from the previous year, and covered all key maturities from one year to ten years. The cumulative OTC trading of book-entry treasury bonds reached 1.931 billion yuan, a 3.15% increase compared with the previous year. The sale of savings treasury bonds on the OTC market stood at 188.405 billion yuan, dropping 13.16% compared with the previous year.

2. Main features of bond market performance

2.1 Policy bank bonds and book-entry treasury bonds continued to account for the major bulks in issuance

Newly issued bonds on the national interbank bonds market in 2014 showed the following facts: the issuance of enterprise bonds totaled 695.2 billion yuan, a growth of 46.29% year-on-year; the issuance of policy bank bonds totaled 2,290.05 billion yuan, which was a 214.02 billion yuan increase from the previous year, or a 10.31% increase; commercial banks' ordinary financial bonds issuance was 189.1 billion yuan, which was a 58.5 billion yuan increase from the previous year, or a 44.79% increase; the issuance of Tier 2 capital instruments was 356.85 billion yuan; book-entry treasury bonds issuance totaled 1,420.75 billion yuan, adding 97.05 billion yuan or 7.33% to the previous year's level. Policy bank bonds and book-entry treasury bonds were still the biggest bulk, with their issuance jointly accounting for 35.72% of total bond issuance. In addition, two types of innovative financial products, interbank certificates of deposit and project revenue notes, were introduced to the bond market in 2014, whose issuances amounted to 891.45 billion yuan and 800 million yuan respectively.

Figure 3.5 Term Structure of Bonds Issued on the Interbank Market in 2014



Note: Each term is exclusive of the lower bound but inclusive of the upper bound.
Sources: China Central Depository & Clearing Co., Ltd. and Shanghai Clearing House.

2.2 Share of long-term bonds increased in the term structure of bond issuance

Newly issued bonds on the national interbank bonds market showed the following facts about the term structure in 2014: short-term (0-3 years) bonds accounted for 54% of the total issuance, down 2.85 percentage points over the previous year; the share of medium and long-term (3-10 years) bonds stood at 43.37%, up 3.65 percentage points, and that of long-term (over 10 years) bonds was 2.63%, dropping 0.8 percentage points from the previous year.

2.3 The annual turnover rate of spot bonds on the interbank market declined slightly

In 2014, the annual turnover rate of bonds on the interbank market was 107.83%, down 9.69 percentage points from the previous year. By breakdown, such major products as enterprise bonds and medium-term notes were top performers in terms of liquidity, with their respective turnover rate being 268.66% and 171.88%. The non-bank financial institution bonds, policy bank bonds and asset-backed securities were traded more actively compared with one year ago, with their turnover rates increasing 113.82, 17.06 and 0.78 percentage points. Other types of bonds witnessed declines in their turnover rates at different degrees, with enterprise bonds, central bank bills and medium-term notes as the top three when their turnover rates dropping 404.37, 162.57 and 152.23 percentage points respectively.

2.4 Debenture bonds issuance grew substantially

The total issuance of debenture bond[1] on

1 Debenture bonds include enterprises bonds, medium-term notes, short-term financing bills, super short-term financing bills, ordinary financial bonds of commercial banks, bonds of non-bank financial institution, asset-backed securities, collective notes, capital instruments, targeted financing instruments of non-financial enterprises, collective notes issued by promising regional SMEs, short-term financing bills of financial enterprises, asset-backed notes of non-financial enterprises, financial bonds of asset management companies and interbank certificates of deposit.

Table 3.1 Comparison of Turnover Ratio of Bonds on the Interbank Bond Market in 2013 and 2014

Unit: %

Types of bonds	2013	2014	YOY change
Book-entry treasuries	66.98	71.29	-4.31
Local government bonds	9.15	26.79	-17.64
Central bank bills	29.53	192.1	-162.57
Policy bank bonds	163.48	146.42	17.06
Government-backed agency bonds	53.28	123.57	-70.29
Commercial bank bonds	8.47	22.72	-14.25
Capital instruments	5.71	26.67	-20.96
Non-bank financial institution bonds	131.64	17.82	113.82
Enterprise bonds	268.66	673.03	-404.37
Asset-backed securities	0.78	0	0.78
Medium-term notes	171.88	324.10	-152.23
Collective notes	138.31	174.4	-36.09
Average turnover rate of bonds on interbank market	107.83	117.5	-9.69

Sources: China Central Depository & Clearing Co., Ltd., Shanghai Clearing House.

the national interbank bond market reached 5.66 trillion yuan in 2014, up 74.39% from the previous year's level. The breakdown shows the cumulative issuance and changes compared with the previous year of each type of bonds in 2014 were as follows: enterprise bonds issuance reached 696.198 billion yuan, up 46.5% year-on-year; short-term and super short-term commercial paper issuance reached to 2,151.753 billion yuan, up 35.64%; mid-term notes issuance reached 946.84 billion yuan, up 40.97%; commercial bank bonds issuance reached 83.4 billion yuan, down 25.35%; the non-public directional issuance of debt financing instruments issuance reached 1021.516 billion yuan, up 80.22%; the issuance of collective notes issued by SME regional leader joint bonds reached 517 million yuan, down 91.55%; the issuance of short-term financing bills of financial enterprises (securities company and securities finance company) reached 424.69 billion yuan, up 41.76%, the issuance of asset-backed notes of non-financial enterprises reached 8.92 billion yuan, up 85.83%; and the non-bank financial institution bonds issuance reached 63.2 billion yuan, up 815.94%.

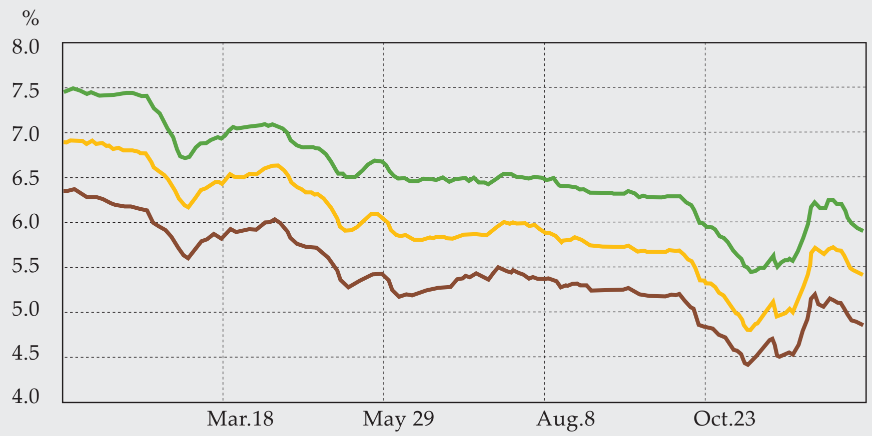
2.5 Debenture bond issue rates declined markedly

PBC has been continuing it prudent monetary policy since 2014, with application of several new monetary policy instruments such as SLO and MLF, together with other tools such as directional reserve ration cut and interest rate cut, to guide the downward movement of the market interest rates. In 2014, the issue rate of the debenture bonds on the primary market experienced rapid decline, with the issue rate on AAA, AA+ and AA 5-year industry category medium-term notes dropping 56, 100 and 161

Table 3.2 Comparison of Average Issue Rates of Five-Year Industrial Medium-Term Notes in Two Quarters

Rating	Average issue rate (%)		Change (bps)
	2014 Q1	2014 Q4	
AAA	6.00	5.44	-56
AA+	6.44	5.44	-100
AA	7.72	6.11	-161

Figure 3.6 Movement of Yields on Interbank Short and Medium-Term Notes in 2014



Colour	Curve	Date	Yield
■	Interbank short and medium-term notes (AAA) (YTM)	Jan.3	6.3396
■	Interbank short and medium-term notes (AA+) (YTM)	Jan.3	6.8796
■	Interbank short and medium-term notes (AA) (YTM)	Jan.3	7.4496

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

bps respectively in the whole year. On the secondary market, the yields on AAA, AA+ and AA-rated short and medium-term notes declined 150, 148 and 157 bps respectively for the full year. The down-sloping interest rates on both primary and secondary markets indicated that the financing cost of enterprises via bond market declined and the issue of high financing cost experienced by enterprises was effectively eased.

2.6 The band of yield fluctuation widened

With the constant progress of interest rate liberalization, the fluctuation of bond prices has enlarged to some extent in 2014. Take a look at the ChinaBond yield curves of key maturities: the average two-day change in yield for 10-year treasury bonds in 2014 was 2.19 bps, up 17% from the 2013 level. The yield of 10-year CDB bonds fluctuated more obviously, with the absolute value of the 2-day yield change

Table 3.3 Daily Change in ChinaBond Yield Curves of Major Interest Rate Bonds and Debenture Bonds of Key Tenors (By Bond Type)

Treasury bonds	2013 (bps)	2014 (bps)	Change (%)
1-year	2.21	2.87	29.86
3-year	2.35	2.34	-0.43
5-year	2.12	2.11	-0.47
7-year	2.01	2.18	8.46
10-year	1.87	2.19	17.11
CDB bonds	**2013 (bps)**	**2014 (bps)**	**Change (%)**
1-year	2.59	3.37	30.12
3-year	2.32	3.64	56.90
5-year	2.16	3.56	64.81
7-year	1.84	3.22	75.00
10-year	1.76	3.27	85.80
China EximBank and ADBC Bonds	**2013 (bps)**	**2014 (bps)**	**Change (%)**
1-year	2.31	3.08	33.33
3-year	2.19	3.15	43.84
5-year	2.08	3.11	49.52
7-year	1.77	2.87	62.15
10-year	1.52	2.78	82.89
Short and medium- term notes (AAA)	**2013 (bps)**	**2014 (bps)**	**Change (%)**
1-year	3.02	2.80	-7.28
3-year	2.26	2.45	8.41
5-year	2.07	2.57	24.15
7-year	1.48	2.06	39.19
10-year	1.13	2.01	77.88

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

averaging at 3.27 bps in the first 11 months of 2014, an 85% increase compared with 1.76 bps in the same period of 2013. In general background of bull market in 2014, the fluctuation of long-term bonds is greater than that of short-term bonds. Table 3.3 shows the fluctuation in yields of major debentures bonds and interest-rate bonds in the past two years.

2.7 The credit risk incidents increased

On March 7, 2014, the Shanghai Chaori Solar Energy Science & Technology Co., Ltd. issued an announcement saying that it was unable to pay in full amount the second-term interest of its 2011 bonds. This was the first actual default for a public placed company bond on the exchange-traded bond market. Since then, the incidence of credit risk event on bond market has increased, and the market concern has been rising and its influence has been spreading. The features of these credit risk events show the following: the contingent default risk of SMEs was bigger, and private enterprises had higher risk than that of state-owned enterprises (SOEs); the developed coastal areas where the above two types of enterprises concentrate have shown higher possibility of individual credit risk case; great alert should be given to enterprises of over-capacity industries or industries with strong cyclical feature; and enterprises short of credit-enhancing measures have higher probability of contingent default. In term of their market influence, the credit risk events did not generate an obvious shock to the general issuance and trade on the interbank bond market; however, they triggered the investors' re-evaluation to the credit risk of those non-state enterprises with low and medium-level credit rating, therefore the spread between high and low credit rating enterprise bonds enlarged. In 2014, for the 3-5 year short and medium-term notes, the credit spread between AA- and AAA bonds widened 71 bps by average.

Although the credit risk events formed a shock to the market risk preference in the short term, in the long run, the happening of credit risk events helps all market participants to face the risk, to contain their irrational behaviors, to raise their sense of responsibility and cooperation, and to foster them to take their own responsibility and put greater attention to the establishing of bond market default dissolutionmechanism, which would benefit the long-term sound development of bond market.

2.8 The credit spread of city construction investment bonds (CCI bonds) narrowed

The audit report on local government debt published in 2014 indicates that China's local government debt is controllable. To some extent this eased the market concern over default risk of CCI bonds. Despite frequent occurrences of industrial bond default risks in 2014, there was no credit event related to CCI bonds. The ChinaBond yield curve of 5-year AA-rated CCI bonds declined by a wider margin compared with that of industrial bonds. By the end of December 2014, the ChinaBond yield curve of 5-year AA-rated CCI bonds declined 171 bps for the full year. Credit spreads between different credit levels of CCI bonds actually narrowed slightly. By the end of December 2014, the credit spread between AA and AAA 3-5 year CCI bonds shrunk 15 bps by average.

2.9 Bonds with high credit ratings became a new means for liquidity management

In the past two years PBC actively applied the innovative monetary policy tools- Standing Lending Facility (SLF) and Medium-term Lending Facility (MLF) – to provide fund to support commercial banks compliant macroeconomic prudential requirements. These two tools release liquidity by collaterals, requiring commercial banks to provide high credit level bonds such as treasury bonds, central bank bills, policy bank bonds or high credit rating credit assets as collaterals. Therefore, high credit level bonds have become one type of important collateral in the liquidity management for the central bank and commercial banks. Meanwhile, these bonds also became the major collateral on the market because of their high liquidity and relatively low fluctuation in value. They were used as guarantee for performance bond in repurchase and securities lending activities as well as the clearing provisions and bond provided to the counterparty. On one hand, this helped cover the open risk effective and prevent the risk, playing a role in minimizing the cash occupation to the biggest extent and lowering the cost. On the other hand, this also helped improve the liquidity of commercial banks' ordinary financial bonds and efficiency of their assets, and meet the requirement on newly increased liquidity set in Basel III.

3. Bond market innovation

3.1 Innovation in OTC bond business

In order to implement the Party Central Committee and the State Council's requirements to development inclusive financial system and broaden the financial channels, PBC enacted the No3 Public Notice in March 2014, aimed at increasing the types of OTC bond business that commercial banks can engage in from only book-entry treasury bonds to bonds issued by policy banks and government supported agencies such as the Chinese Railway Corporation. In the meantime, administrative approval requirements for commercial banks to undertake OTC trading of book-entry treasury bonds was removed, and the PBC will not set market-entry requirement to market players that may enter this market so there will be no binding condition. This increase in bonds type that commercial banks can undertake is the first since 2002 when commercial banks started OTC book-entry treasury bond trading. According to the Notice, via their network and e-banking, the undertaking banks can sell bonds to investors, trade with investors and conduct bonds custody and settlement. During 5-8 May 2014, the CDB successfully issued through the Industrial and Commercial Bank of China (ICBC) the first commercial bank OTC financial bonds, with one-year maturity. The ICBC provides for investors double-side bidding and market making services, and investors can trade during trading hours via ICBC's network offices, online banking and mobile banking, with trading fund real-time settlement. In June 2014, the China EximBank issued, to individual and non-financial institutions through the ICBC, 2-year fixed interest coupon bonds and 1-year discount bonds. In December 2014, the CDB issued its initial OTC bonds through the Bank of China. By the end of 2014, the CDB and the China EximBank have sold 6.7 billion and 3 billion yuan OTC bonds respectively via commercial bank.

OTC financial bonds of commercial banks have many advantages such as low entry requirement, low risk, high yield and strong flexibility and so provide more options for investors to allocate their assets in a rational way. To increase the types of OTC bond business of commercial banks is an important measure to carry out the CPC Central Committee's requirement of "regulating the development of bond market" stated at its 3rd plenary session of it 18th Central Committee. It is in line with the market idea of "inclusive finance". It not only opened a new channel for social public to invest in financial bonds, but also helped to raise the market liquidity and the efficiency of social funds utilization and to improve the investor structure of bond products, which would benefit the development of bond market towards a wider and deeper one.

3.2 Innovation in four types of products

Several important innovative bond products including carbon revenue notes, merger and acquisition (M&A) notes, targeted negotiable notes and project revenue notes were introduced to the interbank bond market since 2014, which enriched the product structure of bond market and provide wider options to issuers and investors.

In May 2014, carbon revenue notes, the first green bond that was closely related to energy conservation and emission reduction, were successfully issued by the China Guangdong Nuclear Power Holding Co., Ltd. on the interbank market. This event effectively connected the capital market and domestic carbon trading market, and widened the financing channel of the carbon trading market.

In June 2014, M&A notes, the first debt financing instrument for M&A payment, were issued successfully by the Guizhou Kailin (Group) Co., Ltd., with an issue size of 1 billion. This issuance was an innovative breakthrough on the basis of raising funds to pay for merger loans in the first stage. It promoted the solutions in many aspects such as supporting M&A, M&A leverage ratio, issuance method, information disclosure, connecting registration and issuance with M&A flow and M&A failure resolution. By end-2014, there had been 9 enterprises issued 9 M&A notes, with an issue size of 15.638 billion yuan.

In July 2014, the first targeted negotiable note on the interbank market, the first tranche of 2014 Targeted Negotiable Notes by Yangling Besun Agricultural Industrial Group Corporation, was successfully issued. The negotiable instrument met the risk-yield preferences of different types of investors while fulfilling the financing demand of the enterprise to the maximum degree and lowering the financing cost by way of a layer-structure design and reasonably setting the conditions for the instruments to be converted into shares.

In July 2014, the first project revenue note in China, 14 Zhengzhou Dikun PRN001, was officially issued. The project revenue note is a new debt financing instrument, which takes the operational cash inflows coming from project building and operation as major source of repayment and raises funds specifically for urbanization construction projects. The introduction of this innovation reflects the important role played by financial services to support new urbanization construction, which can guide local financing platform to gradually away from the governmental financing feature. Therefore, it is a helpful trial aimed at exploring the establishment of a transparent and regulated investment and financing system in urban construction.

3.3 The launch of the pilot program of independent issuance and repayment of local governmental bonds

Since the pilot program was introduced in 2011 for local governments to issue bonds on their own, in an effort to strengthen local government debt administration, the Ministry of Finance (MOF) has been studying and making a plan to reform local governments debts with the aim of promoting independent issuance and repayment of their own bonds. The MOF enacted in May 2014 the *Measures for the Pilot Program of Independent Issuance and Repayment of Local Governmental Bonds ("the Measures")* for conducting the pilot program in the following ten provinces and cities: Shanghai, Zhejiang, Guangdong, Shenzhen, Jiangsu, Shandong, Beijing, Jiangxi, Ningxia and Qingdao. The so-called "independent issuance and repayment" means that, these pilot participants' governments can organize by themselves the mechanism for the issuance, payment of interest and repayment of the principal of bonds of their own jurisdictions, within the limits of bond issuance approved by the State Council. In order to effectively prevent and control the risk, the *Measures* requires the participant governments to introduce bond credit ranking and to disclose information about bonds, fiscal and economic performance of the bond-issuing government and local debts according to the related regulations. After the official publication of the *Measures*, the Guangdong provincial government issued on June 23, 2014 the first municipal bond in China that local governments issue and repay on their own, followed by the smooth progress in issuing such bonds by other trial participants. A total 109.2 billion yuan such bonds were issued by ten trial participant governments whose credit ranking all at AAA, with bonds' interest rates closing to those of the Treasury bonds and issuance being conducted by tender in all cases.

The launch of the pilot program of independent issuance and repayment of local governmental bonds is a significant step in the process of exploring a normative financing mechanism of local government debts. It has positive meaning in aspects such as relieving local governments from debt-repayment pressure, mitigating debt risk and improving local fiscal transparency. With the approval of the amended Budget Law of the People's Republic of China by the Standing Committee of the National People's Congress on August 31, 2014, local governments bonds are set to become the major channel for local government financing. In the future, it is expected that independent issuance and repayment of local government bonds as well as the local government bond market will gradually grow in size, and their market-oriented pricing mechanism will improve accordingly.

4. Bond market institution and infrastructure development

4.1 The market making system was optimized

On June 12, 2014, the National Interbank Funding Center issued, with the approval of the PBC, the *Provisions on Trial Market Making in the Interbank Bond Market*. Trial market making business has become an important component of market making system, with it playing a positive role in selecting market makers while showing the characteristics of having abundant number and various types of institutions and increasing market making size year by year. The promulgation of *the Business Procedure* further improves the market making system on the interbank bond market, and helps trial market making institutions to full play its active role.

4.2 The administration over the use of funds raised via financial bonds by micro and small enterprises was strengthened

In order to support commercial banks to issue financial bonds oriented to finance lending to micro and small enterprises (MSEs), the *Notice of the People's Bank of China on Matters Related to Follow-up Regulation and Administration for Financial Bonds Specifically Used for Lending to Micro and Small Enterprises* (PBC Document [2013] No.318), issued on December 31, 2013, makes clear the requirements to institutions including issuers and key subscribers on aspects such as internal control and information reporting for periods both before issuance and during the existence of bonds. It also lists the contents that the PBC and its affiliates conducting follow-up regulation to commercial banks who issue financial bonds for lending to MSEs. Strengthening administration on the application of funds collected by issuing financial bonds for lending to MSEs during the existence of the bonds is helpful to ensure those funds to be used on the targeted purpose and therefore to improve financial services to the MSEs.

4.3 The financing channel for consumer finance companies was broadened

On May 8, 2014, the PBC and the China Banking Regulatory Commission (CBRC) jointed issued the *Notice of PBC and CBRC [2014] No.8*, in which the consumer finance company was permitted to enter the interbank bond market as issuer for the first time, and in the meantime the conditions for financial leasing companies and auto financing companies to apply for financial bonds issuance were lowered to encourage qualified financial leasing companies, auto financing companies and consumer finance companies to issue financial bonds. The Notice also provides the reporting documents and usage of funds collected from bonds issuance. This measure will enhance the financial support to consumption and benefit improving financial service to the real economy.

4.4 The price discovery mechanism on the bond market was improved

The Administrative Rules for Bond Pre-Issuance Business on the National Interbank Bond Market [PBC Public Notice (2014) No.29] promulgated by the PBC on December 18, 2014 provides requirements for the types of bonds and the method of trading and settlement for bond pre-issuance business and suggested the risk control measures. The introduction of pre-issuance trading help to improve the transparency and competition in bond issuing pricing, improve the bond yield curve and promote the activities on the secondary market.

4.5 The transparency in the pricing of bond issues was improved

For this purpose, and also for guiding bond issuance towards tender, the PBC released on April 9, 2014 *the Notice on Matters related to Bond Issuance through Tender on the Interbank Bond Market* (PBC Financial Market [2014] No.16), in which the requirements for the credit ranking of issuers, the size of issuance and the number of bidders were lowered. It also provided detailed requirements for the information that issuer and intermediate agencies need to disclose to the public and to report to the PBC after the tender finishes. This policy adjusted the threshold for non-financial enterprises to issue bonds through tender method and thereby give institutional support to encourage their bond tender issuance.

4.6 Qualified non-financial institutional investors gained access to the interbank bond market

On January 26, 2014, the PBC issued *the Notice on Issues Concerning the Access of Commercial Banks' Wealth Management Products to the Interbank Bond Market* (PBC Financial Market Document [2014] No.1) to set regulations for the access of commercial banks' wealth management products to the interbank market, based on requirements for strengthening administration on qualified institutions' access into the interbank bond market. On October 17, 2014, the PBC issued the *Notice on Matters regarding Access of Non-financial Institutional*

Qualified Investors into Interbank Bond Market (PBC Financial Market [2014] No.35) to allow qualified non-financial institutional investors to conduct bond investment trading via the trading platform for these investors. On November 28, 2014, the PBC issued *the Notice on Matters regarding Access of Selected Qualified Institutional Investors into Interbank Bond Market* (PBC Financial Market [2014] No.43) to promote the access in a formal and regulated way into the interbank bond market by four categories of non-legal person investors: the rural financial institutions and their trust products, assets management programs of securities companies, specific customer assets management programs of fund management companies and its affiliates, and assets management products of insurance assets management companies, as well as to conduct on a trial basis spot bond trading with market makers or experimental market making institutions via two-way quoting and request quoting method.

4.7 The MOF released standardized yield curves of key-tenor treasury bonds

On November 2, 2014, the MOF released for the first time via its official website key-tenor Chinese treasury bond yield curves. The released contents were compiled and provided by the China Central Depository & Clearing Co., Ltd. and included graphs and tables for yields and their formation for 1-year, 3-year, 5-year, 7-year and 10-year treasury bonds. Over the past 10 years, with joint efforts of the PBC, the MOF and other related parties, China's treasury bond market has achieved substantial development, and the technical conditions for compiling treasury bond yield curves have been constantly improved and towards ready. In the process of market-oriented interest rate reform, the most important financial function of the treasury bonds as the benchmark for the financial market, has gradually emerged. Through making adjustments to the height and curve degree of the treasury bonds yield curves by way of adjusting base rate and open market operations (OMOs), the PBC reached its objective of macro-adjustment to the financial markets. As the benchmark price for domestic currency assets, the importance of the yield of treasury bonds has been stressed by state leaders. The 3rd Plenary Conference of the 18th Central Committee of the Chinese Communist Party once raised the request of "developing the treasury bond yield curves that reflect correctly the supply and demand on the market". Therefore, the release by the MOF of the treasury bond yield curves, which is a response to the above request, will benefit further improvement in fiscal information disclosure. It will play an important role in promoting the transparency of treasury bond administration policies, in enabling the treasury bond's market rate to play a role of bench mark price, in improving the treasury bonds' yield curves and in promote the continuous steady and sound development of the treasury bond market.

4.8 The National Development and Reform Commission (NDRC) regulated the issuance of enterprise bonds

With many regulations released, the NDRC has further strengthened the administration on the issuance of enterprise bonds since 2014. In order to promote the buildup of enterprise bond issuance system, to further strengthen and normalize enterprise bond book-building offer and tender offer, to protect the legal rights of all participating parties, the NDRC, based on its consultation and agreements with market participants, released on April 24, 2014 the *Guidelines for Book-building Offer of Enterprise Bonds (Interim)* and the *Guidelines for Tender Offer of Enterprise Bonds (Interim).* With the two guidelines coming into effect on June 1, 2014, the book-building offer and tender offer of enterprise bonds will be transferred to the China Central Depository & Clearing Co., Ltd.. In its *Selected Opinions on Comprehensively Strengthen the Prevention and Mitigation of Enterprise Bond Risks* (in short "the Opinions") issued on September 26, 2014, the NDRC provided that a systemic risk prevention and mitigation policy system is to be formed by way of straightly normalizing bond issuer access, strengthening monitor and regulation during bond existence period, strengthening debt-repayment security and standardizing and restraining behaviors of subscriber and credit rating institutions. On October 15, 2014, the NDRC issued the *Newly-added Matters for Attention in the Review and Approval of Enterprise Bonds*. It was detailed rules based on the Opinion, which elaborate data and information that need to be supplemented for issuing enterprise bonds and so further raise the access requirements, and standardize enterprises' bond issuance activities.

4.9 Assessment of infrastructures and intermediaries were strengthened

In 2014, PBC and the China Securities Regulatory Commission (CSRC) jointly kicked off the evaluation of financial markets infrastructure, starting to regulate domestic financial infrastructure based on *the Principle for Financial Market Infrastructure* ("the *Principle*") and to organize related evaluation jointly. According to the schedule arrangements, PBC and CSRC conducted interpretation of the *Principle* in the first stage, in which who are to be evaluated and how to evaluate are made clear. Based on this, joint evaluation groups composed of experts were set up and a series of effective evaluations including infrastructure self-evaluation, cross evaluation with peers and external evaluation by regulatory bodies were carried out. These work had lay sound foundation for the next step – evaluation by experts from the international organization.

Since the global financial crisis of 2008, the international community has been putting great importance to and formed wide agreement on building up highly efficient, transparent and standardized financial market infrastructure. The *Principle* was jointly released by the International Payment and Settlement System Committee (renamed as the Committee on Payment and Market Infrastructure) and the International Securities Regulatory Agency, based on lessons they learned from the crisis and experience from conducting existing important national standards on payment system and securities settlement system. China is the member to relevant international organizations and therefore the evaluation conducted was to meet its international obligation. A systemic review of the implementation status of the Principle also serves the purpose of laying a solid foundation for the financial stability. Before this evaluation, China took part in the Financial Soundness Assessment Program of relevant international organizations and obtained positive feedback. It set a good example for exhibiting China's achievements in financial infrastructure construction and further improving Chinese financial infrastructure.

5. The opening up of China's bond market

In recent years, PBC has been stepping forward quickly in opening up the interbank bond market. With effective prevention and mitigation of risks as the basis, PBC has gradually broadened the range of foreign issuers who can issue bonds in China, permitted more domestic institutions to issue bonds abroad, and deepened communications and coordination s with international organizations and relevant government agencies of other countries, all of which have effectively improved the width, depth and the degree of opening up of China's bond market.

5.1 Overseas non-financial enterprises were allowe to issue bonds on China's bond market

With the opening up of the national interbank bond market, the coverage of foreign bond issuers has been broadened gradually. In 2005, the so-called Panda bonds, bonds denominated in RMB and issued by international development institutions in China was introduced to the China's bond market. The Asia Development Bank (ADB) and the International Financial Corporation (IFC) issued 2 billion yuan panda bonds respectively in that year. On March 14, 2014, a first-stage 500 million yuan targeted instruments were successfully issued by Daimler AG through the centralized book-building system for debt financing instruments of non-financial enterprises on the interbank bond market. Therefore the issuer coverage was broadened to cover non-financial enterprise apart from financial institutions. This measure enriched the variety of issuers and was expected to help enhance the attractiveness to foreign funds and promote foreign direct investment. Recently, a new measure to allow foreign parent companies, who locate outside China, of enterprises in the China (Shanghai) Free Trade Zone are permitted to issue RMB-denominated bonds has been carried out as a financial support to the free trade zone. It is expected that the pace of more foreign bond issuers accessing China's bond market would get bigger constantly.

5.2 Foreign investors became more active on China's bond market

The number of foreign institutional investors on the National interbank bond market increased substantially in 2014, and their holding of bonds surged. Since the entry of Pan-Asia Bond Fund into the interbank bond market in 2005, the number of foreign investors has experienced a steady growth. By end-2014, the number of foreign institutional investors that had been approved to enter the interbank bond market has reached 211, adding 73 to the number by end-2013. Foreign investors included foreign central banks, international financial organizations, sovereignty wealth funds, RMB settlement banks in Hong Kong and Macau, foreign insurance institutions, RQFII and QFII. By end-2014, the outstanding of various bonds on the interbank market held by foreign institutions was 572 billion yuan, increasing 73.24% compared with that at end-2013; its share in the market reached 1.77%, a 0.58 percentage points increase from end-2015 share. With the continuous deepening of opening up of domestic bond market, the approval to foreign institutions will speed up and the permitted investment quote will be raised gradually. As a result, the share of holding of Chinese bonds by foreign institutional investors will increase constantly.

5.3 The size of off-shore RMB bond issuance increased substantially

According to the statistics by Reuters, the total RMB bond issuance reached 219.942 billion yuan in 2014, increasing one fold compared with that of 109.055 billion yuan in 2013. Overseas affiliates of domestic financial institutions were the major issuers. Local municipal investment platforms and real estate enterprises also actively issued off-shore RMB bonds abroad. In the meantime, innovation in the methods of issuing bonds has been witnessed. In July 2014, Sichuan Development Pty Ltd., the investing and financing platform of Sichuan Province government, issued RMB bonds in Hong Kong, which was the first to have stand-by credit provided by a commercial bank across the border, with ICBC Sichuan branch providing stand-by credit to enhance the credibility of the bond issuer. The stand-by credit will only be used to repay this issuance and will not be revocable. This practice explored a new channel for local SOEs to conduct oversea financing. On December 24, 2014, at a State Council executive meeting chaired by Premier Li Keqiang, it was decided to simplify the approval procedure to facilitate enterprises' "going abroad" activities. Specifically, it was decided to remove the locality restriction over issuing RMB bonds abroad by domestic enterprises and commercial banks, which will further promote the interest of domestic financial institutions and non-financial enterprises in issuing bonds overseas. The size of such issuance is expected to grow steadily and the market space will be broadened further.

At the same time, off-shore RMB bonds have becoming increasingly popular at the international financial market. Before 2014, off-shore RMB bonds were only issued in four regions: Hong Kong, Taiwan, London and Singapore. In 2014, they were issued in 17 countries and regions including Hong Kong, Taiwan, London, Singapore, Frankfurt, Luxembourg, Sydney, Switzerland, Paris, Malaysia, Korea, and Bahrain. Some RMB bonds were listed simultaneously on several markets. For example, the Golden Developments Holdings Ltd. issued 300 million yuan RMB bonds in Taiwan and Singapore simultaneously in July; China Construction Bank (Asia) Limited issued 3.3 billion yuan RMB bonds in three places at the same time in November: Hong Kong, Taiwan and Luxemburg, and started trading in the exchanges of the three regions. With the steadily rising international status of RMB, governmental institutions of advanced countries also joined other issuers, which added more categories to the group of issuers. In October, the British government issued 3 billion yuan RMB bonds in London and the proceeds of the bond sale were used to finance Britain's foreign exchange reserves. Other examples include the issuance of 3 billion yuan RMB bonds by the government of the Canadian province of British Columbia and the issuance of 1 billion yuan RMB bonds by the state government of New South Wales in Australia. The varieties of off-shore RMB bonds have been getting richer, with the example of IFC's issuance of 500 million yuan Green Bonds, which is the first such bonds denominated in RMB, in London in June 2014.

5.4 Self-regulatory organizations and intermediaries enhanced their cooperation with counterparties abroad

In September 2014, the National Association of Financial Market Institutional Investors (NAFMII) took part in the China-UK Financial Roundtable, which is one of the series events under the Economic and Financial Dialogue (EFD) between China and the UK. Among the achievements that were written in the final documents, a consensus to strengthen the cooperation at the financial market self-regulatory organizations level has been reached between China and the UK. In August 2014, the Shanghai Clearing House and the European Clearing Bank Group signed the letter of intention on mutual cooperation for further advance the communication to discuss the concrete cooperation method on business and technology aspects. In September 2014, Shanghai Clearing House and the Chicago Mercantile Exchange (CME) signed the memorandum of cooperation, with the expectation to promote comprehensive cooperation on aspects such as developing products, platform technology and staff exchange, to push forward cross-border RMB bond market development, broaden channels for cross-border RMB investment and advance the internationalization of RMB. In October 2014, China Central Depository & Clearing Co., Ltd. assisted the holding of 18th annual meeting of Asia Pacific Central Securities Depository Group (ACG), on which the Xi'an Initiative was passed and published. This is the first initiative document that has been released since ACG was established in 1997. The Xi'an Initiative states that: all ACG members pledged to thrive on the purpose to fulfil the facilitation of information exchange between its members and as a result develop the securities market in the region; to cultivate the core financial infrastructures such as central securities depositories (CSDs) through the concerted efforts of ACG members; to nurture a secure, efficient, inclusive, and comprehensive circle of cooperation of financial infrastructure in Asia-Pacific; to bring the scale economy advantage of CSDs into play to promote orderly distribution of market resources and boost efficiency and transparency of services; to develop cross-border linkage; to implement principles based on equality, mutual assistance, openness, and win-win cooperation to adjust to market diversity and innovation, and expand the value chain. In cross-border business, it shall be necessary to seek thorough involvement and participation of all types of institutions within and outside the region.

6. Outlook for bond market development

The year 2015 is a crucial year to deepen reforms comprehensively and a year for bond market to take new steps forward in the economic new normal. In order to fulfill the requirements to stabilize the economic growth, adjust the structure and advance the reforms under new normal, the market dynamics will be released and initiative for innovation will be strengthened, therefore the bond market will have a valuable opportunity. With the deepening of reforms, the rigid repayment expectation on the bond market will be broken, and the bond market will have a new normal development. The market size will grow, product innovation will speed up, credit risk will be decentralized, fluctuation on the market will get broader, all of which will impose new challenges to the improvement in rules and regulations, and product innovation.

6.1 Size of issuance on the interbank bond market is expected to grow continuously

The 2014 Central Economic Work Conference required continuing the conducting of pro-active fiscal policy. With economic growth slowing down and the increase in fiscal revenue leveling off, the share of fiscal deficit to GDP is expected to rise. This means that the size of new issuance of increased treasury bonds will be expected to be bigger. In the meantime, with regulatory policies getting looser gradually, it is expected that the size of the asset-backed securities (ABS) will continue to grow, while basic assets will transfer from lending to enterprises gradually towards more diversified items such as individual collateral loans, vehicle loans, credit card collectables and infrastructure fees. Moreover, the emerge of various asset management business such as financial business and further opening up of the bond market will bring in more new funds to the bond market from demand side.

6.2 Investors on the interbank bond market will further expand

The qualification of investors is the basis for a market to develop in a normal way. The diversification of investors benefits the high liquidity of market. The interbank bond market has always been opening to qualified institutions and has been input great attention in broaden the coverage of qualified institutional investors. In the next period, PBC will continue to study the case of giving qualified institutional investors access to the interbank bond market, steadily carrying out work related to permitting foreign institutional investors invest in the interbank bond market, and further broadening in an orderly way the investor group into the interbank bond market.

6.3 The interbank bond market will witness continuous innovation

Innovation is the precondition for improving the function and efficiency for financial market to allocate resources, and is the original power for market development. Since the establishment of the interbank market, PBC has been sticking on the market oriented reforms and attaching great importance to market participants' innovation, constantly promoting innovation in products, trading instruments and mechanism. In the next stage, PBC will continue to take market demand as the direction of reform, further promote innovative work on the interbank bond market, push forward research and development of new products such as emergency convertible bonds, forward transaction of standardization bonds, RMB interest rate option, and study the net value settlement business of bond repurchase and related depository clearing mechanism.

6.4 Infrastructure construction on the interbank bond market will continue to be improved

Perfect infrastructure is the basis and secure for interbank bond market to be standardized, innovative and efficient. The PBC has forcefully push forward the system construction and formative management on the interbank bond market in the past years, with administration streamlined, decentralization instituted and market mechanism strengthened to promote the development of the interbank bond market. In the next stage, the PBC will further improve the institutional arrangements for issuance, trading, clearing, settlement and deposit, study and promote market participants to conduct affiliate transaction legally and compliantly, revise institutional documents such as rules on transaction and circulation, the administrative method on repurchase and the notice on RMB interest swap, explore improvement of regime via methods such as business integration, perfect infrastructure construction on bond market, and promote the sound and standardized development of bond market.

6.5 The opening up of the interbank bond market will be further enhanced

The opening up of the interbank bond market has been pushed forward gradually in recent years, and the degree of opening up has been raised, with more foreign institutions accessing the interbank bond market and domestic institutions issuing bonds more actively overseas. As the next step, PBC will consider work related to RMB internationalization and capital account liberalization, further broaden foreign institutional investors, study the possibility of permitting foreign institutional investors to participate into repurchase and interbank lending business on the interbank market, expand the issuer category and regional coverage for domestic institutions to issue RMB bonds abroad, attract more foreign institutions to issue panda bonds in China, and further raise the opening up degree of China's bond market.

Box 1 The Issuance of RMB Debt Financing Instruments by Overseas Non-financial Enterprises on the Interbank Market

On March 14, 2014, the first tranche of targeted RMB instruments by Daimler AG was successfully issued through the centralized book-building system for debt financing instruments of non-financial enterprises on the interbank bond market, with an issue size of 500 million yuan. The successful issuance of RMB debt financing instrument by a foreign non-financial enterprise is a signal for the interbank bond market to open up further.

1. Background information and issuance introduction

China has achieved great economic development achievements ever since the reform and opening up policy started. China's financial industry, including China's bond market, has experienced steady opening up. The 3rd plenary session of the 18th Central Committee of the Communist Party of China has set up the strategic task of "expand the opening up of China's financial industry". In the Opinions on the Key Work for Intensifying Economic System Reform in 2013, the State Council stated explicitly to study how to promote qualified foreign institutions to issue RMB bonds in China. The NAFMII organized market participants to learn the rules and regulations as well as the practice of the international mature markets. Taking market demand as the direction of efforts and certain products as the starting point, NAFMII has been actively exploring the opening up and consistent innovation on the interbank bond market within the current non-financial enterprises debt financing instruments registration and administration framework.

On December 26, 2013, NAFMII accepted the registration by Daimler AG of 5 billion yuan oriented debt financing instruments. On December 30, 2013, the head of the NAFMII hosted a meeting to issue the registration acceptance notice to the issuer Daimler AG and the lead underwriter Bank of China. On March 14, 2014, Daimler AG's first-stage 500 million yuan oriented instruments were successfully issued through the centralized book-building system for debt financing instruments of non-financial enterprises on the interbank bond market. Its issuing period was 1-year, and the issuing interest rate was 5.2%. By end- 2014, RMB debt financing instruments issued by foreign non-financial enterprises had accumulated to 2 billion yuan.

2. Significance of overseas non-financial enterprises' issuance of debt financing instruments

Allowing issuing RMB debt financing instruments by a foreign non-financial enterprise was a milestone showing the establishment of a financing channel in China's bond market for foreign non-financial enterprises. It has great significance in the development of interbank market.

First, it helps the further opening up of the interbank bond market. Issuing RMB bonds in China by foreign institutions has many aspects of positive outcome: not only provide convenience to trade and investment, enrich the products layers on the interbank bond market, meet the demand of institutional investors, both foreign and domestic, with various different preferences, but also benefit us in learning and introducing international experience in term of market institutional arrangements, construction of infrastructure, development of intermediate agencies and market supervision system construction. This is helpful in seeking the connection between domestic and international bond market management, and to improve financial market rules and regulations toward the direction of improving the internationalization and international influence.

Second, it is helpful to improve the competitiveness of Chinese financial institutions and deepen the financial market reform. Issuing RMB debt financing instruments in China by foreign institutions has the benefit of enriching the issuer category of participants on the interbank market, and broadening the business coverage of financial institutions, both domestic and foreign, which provides important market foundation for financial institutions to improve their business structure and profit-earning methods. This would further promote the competitiveness of Chinese financial institutions and deepen the reforms on financial system.

Third, it is helpful to promote the cross-border usage of RMB. The outflow and inflow of RMB cross the border together form a circuit for RMB funds to flow cross the border. With the orderly promotion of the cross-border usage of RMB, the demand of international enterprises to use RMB both in and outside China has increased consistently and thereto their demand for broadening RMB financing channels. In this case, making financing channel smooth for non-financial enterprises to obtain RMB funds would provide great convenience to foreign enterprises to get RMB funds and promote their willingness in making settlement in RMB. This would effectively improve the liquidity of off-shore RMB on the market, which would benefit the growth of RMB settlement in cross-border trade.

Fourth, it is helpful to promote the economic structure adjustment and transition and upgrading. China is at a key point undertaking structural adjustment and transition and upgrading. Starting the issuance of RMB debt financing instruments on the interbank bond market by foreign enterprises against such a macroeconomic background has the following benefits: promoting the opening up of China's financial markets, more effectively utilizing both domestic and foreign markets and their resources; helping the Chinese economy keeps a balanced and continuous growth, and supporting economic restructuring, transformation and upgrading.

Therefore, the successful issuance of RMB debt financing instruments in China by foreign enterprises indicated that the innovation and opening up of the interbank bond market has entered a new stage. A more open interbank bond market will benefit the development of China's bond market and overall financial market, broaden the coverage of resource allocation by domestic bond market and so provide better service to market. It would increase the variety of issuers on the bond market and promote market vividness.

Box 2 Reform and Development of China's Debt Capital Market in the Past 10 Years

1. The history of China's bond market development

China's bond market started from the resumption of treasury bond issuance in 1981. The bond market has developed very slowly in the next 10 years because of the institutional defect. A series of risk events appeared in some regional securities trading center in the middle of 1990s.

Based on lessons learned from the development of both domestic and foreign bond markets, the State Council approved the initiative of establishing interbank bond market in 1997 and since then China's bond market has started its sound development process. Treasury bond and financial bond markets developed relatively fast during that period while corporate debenture bonds market was lagged behind. In 2000, the total issuance of bonds in China was 441.5 billion yuan, in which the issuance of treasury bonds and financial bonds was 436.5 billion yuan, accounting for nearly 99%. By 2003, the corporate debenture bonds had an issuance of just over 50 billion yuan, accounting to 3% of total bond issuance[1]*.*

In the early 21st century, the macroeconomic situation triggered the necessity of establishing an effective corporate debenture bond market, to meet the diversified financing demand of entity enterprises on the one hand and to create conditions for effectively implementing monetary policies on the other hand. In 2004, in the Several Opinions on Promoting Reform and Opening up and Stable Development of the Capital Market (State Council Document [2005] No.3) released by the State Council, it is clearly encouraged to further develop bond market in an active but steady way, and qualified enterprises are encouraged to issue corporate debenture bonds to raise funds. According to the State Council's requirements, ministries such as the NDRC, PBC and China Securities Regulatory Commission (CSRC) took marketization as the guiding direction, made substantial efforts in removing unnecessary administration and restraints, improving issuance administrative regime based on market, and promote financial innovation that was in line with the demand of entity economy, and actively pushed the deepening of the corporate debenture bonds. By end of 2013, the total issuance of corporate debenture bonds reached 3,675.9 billion yuan, accounting for 41.4% of the total issuance of year. In 2014, the

1 China Financial Market Development Report 2013.

issuance of CDBs increased to 5,133.6 billion yuan and its share in the total bond issuance reached 50.2%.[1]

2. Achievements of 10 years of debt capital market development

In May 2005, for the purpose of implementing the requirements of the State Council to actively but steadily development bond market, PBC entrusted interbank bond market to start the practice of short-term financing notes issued by non-financial enterprises, which formed a basis for China's debt capital market. In the past ten years, this market has been growing from a baby to a big market, and has gradually become an important financing channel for non-financial enterprises and a new method for financial market to serve business entities. By the end of 2014, the cumulative issuance of various debt financing tools reached 15.3 trillion yuan, with outstanding balance at 7,056 billion yuan. There are several characters.

First, the lines of products have been gradually improved and diversified. After the introduction to the market of short-term financing bills, many innovative products that suit the demand of the real economy have been developed, such as medium-term notes, targeted instruments, super short-term financing bills, asset-backed securities and project revenue notes. So far, China's debt capital market has developed into a market containing series of securities with various maturities, issued either publicly or privately, issued by domestic and overseas entities, with fixed or floating rates, and adapted to different uses of funds. The product series have been close to those of developed bond markets.

Second, the ranks of issuers have been expanded considerably. The multi-layer product lines of China's debt capital market enable issuers to have abundant financing options. The convenience that various issuers enjoyed in using the bond market to meet their financing needs and thereby their motivation have been raised. The number of enterprises that used bond financing channel in 2005 reached 58, with this number increased to 1,233 in 2013 and 1,469 in 2014. Nowadays the issuers on the debt capital market almost cover all industries of the national economy.

Third, the investor structure has been optimized markedly. In the early stage, due to the lack of investor category, investors mainly concentrated in banking industry. At the end of 2006, the share of short-term financing securities that were held by commercial banks was 58.9%. In recently years, the investor category has getting wider under the concerted efforts of various parties, and the share of debt financing instruments held by banks declined to around 40%, while the other 60% were held by different types of investors such as mutual funds, insurance, enterprise annuity, etc.. What is more, this trend of investors scattering among various types is continuing. In term of amount of real applicable assets held by various types of financial institutions, the improvement in investor structure of debt capital market has been advanced than that of China's financial system.

3. The influence of debt capital market development on the real economy

Ten years of development enables the debt capital market to form an important part of China's financial market system and play

1 Data is from the monthly statistical report of non-financial enterprises' debt financing instruments. Similarly hereinafter.

an increasingly significant role in aspects such as meeting financing demand of the real economy enterprises, promoting adjustment and upgrading of economic structure and optimizing social financing structure.

First, the financing channels for enterprises have been broadened remarkably so as to relieve the real economy from financing difficulties. The share of debt financing instruments in total social financing increased from 4.6% in 2005 to 10.1% in 2014. This means that over one tenth the total financing for the real economy was met by the debt capital market. Compared with traditional credit channels, in 2005, the financing through debt financing instruments only accounted for 5.9% of newly increased RMB lending and 6.8% of new RMB lending by non-financial companies. In 2014, these two ratios reached 17% and 25.7% respectively. The debt capital market has become the second largest channel next to RMB lending for enterprises to obtain funds.

Second, the enterprises' comprehensive financing costs have been reduced considerably so as to relieve them of the high costs of financing. Because of its more market-oriented pricing method, the cost of financing through bonds is the lowest among all financing channels of enterprises. Rough estimates indicate that, for enterprises with the same credit rating, the cost of bond issuance is lower than the cost of loan at the base rest by 1 to 1.5 percentage points. By end-2014, the outstanding balance of the debt capital market has broken the milestone of 7 trillion yuan, which means a saving of 70~100 billion yuan financial cost for the real economy. This is a most direct and effective support given to the real economy by the debt capital market.

Third, with the reduction in banking institutions' capital occupation, the stock market has been relieved of pressures from the so-called "IPO barrier lake" phenomenon. Currently, the size of financing via the debt capital market has been close to 20% of the newly increase RMB loans, correspondently which lower the demand and occupation of commercial banks' credit quota and capital. Given that Basel III further strengthens the requirements of supervision on bank capital, bank lending in China has been increasingly restrained by their capital. Against the backdrop, the development of debt capital market has lowered the demand of commercial banks for capital replenishment via the stock market so that the financing pressure on the stock market has been reduced, in the meantime making room for other enterprises' stock financing.

Fourth, commercial banks have been prompted to save more credit and financial resources for micro, small and medium-sized enterprises. Because financing via issuing bonds has the advantage of higher efficiency and lower cost, its share in total financing of large-sized enterprises has been increasing gradually, approaching 30% for central SOEs. Large enterprises using debt capital instruments more to finance themselves enables them to downsize the usage and occupation of credit resources, which gives commercial banks to have more credit resources to provide to SMEs. Currently, the average outstanding balance of bonds for each bond-issuing enterprise is 3.51 billion yuan. According to the standard set by CBRC for defining MSEs, that is, a single business with a loan balance of no more than 5 million yuan would be classified as an MSE, the support given to each bond issuing enterprise by the debt capital market *equals, theoretically, the support for 700 MSEs to obtain credit financing. This is a significant effect in terms of relieving SMEs and MSEs from their financing difficulty.*

4. The influence of debt capital market development on the mechanism of financial market operations

While enhancing its support and service to the real economy, 10 years of debt capital market development has hade positive influence on the mechanism of financial market operations in aspects such as ideas of market development, the administration of government debt and credit risk management. Moreover, it has brought about profound changes in some areas.

First, the idea of developing a registration system and the requirements of the central government for streamlining administration and delegating power have been consistently implemented in the development of the bond market. In 2008, the PBC authorized the NAFMII to implement self-regulatory administration of debt capital market. Since then, the registration system has been introduced in the issuance administration of debt financing instruments, which was a significant breakthrough. The practice of pushing forwarding with the registration system on the debt capital market provides convenience to enterprises for their financing. The rapid development of the debt capital market also confirmed the advantage of the registration system. It was exactly because of this institutional advantage that China's corporate debenture bond market developed fast, from a middle-level market in Asia into the second biggest market in the world. What is more, the introduction of registration system in China's debt financing instrument market brought about the spillover effect, resulting in the verification system reform of enterprise bonds in 2008 and the improvement in efficiency of administrating corporate bonds issuance.

Second, the information disclosure system has been constantly improved, micro-constraint in enterprises has been strengthened, and valuable experiences have been obtained for governing local government debt in a scientific way and developing municipal bonds and project revenue bonds. In the process of developing debt capital market, it has been consistently emphasized that information disclosure is the core of the registration system. A strict and formalized information disclosure system with clear layers and transparent operation has been established. Restrained by the information disclosure system, issuers issue bonds in line with regulations and the problem of soft budget constraints is addressed in a sense. The sound practice of information disclosure on debt capital market would provide experience and policy option for managing local government debt financing.

Third, setting up and improving market-oriented risk sharing mechanism is helpful to breaking the expectations of repayment rigidity and preventing regional and systemic financial risks. In the past 10 years, in the whole process from the issuance to repayment of a bond, market-oriented risk prevention and resolution system has been gradually established through a series of measures such as constantly increasing qualified issuer categories, persistently enhancing issuer risk education, creating a credit risk slow releasing instrument in an innovative way, and promoting the establishment of a credit-enhancing booster on the debt capital market.

The purpose is to relieve the government from making fundamental judgment on issuers under the approval system and verification system, to transfer risk identification and risk bearing responsibility to investors and risk reminding function to the intermediate agencies, which help to prevent moral hazard produced by government implicit guarantee. The resolution in several individual risk event cases show that this market-oriented risk sharing mechanism has been playing a positive role, and important meaning to preventing regional and systemic risks.

Fourth, the opening up of the bond market has been continuously enhanced, and the pilot programs of international bond issuance have been launched to explore the effective way of financial market opening up. Promoting the capital market's double direction opening is an important task set by the 3rd plenary session of the 18th CCPCC. In March 2014, the first foreign non-financial enterprise successfully issued RMB debt financing instrument on the interbank bond market, indicating a channel for foreign non-financial enterprises to raise funds on the Chinese market has been established in China's debt capital market. This is a significant breakthrough in the opening up of China's bond market. It also has a positive role in broadening the cross-border usage and the internationalization of RMB. The debt capital market has become a trial place for the opening up of China's financial markets.

5. The implications of debt capital market development for market supervision

How to supervise financial markets? How to strike a balance between effective supervision and sustained development? These are questions to which countries around the world have been searching for answers. In view of the supervisory practices of different countries, there is no standardized model, with some countries having single supervisory mechanism, some conducting objective-based supervision, and some combining both approaches. The consensus that has been reached in the practice and exploration of international financial market regulation and supervision is: whether a regulatory system is appropriate or not depends on whether it can meet the requirements of domestic financial market development and systemic risk prevention.

With constant study and exploration, the supervision on OTC bond market in China has formed a system of four layers. The first layer is the front line monitoring of market platform institutions, including daily real time monitoring on trading systems, settlement and custody systems and funds clearing systems and reporting of abnormal transactions. The second layer is the self-regulatory administration by self-regulatory organizations. This is a de-administration reform measure, which is also the experience of developed markets, to avoid the drain on public resources by unnecessary administrative regulation. The third layer is the comprehensive law enforcement by securities law enforcement agencies, so as to safeguard basic market order by applying public power to punish those involved in securities fraud and insider trading. The fourth layer is the central bank preventing systemic risks of financial markets as the ultimate risk bearer, by setting market standards, administrating systemically important institutions, etc. The four layers, effectively linked and mutually supportive, have jointly promoted the leap forward and low-risk operation of China's debt capital market in the *past 10 years.*

The rapid development of China's debt capital market and its positive influence on the real economy and market operation mechanism since 2005 clearly indicate that current debt capital market regulatory framework of China has been in line with the rules of market development and is suitable to China's national circumstances and market development stage. To further improve China's bond market regulatory system, effective practices should be learned from the 10 years of debt capital market development. A basic supervisory system that is multi-layered and multidimensional should be followed, with supervisory responsibilities defined between layers, so as to form market supervisory arrangements that suit China's national circumstances.

Part IV Stock Market

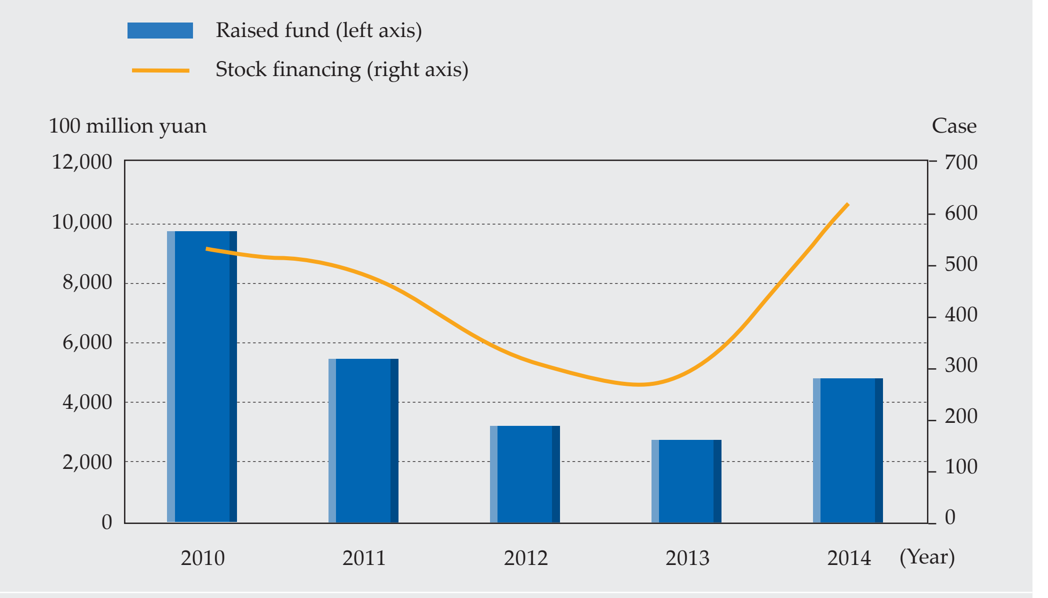
In 2014, China's stock market witnessed a substantial expansion in fundraising scale, with the restart of Initial Public Offerings (IPOs) and additional offering playing a dominant role. Both the Shanghai Stock Exchange (SSE) Composite Index and Shenzhen Stock Exchange (SZSE) Component Index moved upward after an initial decline while the ChiNext Index fluctuated at a high level. Market capitalization saw noteworthy growth. Institutional investors grew further in number, stock transactions were brisk, and margin trading and short selling increased significantly. Construction of a multi-tiered capital market was continuously advanced and basic institutional reform was deepened. With the market innovation achieving new progress, the market opening up made stride forward.

1. Stock market performance

1.1 New share issue and financing

In 2014, the fundraising scale of China's stock market witnessed a substantial increase. There were 616 cases of stock financing in the year, with the raised fund registering 485.643 billion yuan, a year-on-year increase of 73.27%. With the restart of IPOs, fundraising through initial offering recovered although the financing scale

Figure 4.1 Stock Financing, 2010—2014



Sources: China Securities Regulatory Commission (CSRC) and Wind Info.

Figure 4.2 Financing Type on the Stock Market, 2010—2014

Source: Wind Info.

remained small. Additional offering still played a dominant role in fundraising. The year of 2014 saw 125 cases of IPOs, 478 cases of additional offering and 13 cases of rights issue, with the raised fund of 66.889 billion yuan, 404.956 billion yuan and 13.798 billion yuan, accounting for 13.77%, 83.39% and 2.84% of the total respectively. In particular, the number of cases of additional offering was 71.94% higher than that of the previous year while the fund raised through public and targeted additional offering (cash) was 74.02% more than that of 2013.

1.2 Stock index and trading

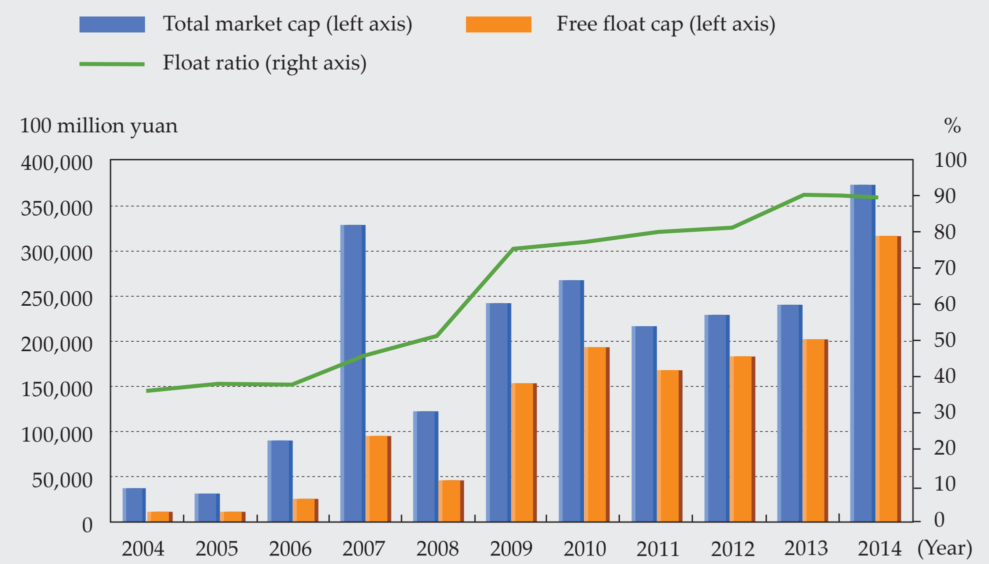
1.2.1 Stock market capitalization grew substantially with the float ratio declining

As of end-2014, there had been 2,613 companies listed on Shanghai and Shenzhen markets, 124 more as compared with than that at the end of the previous year. The number of stock had reached 2,696, 122 more than that at end-2013, of which 2,592 were on the A-share market and 104 on the B-share. The market capitalization (cap) registered 37.25 trillion yuan, 13.35 trillion yuan higher than 2013, or a year-on-year growth rate of 55.83%. Free float cap registered 31.56 trillion yuan, an increase of 11.6 trillion yuan or 58.14% higher as compared with the end of 2013. Issued equity shares grew 7.5% over end-2013 to 4.36 trillion, of which float shares totaled 3.91 trillion, a year-on-year increase of 6.42%, taking up 89.67% of the total. The float ratio dipped as compared with end-2013.

1.2.2 SSE Composite Index and SZSE Component Index soared at the year-end while the ChiNext Index fluctuated at a high level

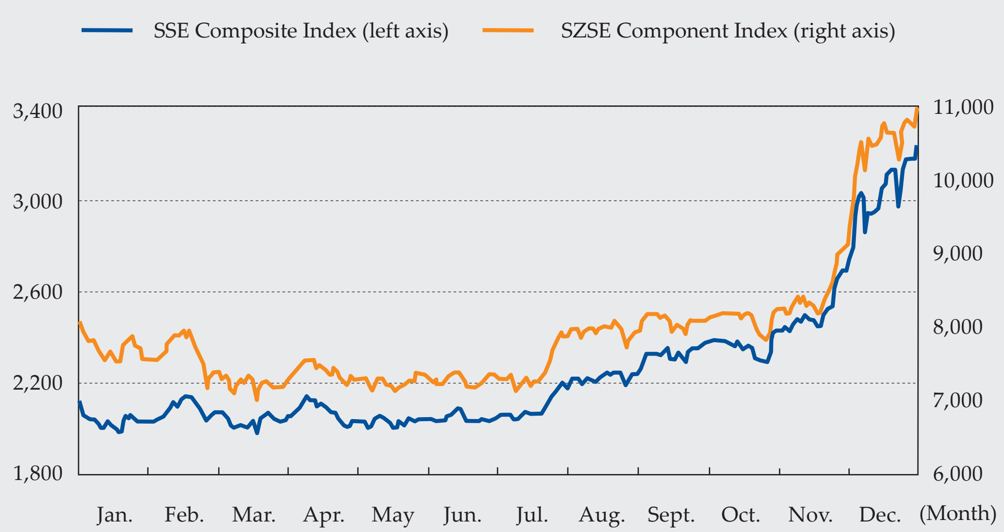
Main board indexes of Shanghai and Shenzhen stock markets remained relatively stable in the first half of 2014 before soaring in the

Figure 4.3 Growth of Stock Market Capitalization, 2004—2014



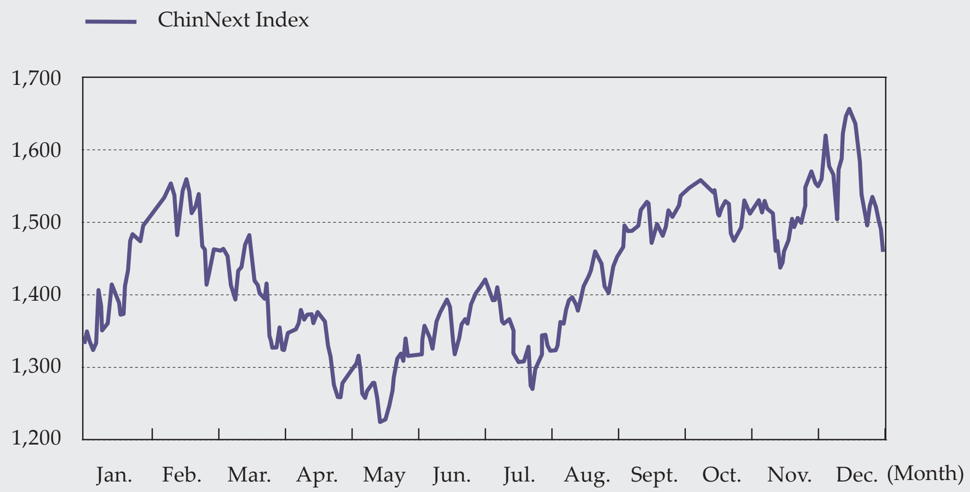
Sources: CSRC.

Figure 4.4 Performances of SSE Composite Index and SZSE Component Index in 2014



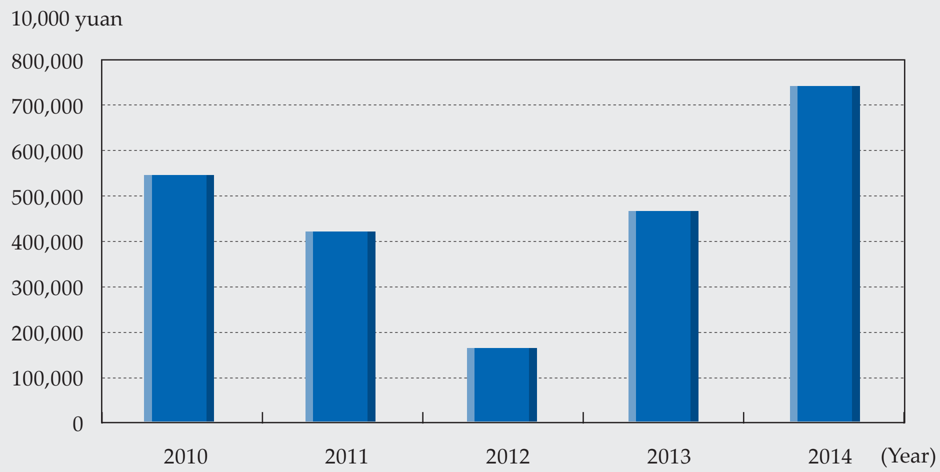
Sources: Wind Info.

Figure 4.5 Performance of GSB Index in 2014



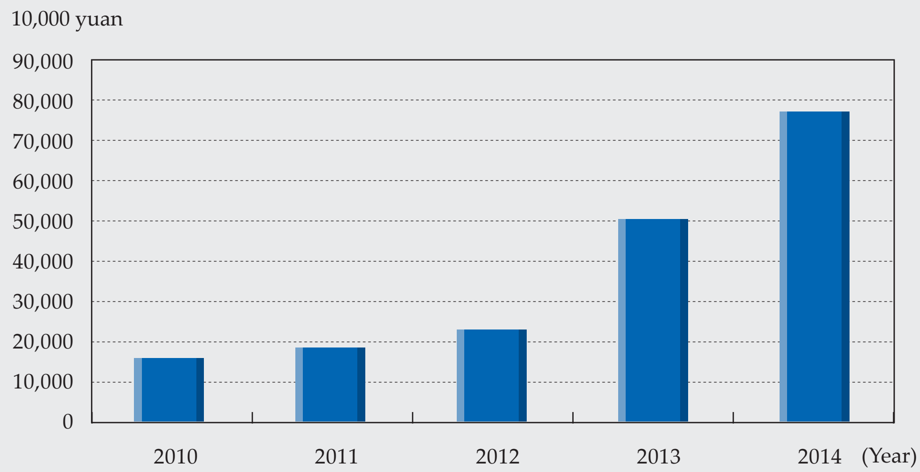
Sources: Wind Info.

Figure 4.6 Stock Market Trading, 2010—2014



Sources: CSRC and Wind Info.

Figure 4.7 Trading on the ChiNext, 2010—2014



Sources: SZSE and Wind Info.

third quarter and the year-end in particular, while the ChiNext Index fluctuated at a high level. On December 31 2014, SSE Composite Index and SZSE Component Index closed at 3,234.68 points and 11,014.62 points, a year-on-year increase of 1,118.7 points and 2,892.84 points, or a growth rate of 52.87% and 35.62% respectively. The ChiNext Index grew 167.32 points over the previous year to close at 1,471.76 points, up 12.83% on a year-on-year basis. The weighted average PE ratio of SSE rose from 10.99 at the end of 2013 to 15.99, a year-on-year increase of 45.5%, while at of SZSE grew from 27.76 at end-2013 to 34.05, up 22.66% over the previous year.

1.2.3 Both the stock trading volume and trading value rose significantly

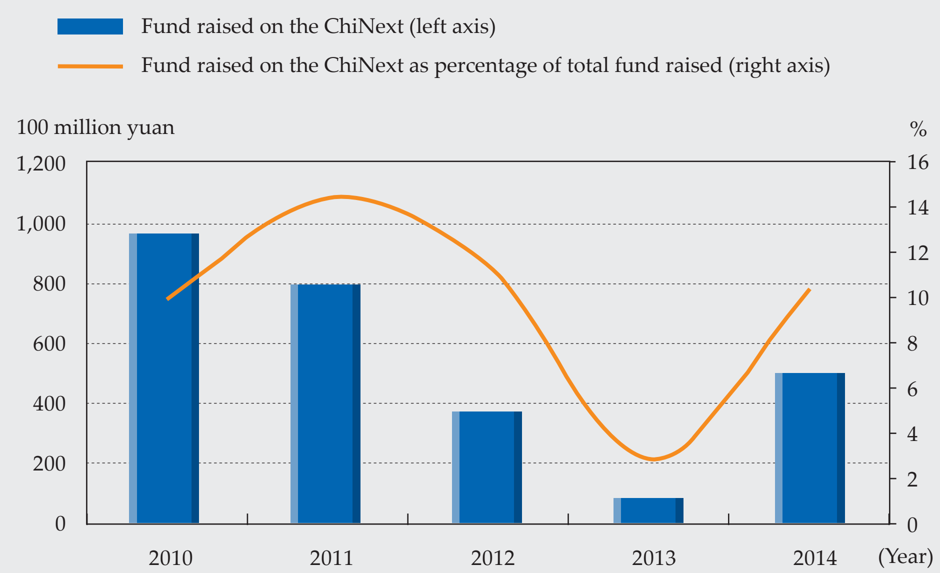
In 2014, the cumulative trading volume of SSE and SZSE hit 7,375.461 billion, up 52.47% over the previous year, with a daily average trading volume of 30.104 billion, a year-on-year increase of 48.11%. The cumulative trading value hit 74.39 trillion yuan, 58.72% higher than end-2013, with the daily average trading value surging 54.17% to reach 303.63 billion yuan. Specifically, the trading value of the main board, small and medium-sized enterprises (SME) board and the ChiNext registered 51.37 trillion yuan, 15.22 trillion yuan and 7.8 trillion yuan, an year-on-year increase of 61.89%, 51.83% and 52.48% respectively.

2. Main features of stock market performance

2.1 Stock issuance volume increased significantly and ChiNext's share in market fundraising rose

In 2014, a total of 125.197 billion stocks were issued on the stock market by various enterprises, a year-on-year increase of 104.3%. In particular, 7.01 billion stocks, 115.687 billion stocks and 2.5 billion stocks were issued

Figure 4.8 Fundraising on the ChiNext, 2010—2014



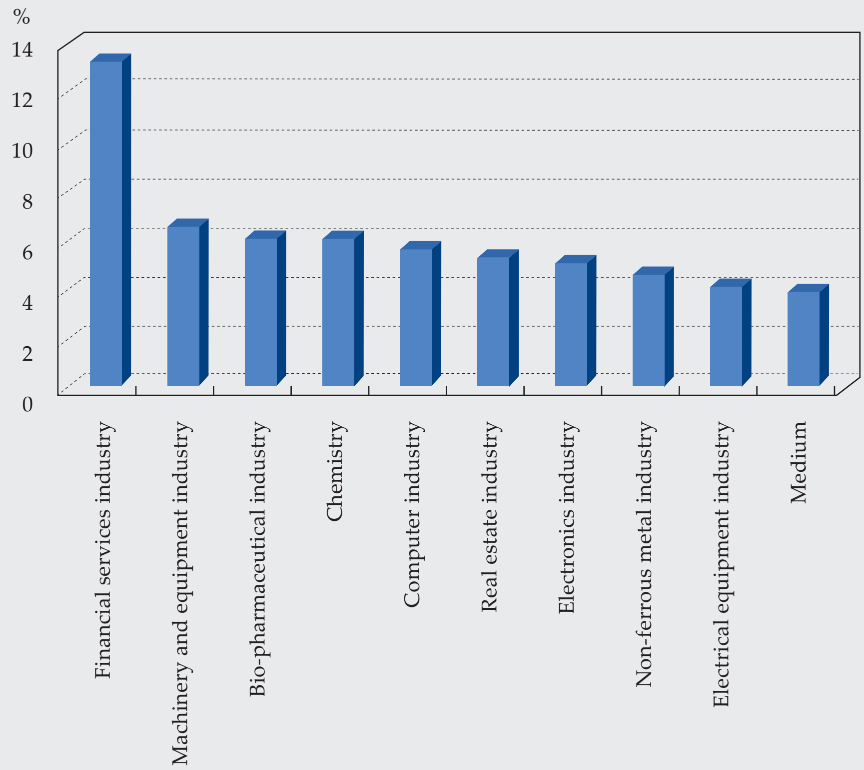
Sources: SZSE and Wind Info.

through the IPO, additional offering and rights issue respectively, cumulatively raising 485.643 billion yuan, up 73.27%. Specifically, fund raised on the ChiNext registered 50.008 billion yuan, a year-on-year increase of 535.26%, taking up 10.3% of the market total. The ChiNext market witnessed a total of 148 fund raising cases, up 543.48% from the previous year, accounting for 24.03% of all the fund raising cases in the year. The share of the ChiNext in market fundraising rose significantly.

2.2 Stock trading grew brisker and the financial services industry took the top position in trading value

In 2014, trading on the stock market grew increasingly brisker with the cumulative trading value hitting 74.39 trillion yuan across the year. The trading value on a single day in December even exceeded 1 trillion yuan, making historic new highs. The financial services industry continued to be the largest one in terms of trading value. Even since the fourth quarter, the stock trading value of commercial banks and securities companies had grown substantially, accounting for 13.35% of the total, making it the top one industry in terms of trading value on the stock market, which was followed by the machinery and equipment industry, whose share declined from 9.24% in 2013 to 6.57%. Other actively traded industries included bio-pharmaceutical industry, chemistry, computer, real estate, electronics industry, non-ferrous metal industry, electrical equipment industry and medium.

Figure 4.9 The Percentage of Top Ten Industry Sectors in Terms of Trading Value in 2014



Notes: 1. Sectors in this figure are primary sectors under the classification of Shenyin and Wanguo Securities.
2. Non-bank financial industry and Banking industry are unified into financial services industry in the primary sector classification of Shenyin and Wanguo Securities in 2014.
Source: Wind Info.

2.3 Institutional investors kept growing in number and the balance of margin trading and short selling increased considerably

In 2014, institutional investors grew further in number on the stock market. As of end-2014, both A share and B share accounts on Shanghai and Shenzhen market totaled 183 million, up 4.57% over end-2013. To be specific, A share accounts totaled 181.5 million, including 180.7 million natural person accounts, 88,500 securities company accounts, 14,500 fund accounts and 27,000 other institution's accounts (including social security fund, enterprise annuity, QFII, RQFII, insurance and trust) and 569,800 ordinary institution accounts. In comparison with end-2013, institutional investors, including fund, social security fund, enterprise annuity, QFII, RQFII, insurance and trust companies, enjoyed growth in account number, with the exception of securities companies. In particular, RQFII and fund witnessed the largest growth margin in account number, with a year-on-year increase of 260.90% and 109.12% respectively.

In 2014, margin trading and short selling continued to grow significantly, which helped

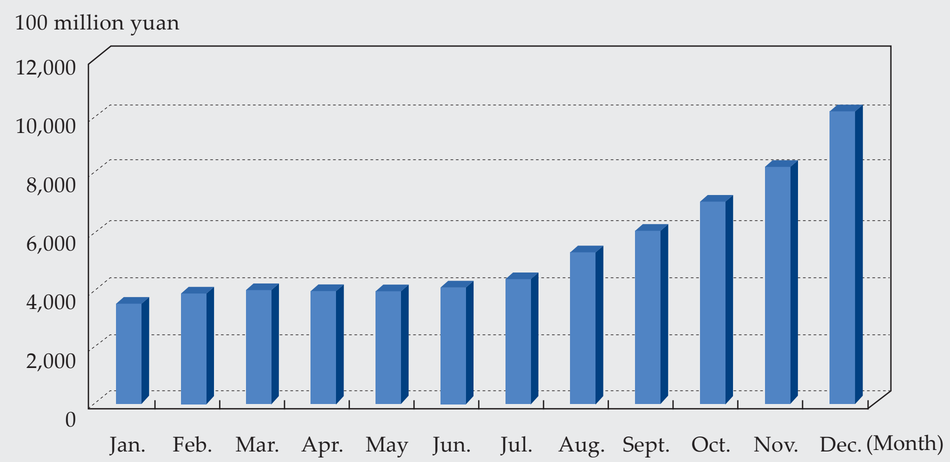
Table 4.1 Number of A-share Accounts Held by All Types of Investors

Unit: %

	December 2014	December 2013	Change rate
Natural person	180,756,405	171,978,413	5.10
Securities companies	88,516	93,425	-5.25
Fund	14,530	6,948	109.12
Other institutions	26,952	21,860	23.29
Of which: Social security fund	254	230	10.43
Enterprise annuity	6,184	5,598	10.47
QFII	826	612	34.97
RQFII	563	156	260.90
Insurance	1,955	1,564	25.00
Trust	17,170	13,700	25.33
Ordinary	569,792	533,107	6.88
Total	181,456,195	172,633,753	5.11

Source: China Securities Depository and Clearing Company Limited.

Figure 4.10 Monthly Balance of Margin Trading and Short Selling in 2014



Source: China Securities Finance Corporation Limited.

optimize the trading structure on the stock market to a further extent. In the second half of 2014, the balance of margin trading and short selling soared with the indexes on A share markets rising significantly. The balance grew 195.89% from 346.547 billion yuan at end-2013 to 1.03 trillion yuan at the end of December 2014.

3. Institution and infrastructure building

3.1 Advancing the construction of a multi-level capital market

3.1.1 Top design of institutional construction made progress

On May 9, 2014, the State Council promulgated the *Several Opinions on Further Promoting the Sound Development of Capital Market (State Council Document* [2014] No.17), based on the principles of maintaining a balanced relationship between market and government, innovative development and risk prevention, self-undertaking of risks and investor protection as well as proactive advancement and steady implementation, putting forward suggestions in the following aspects: promoting the development of a multi-level stock market, regulating the development of the bond market, cultivating an private equity market, advancing the construction of the futures market, enhancing the competitiveness of the securities and futures sector, promoting the opening up of the capital market, preventing and mitigating financial risks as well as cultivating a beneficial development environment for the capital market. The document stipulated the future development of the capital market, which was set to help accelerate the construction of a modernized market system, expand the fund raising channel of both enterprises and residents, optimize resource allocation and promote economic restructuring and upgrading. In particular, in terms of constructing a multi-level stock market, the document proposed the following five suggestions: advancing the registration-based stock issuance regime reform in a active and stable manner, accelerating the construction of a multi-level equity market, improving the quality of listed companies, encouraging the market-base mergers and acquisitions was well strengthening the market exit system.

3.1.2 Reform of the ChiNext advanced steadily

On May 14, 2014, the CSRC promulgated the revised *Administrative Regulation on the IPO and Listing on the ChiNext* as well as the *Interim Regulation on Securities Issuance on the ChiNext*. Specifically, revisions to the regulation on the IPOs on the ChiNext were as follows: First, lowering the financial entry threshold and eliminating the requirement for sustainable growth. Second, simplifying other requirements for issuance and strengthening information disclosure. Third, implementing the requirements for protecting the legitimate rights of small and medium-sized investors and the reform of stock issuance system. Besides, the *Guidelines on the Recommendation Work of the ChiNext (CSRC Document* [2014] No.8*)* was abolished. The market service scope was expanded and enterprises that could make declaration on the ChiNext were not restricted within the previously nine industries. Regulations on refinancing on the ChiNext included: First, simplifying and unifying the requirements for issuance and reinforcing the constraint mechanism for refinancing. Second, launching the targeted additional offering mechanism featured by small amount and rapid response. Application for targeted additional offering needed to be approved or rejected with 15 working days and no sponsor or underwriter was required. Third, listed companies were encouraged to sell privately issued stocks within a designated scope so as to reduce their financing cost. Fourth, enhancing the self-discipline of the board and reinforce the management's responsibility awareness in refinancing. The revision to regulation on the IPOs on the ChiNext and the launch of regulation on refinancing on the

ChiNext marked an important step forward in comprehensively promoting the reform of the ChiNext. The market positioning of the ChiNext to support growth and innovative small and medium-sized enterprises was stipulated, which would promote the construction of a multi-level capital market.

3.1.3 Construction of the share transfer system, the regional equity market and the OTC market enjoyed steady advancement

In 2014, the national SME share transfer system witnessed smooth operation with the number of listed companies rising from 347 at the beginning of the year to 1,579. On June 5, the *Rules on Market Making of National SME Share Transfer System (for Trial Implementation)* was promulgated, stipulating the five conditions that needed to be met when a securities company applied for market making. On August 25, the market making system was officially put into operation. Listed companies could choose covenant, bidding or market making to transfer shares. The introduction of market making system reinvigorated the board, helped realize the market's function of price discovery and promoted price stability.

In 2014, regional equity market continued to maintain rapid growth momentum. According to incomplete statistics, there had been 20 regional equity markets officially unveiled in China, with the total number of listed companies exceeding 15,000, 9,000 more as compared with 2013, about 5 times that of companies listed on China's main board. In particular, Qianhan Equity Trading Center, Shanghai Equity Custody Trading Center and Zhejiang Equity Trading Center were the most active regional equity markets, boasting 4,378, 3,105 and 1,586 listed companies respectively. In terms of the industrial distribution of listed companies, the banking sector, multi financial sector, food, beverage and tobacco took up a high proportion.

Construction of the OTC market of securities companies made headways and the OTC market system was put into operation, with eligibility management of investors advancing smoothly. On August 15, 2014, the Securities Council of China promulgated the *Administrative Rules on the OTC Market of Securities Companies (for Trial Implementation)* and the *Administrative Rules on the Inter-institution Private Products Pricing and Service System (for Trial Implementation)*, further regulating the OTC market of securities companies in terms of the issuance, sales and transfer, registration custody and settlement, information disclosure as well as self-discipline, etc., which played an important role in rebuilding the fundamental functions of securities companies and building them into modernized investment banks.

3.2 Market-oriented reform of basic institutions deepened

3.2.1 Market exit system continued to be improved

On October 15, 2014, the CSRC promulgated the *Several Opinions on Reform and Strictly Implementing Market Exit System of Listed Companies*, after which both the SSE and SZSE issued a number of detailed rules to implement the new policy. The document put forth suggestions regarding the market exit system in the following five aspects: First, improving the autonomous market exist mechanism of listed companies. Second, stipulating the compulsory market exit mechanism of companies with serious violations. Third, improving the supporting institutional arrangement regarding market exit, requiring stock exchanges to set up a "clearing-up period" for stocks of compulsorily existing companies when the stocks could be traded on a special board of National Share Transfer System. Fifth, enhancing the protection of the legitimate rights of investors of existing companies. Reform and strict implementation of the market exit system would play a key role in making the market exit system market-oriented, law-based and a normal practice. It would also enhance market effectiveness by letting the fittest to survive. Besides, listed companies would be more actively involved in making and implementing development strategy with raised quality and growing competitiveness and vitality. The system would also do good to nurturing the equity culture of rational investment and protecting the legal rights of investors.

3.2.2 Restrictions on M&A and restructuring were loosened

On October 23, 2014, the CSRC promulgated the revised *Regulations on Significant Assets Restructuring of Listed Companies* and the *Decision on Revising Regulation on Acquisitions of Listed Companies*. In line with the principle of relaxing restrictions and strengthening regulations, the documents were focused on reducing and simplifying the administrative approval of M&A and restructuring, reinforcing information disclosure, enhancing regulation in the process and ex post supervision, encouraging the due diligence of agent institutions and promoting investor protection. The main contents of the document included the following aspects: First, eliminating the administrative approval for major asset purchasing, sales and displacement of listed companies not seeking back-door listing and abolishing ex ante administrative approval for acquisition offer and related exemptions. Second, improving the market-based pricing mechanism of assets purchased through stock issuance and enhancing the elasticity and adjustability of issuance prices of stocks. Third, improving the definition of back-door listing, stipulating that different requirements were applied to back-door listing and IPOs and back-door listing was prohibited from the ChiNext. Fourth, enriching the payment instruments of M&A and restructuring activities, making possible for listed companies to issue preferred stocks, targeted convertible bonds and targeted warrants as payment instruments in M&A and asset restructuring. Fifth, eliminating the mandatory requirement for the threshold and compensation of profit forecast of asset purchased through issuing stocks to non-affiliated third parties and obeying the rule of market game. Sixth, diversifying the performance warrants of acquisition offers so as to reduce the cost of acquisition and strengthen the responsibilities of fiscal counseling. Seventh, clarifying a layered approval system, reinforcing the regulation in the process and ex post supervision and encouraging the due diligence of related parties. The above-mentioned revisions would promote the M&A and restructuring activities of listed companies, enhancing the competitiveness and value of list companies, optimizing market resource allocation and better serving the development of the real economy.

3.3 Promoting the innovative development of the capital market

3.3.1 The pilot program of preferred stock issuance enriched the securities portfolio

On March 21, 2014, the CSRC published the *Regulations on the Pilot Program of Preferred Stock Issuance* (hereinafter referred to as the *Regulation*), which clarified the following aspects: First, listed companies could issue preferred stocks while non-listed public companies were allowed to issue preferred stocks on a private placement basis. Second, three types of listed companies were granted rights to publicly issue preferred stocks. Third, preferred stocks could be issued in batches under one approval. Fourth, the non-public issuance of preferred stocks could be only targeted at qualified investors specified in the *Regulation* with a maximum number of 200 and the number of investors of preferred stocks with the same clauses could not exceed 200 accumulatively. Fifth, the eligibility standard of investors in terms of the trading and transfer of preferred stocks were the same with that of the issuance. Non-publicly issued preferred stocks with the same clauses, after being traded or transferred, could not have an investor number exceeding 200. On April 3, the China Banking Regulatory Commission (CBRC), in collaboration with the CSRC, promulgated the *Guiding Opinions on Commercial Banks Issuing Preferred Stocks to Replenish Tier 1 Capital* (CBRC Document [2014] No.12), clarifying the regulatory requirements and roadmap for commercial banks to issue preferred stocks to replenish Tier 1 capital. The SSE and SZSE published the *Regulations of SSE on the Pilot Program of Preferred Stock Issuance* and the *Detailed Implementation Rules of SZSE for the Pilot Program of Preferred Stock Issuance* respectively afterwards and the China Securities Depository and Clearing Company released the *Detailed Implementation Rules for the Pilot Program of Preferred Stock Registration and Clearing*. The launch of the pilot program of preferred stocks would promote the development of direct financing, support the M&A and asset restructuring of enterprises, enrich the securities portfolio and provide diversifies investment channel for investors. As of the end of the year, a total of eighteen listed companies on the A-share board publicized the plan for preferred stock issuance with a cumulative issuance value of 457.4 billion yuan, including 11 listed banks, 4 infrastructure companies, 1 energy company, 1 pharmaceutical company and 1 manufacturing company.

3.3.2 Numerous measures were taken to promote the innovation of securities institutions

On May 13 2014, the CSRC issued the *Opinions of Further Promoting the Innovation and Development of Securities Institutions* (CSRC Document [2014] No.37) (hereinafter referred to as the *Opinions*), rolling out the general principle, main tasks and implementation measures with regard to the innovation and development of securities institutions in the future. The *Opinions* put forth fifteen suggestions in three aspects to clarify the main tasks and implementation measure. First, constructing a modernized investment bank system. Efforts would be made to strengthen securities institutions' comprehensive financial service capabilities, improve their basic functions, expand financing channel, develop cross-border businesses, enhance compliance and risk-control abilities so as to build a modernized investment bank system that boasted international competitiveness, brand influence and systemic importance. Second, supporting business and product innovation. Efforts would also be made to encourage the development of asset management, fixed income, foreign exchange and commodities businesses, support the innovation of margin trading businesses, steadily conduct derivatives and OTC businesses and bolster the autonomous establishment of private-placement products. Third, boosting regulatory transformation. Efforts would be made to transform regulatory mode, deepen the reform of administrative approval, lower the market entry barrier and adopt the business license management.

3.3.3 The promulgation of new regulations boosted the development of private fund sector

On August 21, 2014, the CSRC promulgated the *Interim Regulation on Supervision and Administration of Private Funds* in a bid to boost the development of private funds and bring into full play its role in promoting the stable operation of a multi-level capital market, optimizing resource allocation and promoting the strategic adjustment of economic structure. The document specified institutional arrangements in the following five aspects: First, stipulating the establishment of a full-caliber registration and filing system. Private fund managers were required to register at Asset Management Association of China (AMAC) and private funds, once the funds were raised, were required to be put on file at AMAC. Second, setting up a qualified investor system. Eligibility of qualified investors was clarified in terms of asset size or income, risk identification and management capabilities as well as the minimum amount for single subscription. Third, stipulating the rules for placement of private funds. Fourth, putting forward the rules regulating the investment of private funds. Fifth, setting up the differential institutional arrangements for the self-discipline and regulation mechanism of different types of private funds. Private funds, when applying for filing at the AMAC, were required to clarify their investment orientation and stipulate the specific type of fund they belonged to. Besides, private fund managers should adhere to the principle of professional management when managing different types of private funds. As of end-2014, there had been 4,856 private fund companies that completed filing with the AMAC with 6,787 private funds under management or an asset management size of 1,959.79 billion yuan and 85,504 practitioners. To be specific, the number of private securities investment funds, private equity funds, venture capital funds and other funds stood at 3,163, 2,544, 665 and 451 respectively, with an asset size of 388.22 billion yuan, 1,204.69 billion yuan, 144.07 billion yuan and 222.81 billion yuan respectively.

3.4 Expanding the opening up of the capital market

3.4.1 Steadily launching the pilot program of Shanghai-Hong Kong Stock Connect Program

On April 10, 2014, the securities regulatory authorities of mainland China and Hong Kong released the *Joint Announcement*, approving the launch of the pilot program of Shanghai-Hong Kong Stock Market Connectivity Mechanism. Both SSE and Hong Kong Stock Exchange allowed investors of the two sides to trade eligible stocks listed on the other's stock exchange through local securities companies or brokers. On June 13, the CSRC promulgated the *Regulations on the Pilot Program of Shanghai-Hong Kong Stock Market Connectivity Mechanism*, putting forth the principle requirements for domestic securities companies and clarifying the business scope, the shareholding ratio of foreign ownership, the clearing and delivery mode and settlement currency. Besides, the requirements for investor protection, supervision and administration as well as data preservation were also rolled out. On September 26, the SSE issued the *Rules on the Pilot Program of Shanghai-Hong Kong Stock Connect Program of SSE*, stipulating the basic business mode and relevant requirements. On November 4, the PBC and the CSRC jointly released the *Announcements of Several Issues in the Pilot Program of Shanghai-Hong Kong Stock Market Connectivity Mechanism*

(PBC Document [2014] No.336), regulating the management of fund flows, which laid a solid foundation for the pilot program. On November 10, the securities regulatory authorities of the two sides released the *Joint Announcement* again, officially kicking off the pilot program. On November 17, ceremonies were held simultaneously in Shanghai and Hong Kong, marking the start of the pilot program. Shanghai-Hong Kong Stock Connect Program was an important part of the opening up of China's capital market and played a positive role in strengthening the bond between the capital markets of the two sides and promoting the two-way opening up of the capital market. First, the program, as a brand new corporative mechanism, would reinforce the comprehensive capabilities of the capital market. Second, it would help consolidate the status of Shanghai and Hong Kong as an international financial center. Third, it would enhance the internationalization of RMB so as to build Hong Kong into an offshore RMB business center. As of end-2014, the Stock Connect Program enjoyed stable operation. 74.632 billion yuan was employed out of the annual quota of 300 billion yuan of Shanghai Stock Connect Program, while 10.5 billion yuan was used out of Hong Stock Connect Program's annual quota of 250 billion yuan.

3.4.2 Further expanding the investment scope of QFIIs and RQFIIs

On March 19, 2014, the SSE promulgated the D*etailed Implementation Rules for the Securities Trading of Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors*, relaxing the restrictions regarding the invest scope of QFIIS. According to the document, the investment scope of QFIIs and RQFIIS, previously covering the traditional securities like common shares, treasury bonds, corporate bonds, enterprise bonds and convertible bonds as well as ETF, close-ended funds, open-ended funds, money market funds and warrants, was expanded to incorporate preferred stocks, policy financial bonds, subordinated bonds, and ABS. The upper limit for proportion of shares held by domestic investors in one single listed company on the A-share market was increased from 20% to 30%.

4. Outlook for stock market development

In 2015, the revision to the *Securities Laws of the People's Republic of China* will be sped up. Stepped-up efforts will be made to develop the capital market based on market-orientation and laws, construct a multi-level market system, expand market width and depth and improve market constraint mechanism, endogenous development mechanism and innovation mechanism so as to bring into play the market's function of resource allocation, investment and fund raising, wealth management and risk management. First, boosting the stable and sound development of the stock market. Job will be done to promote the registration-based stock issuance regime reform so as to attract long-term funds into the market. On the basis of stable market expectation, stock issuance will be enhanced at an appropriate time and with appropriate frequency, contributing to the formation of capital. Market regulation and risk prompts will be reinforced to better protect small and medium-sized investors. Strengthened efforts will be made to crack down on illegal practices or malpractices to safeguard the market fairness and impartiality. Second, constructing a multi-level equity market system. Efforts will be made to reinforce the main boards, reform the ChiNext, improve the New Third Board and regulate the development of regional equity market. Pilot program of crowd funding will be launched and continued efforts will be made to improve the market environment for M&A and asset restructuring in a bid to deepen the reform of state-owned enterprises, promote industrial unification and structural adjustment so as to rigorously support business startups and innovation. Third, bolstering the development of the private placement market. Job will be done to improve the issuance system of private placement market, promote the regulated development of private funds, invigorate the market participation of private investment and promote the linkage of capital with business startups and innovations. Fourth, advancing the reform measures by means of opening up. Job will also be done to improve Shanghai-Hong Kong Stock Connect Program, facilitate domestic enterprises to get listed on the overseas market, improve the QFII and RQFII systems and implement the strategies of "binging in" and "Going out" based on the exploration of both domestic and international markets so as to bolster the competitiveness of Chinese economy on the global market. Fifth, adhering to market regulation based on laws and enhancing the compilation of basic laws and regulations of the market. Efforts will be made to reinforce the monitoring and risk control systems so as to prevent the contagion and accumulation of both internal and external risks and forestall the systemic and regional risks.

Box 3 Advancement of the Construction of Preferred Stock Market

Since the Guiding Opinions of Launching the Pilot program of Preferred Stock (State Council Document [2013] No.46) was promulgated by the State Council on November 30, 2013, both the institutional building of the preferred stock market and issuance of preferred stocks had witnessed rapid development in 2014. The preferred stock market had taken shape and preferred stocks had become an important financial instrument for enterprises to enrich financing channel and implement business strategies and at the same time facilitate financial institutions' capital replenishment.

1. The institutional framework of the preferred stock market was established and the stock issuance kicked off

As of December 2014, issuance, trading and accounting of preferred stocks had been preliminarily established, providing the necessary institutional arrangements for the development of preferred stock market. The promulgation of the Guiding Opinions on Commercial Banks' Issuance of Preferred Stocks to replenish Tier 1 Capital, putting the issuance of preferred stocks by commercial banks on the agenda, became an important driving force for the market development. However, the preferred stock investment and market-making system of various financial institutions remained the impediments to the liquidity and profitability of preferred stocks and needed to be further improved.

At the same time, the advancement of preferred stock issuance reflected its market recognition as a new financing instrument. In October 2014, Bank of China successfully issued 40 billion yuan (USD6.5 billion) worth of preferred stocks on the overseas market with a fixed dividend rate of 6.75%. After that, Agricultural Bank *of China (domestic), Bank of China (domestic) and Industrial and Commercial Bank of China (overseas) consecutively issued preferred stocks. The fixed yield of 6% of preferred stocks issued by commercial banks, amid declining market rate, not only greatly attracted market attention, but also provided experience for non-bank listed companies when they planned to issue preferred stocks. As of December 2014, a total of 18 listed companies had publicized their preferred stock issuance plan, including such sectors as commercial banks, infrastructure, medicine and energy, etc.. In terms of issuance procedure, except that Agricultural Bank of China, Bank of China and Industrial and Commercial Bank of China had completed their issuance, the preferred stock issuance plans of Pudong Development Bank, Industrial Bank, Guanghui Energy and Kangmei Phamaceutical Co., Ltd. were undergoing the inspection by the CSRC.*

2. Preferred stock will exert significant influence on the development of China's capital market

Preferred stock will exert positive influence on China's capital market development in the following three aspects:

First, preferred stock, as a hybrid product of stock financing and debt financing, helps expand the financing channel of enterprises, enrich investment mode and promote the construction of a multi-level capital market. As for enterprises, issuance of preferred stocks, in times of adverse economic and capital market environment, will help them expand financing channel and tackle with operating difficulties. For one thing, the stock prices of a large number of blue-chip enterprises dropped below their net value, driving up the cost of stock financing. For another, declining capital turnover leads to climbing financial leverage. Therefore, SMEs are faced with more difficulties in fund-raising with the possibility for debt financing drained. Preferred stock, as a hybrid instrument, not only enriches the financing channel of enterprises, but also solves information asymmetry between issuers and investors with its flexible terms so as to reduce the financial costs of enterprises to some extent. In terms of the capital market, preferred stocks, with fixed dividend, could make up for the market's overly low dividend rate. As for investors, dividend rates of preferred stocks are higher than yield of bonds and the entry barrier is relatively lower, making preferred stocks an ideal investment instrument for stable and conservative investors and provides a brand new investment channel for social security fund and pension funds.

Second, preferred stocks will promote the current industrial restructuring and upgrading of China. For one thing, based on international experiences, preferred stocks play a key role in M&A as well as venture capital investment. Firstly, preferred stocks, as a hybrid financial instrument, boast the flexibility of their terms. For example, different terms could be designed in accordance with the earnings of a company, such as cumulative and non-cumulative preferred stocks, convertible preferred stocks and callable preferred stocks. Secondly, preferred stocks make a long-term stable source of funds when the financing costs of an enterprise are cut back. In terms of venture capital investment, both investors and enterprises favor preferred stocks. Holders of preferred stocks, while enjoying the fixed yields, are entitled to dividend distribution on the basis of different terms. As for enterprises, their controlling power will not be diluted by issuing preferred stocks

Table 4.2 Relevant Documents on Preferred Stocks

Documents	Contents	Issuing date
Guiding Opinions on Launching Pilot Program of Preferred Stock of the State Council	Institutional framework	Nov. 30, 2013
Administrative regulation on the Pilot Program of Preferred Stock	Market framework	Mar. 21, 2014
Differences of Financial Liabilities and Equity Instruments and Relevant Accounting Regulation	Accounting	Mar. 21, 2014
Regulation on Commercial Bank Capital Management (for Trial Implemenation)	Capital management of banks	Jun. 7, 2012
Guiding Opinions on Commercial Banks' Issuance of Preferred Stocks to replenish Tier-1 Capital	Banks issuing preferred stocks to replenish Tier-1 capital	Apr. 18, 2014
Regulation on Pilot Program of Preferred Stocks of Shanghai Stock Exchange	Trading	May 9, 2014
Implementation Bylaws of Pilot Program of Preferred Stocks of Shenzhen Stock Exchange	Trading	Jun. 12, 2014
Notice on Issues Regarding Insurance Companies Issuing Preferred Stocks of the CIRC (Internal opinion-soliciting version)	Insurance companies issuing preferred stocks to replenish capital	Sept. 18, 2014
Notice on Issues Regarding Insurance Funds Making Investment in Preferred Stocks	Bylaws of insurance funds investment	Oct. 17, 2014
Regulation on Capital Replenishment of Insurance Companies (Opinion-soliciting version)	Capital replenishment of insurance companies	Nov. 13, 2014
Information Disclosure Contents and Formats of Non-listed Public Companies No.7	Information disclosure of the new third board	Sept. 2014
Notice on Issues Regarding Incorporating Preferred Stocks into the Underlying Asset Pool of Pledged Stock Repos	Pledged stock repo transactions	Nov. 2014

Source: SWS Research.

while the financial burden will be relieved. Thirdly, according to the regulation on the pilot program of preferred stock issuance of our country, preferred stocks that will be employed in M&A or to repurchase common stocks could be issued through public offerings. Therefore, the issuance cost will be lowered through increasing the stocks' liquidity. For another, issuance of preferred stocks will promote the reform of state-owned enterprises. Firstly, issuance of preferred stocks provides a new fund raising channel for state-owned enterprises. For highly indebted enterprises, especially those enterprises under the central government whose debt ratio hit the upper limit of 75% set by State-owned Assets Supervision and Administration Commission (SASAC), issuance of preferred stocks will relieve their financial difficulties and solve the temporary liquidity problems. Secondly, converting the stock state-owned shares into preferred stocks will make a new channel for the exit of state-owned shares. State-owned enterprises with some of the state-owned shares converting into preferred stocks will tackle with the governance dilemma brought about the predominance of the state holder. In the meanwhile, the conversion will iron the impact that might be bought to the secondary market by state-owned shares reduction so as to preserve and increase the value of state-owned assets.

Third, issuance of preferred stocks enriches the capital replenishment channel for financial institutions and in this way promotes the competitiveness and resilience of financial institutions. For one thing, ever since 2012, commercial banks have been faced with ever-increasingly fiercer competition due to narrower spread and broadening investment scope of securities, insurance and trust companies amid deepening financial reforms. For another, economic downturn drives up the bad debt risks of banks and risks of regional economic operation tend to concentrate inside the banking system. Preferred stocks, as an alternative for tier-1 capital replenishment, diversifies banks' capital replenishment channel. Besides, the hybrid features and special contract terms of preferred stocks provide an effective way for commercial banks to diversify risks in a market-oriented manner, which not only enhances their resilience but also enrich the investment portfolio for investors for the relatively high credit ratings of commercial banks. At the same time, capital size of commercial banks will be substantially expanded due to the leverage effects brought about by preferred stocks, making possible for commercial banks to participate in capital-intensive intermediary businesses and enhance their overall competitiveness. Besides, as a capital replenishment instrument for financial institutions, preferred stocks also make an important capital replenishment channel for insurance, securities and trust companies as well as financial holding corporations. In September 2014, the China Insurance Regulatory Commission (CIRC) promulgated the Guiding Opinions on Issuance Companies Issuing Preferred Stocks to Replenish Capital (Internal Consultation Draft). Special accounting methods adopted by insurance companies aggravate the capital pressure of some insurance companies, especially small and medium-sized insurance companies, constraining their business expansion. Compared with banks, insurance companies provide more beneficial terms for investors in their preferred stock issuance contracts, making preferred stocks issued by insurance companies an important financial instrument on the capital market and a popular alternative for investors.

Table 4.3 Preferred Stock Issuance Proposals of Listed Companies

Unit: 100 million yuan

Listed companies	Issue size	Preferred stocks issued/ to be issued	Dividend rate	Issuer rating/ issue rating/ preferred stock rating	Main terms of contract
Agricultural Bank of China	800	400	6%	AAA/AAA/AA+	Periodic adjustment of fixed dividend, non-cumulative, non-participating, perpetual
Bank of China	600+400	400+320	6.75%, 6%	AAA/AAA/AA+	Periodic adjustment of fixed dividend, non-cumulative, non-participating, perpetual
Industrial and Commercial Bank of China	450+350	350 (Overseas)	6%	AAA/AAA	Periodic adjustment of fixed dividend, non-cumulative, non-participating, perpetual
Shanghai Pudong Development Bank	300	150	6%	AAA/AAA/AA+	Periodic adjustment of fixed dividend, non-cumulative, non-participating, perpetual
Industrial Bank	260	130	6%	AAA/AAA/AA+	Periodic adjustment of fixed dividend, non-cumulative, non-participating, perpetual
China Construction Bank	600+200	100	6%	AAA/AAA	Periodic adjustment of fixed dividend rate, non-cumulative, non-participating, perpetual
Ping An Bank	200	100	6.3%-6.5%	AAA/AA+	Fixed dividend rate, non-cumulative, non-participating, perpetual
Bank of Ningbo	50	25	6.5%-6.7%	AA+/AA	Periodic adjustment of fixed dividend rate, non-cumulative, non-participating, perpetual
China Everbright Bank	300	150	6%-6.3%	AAA/AAA	Periodic adjustment of fixed dividend rate, non-cumulative, non-participating, perpetual
China Minsheng Bank	200	100	6.3%-6.5%	AAA/AA+	Periodic adjustment of fixed dividend rate, non-cumulative, non-participating, perpetual
Bank of Beijing	150	75	6.3%-6.5%	AAA/AA+	Periodic adjustment of fixed dividend rate, non-cumulative, non-participating, perpetual

Table 4.3 Preferred Stock Issuance Proposals of Listed Companies

Unit: 100 million yuan

Listed companies	Issue size	Preferred stocks issued/ to be issued	Dividend rate	Issuer rating/ issue rating/ preferred stock rating	Main terms of contract
Kangmei Pharmaceutical	60	30	7.5%	AA+/AA+/AA-	Fixed dividend rate, non-cumulative, non-participating, perpetual, non-convertible
Guanghui Energy	50	25	8%-9%	AA/AA	Floating dividend rate, non-cumulative, non-participating, perpetual, non-convertible
China State Construction	300	150-300	6%-6.5%	AAA/AAA	Fixed dividend rate subject to a single rise, non-cumulative, non-participating, callable but non-puttable
Henan Zhongyuan Expressway	34	17	5%-6%	AAA/AAA	Fixed dividend rate, cumulative, participating, callable without terms for put option
Power Construction Corporation of China	20	10	6%-6.3%	AAA/AAA	Fixed dividend rate subject to a single rise, cumulative, non-participating, callable but non-puttable
China Communications Construction	145	75	6%-6.5%	AAA/AAA	Fixed dividend rate subject to a single rise, non-cumulative, non-participating, callable but non-puttable
Shandong Chenming Paper	45	22.5	3.5%-4%	AA+/AA+	Fixed dividend rate subject to a single rise, cumulative, participating, callable but non-puttable

Part V Foreign Exchange Market

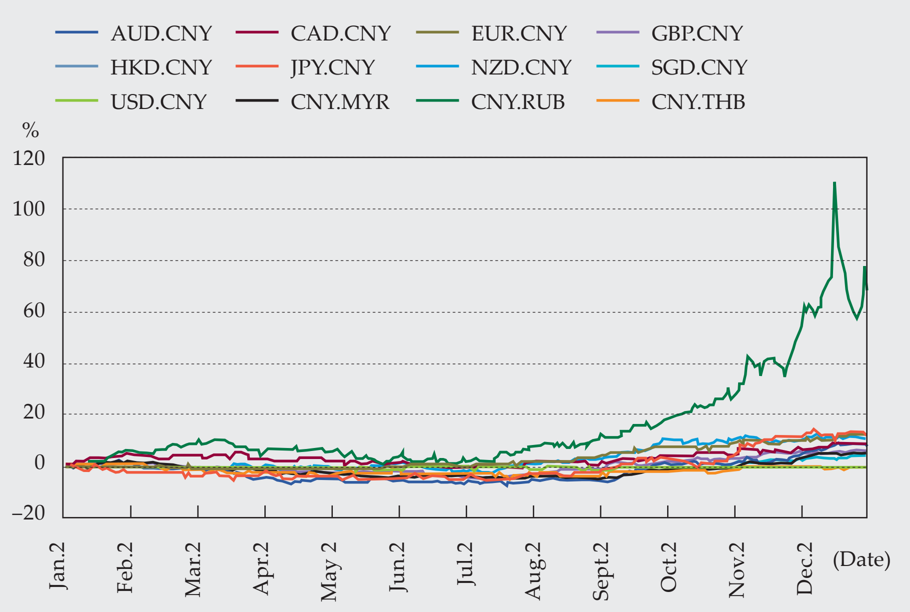
The RMB exchange rate showed enhanced flexibility of two-way fluctuation in 2014. The turnover of foreign exchange (FX) spot market grew marginally, market structure continued to improve, and direct trading of RMB vs. major international currencies and emerging market currencies kept expanding. Meanwhile, market structure became more balanced in terms of participant types and corresponding market share, and the reform on exchange rate formation mechanism and market management further deepened. In the future, FX market will move forward aiming at more market-based, further diversified products and participants, as well as improved market mechanism and infrastructure.

1. FX market performance

1.1 The RMB/FX central parity

The year 2014 marked the year of complicated domestic and international economic situation. World economy stood at a stage of post-crisis deep adjustment, whereas China's GDP growth maintained at a reasonable band supported by positive economic restructuring. Global financial market turbulence intensified, the

Figure 5.1 Movements of RMB Central Parities in 2014



Source: China Foreign Exchange Trade System.

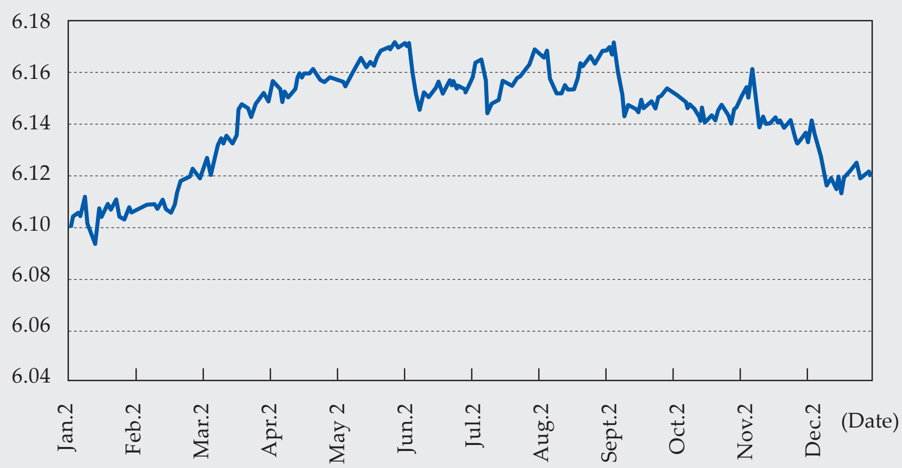
US dollar index went strong markedly, while Japanese yen and several emerging market currencies tumbled, central parities of RMB against other currencies mostly registered appreciation. Specifically, RMB appreciated against 9 currencies in terms of central parity, and depreciated against 3. Among those, RMB appreciated over 10% relative to Japanese yen, euro, New Zealand dollar and Russian ruble, and JPY/CNY central parity hit a record high. According to BIS statistics, RMB appreciated 6.4% and 6.2% measured by NEER and REER respectively in 2014.

The USD/CNY central parity moved up and down in 2014, the two-way fluctuation feature further stood out. The USD/CNY central parity registered 6.0990 yuan at the beginning of 2014, and closed at 6.1190 yuan at year-end, depreciating 0.4% compared with end-2013. The USD/CNY central parity fluctuated 780 bps across 2014, 1,149 bps narrower from the previous year. And the central parity had cumulatively appreciated 35.3% since the RMB exchange rate regime reform in July 2005.

With respect to non-USD currencies, RMB appreciated against most currencies and even rose to a record high or by a large margin against certain currencies; and depreciated a bit against few.

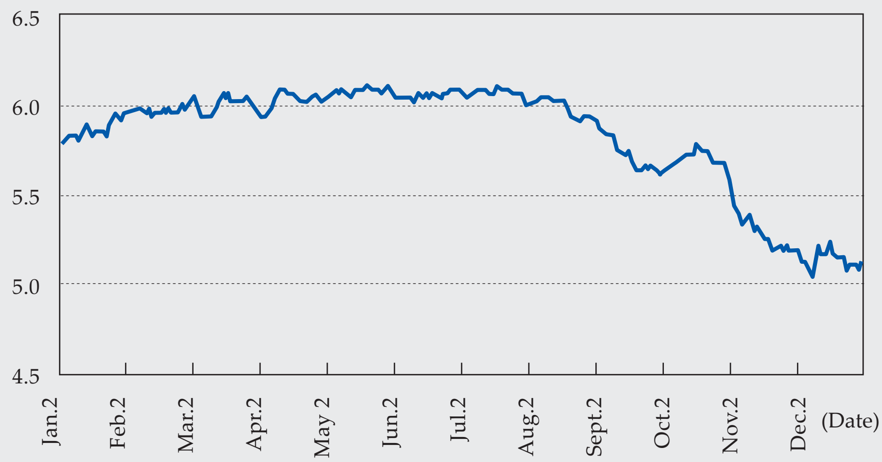
The JPY/CNY central parity stood at 5.7827 yuan at the beginning of 2014, and ended at 5.1371 yuan, registering a yearly appreciation of 12.5%. The JPY/CNY central parity fluctuated by 10,463 bps, down 3,751 bps on the previous year. Since the exchange rate regime reform in July 2005, the cumulative RMB appreciation had reached 42.4% till end-2014. The JPY/CNY central parity hit a new 20-year high in 2014.

Figure 5.2 Movements of USD/CNY Central Parity in 2014



Source: China Foreign Exchange Trade System.

Figure 5.3 Movements of JPY100/CNY Central Parity in 2014



Source: China Foreign Exchange Trade System.

As at end-2014, the EUR/CNY central parity closed at 7.4556 relative to 8.3937 at the beginning of 2014, indicating a 12.9% appreciation of RMB. The EUR/CNY central parity fluctuated 11,200 bps across 2014, widening 4,179 bps year-on-year. Since the RMB exchange rate regime reform in July 2005, the RMB had appreciated 34.0% against the euro cumulatively till end-2014.

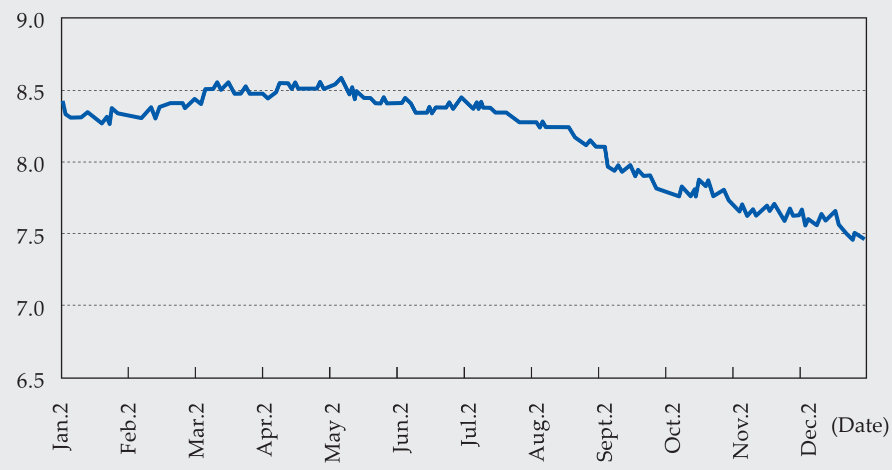
The GBP/CNY central parity opened at 10.1118 yuan at the beginning of 2014, and closed at 9.5437 yuan at year-end, RMB gaining 5.4% year-on-year. The GBP/CNY central parity fluctuated 10,654 bps across 2014, 889 bps more than the previous year.

The AUD/CNY central parity moved from 5.4212 yuan at the beginning of 2014 to the year-end 5.0174 yuan, with the RMB value up 8.2% against the Australian dollar. The AUD/CNY central parity fluctuated 9,032 bps across 2014, a drop of 3,388 bps compared with the previous year.

The CAD/CNY central parity started the year from 5.7321 yuan and ended at 5.2755 yuan, an appreciation of RMB by 8.5%. The CAD/CNY central parity fluctuated 5,466 bps across the year, narrowing 1,340 bps from 2013.

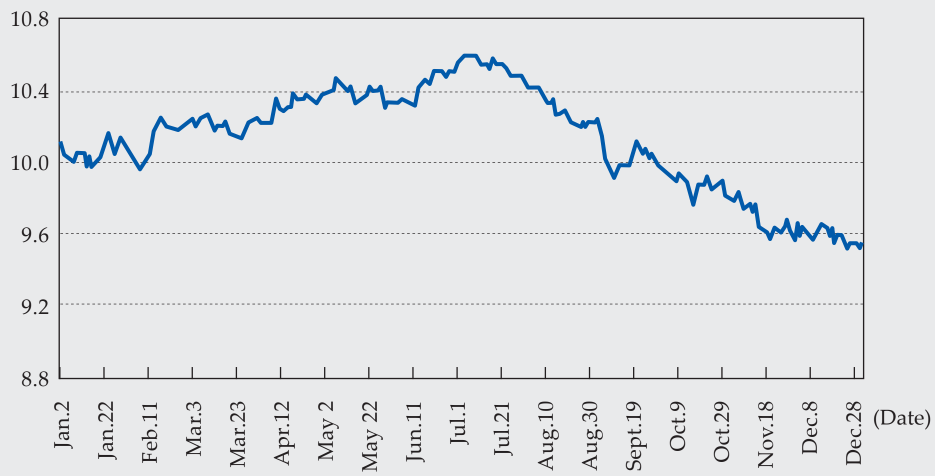
The NZD/CNY pair was introduced to the interbank market on March 19, 2014, with the central parity at 5.2899 yuan on the first day. The NZD/CNY central parity closed at 4.8034 yuan at year-end, indicating the RMB appreciation of 10.1%. The NZD/CNY central parity fluctuated 7,484 bps across 2014.

Figure 5.4 Movements of EUR/CNY Central Parity in 2014



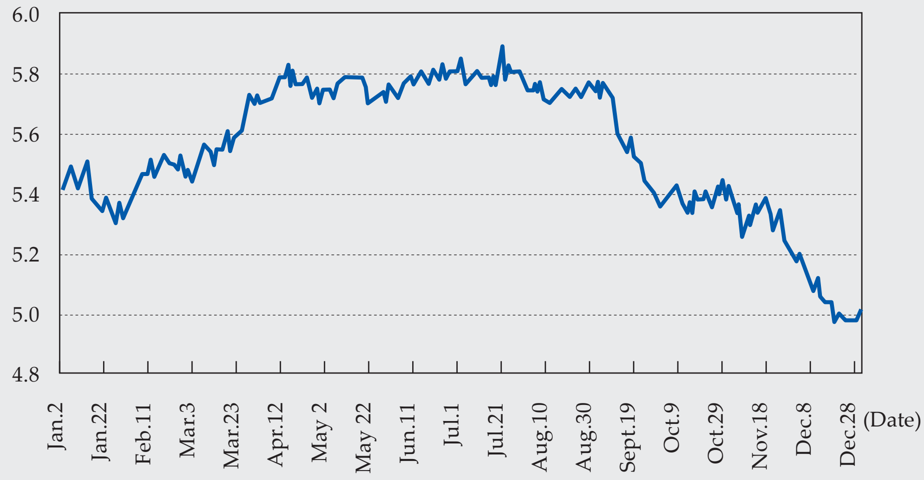
Source: China Foreign Exchange Trade System.

Figure 5.5 Movements of GBP/CNY Central Parity in 2014



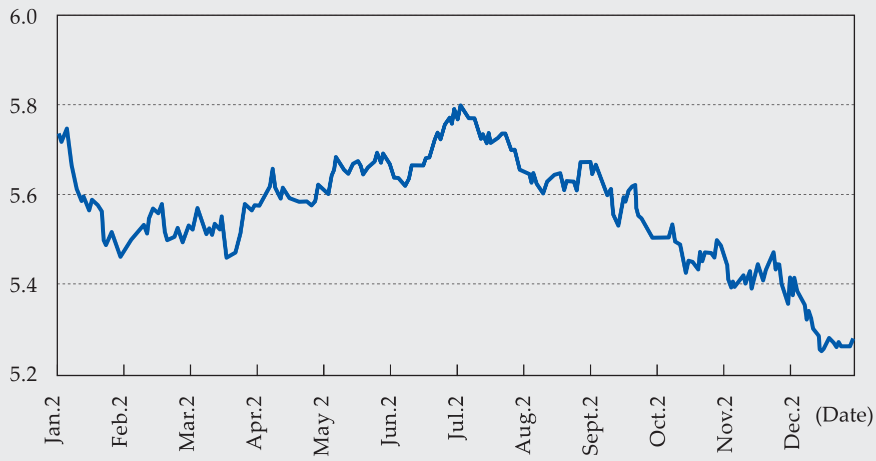
Source: China Foreign Exchange Trade System.

Figure 5.6 Movements of AUD/CNY Central Parity in 2014



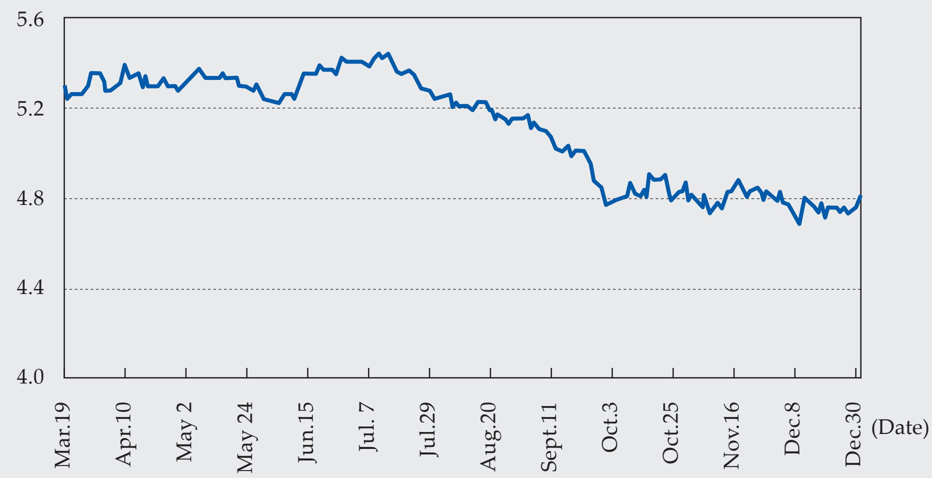
Source: China Foreign Exchange Trade System.

Figure 5.7 Movements of CAD/CNY Central Parity in 2014



Source: China Foreign Exchange Trade System.

Figure 5.8 Movements of NZD/CNY Central Parity in 2014



Source: China Foreign Exchange Trade System.

The trading of SGD/CNY was launched on October 28, 2014. The SGD/CNY central parity moved from 4.8184 yuan at the beginning to 4.6396 yuan at year-end, appreciating 3.9% in favor of RMB. The SGD/CNY central parity fluctuated 1,854 bps across the year.

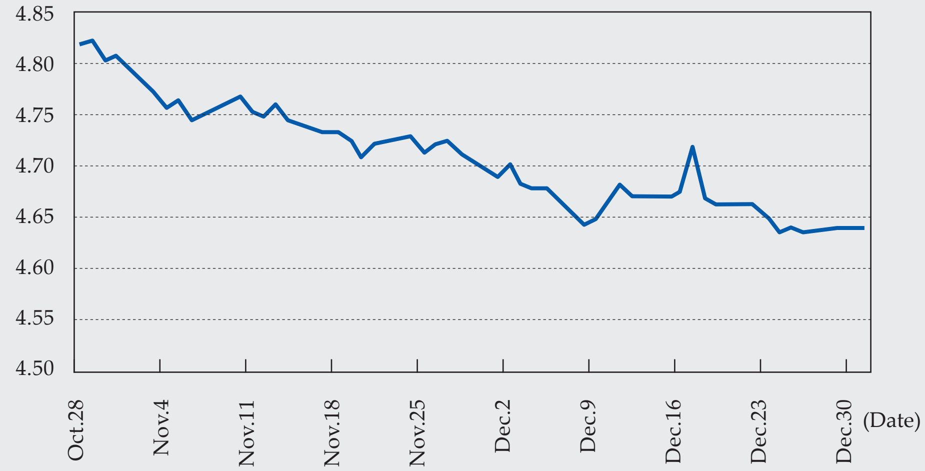
The CNY/RUB central parity registered 5.4134 ruble at the beginning of 2014, and closed at 9.0536 ruble at year-end, RMB appreciating 67.7% in 2014. The CNY/RUB central parity fluctuated 59,299 bps across the year, an increase of 52,434 bps year-on-year.

The HKD/CNY central parity recorded 0.7867 yuan at the beginning of 2014, and closed at 0.7889 yuan as at end-2014. The RMB traded 0.3% lower against the HKD across 2014. During the year, the HKD/CNY central parity fluctuated by 104bps, 148 bps less than the previous year. From July 2005 of the RMB exchange rate regime reform till end-2014, the RMB had appreciated 34.8% against the Hong Kong dollar cumulatively.

As for the CNY/MYR central parity, its opening and closing rates were 0.5398 ringgit and 0.5674 ringgit respectively for 2014, showing 4.8% RMB appreciation. The CNY/MYR central parity fluctuated 579 bps across 2014, down 47 bps year-on-year.

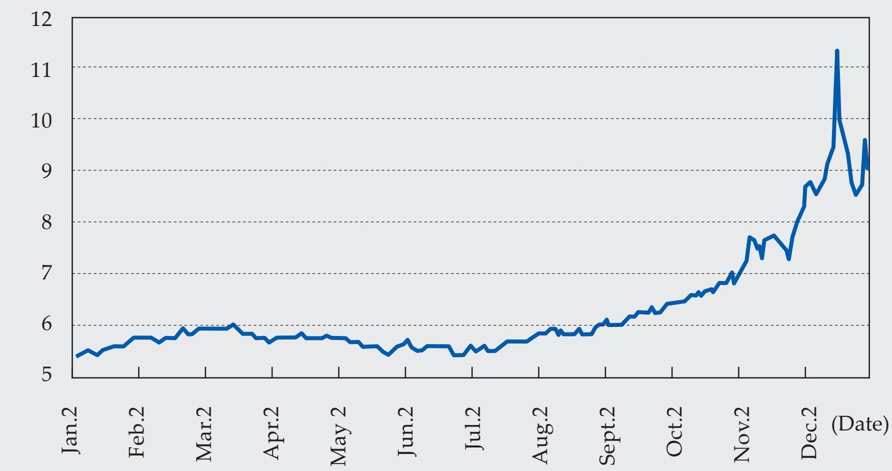
The CNY/THB indicative rate was quoted at 5.388 Thai baht at the beginning of 2014, and registered 5.3415 Thai baht at year-end. The RMB appreciated 0.5% against Thai baht year-on-year. The CNY/THB indicative rate fluctuated 3,006 bps across the year, a drop of 4,873 bps from the previous year.

Figure 5.9 Movements of SGD/CNY Central Parity in 2014



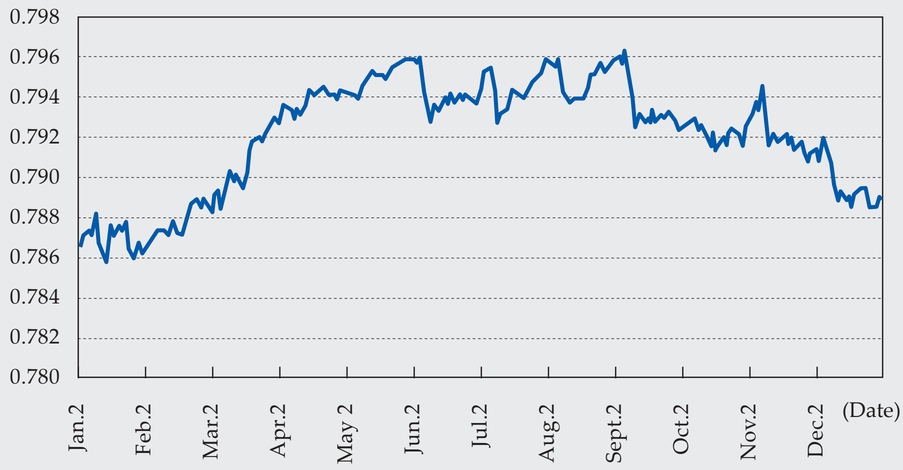
Source: China Foreign Exchange Trade System.

Figure 5.10 Movements of CNY/RUB Central Parity in 2014



Source: China Foreign Exchange Trade System.

Figure 5.11 Movements of HKD/CNY Central Parity in 2014



Source: China Foreign Exchange Trade System.

Figure 5.12 Movements of CNY/MYR Central Parity in 2014

Source: China Foreign Exchange Trade System.

Figure 5.13 Movements of CNY/THB Central Parity in 2014

Source: China Foreign Exchange Trade System.

The CNY/KZT regional trading was launched in the interbank market on December 15, 2014, marking the first-day indicative rate at 29.5775 tenge, and closed at 29.6822 tenge at year-end, presenting a 0.4% appreciation of RMB. The CNY/KZT indicative rate fluctuated 2,395 bps across 2014.

1.2 The RMB/FX spot market

In 2014, China saw declined foreign trade and negative surplus growth on FX sale and purchase. Therefore, turnover of interbank FX spot market grew at a slower pace, recording 25.4 trillion yuan for 2014, up 1.4% year-on-year, decelerating 16.7 percentage points from the previous year. Among those, the USD/CNY traded 24 trillion yuan, up 3.6% year-on-year, 11.2 percentage points slower than in 2013.

However, non-USD currencies traded more actively. Specifically, the EUR/CNY, HKD/CNY, GBP/CNY spot trade concluded 315.48 billion yuan, 203.14 billion yuan and 137.7 billion yuan respectively, up 14.8%, 39.6% and 702.2% respectively. Whereas, the RMB traded less against Japanese yen and Australian dollar, with 455.09 billion yuan and 148.61 billion yuan in absolute volume, indicating the negative growth of 64.3% and 0.7% respectively. The turnover of SGD/CNY, NZD/CNY and CNY/RUB registered 83.8 billion yuan, 28.07 billion yuan and 25.49 billion yuan for each pair. And those for CAD/CNY, CNY/MYR and CNY/THB 1.36 billion yuan, 1.19 billion yuan and 210 million yuan respectively.

2. Features of FX market performance

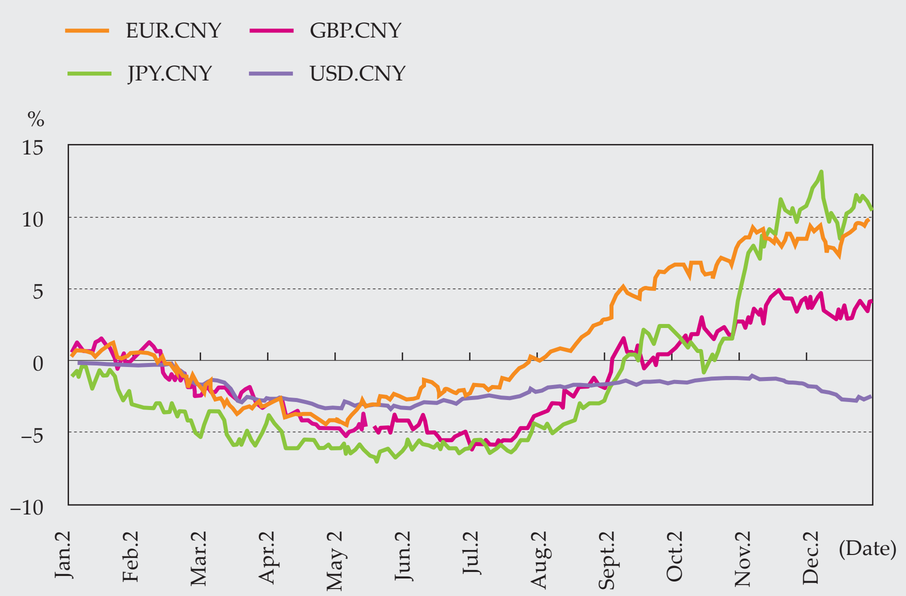
2.1 The RMB exchange rate showed markedly enhanced flexibility

Global FX market experienced strong turbulence during 2014. The US dollar index went up 13%, in sharp contrast to the free fall of Japanese yen and Russian ruble by 12% and 43% respectively. Certain emerging market currencies also suffered dramatic depreciation. The RMB exchange rate moved up and down across the year, with expanded two-way fluctuation.

In terms of the USD/CNY central parity, the flexibility improved significantly. The weakest rate touched 6.171 yuan during 2014, depreciating 720 bps or 1.2% compared with the beginning of the year; while the strongest hit 6.093 yuan, appreciating 60 bps or 0.1%. The two-way fluctuation of the USD/CNY central parity became more obvious, so were for those of the RMB against other currencies. Take JPY/CNY, EUR/CNY and GBP/CNY, the central parities appreciated by the most of 14.4%, 12.6% and 6.2% for each, and depreciated by the largest of 5.2%, 2.1% and 4.5% respectively, showing a clearer feature of two-way fluctuation.

In terms of trading prices, the exchange rates fluctuated by an even larger margin. The USD/CNY once traded as weak as 6.2593 yuan during the year, 2,087 bps or 3.3% weaker than at the beginning of the year; while also moved to the strongest level of 6.0421 yuan, 94 bps or 0.2% appreciation compared with the beginning of the year. It turned out that the two-way fluctuation of the USD/CNY trading prices was wider than the central parity. It was also the case for trading prices of RMB vs. non-USD currencies. As for JPY/CNY, EUR/CNY and GBP/CNY, the strongest in favor of RMB were

Figure 5.14 Movements of Selected RMB/FX Trading Prices in 2014



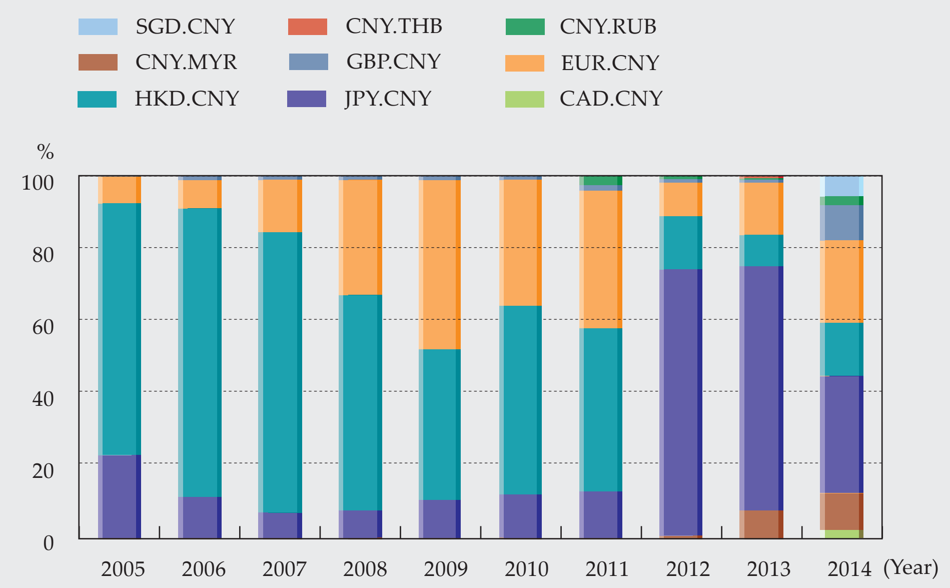
Source: China Foreign Exchange Trade System.

12.9%, 10.1% and 4.9% appreciation relative to the year-beginning level, and the weakest recorded 7%, 4.4% and 5.9% depreciation respectively. Those showed a larger fluctuating range compared with the corresponding central parities.

2.2 Currency pair structure continued to improve

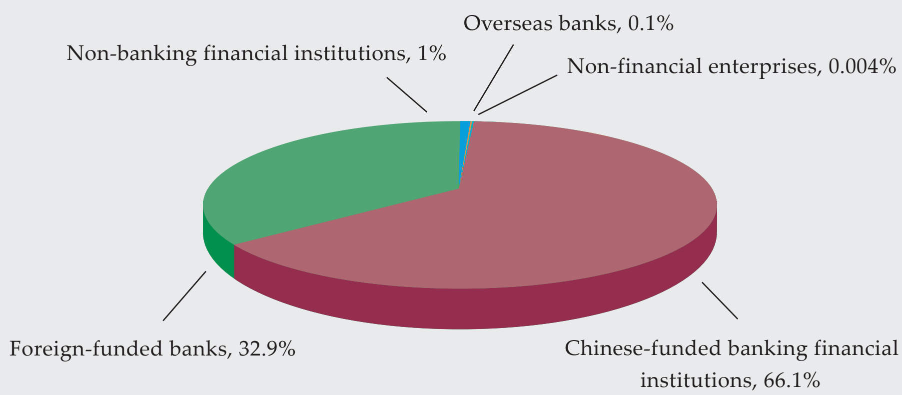
2014 witnessed new currencies entering the interbank FX market, RMB/FX direct trading kept expanding, and non-USD currencies traded more actively. As a result, currency pair structure was further optimized. In 2014, NZD/CNY, SGD/CNY direct trading and CNY/KZT regional trading were introduced to the interbank market, direct trading between RMB and major currencies of euro and Great Britain pound gained traction. Currency coverage therefore was widened, with a total of 13 RMB/FX currency pairs available in the market. Although USD/CNY still remained dominant in the market, accounting for almost 24 trillion yuan in 2014, trading between RMB and non-USD currencies was also brisk. The total turnover of RMB/non-USD currencies exceeded 1.4 trillion yuan in 2014, the third consecutive year of breaking the 1-trillion-yuan mark. Among those, JPY/CNY, EUR/CNY, HKD/CNY, AUD/CNY, GBP/CNY and SGD/CNY accounted for the respective market share of 32.5%, 22.5%, 14.5%, 10.6%, 9.8% and 6%, taking up a combined 96% share among 12 RMB/non-USD currency pairs, down 3.6 percentage points from the previous year. Such drop was mainly due to the 34.4 percentage points slump of JPY/CNY share, while shares of GBP/CNY, EUR/CNY, HKD/CNY and AUD/CNY all went up, and by 8.9 percentage points, 7.6 percentage points, 5.6 percentage points and 2.8 percentage points respectively. All these contributed to a more balanced structure of RMB/non-USD currency trading.

Figure 5.15 Composition of Interbank RMB/Non-USD Currency Trading, 2005—2014



Source: China Foreign Exchange Trade System.

Figure 5.16 Market Share of Different FX Market Participant Types in 2014



Source: China Foreign Exchange Trade System.

2.3 Market participants got more diversified

More and more market participants got access to the interbank FX market, leading to an improved structure. As at end-2014, FX spot market members climbed to 465, 60 more compared with end-2013. Members participating FX forward/swap and options increased 10 and 5 respectively during the year, and amounted to 98 and 38 till end-2014.

Not only participant types got diversified, but also more balanced development of different types contributed to the structure optimization. In 2014, 40 new members were domestic banking financial institutions, among which the rural institutions accounted for 28, including rural commercial banks, rural cooperative banks and rural credit cooperatives. Besides, non-banking financial institutions (mainly finance companies) increased 10, foreign-funded banks 7 and overseas banks 3. In terms of market share, those of non-banking financial institutions and foreign funded banks rose 0.2 percentage points and 1.5 percentage points respectively; while those of domestic banking financial institutions and overseas banks dropped 1.6 percentage points and 0.1 percentage points respectively. Obviously, different types of member institutions achieved more balanced performance in the market.

2.4 Trading structure kept improving

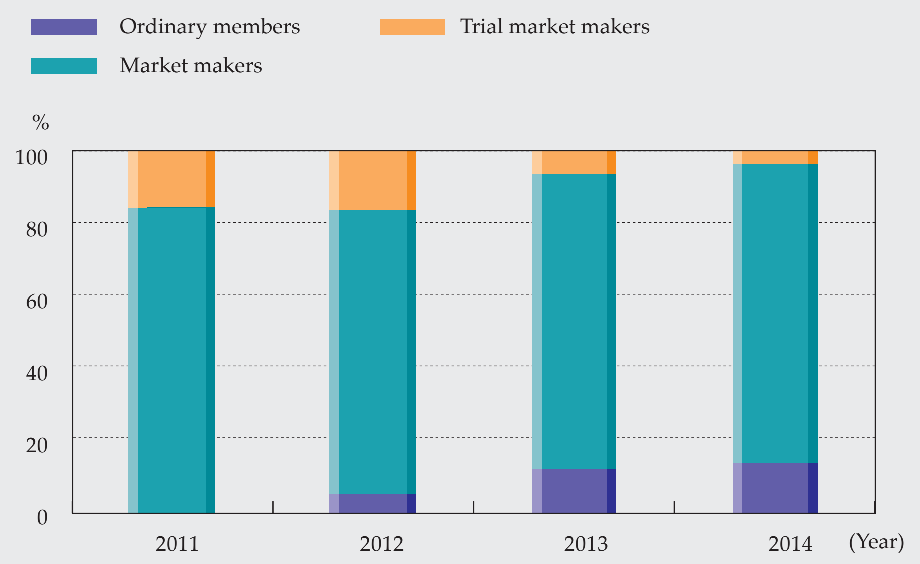
The leading role of market makers was consolidated, and other members saw increased market share in 2014, indicating a further improvement in trading structure. The market-making mechanism was launched in 2006, and trial market makers introduced to the FX spot and forward/swap market in 2011, providing abundant liquidity and playing an important role in the market. In FX spot market, market makers and trial market makers each accounted for 84.4% and 3.1% of the market total, down 1.7 percentage points and 1.8 percentage points respectively, still holding dominant position. Other members accounted for 12.5%, up 3.5 percentage points year-on-year, and it was the first time that such share exceeded 10% since the launch of market making mechanism in 2006. In the FX forward/swap market, market makers and trial market makers each accounted for 79.4% and 4.4%, up 2.4 percentage points and down 3.3 percentage points year-on-year respectively. The market share of other members climbed 0.9 percentage points to 16.3%. In addition, market making mechanism was also applicable to direct trading between RMB and euro, Japanese yen, Great Britain pound, Australian dollar, New Zealand dollar, Singapore dollar. Market makers in those markets also took a lion share, providing two-way quotes and liquidity to the market.

3. The inter-bank FX market institution building and product innovation

3.1 The RMB floating band further widened

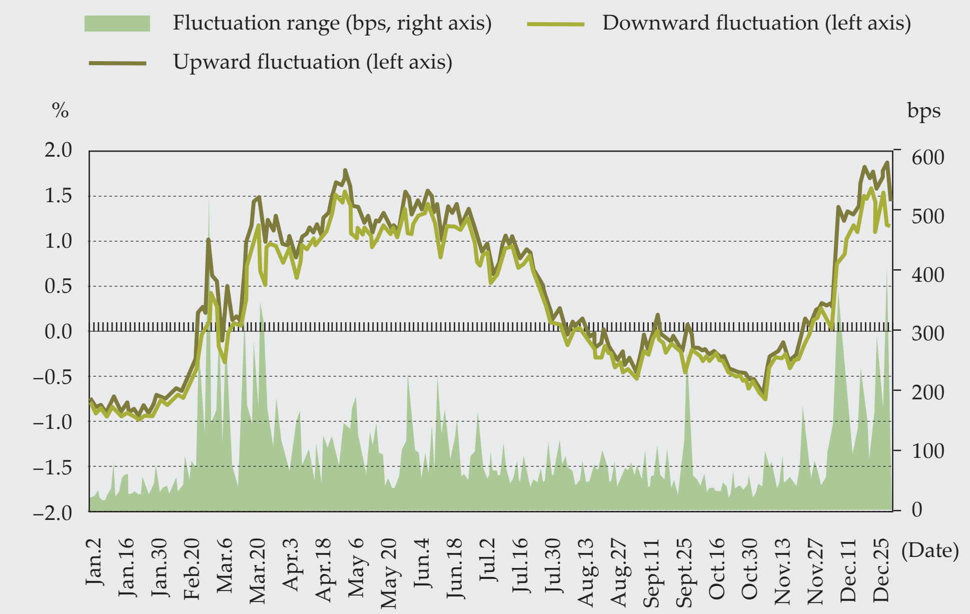
The People's Bank of China (PBC) issued notice in March 2014, announcing that the floating band of USD/CNY trading rates around the central parity would be expanded to 2% (up or down) since March 17. It followed the gradual reform path of expanding the floating band step by step, i.e. expanding from the 1994-level of 0.3% to 0.5% in May 2007, and further widening to 1% in April 2012, and the third widening to 2% in 2014. In recent years, China's FX market grew more mature, trading volume was on the rise, more and more products were available in the market. At the same time, market participants increasingly built their risk control capability, and became more willing to set prices independently. Therefore, it's imperative

Figure 5.17 Interbank FX Market Trading Structure, 2011—2014



Source: China Foreign Exchange Trade System.

Figure 5.18 The Two-Way Fluctuation of USD/CNY Trading Prices in 2014



Source: China Foreign Exchange Trade System.

that the floating band widened gradually so as to adapt to the new developments. Actually, the band widening will be conducive to enhancing RMB exchange rate flexibility, improving fund allocation efficiency, therefore it'll let market forces play a decisive role in resource allocation.

3.2 The RMB/FX retail rates were liberalized

According to the notice issued by the PBC, banks could, from July 1, 2014, set the RMB/FX retail rates for their clients without any restrictions, covering the rates for deposit exchange and cash exchange. Price-making will be absolutely based on market demand and supply as well as banks' specific conditions. This marked another important step in market-based exchange rate regime reform since the removal of limits on bid-ask spread quoted by banks for RMB/non-USD deposit exchange and cash exchange in September 2005. Therefore, all RMB/FX retail rates, including USD/CNY rates, had shifted to market-based mechanism thanks to the liberalization measures.

3.3 More international major currencies and emerging market currencies were included in the RMB/FX direct trading

The direct trading between RMB and New Zealand dollar was launched in March 2014, followed by Great Britain pound, euro and Singapore dollar in June, September and October respectively. The formation of the central parities of RMB against these currencies was based on market making mechanism, that is, derived directly from the quotes of corresponding market makers for each currency pair. Furthermore, the CNY/KZT region trading was kicked off in December 2014, which pushed the number of RMB/FX currency pairs to 13, covering international major currencies and emerging market currencies. The direct trading mechanism has led to more active price quoting and trading. In 2014, the direct trading of those RMB/FX currency pairs break 1 trillion yuan in trading volume, which played a positive role in increasing market liquidity and reducing exchange conversion costs of retail clients. In addition, this would benefit bilateral trade and investments between China and relevant countries and regions, facilitate cross-border use of RMB.

3.4 Securities firms and fund management companies gained access to the interbank FX market

Guotai Junan Securities and Harvest Fund were granted the member status of interbank FX market, and were allowed to participate in FX spot trading since 2015. This marked the first time that non-banking financial institutions of such kind entered the interbank FX market. In August, 2005, the PBC issued notice to expand the participant types in the interbank FX market, permitting the access of qualified non-banking financial institutions and non-financial enterprise. Ever since then, over 50 non-banking financial institutions mainly consisted of finance companies became the interbank FX market members. Therefore, the inclusion of securities firms and fund management companies this time would give rise to increased variety of market participants, improve the multi-tier market structure and diversify market demands. Consequently, this would contribute to enhanced FX market functions of price discovery and risk management, to widened coverage of market services, and to the development of China's FX market up to a new high level.

3.5 Further measures were taken to promote FX market management streamline and decentralization

From the perspective of institutions, the *Administrative Measures governing FX Sale and Purchase of Banks* (hereinafter referred to as the *Measures*) was put into force from August 2014. The *Measures* differentiates the administrative measures concerning FX sale and purchase from those governing FX derivatives business, lower the market access threshold, so as to help banks change the way in position management. Also, according to the *Measures*, certain pre-access administrative permission and qualification requirements are eliminated, shifting from pre-access ratification focused to more reliant on post-access regulation. This *Measures* is helpful to simplify market access procedures, motivate market participants by delegating them more powers, and promote function transformation of FX administrative agency. From the perspective of implementation, steps were taken to simplify market access procedures. Since January of 2015, those banks and branches which have got the permission of providing forward FX sale and purchase services to clients could automatically have access to the FX swap and cross currency swap market, needing no additional application and file for record. Since August of 2014, access to all kinds of FX derivatives markets has been simplified to once for all. The State Administration of Foreign Exchange (SAFE) issued notice again in December 2014, stipulating that market access to the interbank FX market is no more subject to pre-access permission, neither for money brokers, so as to further simplify market access procedures and facilitate the access of market participants.

4. Outlook for the FX market

In the future, the RMB exchange rate regime reform will stick to the principle of market-based and letting market forces play a decisive role. The aim is to establish a managed floating exchange rate system based on market supply and demand, and promote the BOP balance. As a result, efforts will be made to further enhance RMB exchange rate flexibility of two-way fluctuation and maintain the RMB exchange rate stable at an adaptive and reasonable level, in line with market conditions as well as economic and financial situation. Attentions will be paid to transfer the way how regulation is carried out, press ahead with management streamline and deceleration, and allocate more regulatory resources on market infrastructure construction and risk control. At the same time, self-regulation should be strengthened, professional ethics be emphasized and code of conduct well implemented.

Enriching instruments is key to FX market development. Therefore, significance will be attached to further diversify products, promote innovation of complicated options and futures, and establish a complete set of products. In addition, measures will be taken to expand RMB/FX direct trading and regional trading, enable FX market to better serve real economy and national strategy. The breadth and depth of FX market will be further improved, in a bid to meet increasing demand of enterprises and individuals.

Diversified market participants are conducive to stimulating market vitality, since their demand is different from each other. To that end, we'll promote more non-banking financial institutions such as securities firms to enter the market, support individuals to appropriately participate in the market, and allow qualified domestic and overseas institutions to conduct cross-border FX transactions. All these are to orderly expand market participants, form a multi-tier market structure, optimize market supply and demand, improve the trading style, and enhance market liquidity.

The competitive market mechanism and infrastructure serve as a safeguard for FX market development. Steps will be taken to further improve trading mechanism and service mode, establish a comprehensive service system combining the functions of facilitating trade and providing information etc.. Trading mode will be further optimized, products consolidated, automatic processing and trading efficiency further improved. Also, efforts will be made to make the trading platform and related infrastructures more competitive and inclusive, establish and improve a centralized and full-covering trade repository for FX market. All in all, it's an unswerving task to provide solid mechanism and technology support for the new-normal development of FX market.

Box 4 Promoting Direct Trading Between RMB and Regional Currencies

China has seen rapid economic growth and strengthened clout in recent years, which in turn lifted the international status of RMB. Cross border RMB settlement in trade and investments has increased dramatically. According to relevant statistics, RMB has become the second most used currency in China's cross-border payments, and the cross-border payments in RMB has *accounted for almost 25% of the total payments in both RMB and foreign currencies. In terms of foreign trade in goods, RMB settlement has taken up a share of over 15%, and there were over 170 countries and regions using RMB for cross-border settlement. Since 2009, the PBC has signed bilateral local currency swap agreements with 26 foreign central banks or monetary authorities, the amount climbing to 3 trillion yuan, which demonstrated that the international cooperation in promoting local currency use kept moving forward. Actually, RMB has been well received in surrounding and other counties and regions, and some have already included RMB into their official foreign reserve. Currently, RMB has ranked the seventh most commonly held world's reserve currency.*

Under the instructions of the PBC and SAFE, The China Foreign Exchange Trade System (CFETS) promptly responded to market demand, and actively promote the development of RMB/FX market. Besides the direct trading between RMB and major currencies such as the US dollar, euro, Japanese yen and British pound, more direct trading has been launched between RMB and Russian ruble, Malaysia Ringgit, Australian dollar, New Zealand dollar, and the CFETS also introduced regional trading between RMB and Thai baht, Kazakhstani Tenge. As a result, the currency pairs increased to 13 in the interbank RMB/FX market. The aforementioned direct trading and regional trading recorded an annual trading volume of over 1 trillion yuan, playing an important role in enhancing market liquidity and reducing exchange conversion costs of retail clients. It also benefits the bilateral trade and investments between China and relevant countries and regions, and facilitate cross border use of RMB. The regional trading of CNY/THB and CNY/KZT launched by CFETS on December 19, 2011 and December 15, 2014 provided financial support for bilateral trade and investments.

The trading mechanism is as follows: regional trading is a kind of spot trading based on bilateral negotiation, with settlement arrangements of T+0, T+1 and T+2. The indicative rate is formed in the following way: the CFETS enquires prices from liquidity providers designated for corresponding currency pair before the opening of the market on each business day, and then calculates the arithmetic average of all quotes as the indicative rate of RMB against Thai baht or against Kazakhstani Tenge for that day. The CFETS published the CNY/THB indicative rate on 9:15 each business day, and the CNY/KZT indicative rate on 10:15 each business day. The floating band of trading prices is limited to plus and minus 10% around the indicative rate. Trading hours are from 9:30 to 16:30 for CNY/THB, and from 10:30 to 16:30 for CNY/KZT, from Monday to Friday.

The regional trading is expected to provide services for banks which quote bid/ask rates of relevant currency pairs to retail clients, such as banks located in Yunnan province and Xinjiang Uygur autonomous region, as well as other domestic banks. CFETS platform could facilitate trading between those banks. Till now, CNY/THB regional trading registered a trading volume of almost 3 billion yuan, and those for CNY/KZT has also been on the rise steadily. CFETS will continue to develop regional trading market in response to market demand, so as to support bilateral trade and investments, better serve real economy, and provide safeguard for national strategies of RMB internationalization and "one belt, one road".

Part VI Gold Market

The international gold price saw weaker fluctuation in 2014 by slightly declining 1.68%. Despite drop of the trading volume to varying degrees on US, London and other major international gold markets, China's gold market witnessed active trading, more product innovations, and further improvement of trading mechanisms. Moreover, as opening up to the outside world made progress, the international board for gold trading was officially launched. Commercial banks' gold trading kept increasing in general, with gold forwards, gold leasing and some other business growing particularly fast.

I. Gold market performance

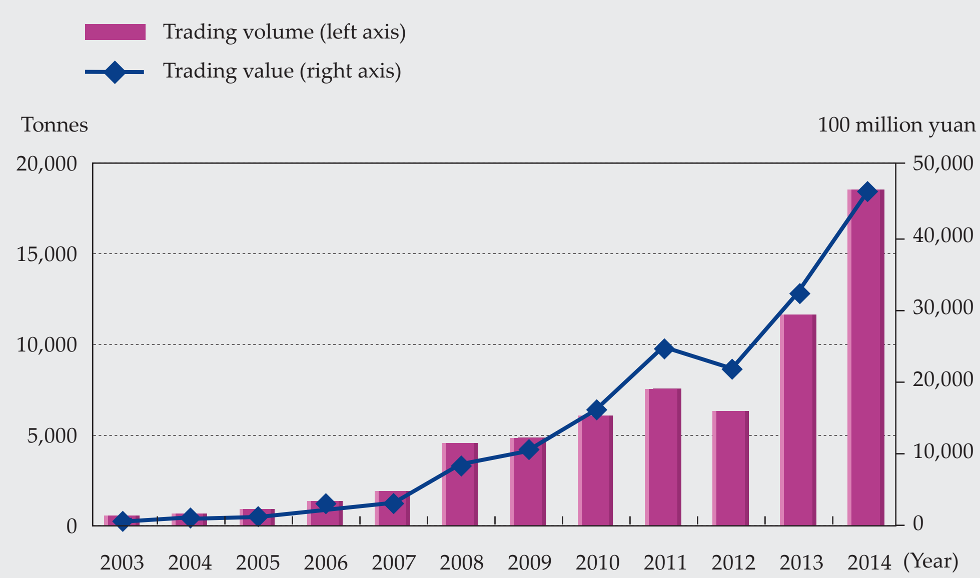
1.1 SGE spot gold market performance

1.1.1.Trading volume surged amid fluctuation of the spot gold price

In 2014, the gold price rose first, then fell and bounced back at the year-end. By end-2014, the dominant contract on Shanghai Gold Exchange (SGE) closed at 240.59 yuan per gram, 1.75% up from a year earlier.

In 2014, on a year-on-year basis, the cumulative trading volume of gold on the SGE registered 18,500 tonnes, an increase of 59.17%; the trading

Figure 6.1 Gold Trading Volume and Value on SGE, 2003—2014



Source: SGE.

value grew by 42.81% to hit 4.59 trillion yuan; and the average daily trading volume amounted to 75.46 tonnes, up by 54.63%.

1.1.2 Gold spot trading accounted for a higher proportion with more deferred contracts

The SGE launched the new mini deferred gold trading contract mAu(T+D) and improved the Au(T+N) contract in 2014. The cumulative trading volume of all deferred contracts surged by 47.58% on a year-on-year basis, or 3,499.11 tonnes, to 9,880.19 tonnes across the year. In particular, the trading volume of the mAu(T+D) contract reached 543.32 tonnes, and that of Au(T+N) hit 671.85 tonnes.

In 2014, the trading volume under all gold spot contracts on the SGE hit 8,606.49 tonnes, registering a year-on-year increase of 74.94%. The proportion of gold spot trading grew by 4.2 percentage points to 46.56%.

1.1.3 Gold bilateral transaction grew fast with strengthened market liquidity

The cumulative trading volume through the SGE and interbank gold bilateral transaction platforms rocketed by 192.33% over the previous year to hit 2,799.35 tonnes, including 1,163.89 tonnes of interbank gold bilateral transactions, a year-on-year growth of 752.02%. The proportion of gold bilateral transaction in the SGE's total gold trading volume increased from 8.18% in 2013 to 15.58% in 2014. The number of institutions involved in interbank gold bilateral transaction grew from 27 in 2013 to 43 in 2014, and that of those involved in SGE gold bilateral transaction surged by 118.47%, or 263.

1.1.4 Clearing and delivery went safely and smoothly, providing efficient and convenient services to the market

The annual clearing on the SGE registered 1.78 trillion yuan in 2014, up by 6.04% over the previous year, including 1.03 trillion yuan from proprietary business and 0.75 trillion yuan from agent business, which increased by 4.49% and 7.73% respectively.

Among 59 SGE-designated vaults in 35 cities across the country, 78.67% were in use in 2014. One vault was especially for the international board. Gold put into storage in these warehouses of the year totaled 2,928.8 tonnes, and 2,835.3 tonnes were delivered out of warehouses. The SGE strictly inspected the quality of delivered gold and imposed tighter restrictions on the authentication of gold ingot and gold bullion, to provide comprehensive services covering warehousing and distribution of physical gold.

1.2 Shanghai Futures Exchange (SHFE) gold futures market performance

1.2.1 Domestic and foreign prices of gold futures were correlated

The dominant contract of domestic gold futures opened at 241.1 yuan per gram and the year beginning and closed at 241.65 yuan per gram at the yearend of 2014, with the peak at 273.4 yuan per gram and the bottom at 223.6 yuan per gram. The price at domestic and international gold futures market and that at domestic gold futures and spot market were growingly correlated, and the pricing efficiency of domestic gold futures has been further improved. On the one hand, the movements of domestic and US COMEX gold futures prices maintained highly connected, and the correlation coefficient between the two was as high as 0.96. On the other hand, the spread between domestic gold futures and spot decreased. In 2014, the average spread between SHFE gold futures and SGE Au(T+D) was down by 41.6% on a year-on-year basis to 1.27 yuan per gram.

1.2.2 The size of gold futures market kept growing

As per bilateral statistics, the cumulative trading volume of gold futures at SHFE recorded 4,773.08 lots in 2014, up by 18.81% over the previous year, and the trading value grew by 11.89% to 11.98 trillion yuan, accounting for 9.47% of the total trading value of all futures at the SHFE, 0.61 percentage points higher than in 2013. The continuous trading of gold futures remained active, with the annual trading volume hitting 2,995.5 lots and accounting for 62.76% of the total trading volume of gold futures of the year. Since the launch of the night session trading, the trading volume of gold futures in Shanghai has ranked second in the global market and first in the Asia-Pacific region.

1.2.3 Open interest of gold futures kept expanding

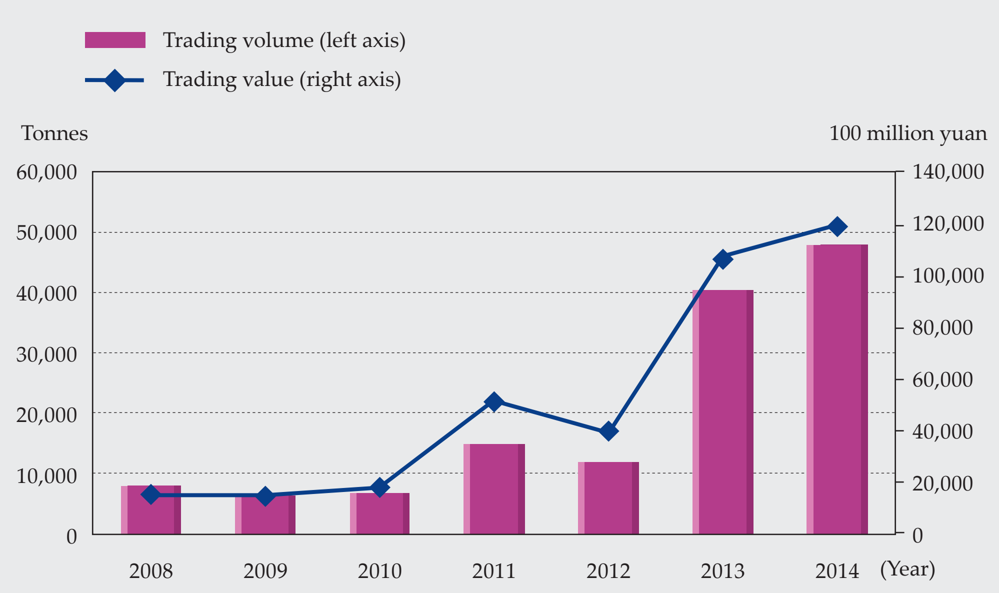
As of the end of 2014, the open interest of gold futures on the SHFE had reached 194,800 lots, up 13.93% over the previous yearend. Since the continuous trading was launched to prolong the trading period, the continuity of gold futures price has been improved, leading to enhanced open interest of investors.

1.3 Commercial banks' gold business performance

1.3.1 Proprietary and agent gold business increased significantly

In 2014, the trading volume of proprietary and

Figure 6.2 Trading Volume and Value of Gold Futures, 2009—2014



Source: SGE.

agent business by commercial banks on the SGE totaled 12,600 tones, 79.38% more than the previous year. It accounted for 68% of the total gold trading volume, 7.7 percentage points over the same period of the previous year.

Proprietary business. In 2014, the cumulative trading volume of proprietary gold business by commercial banks (including international members) on the SGE hiked by 93.44% year on year to 8,263.83 tonnes.

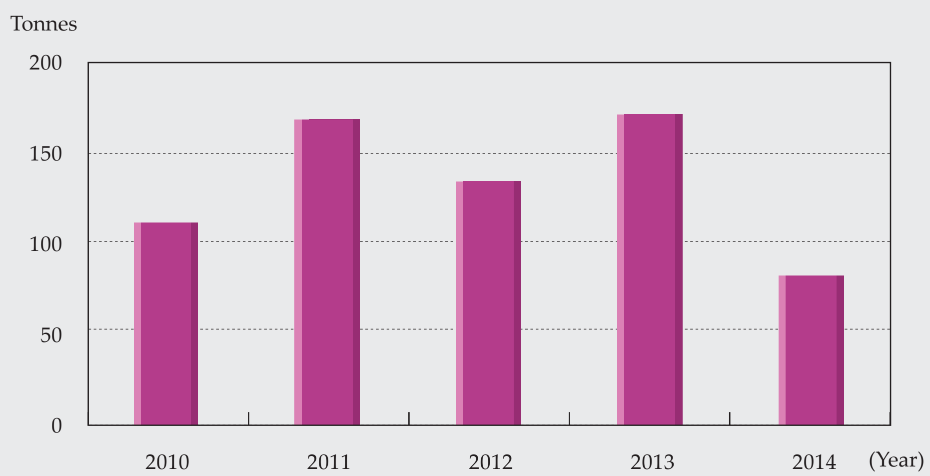
Agent business. In 2014, the trading volume of agent gold business by commercial banks on the SGE totaled 4,307.24 tonnes, soaring by 57.43% over the previous year. Specifically, the trading volume by enterprises increased by 88.3% to 1,761.56 tonnes, and that by individuals grew by 41.3% to 2,545.67 tonnes.

1.3.2 Domestic proprietary gold businesses on the whole kept growing

The year 2014 saw cumulative trading volume of domestic over-the-counter (OTC) gold business by commercial banks increase by 7.48% to 4,428.45 tonnes[1], with gold forward and gold leasing business growing particularly fast.

Sales of physical gold rose slightly. In 2014, physical gold sold by commercial banks cumulatively totaled 411.62 tonnes, 1.69 tonnes more than the previous year. The sales value amounted to 108.114 billion yuan, a year-on-year decrease of 12.9%. Specifically, sales of proprietary branded gold decreased by 58.24% to 78.08 tonnes and that of agent branded gold decreased by 3.08% to 23.51 tonnes, while sales of gold accumulation (automatic gold investment plan) increased by 56.04% to 310.03

Figure 6.3 Average Monthly Trading Volume of Commercial Banks' Account Gold Business, 2010—2014



Source: PBC Shanghai Head Office.

1 Since the adjustment of statistical rules in 2014, the returned part of gold leasing business is no longer included in the calculation of the trading volume any more.

tonnes. Commercial banks' proprietary and agent branded gold bought back in 2014 was respectively 13.27 tonnes and 1.65 tonnes, and 284.21 tonnes of gold accumulation (automatic gold investment plan) were redeemed, with the respective year-on-year increase being 21.44%, 160.42% and 185.46%.

Account gold business plummeted. In 2014, the cumulative trading volume of account gold business by commercial banks was down by 51.04% to 988.65 tonnes and the trading value dropped by 55.61% to 248.388 trillion yuan on a year-on-year basis in 2014. In particular, the trading volume of US dollar account gold and the RMB account gold declined by 49.65% and 51.15% to 77.87 tonnes and 910.78 tonnes respectively. The average monthly trading volume of account gold in 2014 hit the record low in recent five years to stand at 82.93 tonnes.

Gold leasing business kept growing. The gold leasing business consists of interbank gold lending between commercial banks and gold leasing between commercial banks and their corporate clients. In 2014, the trading volume of gold leasing business of commercial banks increased by 110.11% over the previous year to 1,845.49 tonnes, and the trading surged by 94.14% to 461.916 billion yuan. In particular, the trading volume of gold leading for clients was up by 88.38% to 1,370.69 tonnes, and that of interbank gold lending hit 474.8 tonnes, a 214.94% increase over the previous year.

Gold pledging business slightly declined. In 2014, commercial banks accumulatively accepted 17.14 tonnes of pledged gold, down by 57% over the previous year, and 21.12 tones of gold pledge was discharged, 1.8% up over 2013.

Gold wealth management grew fast. In 2014, the nominal principal of all wealth management products of gold offered by commercial banks amounted to 852.928 billion yuan, an increase of 516.45% over the previous year, and products worth 785.445 billion yuan were due and redeemed, up by 554.17% over 2013. By end-2014, unmatured wealth management products of gold stood at 272.785 billion yuan.

Domestic gold forwards kept growing. Domestic OTC gold derivatives offered by commercial banks include gold forward, gold swap and gold option denominated in US dollar and RMB. In 2014, the cumulative trading volume of domestic over-the-counter gold directives increased by 30.94% year on year to 866.41 tonnes. In particular, the trading volume gold forward hiked by 117.92% to 737.24 tonnes, and that of gold swap and gold option declined respectively by 58.04% and 72.12% over the previous year.

1.3.3 Offshore gold business continued to grow

In 2014, the trading volume of offshore gold business of commercial banks hit 10,386.81 tonnes and the trading value reached USD423.525 billion, increasing respectively by 38.7% and 25.6% on a year-on-year basis. In particular, the trading volume increased by 132.49% to 6,450.12 tonnes for offshore gold swap, declined by 7.11% to 1,179.75 tonnes for offshore gold forward, hiked by 83.75% to 5.87 tonnes for offshore gold option and dropped by 20.54% to 2,733.98 tonnes for offshore gold spot on a year-on-year basis. In 2014, some commercial banks began to offer offshore gold futures, with the trading volume amounting to 16.89 tonnes.

2. Analysis of gold price movement in 2014

2.1 Gold price fluctuated downward and declined slightly compared with the beginning of the year

The gold price on the international market moved with volatility in general in 2014, and dropped, after increase first, at an obviously slower pace than in 2013. At the beginning of the year, the international gold price opened at USD1,219.75 per ounce and rocketed to the peak of the year at USD1,385 per ounce on March 14. Since then, it declined and touched the bottom of USD1,142 per ounce on November 5, and then bounced back. The international gold price closed at USD1,199.25 per ounce at the yearend, down by 1.68% over the beginning of the year, a margin much lower than that in 2013 (28.55%).

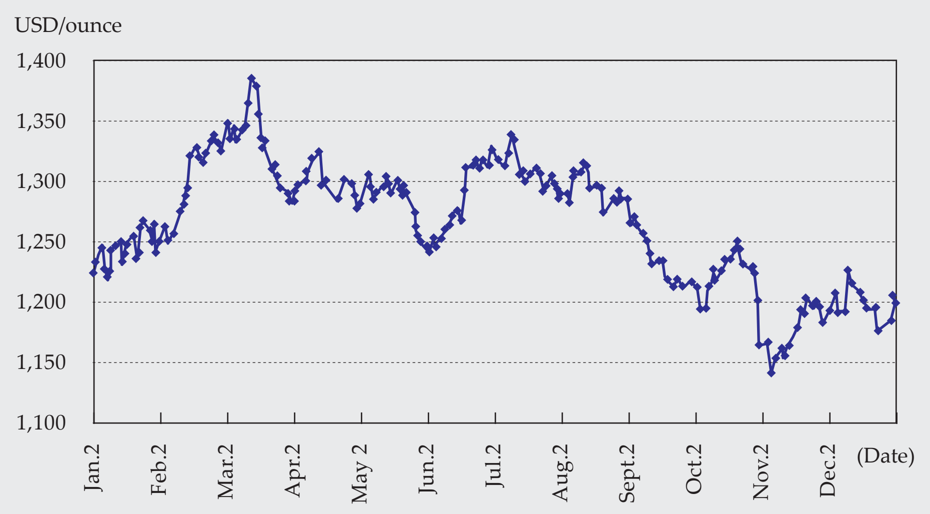
The gold price moved in the same direction at home and abroad. The SGE dominant contract of Au99.99 opened at 238.85 yuan per gram and closed at 235.5 yuan per gram, reaching the peak at 273.6 yuan per gram on March 17 and touching the bottom at 223 yuan per gram on November 7. The weighted average price declined by 10.44% on a year-on-year basis to 249.51 yuan per gram in 2014.

2.2 Analysis of major influences on gold price movement

First, worsening geopolitical tension aggravated short-term change of the gold price. Escalating confliction in Ukraine and increasing tension between U.S. and Russia have caused market concerns, and gold's function as a way to mitigate risks captured attention, which became an important factor underlying short-term change of the gold price. As a result, the gold price hiked by 5.45% in the first quarter.

Second, the general trend of the gold price movement was affected by US economic

Figure 6.4 Gold Price Movement in 2014

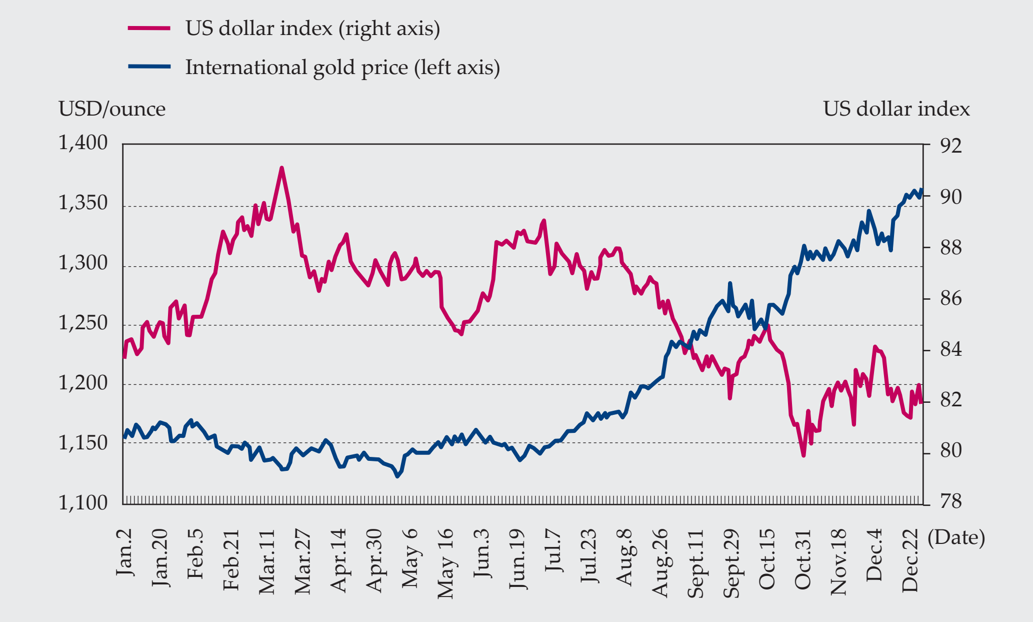


Source: London Bullion Market Association (LBMA). London afternoon fix is used here.

recovery and the monetary policy of the Federal Reserve (hereinafter referred to as the Fed). The US economy showed strong signal of recovery in 2014, as manifested the annualized year-on-year growth rate for each quarter, which were respectively 0.1%, 4.6%, 5% and 2.4%. The unemployment rate of this country dropped gradually from 6.6% at the beginning of the year to 5.6% in December, the lowest since the outbreak of the financial crisis. Given the improved data and mild inflation pressure, the Fed has reduced its debt purchase gradually by USD10 billion per month since 2014, and completely withdrawn QE in October, shifting the market focus to the expectation that the Fed may increase the interest rate sooner. This building up expectation would, on the one hand, reduce the demand for maintaining the value of gold as a non-interest bearing asset; on the other hand, it reflected the restriction of tightening US monetary policy on the gold price. The movement of the international gold price in 2014 basically mirrored the economic development and change of the monetary policy of the US.

Third, the movement of the US dollar played a vital role in affecting the gold price. The US dollar index has rocketed to break above 90 and reached a new high in eight and a half years since July 2014, and has increased by 12.6% across the year. The soaring index has suppressed the rising of the gold price, as gold is denominated in US dollar. Despite the correlation coefficient as high as -0.84 in 2014, the gold price and the US dollar may be positively correlated in the short term as they can be used for risk mitigation during market panics.

Figure 6.5 Comparison of US Dollar Index Movement with International Gold Price Movement in 2014



Note: The data for the US dollar is the daily closing price, and that for the international gold price is the London afternoon fix.
Sources: Reuters and LBMA.

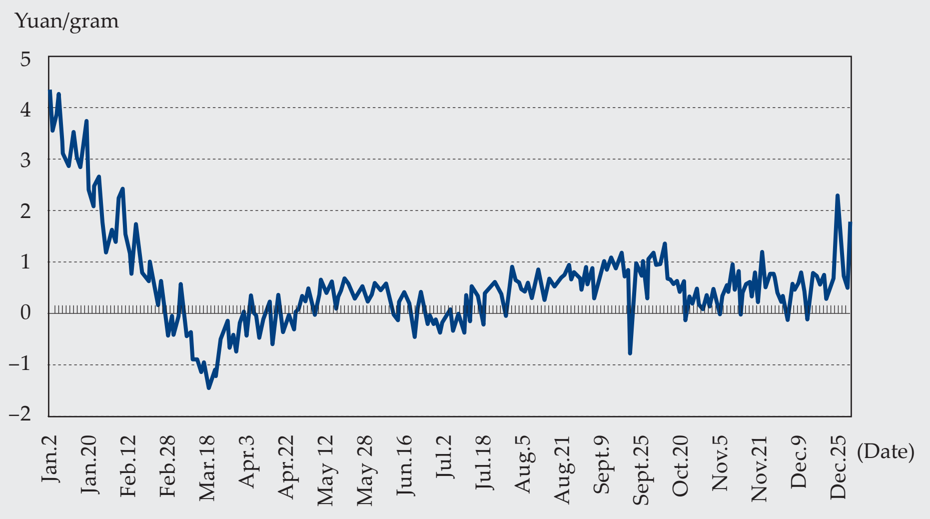
Fourth, the gold price was supported to some degree by the fundamentals of gold supply and demand. In terms of gold supply, USD1,100~1,200 per ounce is regarded as a threshold for gold production. If the price is lower than the threshold, some mining companies will be shut down, leading to gold supply reduction and the comeback of gold price. In addition, the drop of gold price was accompanied by significant decline of gold recovery in advanced countries. In 2014, the recycled gold across the globe was down to 1,121.7 tonnes, recording a new low in seven years. In terms of gold demand, the demand for physical gold in the Asian market remained strong. The year 2014 witnessed the year-on-year increase of 8% to 662.1 tonnes of demand for gold ornaments in India and gold demand in China as high as it was. As central banks kept reducing investment in US dollar-denominated assets and diversifying their asset reserve, gold reserve continued growing. As of the yearend of 2014, the global gold reserve totaled 32,000 tonnes, an increase of 0.58% over the beginning of the year. The gold price increase owed to all the abovementioned factors.

3. Features of gold market performance

3.1 With weaker fluctuations, the spread between domestic and international gold prices became reasonable

The year 2014 saw the international gold price move in a narrower range in general. The fluctuation (difference between the highest and the lowest prices) dropped by 51.57% over the previous year to USD243 per ounce, and the intraday volatility of domestic gold price decreased correspondingly. Among 245 trading days across the year, 153 days saw the intraday volatility of domestic gold spot price below 1%

Figure 6.6 Spread Between Domestic and International Gold Spot Prices in 2014



Source: SGE.

and 15 days saw that above 2% in, compared with 115 days and 24 days respectively in the same period of the previous year.

The spreads between domestic and foreign gold spot and between domestic and foreign gold futures were both narrowed. In particular, the average spread between SGE gold spot and the international gold price XAu declined by 77% from 3.23 yuan per gram to 0.74 yuan per gram, with the maximum being 4.37 yuan per gram which is lower than 10.23 yuan per gram, the peak in 2013. The average spread between SHFE gold futures and COMEX gold futures was down by 20.7% from 2.89 yuan per gram in 2013 to 2.29 yuan per gram in 2014.

3.2 The market kept growing in size but at a slower pace

The trading volume on major international gold markets shrank in general in 2014. In particular, the trading volume of gold spot at London Gold Market and US COMEX gold futures declined on a year-on-year basis by 21.08% and 14.36% respectively. Emerging gold markets in India, Japan, Turkey and other countries also underwent serious downturn. On the contrary, China's gold market maintained growing in size, but at an obviously slower pace due to subdued demand for gold trading. In 2014, the cumulative trading volume of deferred contract AU(T+D) on the SGE registered 8,665.02 tonnes, a year-on-year increase of 29.43%, much lower than the growth rate of 58.43% in 2013. The trading volume of gold futures on the SHFE increased by 18.81% over the previous year, a rate far below that in 2013, which was 234%.

3.3 Market participants became more diversified and membership structure was further optimized

The SGE welcomed 40 international members and 6 securities firms in 2014. By the end of 2014, besides the 40 international members, the SGE's domestic membership reached 173, including 27 financial institutions, 9 foreign-funded financial institutions, 129 in the comprehensive category, 2 involved in proprietary business and 6 special members. It has 8,358 institutional clients, up by 23.17% over the previous year, and 7,332,527 individual clients, increasing by 66.88% over the previous year. The trading volume of all institutions with the legal person status across the year grew by 62.43% to 15,900 tonnes, surging by 62.43% on a year-on-year basis and accounting for 86.23% of the total trading volume. If the 2 commercial banks beginning to get involved in gold futures business were counted, there have been 17 commercial banks involved in proprietary gold futures business on the SHFE by the yearend, which contributed 2% to the total gold trading volume of the SHFE. On the OTC gold market, there have been 233 banks with the legal person status that launched the gold business by the end of 2014.

3.4 With the acceleration of opening up, the gold market saw continuous improvement of its functions

First of all, the international board was launched. In September 2014, the Shanghai International Gold Exchange (SIGE) came into life in China (Shanghai) Pilot Free Trade Zone (Shanghai FTZ), where three international contracts iAu99.5, iAu99.99 and iAu110g were made available. These contracts were denominated in RMB and delivered in the Shanghai FTZ. In 2014, a total of 34 international members and 199 domestic members traded on the SIGE. Secondly, the number of gold exporter and importer further grew. To ensure adequate supply of physical gold at home, China Merchants Bank, Shanghai Pudong Development Bank and Standard Chartered Bank launched the gold export and import business in 2014. By the yearend, 15 banks were qualified to import and export gold, including 3 foreign-funded banks, namely, HSBC Bank Company Limited, Australia and New Zealand Bank Company Limited and Standard Chartered Bank. Third, examination and approval procedures for entry and exit of gold and gold products brought by individuals were canceled. Individuals were asked to report to the Customs if they brought gold and gold ornaments above 50g. This administrative examination and approval item was canceled by the State Council, which propelled further opening up of the gold market.

3.5 Gold market investor education was strengthened and investor protection made progress

To spread knowledge about gold investment and enhance awareness of risk prevention on the gold market, the People's Bank of China (hereinafter referred to as the PBC) launched publicity campaign across the country targeting at gold investors to protect their rights and interests and had made whooping progress. Among all efforts to let people better know investment in precious metals and legal investment channels, the SGE launched a non-profit campaign to publicize knowledge about gold investment, and organized an expert group to give about 30 lectures across the country for investors. Commercial banks also made efforts to advocate knowledge about gold investment and risks among clients of their gold business and other gold investors.

4. Gold market product innovation and infrastructure construction

4.1 Product innovation maintained momentum

4.1.1 Mini deferred gold contract was listed

To meet market demands, the SGE launched the mini deferred gold contract with the trading code mAu (T+D). Parties to the contract should pay margins with the minimum volume for delivery application being one lot which equals 100g. The product for delivery is Au99.99 standard gold bullion of 1kg and with the fineness no less than 99.99%. The year 2014 witnessed the monthly increase of the trading volume of mAu(T+D) which hit 543.32 tonnes for the whole year.

4.1.2 Au(T+N) was optimized

The SGE optimized the original Au (T+N1) and Au (T+N2) and officially provided them to the market in November 2014. Under the optimized Au (T+N) contract, the minimum trading volume is set at 100g at one lot, instead of 1,000g, and the compensation payment interval for deferred trading is extended to reduce the deferred trading fee. By lowering the access threshold to the market and the trading cost for investors, this product has enhanced the activity of the market. In 2014, the trading volume of Au (T+N) amounted to 671.85 tonnes.

4.2 Gold market infrastructure was further improved

4.2.1 The trial market making mechanism for interbank bilateral transaction was established

Upon the approval of the PBC, the SGE established the market making mechanism for the interbank bilateral transaction. A total of 21 commercial banks including the Bank of China and China Citic Bank applied to the SGE for being pilot market makers. Since the trial market making business was launched, relevant market makers have made active efforts to contribute to the increasing activity of trading and investment, and to remarkably improve market liquidity and overall stability of market operation.

4.2.2 The OTC market infrastructure construction was strengthened

The year 2014 saw many measures of the SGE for OTC market infrastructure construction. First, the SGE launched the gold leasing platform by releasing the *General Agreement of Shanghai Gold Exchange on Gold Leasing Business*, which provides the basic rights, duties and institutional arrangements for parties involved in gold leasing business in order to regularize the gold leasing market. Second, the interbank gold forward curve report platform was put online, the *Program of Shanghai Gold Exchange on Benchmark Pricing* was released, and Shanghai Gold Spot Benchmark Price was officially announced to the market. Third, cash spread delivery mechanism for gold bilateral transaction was established which can make the trading more efficient. To be specific, when the contract expired, parties to the bilateral transaction settled accounts as per the spread between price set in the contract and the spot price at the time of delivery.

4.2.3 The night trading was prolonged

The opening time of the night market was changed from 21:00 to 20:00 on September 8, 2014. By so doing, the major trading time on domestic and European and American gold market overlapped, which enhanced the interaction of domestic and foreign gold price and better meet trading demands.

5. Outlook for gold market development

Looking ahead, we should accelerate the construction of the gold bilateral transaction market, properly develop the gold derivatives market, regularize the gold leasing market, further open the gold market, and propel the building of multi-layer gold market system. Considering the development of the gold industry and market, the product system on the gold market should be improved to satisfy needs of relevant enterprises for financing and risk management and provide comprehensive financial service to the gold industry with constantly diversified gold trading products. More investors should be encouraged to get involved in the gold market, to enhance the scope and depth of the gold market. Besides, efforts should be made to enhance the infrastructure service and strengthen the hardware system construction of the gold market, improve the SGE's international board, establish and improve the central clearing system and the benchmark interest rate system for the gold market, and build consummate data statistical and releasing system. Finally, relevant authorities should further regulate the gold market, and reinforce routine regulation and supervision on gold business to practically safeguard the interest of investors.

Box 5 The Launch of the SGE's International Board

1. Significance of setting up an international board on the SGE

Given the importance of the gold market as a part of the financial market, the establishment of the SGE's international board (hereinafter referred to as the SGEI) represented a concrete step of opening China's gold market to the outside world. First, the SGEI helps form Shanghai Gold RMB-denominated gold pricing mechanism and physical delivery standard with international influence. By promoting the global spread and wide acceptance of SGE products, rules and standards, it can enhance the core competitiveness and international influence of the SGE. Second, it is conductive to improving the capacity and cohesiveness of China's gold market. The SGEI can improve China's financial market system, enhance the efficiency of the financial market, and better perform the gold market's function of price discovery. Third, it will contribute to the building of Shanghai into an international financial center by promoting the interconnected development of the Shanghai FTZ and Shanghai as an international financial center, facilitating effective integration of domestic and overseas market and funds, and enriching Shanghai's international financial center building. Fourth, it contributes to the implementation of the national strategy of "Individuals Owing Gold". The SGEI has turned "Shanghai Gold" into "gold of ordinary people", benefits more citizens, enhances the state's capability of gold reserve management, promotes the internationalization of the RMB and maintains national economic and financial security.

2. Products and systems

2.1 Products

Participants in the SGEI can trade through three gold spot contracts latest listed on the SGEI, namely iAu100, iAu99.99 and iAu99.5, and are entitled to trade through SGE gold contracts. Under the iAu100 contract, the trading unit is 100g per lot, and for delivery is 100g-gold-bullion with the fineness no less than 99.99%; under the iAu99.99 contract, the trading unit is 1kg per lot, and good bullions weighing 1kg each with fineness no less than 99.99% are delivered; and for iAu99.5, the trading unit is 12.5kg per lot, and good bullions with each being 12.5kg and the fineness no less than 99.5% are delivered.

2.2 Systems

Observing the principle of "two-way trading, closed fund operation, and compartmental physical delivery" to develop the SGEI, the SGE tries to make trading more convenient for international investors and takes effective measures at the same time to prevent shocks from the international market and isolate risks from the domestic market.

First, the categorized membership management system was established. On the basis of current membership, the SGE adopts strict and prudential market access system to increase the category of international members in a conditional and planned way, adjusts the membership structure, and gradually involves qualified international investors into the trading through international members.

Second, a closed clearing system was built. The SGE launched the SGEI trading center in China (Shanghai) Pilot Free Trade Zone to collectively manage the cross-border capital business. The subsidiary established a closed clearing system on the basis of the free trade account. Besides, by following the principle of "returning the fund to where it came from" in cross-border fund management, the subsidiary tried to prevent negative effects of the international market on the domestic market to ensure stable operation of the latter.

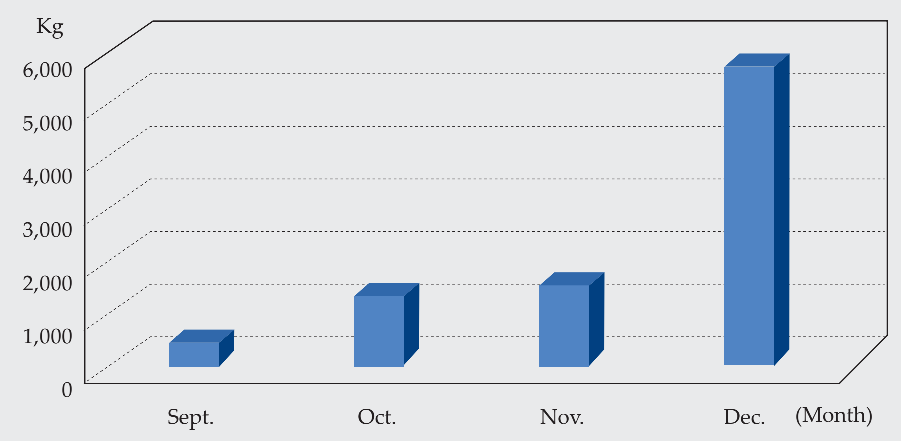
Third, delivery vaults were designated for the international board. Under the current institutional framework for gold import management, the SGE designated vaults in the free trade zone, to provide load-out/load-in, vaulting and delivery service to international investment institutions. Besides, it has formulated regulations according to the compartmental delivery principle, to restrict cross load-in and load-out.

Fourth, an international trading system featuring collective trusteeship was established. Integrating functions of SGE management, membership management and customer management, the system is directly connected to SGE's core system to provide such services as customer management, trading access and settlement to members.

3. SGEI's performance in 2014

Officially launched on September 18, 2014, the SGEI has been operating for 69 trading days in over three month by the end of 2014. It witnessed generally stable operation, gradual increase of the trading volume, high keenness of participation by members, smooth physical import, efficient

Figure 6.7 Daily Average Trading Volume on SGEI in 2014



Source: SGE.

and orderly capital settlement and cross-border transfer, and its market functions have been primarily felt.

3.1 Trading

In 2014, a total of 15 international member traded at the SGEI, mainly proprietary business; and 34 domestic members got involved in trading under contracts on the international board. The 69 trading days in 2014 on the international board saw the trading volume hit 190.55 tonnes with the accumulative value of 45.453 billion yuan. Among others, the accumulative trading volume under gold contracts reached 156.29 tonnes with the value of 37.247 billion yuan; and the trading volume of international members under the gold contracts on the main board amounted to 34.26 tonnes with the value of 8.206 billion yuan. The daily average trading volume has been steadily increasing from September (See Figure 6.7 below) to 5,749.39kg through December.

3.2 Membership

Among 40 international member first admitted to the SGEI are 24 foreign members and 16 domestic ones. Besides, over 20 overseas institutions are trying to apply for the SGEI membership.

3.3 Fund clearing

The SGE has approved 7 commercial banks including the Industrial and Commercial Bank of China as the designated settlement banks for the international board, and requires that fund clearing for the international board should follow the principle of isolated fund operation. On the international board, the net cleared fund hit 4.315 billion yuan in 2014, the fund clearing path of free trade account system was generally normal, and the fund clearing and cross-border transfer were efficient and convenient.

3.4 Physical delivery

In 2014, the SGE registered with the free trade zone to establish Shanghai International Gold Exchange Center Co., Ltd., set up kiloton-size vaults for the international board with the function of bonded gold delivery, to provide gold import and transit with a series of supporting services, such as delivery, warehousing and customs clearance. The international board smoothed the path of gold import, enhanced the efficiency of customs clearance and made load-in and load-out more convenient. By the end of 2014, a total of 15.95 tonnes of gold were cleared by the customs and deposited into designated vaults. Among them, 14.54 tonnes were imported gold.

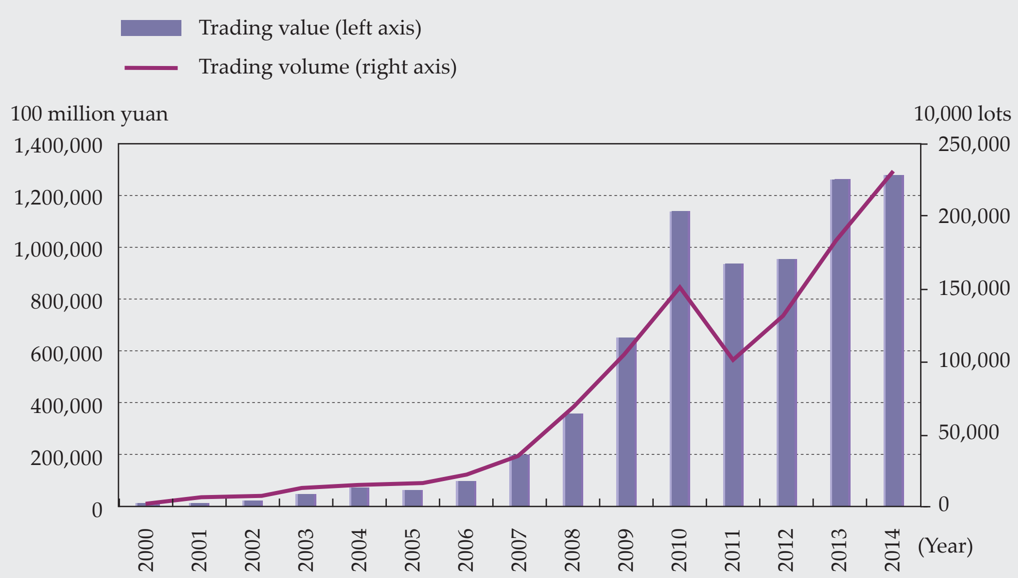
Part VII Futures Market

In 2014, in China's commodity futures market, innovative products were constantly launched, trading remained brisk, and the prices of most commodity futures kept going down. Besides, institutional investors participated more in the financial futures market so that the role of the market was further brought into play. Efforts were made to promote innovative development of futures institutions, and strengthen the formulation of regulations for futures companies in a bid to enhance their service capability and competitiveness. With the expansion of the pilot program of bonded futures delivery, the increase in the products for after-hours trading and the improvement of the margin system for futures trading, the futures market has become better able to perform price discovery and support the real economy.

1. Futures market performance

In 2014, the futures market (including commodity futures and financial futures) saw a record high in terms of the cumulative trading volume and value, which grew by 21.54% and 9.16% to 2.506 billion lots and 291.99 trillion yuan respectively on a year-on-year basis.

Figure 7.1 Trading Volume and Value of China's Commodity Futures, 2000—2014



Source: China Futures Association (CFA).

1.1 Commodity futures market performance

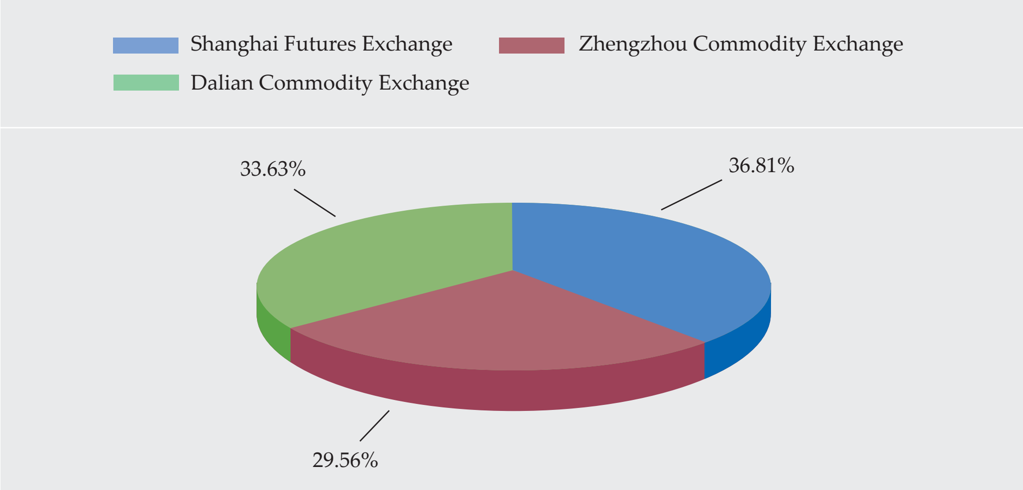
1.1.1 Commodity futures trading remained brisk

Commodity futures trading remained brisk in 2014. On a year-on-year basis, the cumulative trading volume for the full year increased by 22.21% to 2.283 billion lots, and the trading value edged up by 1.19% to 127.97 trillion yuan. Among others, the trading volume of aluminum, zinc, lead, CF, ME, yellow soybean (A), plywood, fiberboard, iron ore, egg saw particularly fast year-on-year increase.

At the exchange-specific level, the trading volume and value of Shanghai Futures Exchange (SHFE) saw year-on-year increase of 31.1% and 4.67% respectively to 842 million lots and 63.24 trillion yuan, accounting for 36.81% and 49.41% respectively of the total commodity futures market; for Zhengzhou Commodity Exchange (ZCE), the trading volume and value hit 676 million lots and 23.24 trillion yuan by growing by 28.76% and 22.98% respectively over the same period of the previous year, taking up 29.56% and 18.16% respectively of the domestic commodity futures market; and Dalian Commodity Exchange (DCE) saw its trading volume grow slightly by 9.87% to 770 million lots and the trading value go down by 12% to 41.49 trillion yuan, making up 33.63% and 32.43% respectively of the commodity futures market.

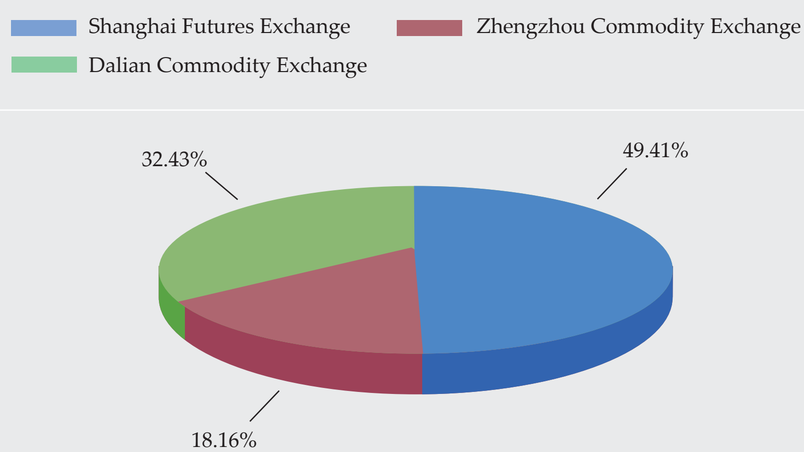
In terms of the trading volume, the top ten commodity futures product in 2014 include, in proper order, steel rebar, rape seed meal, soybean meal, silver, PTA, sugar, iron ore, natural rubber, palm oil and glass, of which the total trading volume hit 1,669 million lots, accounting for 72.95% of the total commodity futures trading volume, lower than 80.43% in 2013. In terms of the trading value, the top ten include successively copper, natural rubber, steel rebar, silver, rape seed meal, coke, soybean

Figure 7.2 Breakdown of the Trading Volume by Commodity Futures Exchange in 2014



Source: CFA.

Figure 7.3 Breakdown of the Trading Value by Commodity Futures Exchange in 2014



Source: CFA.

meal, iron ore, gold and silver, with the trading value totaling 91.38 trillion yuan, accounting for 71.41% of the total value and lower than 82.25% in 2013.

1.1.2 Prices of most products fluctuated downward

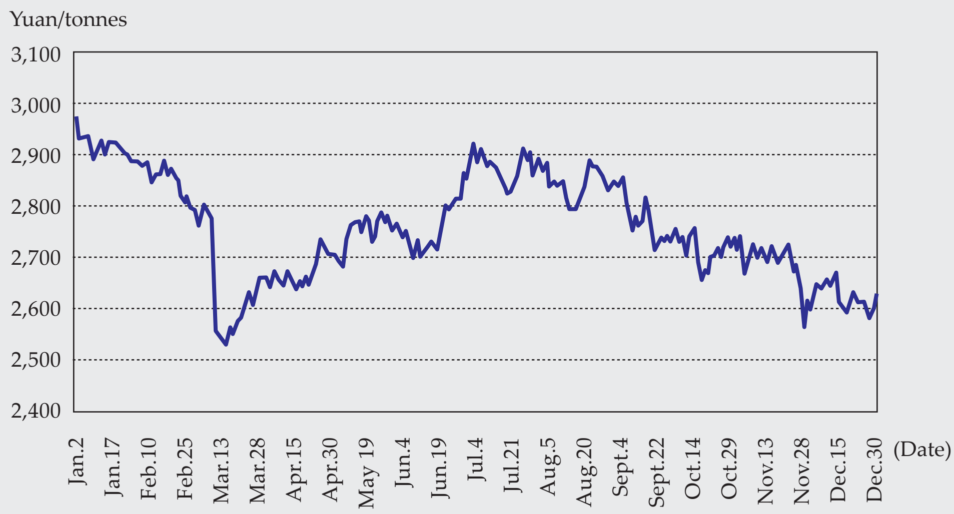
Many commodity futures of metals, energy and chemicals and agricultural products saw their price keep going down through fluctuations in 2014, as they did in 2013.

Precious metal was downside under the increasing pressure posed by recovery of the US economy and QE reduction by the Fed. Meanwhile, the precious metal price was pushed up by risk aversion as affected by geopolitical tension like the Ukraine crisis. Consequently, the gold price hit the rock bottom from January to November 2014, and bounced back to 241 yuan per gram in December, close to the level in October. The price movement of non-ferrous metals was largely restricted by overcapacity and insufficient demand, which was up in mid 2014 due to decline of the total stock compared to the beginning of the year. In general, the SHFE non-ferrous metals index plummeted by 11% altogether in 2014.

Among energy and chemical products, coke followed a significant downward trend due to high upstream coking coal price and the dampened demand of downstream iron and steel products; natural rubber futures plunged from around 18,000 yuan/ton at the beginning of the year to about 12,000 yuan/ton at the end of December, due to oversupply and high inventories.

The price inversion between imported and domestic agricultural products underlay the price decline of many agricultural products. In particular, since April 2014 when the temporary purchase and storage policy for cotton was replaced by the target price policy, cotton has been sold at a market price which kept going

Figure 7.4 SHFE Non-ferrous Metals Index Movement in 2014



Source: SHFE.

down due to price inversion. Sugar import remained high with the price inversion between domestic and foreign market. Products like soybean and soybean meal saw price decline due to sufficient supply and high inventories on the one hand and insufficient demand on the other hand.

1.2 Financial futures market performance

1.2.1 Stock index futures saw steady increase of the trading volume and significant open interest growth

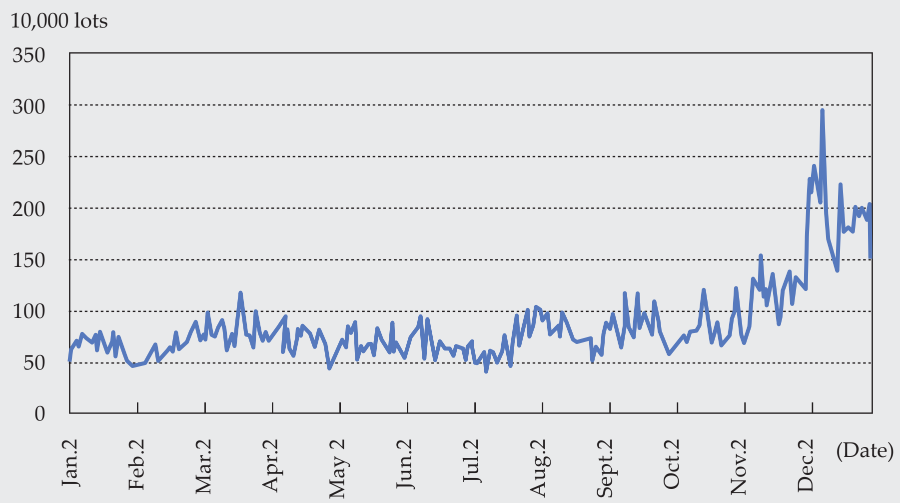
The stock index futures trading volume dropped first and then bounced back, with remarkable open interest growth. For the full year, the CSI 300 stock index futures saw the trading volume hit 217 million lots, the trading value amounted to 163.14 trillion yuan, daily average trading volume reached 887,700 lots and daily average open interest stood at 164,200 lots, respectively increasing by 12.13%, 15.95%, 9.34% and 54.31% on a year-on-year basis. The stock index futures' trading volume has significantly increased since November thanks to growingly brisker spot market. The daily average trading volume of stock index futures has been down by 10.98% over the same period of the previous year to 737,800 lots from January to October, and rocked by 113.95% to 1.5724 million lots on a year-on-year basis from November to December. The trading volume on December 9 hit a new record high at 2.93 million lots. All trading days with daily trading volume above 2 million lots were in December. Having been going up steadily through the year, the open interest saw even faster growth in November and December and made a new record at 249,600 lots on December 15.

As the business rules concerning trading margins, position limits, hedging and arbitrage for the CSI 300 stock index futures have been constantly optimized, the futures market has effectively performed its functions with further enhanced trading efficiency and quality. In 2014, the stock index futures maintained stable price, and the futures-spot spread was kept in a reasonable range with the correlation between futures and spot prices reaching as high as 99.91%. Through the year, 127 trading days saw positive basis (namely, the futures price was above the spot price), accounting for 52% of the total trading days, and those witnessing negative basis were mainly in the period from March to September when the stock index fell amid fluctuations. The stock index futures volatility decreased by 0.19 percentage points from 2013 to 1.21% in 2014, and the ratio between the trading volume and the open interest declined by 36.2% on a year-on-year basis to 5.4.

1.2.2 Treasury futures trading saw stable development and significant open interest growth

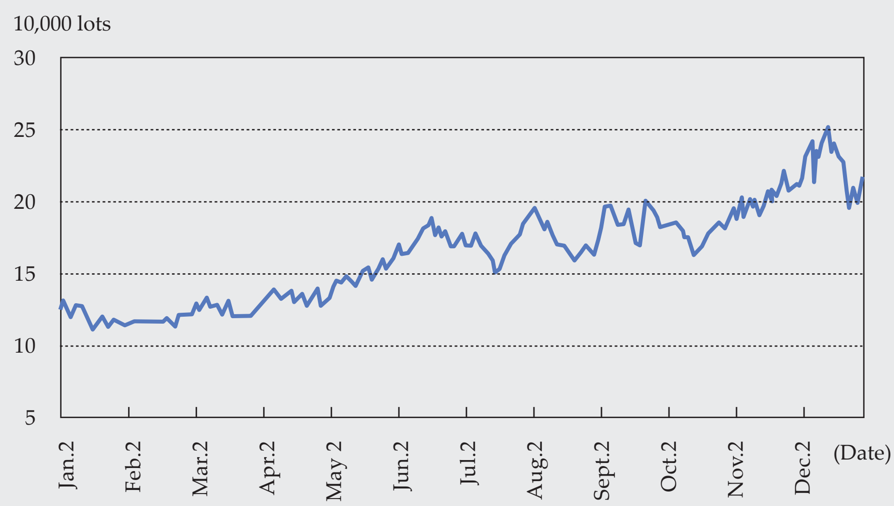
In 2014, both the trading volume and the open interest of the treasury futures have kept constant increase. As investors deepened their understanding and involvement in treasury futures and the trading cost gradually declined, the treasury futures market has remarkably expanded in size compared to its inception. The trading volume on this market hit 922,900 lots for the full year with the daily average being 3,767 lots, and the trading value reached 878.517 billion yuan with the daily average standing at 3.586 billion yuan. In December 2014, the daily trading volume and open interest of the treasury futures respectively amounted to 10,976 lots and 22,630 lots, 3.83 and 7.03 times that in the last December respectively. The average ratio between the trading volume and

Figure 7.5 Daily Trading Volume of the CSI 300 Stock Index Futures in 2014



Source: CFFEX.

Figure 7.6 Daily Open Interest of the CSI 300 Stock Index Futures in 2014



Source: CFFEX.

the open interest stood at 0.40 in 2014, close to that at mature markets, implying that investors kept sober-minded when getting involved.

Accompanied by steady growing size was higher liquidity at the treasury futures market. Between January and December, 2014, the average bid-ask spread on this market dropped from 0.0118 yuan to 0.0078 yuan at the lowest, and the bid-ask spread was 3.9 times the tick size at the lowest, instead of 5.8 times, indicating improved quoted depth.

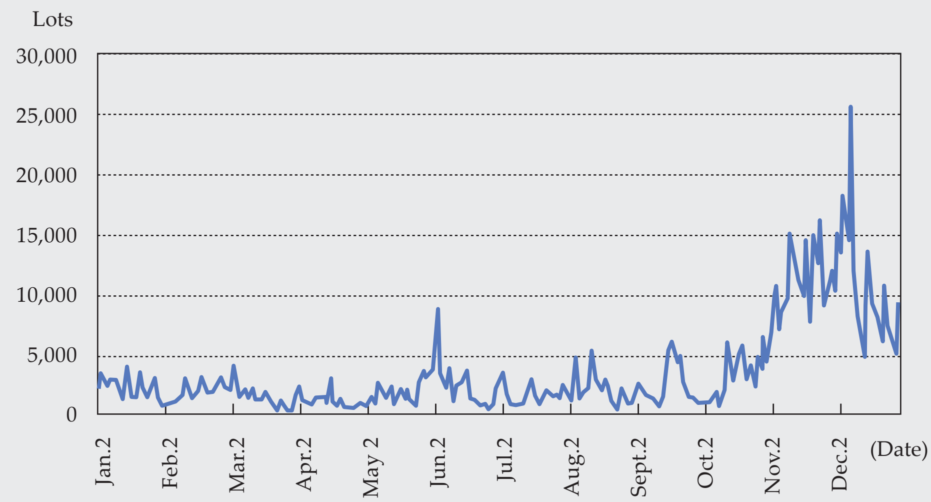
The five-year treasury futures provided financial institutions with more options for interest rate risk management, witnessed steady increase of the trading volume and open interest, and began to perform their market functions and exert influence. Meanwhile, their increasing liquidity has become a major tool of treasury price discovery, and made positive contribution to improving the treasury yield curve which can reflect the supply-demand relationship across the country.

2. Features of futures market performance

2.1 Commodity futures products increased steadily and the lines of products became more diversified

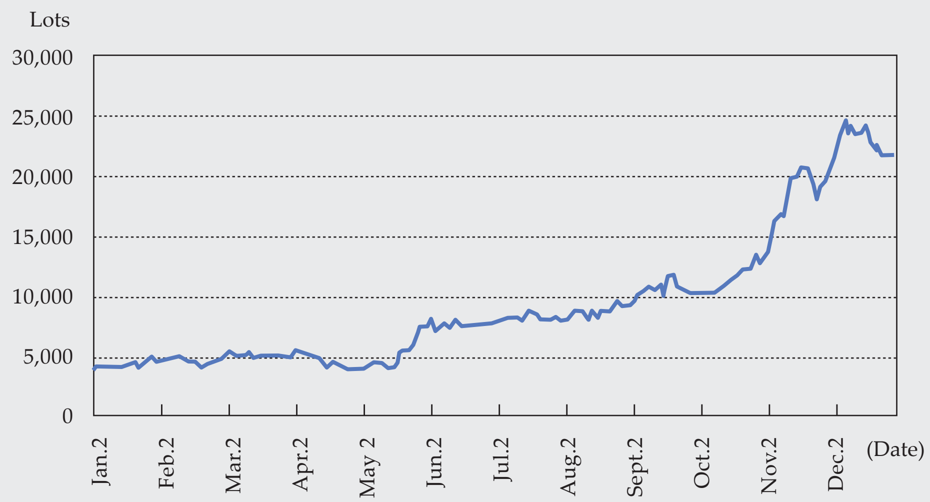
In 2014, five new contracts of commodity futures were launched on the domestic market, including polypropylene and corn starch contract launched by the DCE, hot-rolled coil contract by the SHFE, late indica rice and iron alloy (silicon iron and silicon manganese) by the ZCE. They have further enriched the sequence of chemicals, iron and steel and agricultural products, helped to improve the pricing mechanism of relevant

Figure 7.7 Daily Trading Volume of Five-Year Treasury Futures in 2014



Source: CFFEX.

Figure 7.8 Daily Open Interest of Five-Year Treasury Futures in 2014



Source: CFFEX.

products, gave play to the role of the futures market in guiding production and avoiding risks, and promoted sound and healthy development of relevant industries. As of the end of 2014, the aggregate trading volume under the five contracts hit 27.2897 million lots and the trading value totaled 1.29 trillion yuan.

2.2 Trading of crude oil futures was approved, ushering in a stage of internationalization for product innovation

The CSRC approved trading under crude oil futures contracts on Shanghai International Energy Exchange Corporation, a subsidiary of SHFE, on December 12, 2014. That was an important move to implement the guidelines proposed on the Third Plenary Session of the 18th CPC Central Committee and the *Several Opinions of the State Council on Further Promoting Sound Development of the Capital Market*. The development of the crude oil futures market is conducive to improving the domestic oil market system, helps establish the market-based crude oil pricing mechanism, maintains stable production and operation of the oil industry, and propels reform of the oil circulation system. Trading under crude oil futures contracts is an important attempt to open the domestic futures market. As the crude oil futures contract is the first of its kind, under which foreigners are permitted to trade, an international clearing platform will be established, to engage domestic and overseas traders and brokers and further open the domestic futures market.

2.3 Participation of financial futures institutions increased and the role of the market was further brought into play

On the stock index futures market, as investors were growingly aware of hedging, asset management companies issued more and more neutral products and institutions of different types accelerated their involvement in the market. At the end of 2014, the daily average open interest of special corporate client increased by 80.8% over the previous year to 60,000 lots. As the major player of long position hedging, asset management institutions represented by fund management companies and trust companies saw constantly increasing open interest which accounted for half of the total open interest of institutions. The ratio of blue chip held by 12 highly involved securities companies soared from less than 30% to 50%, which helped maintain stability of the stock market. Meanwhile, since trading under treasury futures contract started, institutional investors have been involved more in terms of scope and depth. In 2014, the daily average trading volume by corporate clients accounted for 28.72% of the total trading volume on the market, increasing by 14.07% over the previous year, and by the end of 2014, the open interest of corporate clients has reached 62.64% of the gross position, up by 24.47% over the end of 2013. Among the top ten clients with the highest position were eight corporate clients. Active involvement of institutional investors enhanced the liquidity on the treasury futures market. Compared with the secondary treasury spot market, the daily average trading volume of futures were over twice that of spot bonds of similar maturity, further bringing into play the price discovery function of futures.

3. Futures market institution building and infrastructure development

3.1 Measures were taken to promote the innovative development of futures institutions

On September 16, 2014, the CSRC released the *Opinions on Further Promoting Innovative Development of Futures Institutions* (hereinafter referred to as the *Opinions*), providing general principles and specific measures to promote creative development of institutions concerned in a period to come. According to the *Opinions*, actions should be taken in the following eight aspects. First, the capability of serving the real economy should be improved; second, the competitive edge of futures institutions should be enhanced; third, restrictions on the market access can be properly relaxed; fourth, a professional group of dealers should be fostered through efforts to establish the dealer system; fifth, futures institutions should be opened to the outside world in a stepwise way; sixth, OTC derivatives should be gradually developed; seventh, investors should be better protected; and eighth, risk prevention should be reinforced. On August 26, the CFA released the *Guidelines for Carrying Out the Pilot Program of Futures Companies Setting Up Subsidiaries Mainly Engaged in the Provision of Risk Management Services (Revised)*, which clearly provided that the pilot programs should be implemented in a market-based, stepwise and stable way and be regularized through self-supervision by the CFA. On December 4, the CFA issued the *Regulations for Futures Companies' Asset Management Business (Trial)*, expressly stipulating that futures companies and their subsidiaries can provide asset management service to a single client or to two or more special clients. On December 15, the CFA, the Asset Management Association of China and China Futures Margin Monitoring Center jointly issued supportive rules, including the *Specification on Documents Needed for Asset Management Business Application by Futures Companies*, the *Notice on Filing on Asset Management Programs of Futures Companies* and the *Circular on Revising the Instructions on Unified Account Opening for Asset Management Service of Futures Companies and Facilitating Asset Management Account Opening*.

3.2 Supervision of futures companies was reinforced and improved

The *Regulations on Supervising Futures Companies* (hereinafter referred to as the *Regulations*) released by the CSRC on October 29, 2014 was an important move to answer the State Council's advocacy of streamlining administration and decentralizing power, implement the guideline of regulation pattern transformation, enhance the ex post and during-trading supervision over futures companies and enhance such companies' capability of providing service and international competitiveness. The *Regulations* mainly consisted of the following parts. First, it canceled some items for administrative approval and delegated them to lower-level authorities; besides, it clearly proposed requirements for filing shareholding change issues to be administratively approved and some other items that should not be approved anymore. Second, it lowered the access threshold and relaxed restrictions on the qualification of shareholders in futures companies by including organizations and natural persons, instead of only Chinese corporations. It clarified requirements for qualification of natural-person shareholders and relaxed those for non-natural-person shareholders. Third, it specified the business scope of futures companies by categorizing it into business immediately launched upon the inception of the company; business to be verified, business that should be put on record and business that can be started upon approval, leaving room for future license management and mixed operation. Fourth, it expressly required futures companies to diversify their business, isolate risks and prevent conflict of interest; and adjusted requirements for setting of business departments and posts. Fifth, it improved the regulation and supervision system, and stressed on protection of investors' legal rights and interests. Sixth, it highlighted futures companies' responsibility for information disclosure. Seventh, it improved supervision measures and legal duties of futures companies. Eighth, it made institutional arrangements under which overseas dealers can get involved in trading under special futures contracts. For example, it relaxed restrictions on futures account opening, to remove barriers for engaging overseas customers to invest in crude oil futures. Ninth, it provided clear rules, according to which futures companies can introduce overseas shareholders and set up overseas institutions.

3.3 Pilot program of bonded futures delivery was expanded

Following the pilot program of copper and aluminum bonded delivery at the SHFE launched in December 2010, DCE officially started its futures bonded delivery pilot program on April 18, 2014. As per the DCE's *Notice on Launching Pilot Program of Bonded Futures Delivery* and the *Notice on Releasing and Implementing the Detailed Rules of Dalian Commodity Exchange on the Implementation of Bonded Delivery (Trial)*, the pilot program dealt with linear low density polyethylene (LLDPE) in Tianjin Dongjiang Bonded Port Area, and designated Xiamen Superchain Logistics Development Co., Ltd. as the bonded delivery warehouse which accepted and processed application for standard bond notes as of May 19, 2014. As an important start for internationalization of domestic futures market, bonded delivery has encouraged more industrial customers and international investors to get involved in trading and delivery and effectively enhance influence on the market and accelerate internationalization of the futures market.

3.4 Futures contracts for after-hours trading increased

To accelerate the innovation of the futures market, enhance its capability of serving customers and give play to the role of the market, the SHFE took the lead to launch the pilot program of after-hours trading under gold and silver futures contracts in July 2013, and included copper, aluminum, lead and zinc into futures contracts for after-hours trading on December 10. Even more futures contracts for after-hours trading were launched in 2014. Continuous trading were under palm oil and coke futures contracts at the DCE on July 4 and under sugar, cotton, reap seed meal, methanol and PTA futures contracts on ZCE on December 12. In addition, after-hours trading was extended to steel rebar, hot-rolled coil, natural rubber and bitumen on the SHFE and to soybean meal, soybean oil, yellow soybean (A), yellow soybean (B), coking coal and iron on the night market of DCE on

December 26. By the end of 2014, after-hours trading under a total of 23 futures contracts has been permitted at three commodity futures exchanges, indicating much elevated market activity. For example, the after-hours trading volume under gold, silver, copper, aluminum, lead and zinc futures contracts on the SHFE accounted by 54.2% of the total trading volume. Among others, the proportion of silver futures reached the highest 65%, and that of gold futures also hit 62%. The after-hours price gap was significantly narrowed as manifested by year-on-year decrease by 50% for daily average price for gold futures and 60.75% for silver futures. Relevant futures contracts have been exerting growing influence. Chinese prices for precious metal futures are being set now, as the trading volume of gold futures on the SHFE topped in the world, and that of silver futures ranked second in the world and first in the Asia-Pacific region.

3.5 The margin system for futures trading was improved

To reduce the trading cost, the SHFE, CFFEX and other institutions launched the one-way large-side margin system. Under this system, positions held by an investor on the same product are treated as a portfolio. When the same customer holds two-sided positions on the same product through the same member company, margins will be charged only with respect to the side of the positions held in larger amount. By so doing, fund efficiency can be enhanced under the condition of risk control. Besides, to prevent delivery risks, the special regulation for the delivery month shall remain applicable; to be specific, margins shall be charged for both trade-in and trade-off in last five trading days before delivery. The one-way large-side margin system conforms to the portfolio-based calculation of margins by overseas exchanges, and can maximally enhance the fund efficiency of traders while effectively controlling risks. Its positive effects have been shown on reducing trading cost and encourage calendar spread arbitrage as well as in other aspects. Take the CFFEX for example, the daily average margin reduced for the CSI 300 stock index futures and five-year treasury bond futures gradually increased from 900 million yuan and 9 million yuan to 2.1 billion yuan and 13 million yuan respectively since October 27. In terms of calendar spread arbitrage trading, customers holding two-sided positions under the two aforementioned futures contracts increased from 1,500 and 60 to 2,500 and 80 respectively; and their open interest grew from 43,000 lots and 3,000 lots to 830,000 lots and 5,000 lots respectively.

4. Outlook for futures market development

In 2015, new products and tools, such as crude oil futures, SSEC 50ETF and ten-year treasury bonds, will be gradually launched, commodity options, stock index futures and stock index options as well as other categories will be enriched step by step, and financial derivative products will be developed in an orderly way to promote the prosperity of the OTC directive market. Efforts will be made to improve the pricing mechanism of commodity futures and financial futures, encourage futures institutions to innovate their service and products, better support the real economy to manage risks, and enable the futures market to play a better role. In addition, the state will involve more institutional investors to trade under futures contracts, support private futures funds, and help public funds, segregated accounts, securities and insurance companies to invest in exchange-traded and OTC derivatives through asset management programs according to the law. We also should strengthen market infrastructure construction by implementing the *Principles for Financial Market Infrastructures* (PFMI) jointly released by relevant international organizations, employ more market-based and reasonable tools for risk management and improve the clearing system for the securities and futures market. By constantly reinforcing efforts on making the *Law of Futures* and integrating rules on futures market into a system, we should provide sound legal protection to ensure sound market development. Finally, new progress will be made in steadily opening the futures market to the outside world, to support the strategy of opening the capital market in two ways and developing China (Shanghai) Pilot Free Trade Zone.

Box 6 The CFFEX Accepts Treasury Bonds as Magins for Treasury Futures Trading

On December 26, 2014, the CFFEX released and started to implement the revised Detailed Clearing Rules of the China Financial Futures Exchange (hereinafter referred to as the Detailed Clearing Rules), and announced to kick-start the pilot program of accepting treasury bonds as margins for treasury futures as of January 1, 2015.

1. Introduction

In order to enhance the assets efficiency, reduce transaction cost and improve market efficiency, the CFFEX accepted treasury bonds as futures margins. As per the Regulations on the Administration of Futures Trading, the exchange accepts funds or marketable securities with stable value and strong liquidity, such as standard warehouse receipts and treasury bonds, deposited as required by futures traders. Featuring stable and transparent value, treasury bonds are highly measurable and easy to circulate; therefore, it is a common practice to deposit treasury bonds as futures margins on the international market. Since standard warehouse receipts have been accepted at home as margins for relevant commodity futures, it is the time to use treasury bonds as margins for treasury futures, which conforms to the legal system concerning the domestic futures market.

The business mode for using treasury bonds as margins is the core problem to be solved. At present, as per the Property Law of the People's Republic of China, and the Guaranty Law of the People's Republic of China and other relevant laws and under the multi-layer clearing system for domestic futures market, pilot programs launched in a stepwise way are a proper way to start the business. As per instructions of the CFFEX and China Central Depository & Clearing Co., Ltd. to get involved into this business, customers shall open a custody account in his own name and deposit treasury bonds as margins to the special account opened at the custodian institution by the CFFEX and its members. Margins should be deposited in a stepwise and level-by-level way and withdrawn by "following the original path", and interests of such margins, if incurred, should be owned by and transferred directly to customers by *the custodian institution. Margins should be withdrawn or pledge be discharged by the exchange members before the maturity date of treasury bonds. In the case of default, the bonds should be transferred to the custody account of and disposed by the entitled, and all funds from the disposal should be used to pay for margins of the breaching party. Despite no tax to be paid, depositing treasury bonds as futures margins incur cost of the futures exchange and the custodian institution which should exchange data through the business system.*

2. Risk control system

Considering risks of marketable securities price volatility, liquidity and default, etc. in futures trading with marketable securities as margins, both domestic and overseas exchanges involved in such business have established the strict risk control system. For the sake of constant and sound development of the futures market, China also should establish a complete risk system prescribing the scope the acceptable marketable securities, mark-to-market valuation, discount rate, cash balance and floor limit, to maintain stable operation of futures trading with treasury bonds as margins. As per the system by the CFFEX, first, the CFFEX accepts on-shore book-entry treasury bonds issued by the Ministry of Finance of the People's Republic of China; second, the CFFEX shall determine the benchmark value of the treasury bonds on each trading day according to the lower of estimates provided by two custodian institutions, to prevent risk accumulation; third, to avert price volatility, the treasury bonds as trading margins shall be equal or less than the benchmark value of the bonds; fourth, a proper cash ratio is set and treasury bonds as margins shall be less than four times the monetary funds; and fifth, with reference on the suitability system for financial futures investors, the face value of treasury bonds deposited by investors each time should be equal to or less than 1 million yuan.

In practice, treasury bonds as margins will not exert negative impact on the current market. As reflected by the business size of futures trading with warehouse receipts as margins on domestic commodity exchanges and trading on futures exchanges in Taiwan and Hong Kong, the value of warehouse receipts as margins is less than 5% of the sum of all margins, and this proportion of bonds deposited as margins on Taiwan and Hong Kong futures exchange is also below 5%. At the end of 2014, the average trading margins on the CFFEX amounted to about 40 billion yuan. If 5% of them took the form of treasury bonds, the total would be 2 billion yuan. The figure might be even smaller, since investment in this regard grows from a low level. Given that, treasury-bond-margins will not significantly shock the current market.

3. Significance

As showed by successful experience on overseas markets, treasury-bond-margins enable the futures market to perform much better function of price discovery and risk management. On the one hand, they can enhance investors' asset efficiency, reduce futures trading cost, enhance liquidity on the futures market, and promote performance of the price discovery function; on the other hand, they enable more convenient and efficient asset risk management by investors and better hedging. Witnessing a good development momentum and *constantly improving quality and efficiency of performance in recent years, the domestic futures market is undergoing critical transition from quantity increase to quality enhancement. Depositing treasury bonds as futures trading margins now is conducive to further improving the performance and competiveness of domestic futures market and promoting its reform, innovation and development. Also by so doing, treasury bonds can be used for more purposes, treasury bond stock can be bought back to active use, the secondary market of treasury bonds will see more liquidity, and the treasury bond yield curve will better reflect the supply-demand relationship.*

Part VIII Financial Derivatives Market

In 2014, China's financial derivatives market continued to grow in scale, and market transactions remained brisk. The notional principal of RMB interest rate swap hit all-time high, the trend of short term trading became more intensified, and market innovation continued to deepen; the trading volume of exchange rate derivatives exceeded spot trading for the first time, option market transaction grew significantly, and exchange rate risk management tools became diversified. Credit derivatives market gradually recovered. The trading volume of foreign currency pair derivatives dropped markedly.

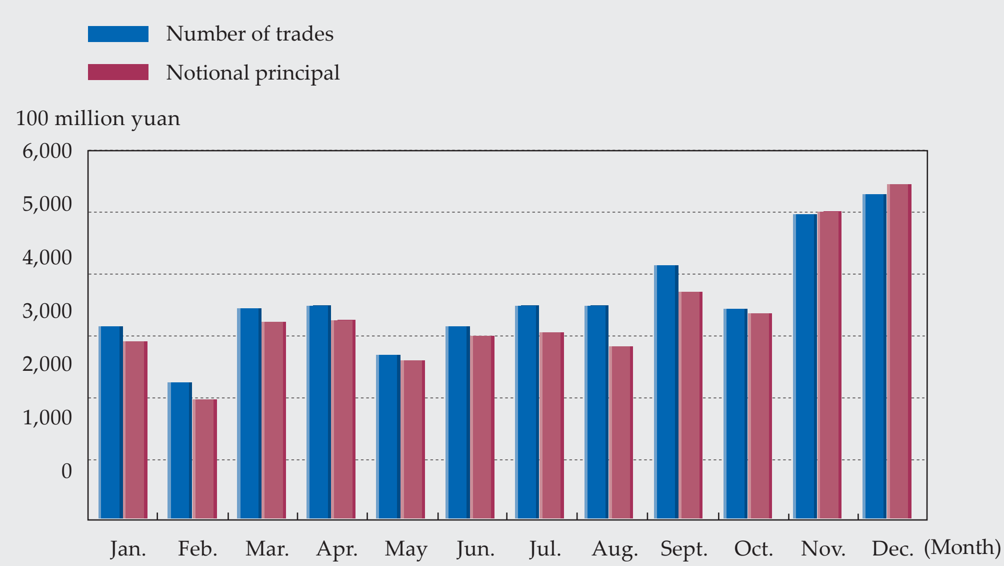
1. RMB interest rate derivatives market

1.1 Performance of RMB interest rate derivatives

In 2014, the trading of interbank RMB interest rate derivatives amounted to 4.03 trillion yuan, up 48% year-on-year. In particular, all deals were transacted in interest rate swap, and there was no trading for bond forward and forward interest rate.

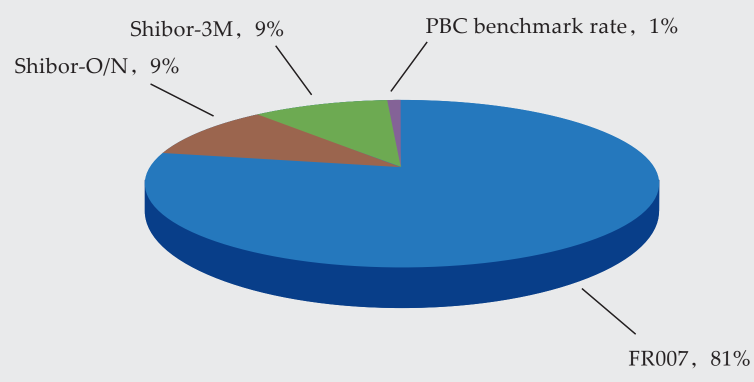
By end 2014, notional principal of uncovered interest rate swaps registered 3.8 trillion yuan (one side), an increase of 1.3 trillion yuan over the previous month. As for monthly

Figure 8.1 Monthly Turnover of Interest Rate Swaps in 2014



Source: China Foreign Exchange Trade System.

Figure 8.2 Shares of Reference Rates for the Floating Rate Side of Interest Rate Swaps in 2014



Source: China Foreign Exchange Trade System.

distribution, September and November witnessed higher monthly increase, up 31% and 51% respectively over the previous month. Transaction in December continued to grow, totaling 546.5 billion yuan, the highest monthly trading volume in history.

As for term structure, short-term transaction dominated interest rate swap. Notional principal of products with maturity of or below 1 year totaled 3.2 trillion yuan, 78.9% of total transaction, or 3.3% higher year-on-year. The proportion of products with maturity between 1-5 years and 5-10 years was 11.2% and 9.9% respectively. As for reference rates, floating reference rates mainly included FR007 (7-day fixed repo rate), 81.1% of total transaction, overnight and 3-month Shibor, 18.2%, and PBC benchmark rate, 0.7%. Compared with 2013, Swaps referred to FR007 as the floating rate grew significantly, with products linked to Shibor or PBC benchmark rates dropped further. As for the share of market participants, foreign banks took the lion's share, 48.5% of total trading volume, followed by domestic shareholding commercial banks, city commercial banks, large commercial banks, securities companies and policy banks, 26.7%, 7.2%, 6.1%, 5.1% and 5% respectively.

By end-2014, the number of institutions that have been filed for trading reached 118, 11 over that at end-2013, covering banking financial institutions, securities companies, insurance institutions and other types of institutions. A total of 90 institutions signed Function Use Commitment Letter, 13 more than that at end-2013. For the forward rate agreements (FRAs) market, 57 institutions has completed institutional filing, dominated by banking institutions and securities firms.

1.2 Features of RMB interest rate derivatives market performance

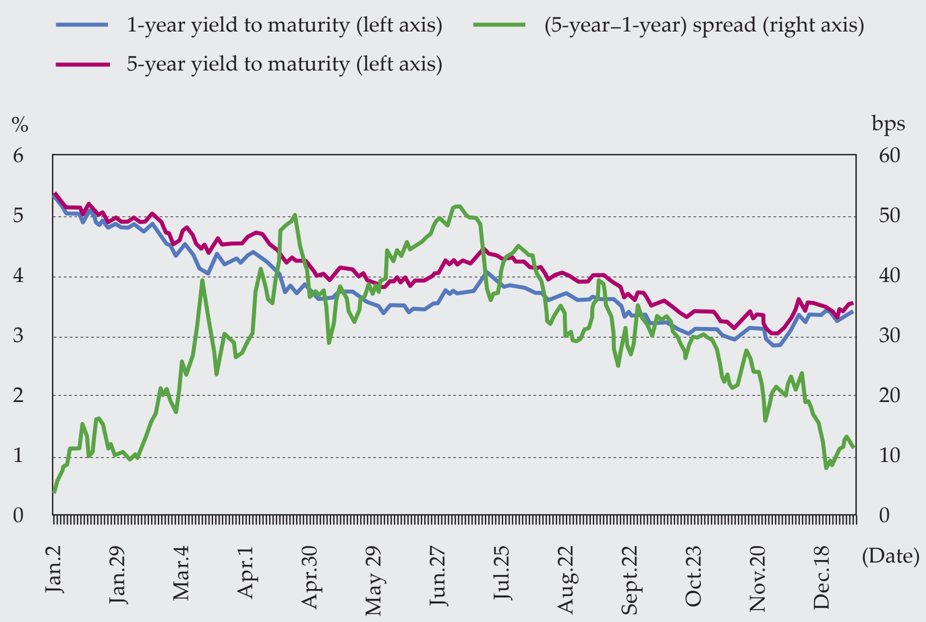
1.2.1 Trading of RMB interest rate swaps recovered

In 2014, the notional principal of RMB interest rate swaps exceeded 4 trillion yuan, standing at 4,034.7 billion yuan, an increase of 1,306.9 billion yuan or 48% over 2013. Since the launch of RMB interest rate swaps in 2006, transaction volume increased rapidly, and notional principal grew from 35.57 billion yuan to 4,034.7 billion yuan, with compound annual growth rate of 81%.

1.2.2 RMB interest rate swaps curve moved downward significantly

Affected by factors like relatively abundant inter-bank liquidity, obvious downward movement of interest rate parity on the money market, and money easing expectation, interest rate swaps moved downward amid fluctuation. The decline of short-term rates was relatively fast, spread of major products narrowed after expanded first. Take FR007-IRS for example. It made up the largest share of swaps transaction. The 1-year rate moved within 4%–5% before April, it then gradually dropped to 3%–4%. In mid-November, the rate dropped further to less than 3%, and at year-end, it moved up to more than 3% as liquidity condition was tight. The spread between 5-year and 1-year rate gradually expanded from 4 basis points at the beginning of this year to the peak of 50 basis points in July, and then narrowed, standing at about 12 basis points at end-December. Generally speaking, the movement of swap curve at year-end was sharper than that at the year's beginning.

Figure 8.3 The Movement and Spread of the Fixed End of 1-year and 5-year FR007-IRS in 2014



Source: China Foreign Exchange Trade System.

1.2.3 Centralized clearing continued to grow

On July 1, with the aim to implement the requirement by the PBC on the centralized clearing of RMB interest rate swaps and to improve centralized management of market risks, Shanghai Clearing House launched agency clearing of RMB interest rate swaps. A total of 24,507 transactions have been concluded on centralized clearing in 2014, with notional principal of 2,304.977 billion yuan. In particular, transactions concluded in the second half of 2014 totaled 2,280.457 billion yuan, accounting for 98.94% of the total. Trading cleared on the centralized basis made up 57% of the total transaction. The second half of 2014 witnessed the gradually monthly increase of daily average, with daily centralized clearing averaged at 24.23 billion yuan in December.

1.2.4 Market innovation continued to deepen

After the global financial crisis, international supervisory authorities appealed for OTC market reform to improve transparency and mitigate systemic risks. A series of consensuses have been reached in standardization measures, electronic trading, the set-up of reporting database, and centralized clearing. In 2014, China has made great headway in electronic trading, standardization of electronic product and compulsory centralized clearing. First, the matchmaking platform, X-swap, was launched based on bilateral credit grant. This is another institutional innovation following the confirmation of electronic trading of derivatives, trading sterilization and interest compute. By end-2014, 51 main financial institutions have participated in trading on the X-swap platform. The number of transactions totaled 5,939, with notional principal of 409.04 billion yuan, accounting for 15.2% of the total in terms of transaction number. Second, standardized interest rate swaps derivatives were launched. This kind of products made standardized description on the due date and maturity etc. for derivatives such as interest rate swaps and forwards. They complemented and made improvement of current interest rate swap products, providing more convenient instruments for risk management. Since the launch of standardized interest rate derivatives, market participants have been actively involved in trading. In 2014, 211 transactions of this type have been concluded, totaling 41.3 billion yuan.

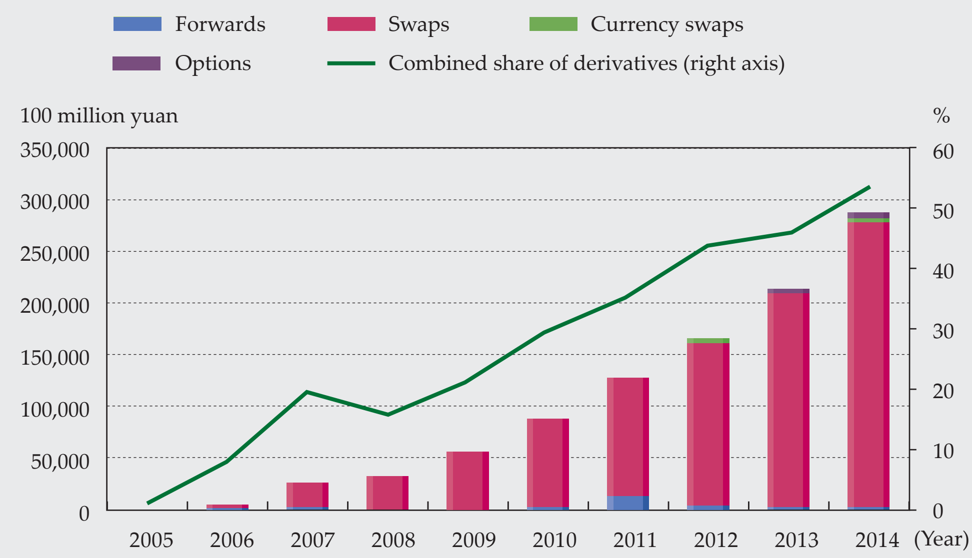
2. RMB exchange rate derivatives market

2.1 Performance of RMB exchange rate derivatives

In 2014, the turnover of RMB exchange rate derivatives market reached 28.9 trillion yuan, up 36% over last year, an acceleration of 7.2 percentage points. In particular, RMB/FX swaps registered a turnover of 27.7 trillion yuan, up 32.5% year-on-year; RMB/FX options reached 802.01 billion yuan, up 501.8% year-on-year; RMB/FX forwards recorded a turnover of 327.44 billion yuan, up 64.7% year-on-year; RMB/FX currency swaps reported a turnover of 61.99 billion yuan, 314.8% higher than that of last year.

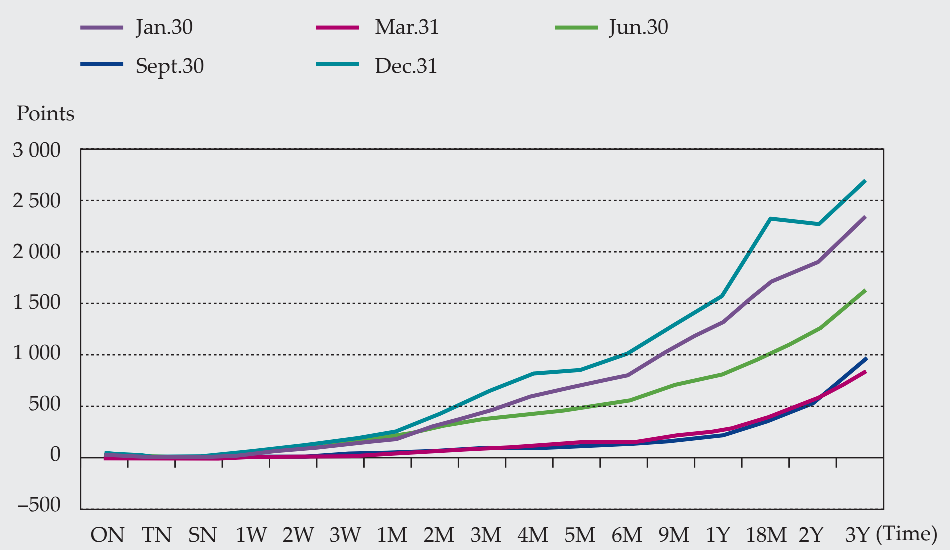
In 2014, as RMB/USD spot rate weakened slightly, foreign exchange swaps rose continuously. In January, the 1-year RMB/USD swap rate quoted above 200 points, it then grew to above 800 points in June. In December, it rose further to more than 1,500 points. Short-term swap rate also rose from

Figure 8.4 Turnover of RMB Exchange Rate Derivatives



Source: China Foreign Exchange Trade System.

Figure 8.5 Curves of RMB/USD Swap Rates in 2014



Source: China Foreign Exchange Trade System.

about 30 points at the beginning of the year to about 200 points at year-end. The 3-month, 6-month, 2-year, and 3-year swap rate also rose significantly. The whole swap rates curve went up markedly.

The fluctuation of options at different maturity all went up by more than 1.5%. 1-week to 1-year options fluctuated from 1.26%-1.74% at the beginning of this year to 2.76%-4.27% at the end of the year.

2.2 Features of RMB exchange rate derivatives market performance

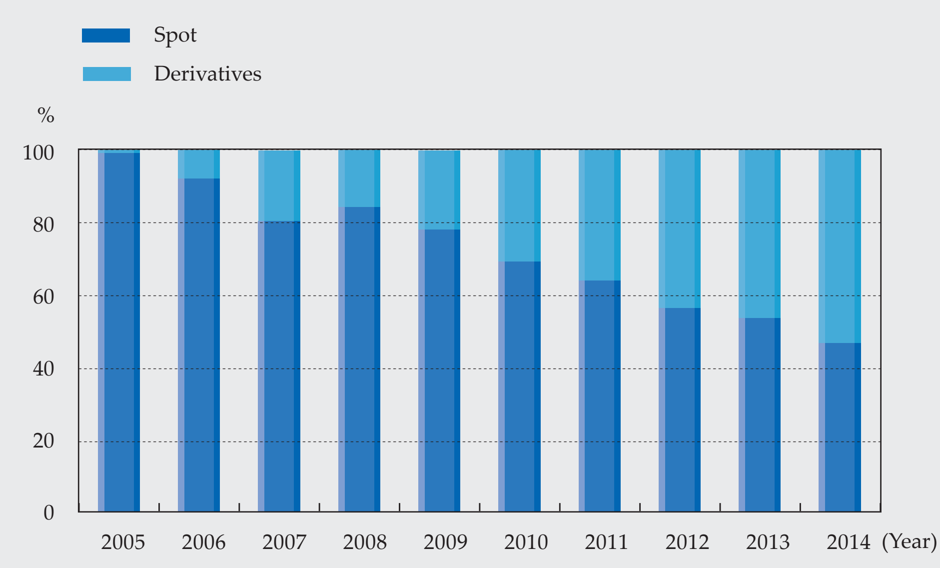
2.2.1 Exchange rate derivatives transactions exceeded spot trading for the first time

In 2014, the share of RMB/FX derivatives transactions in RMB/ FX market increased further, growing from 8% in 2006, 45.9% in 2013 to 53.2% in 2014. The trading of exchange rate derivatives accounted for more than 50% for the first time, which is very close to the feature of international foreign exchange market. In 2013, statistics from BIS indicated that for global FX market, ratio of derivatives trading to spot trading was 1:0.6, while for China's interbank foreign exchange market, the ratio was 1:0.9. Exchange rate derivatives transactions exceeded spot trading for the first time.

2.2.2 Option market transaction went up remarkably

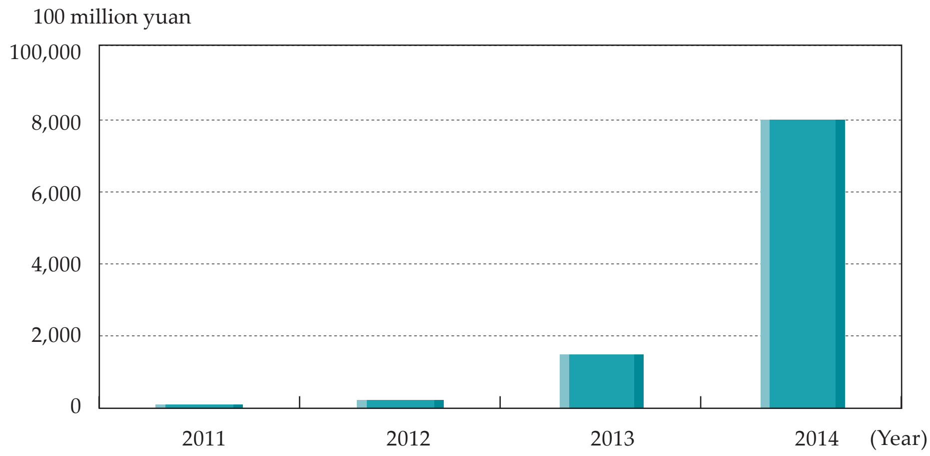
Since 2014, spot exchange rates fluctuated in two opposite directions, and exchange rates expectations became divergent. In August, when administrative authorities relaxed the management over the purchase& sale on the retail market as well was option portfolio, foreign exchange options trading increased rapidly. Option trading in each month of the

Figure 8.6 Trading of Spot and Derivatives on the National Interbank Forex Market



Source: China Foreign Exchange Trade System.

Figure 8.7 Growth of RMB Exchange Rate Option Market



Source: China Foreign Exchange Trade System.

fourth quarter all exceeded 1,000 in number and 100 billion in value. Option reached 802.01 billion yuan this year; 720.59 billion yuan of that for the second half of this year. The number of market participants involved in real trading increased from 24 in 2013 to 30 in 2014. In terms of option type, the proportion of call and put options was basically the same.

2.2.3 The implied depreciation rate widened on the derivatives market

With reference to offshore and onshore spot exchange rates, the depreciation rates implied in 1-year RMB/USD forwards and NDF rate were analyzed. Since March 2014, with the obvious weakening of spot exchange rate, the depreciation rate implied in the price of derivatives continued to widen from 0-1% to the year-end 1.9%-2.6%, an increase of 0.9-1.6 percentage points over the previous year.

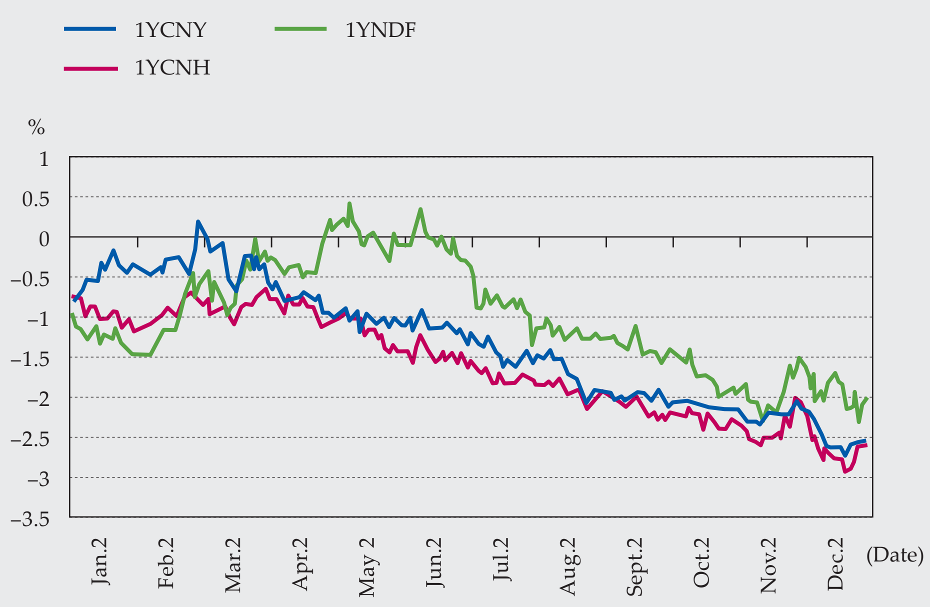
2.2.4 The implied interest rate of US dollar continued to decline

On the basis of RMB/USD swap price and with reference to the spot quote and RMB Fr 007 interest rate, the implied interest rate of US dollar on the offshore market continued to decline. 1-week to 1-year interest rates declined form 3.6%-4.5% at the beginning of this year to year-end range of −1.4%-0.7%. The decline of USD interest rates for various maturities were 4%-6%. The decline of USD interest rate conformed to both the overall downward movement of domestic interest rate, and the slightly exchange rate weakening of derivatives. This also fitted the feature that US dollar lending rate dropped through money broker channels.

2.2.5 The clearing of foreign exchange derivatives grew significantly

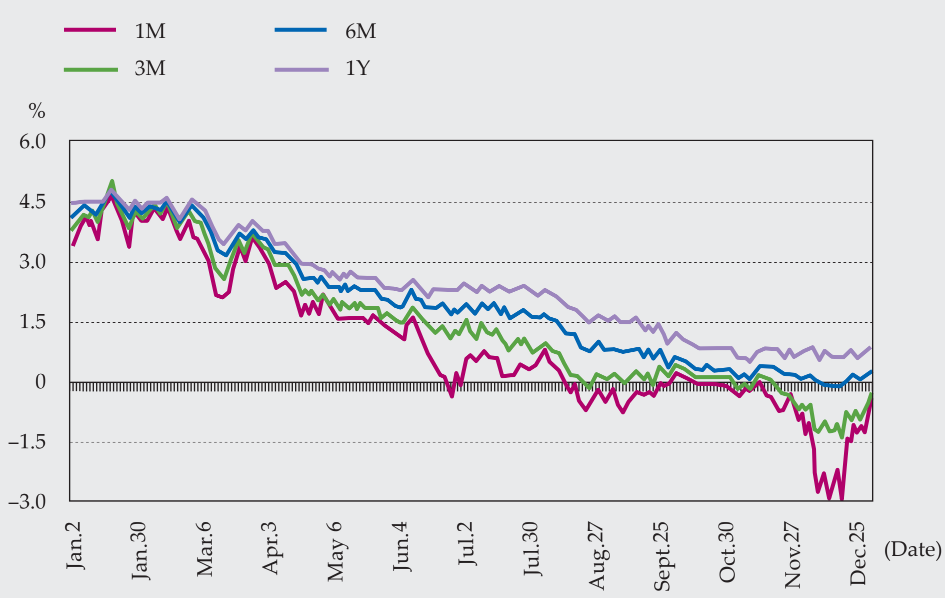
Since November 3, 2014, Shanghai Clearing House officially launched central counterparty clearing for foreign exchange business, covering foreign exchange spots, forwards and swaps. This propelled the rapid increase of clearing amount, foreign exchange forwards and spots in particular. Centralized clearing

Figure 8.8 Appreciation & Depreciation Rate Implied in Both Onshore and Offshore Derivatives in 2014



Source: China Foreign Exchange Trade System and Reuters.

Figure 8.9 US Dollar Interest Rate Implied in Onshore Derivatives in 2014



Source: China Foreign Exchange Trade System.

for RMB/FX derivates included RMB/FX swap inquiry and RMB/FX forwards inquiry. For the whole year of 2014, foreign exchange swaps concluded 6,341 transactions, totaling USD242.948 billion, among which 67.3% were concluded after the launch of central counterparty clearing. For foreign exchange forwards, a total of 190 transactions were concluded in 2014, totaling USD3.99 billion, among which 80.8% were completed after the launch of central counterparty clearing.

3. Other financial derivatives markets

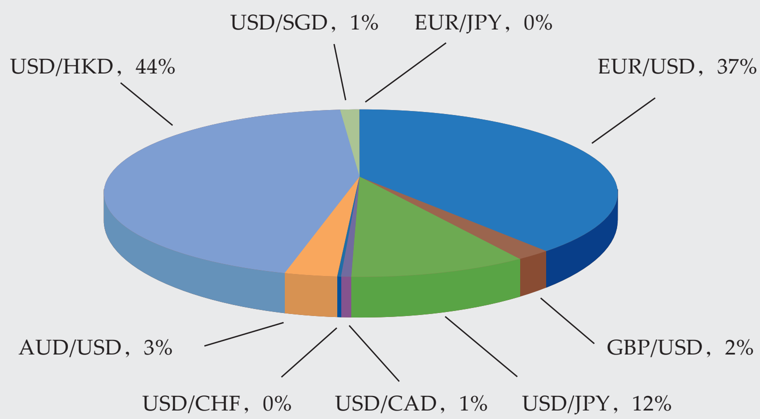
3.1 Performance of Credit Risk Mitigation (CRM) market

In 2014, CRM market showed signs of gradual recovery. In November, a new CRM transaction was concluded, with notional principal of 100 million yuan, maturing at one year. By end-2014, 16 traders concluded 47 CRMA transactions accumulatively, with notional principal totaling 4.04 billion yuan. The underlying debt instruments included short-term financing bills, medium-term notes, notes issued collectively by a group of small and medium-sized enterprises (SMEs), and bank loans, covering more than 10 different instruments. By end-2014, six CRMW issuers had registered and issued 9 CRMWs, with notional principal of 740 million yuan. The underlying instruments included short-term financial bills and medium-term notes, maturing at about one year. In 2014, there was neither new CRMW issuance nor new CRMW transaction in the secondary market.

By end-2014, 47 market participants had been filed as CRM traders, which consisted of 33 domestic and foreign commercial banks, 12 securities companies, 1 financial asset management companies and 1 institution of other type, adding one over end-2013. 26 market participants, which were composed of 24 domestic and foreign commercial banks and 2 securities companies, had been filed as CRM core traders, no change in number over end-2013. 30 market participants, which included 22 domestic and foreign commercial banks, 7 securities companies and 1 institutions of other type, had been filed as CRMW issuers.

Since 2014, China's economy suffered greater downward pressure, and financial risks in some regions or fields became prominent. Zero default no longer existed, and corporate debts experienced real payment default. As credit risk for the bond market became larger, traditional static credit risk management tools couldn't meet the demand of market development, and it had been the consensus that credit derivatives should be more actively employed to manage credit risks. Moreover, in April, CBRC has approved the first batch of 6 banks to implement internal credit rating, which laid policy foundation for CRM capital to exert mitigation function. Against this background, with the aim to propel the development of CRM market, the traders' association conducted thorough first-phase research, and made the decision to launch new products in line with both market demand and regulatory requirements. In October 2014, the trader's association invited both professionals and legal experts to establish CRM work group, drafting relevant documents and promoting the launch of new products. The traders' association had been committed to broadening the base of CRM market participants. In July 2014, CSRC started the approval process for pilot securities companies to conduct CRM selling

Figure 8.10 Breakdown of Foreign Currency Pairs Turnover in 2014



Source: China Foreign Exchange Trade System.

business, and 3 securities firms, China International Capital Corporation Limited (CICC), CITIC Securities Co., Ltd. (CITICS), and China Securities, were allowed to conduct CRM selling business.

3.2 Performance of foreign currency pairs derivatives market

In 2014, the trading of interbank foreign currency pairs derivatives tumbled notably, with turnover reaching USD15.67 billion, down 47.1% year-on-year. In particular, foreign currency forwards registered a turnover of USD4.47 billion, increasing 27% year-on-year; foreign currency swaps reported a turnover of USD11.21 billion, down 57.1% year-on-year.

In 2014, EUR/USD, USD/HKD and USD/JPY remained the most traded foreign currency pairs, with annual turnover reaching USD6.98 billion, USD5.8 billion, and USD1.81 billion respectively, making up 93% of total foreign currency pairs derivatives transaction, up 1.1% from the previous year. However, the share of these three currency pairs experienced year-on-year changes. The share of EUR/USD dropped 15.5%, while the share of USD/HKD increased by 15.6% from last year.

3.3 Performance of shipping and commodities derivatives market

In 2014, the price of RMB Forward Freight Agreements (FFA) saw larger fluctuation. CTC price, in particular, became more volatile as affected by the demand of shipping market. Iron ore experienced structural oversupply, and went lower following price fluctuation at the beginning of the year. The focus price of steam coal move downward further, and seasonal demand factors were still very visible.

Upon approval of the PBC, the Shanghai Clearing House started to provide central counterparty clearing for RMB iron ore and steam coal swaps on August 4, 2014. Back on April 16, 2013, central counterparty clearing business was officially launched for RMB FFA.

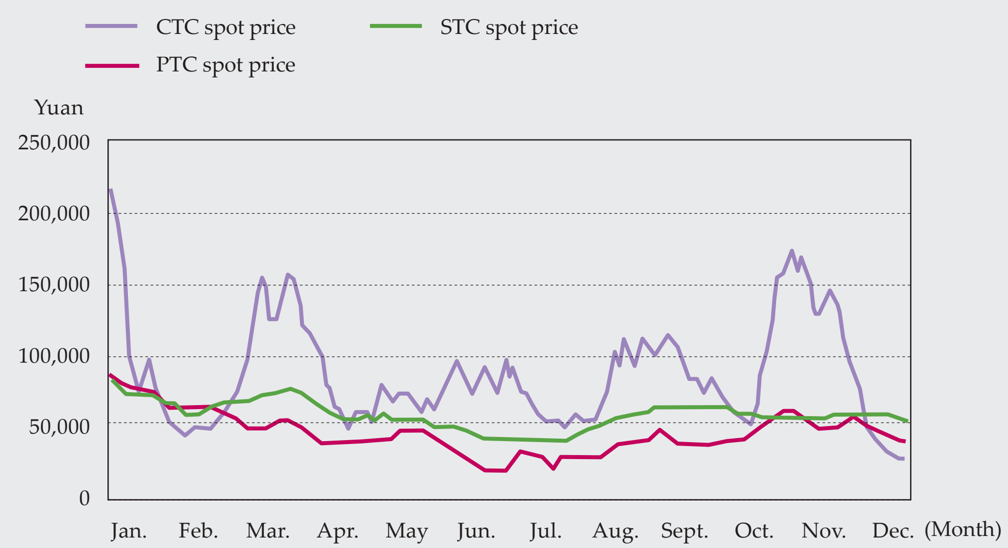
Central counterparty clearing for these three OTC derivatives helped to promote market price discovery function, enhance risk management, centralize transaction and quotation of China's institutional investors, enhance these investors' transaction and quotation capability at the international commodities market, and lay good foundation for RMB pricing power At present, the clearing amount of steam coal swaps by Shanghai clearing House was 15 times of the same product cleared by Singapore Clearing House.

By December 31, 2014, a total of 271,315 transactions (converted to monthly contracts, one side) were cleared by the Shanghai Clearing House concerning shipping and commodities derivatives, with notional principal of 20.485 billion yuan (one side).

3.4 Performance of OTC equity-related derivatives

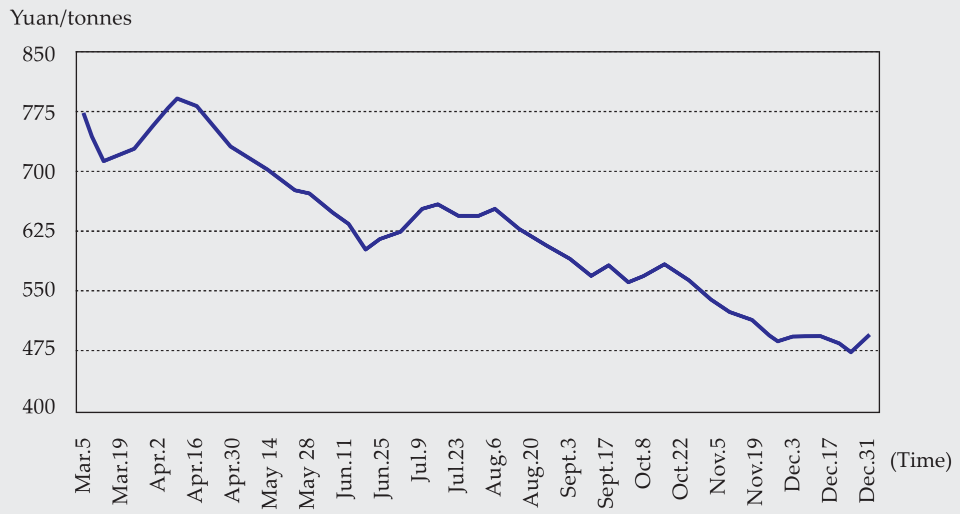
In line with the overall arrangement of CSRC, in December 2012, Securities Association of China released the *Business Standard of OTC Transaction by Securities Companies*, which officially started pilot OTC business. Securities, futures, and funds association jointly released master agreement for OTC derivatives trading (2014 edition) and definition document of Equity-related OTC Derivatives (2014 edition), which complemented the trading system of OTC market.

Figure 8.11 Big Volatility of RMB FFA Spot Price in 2014



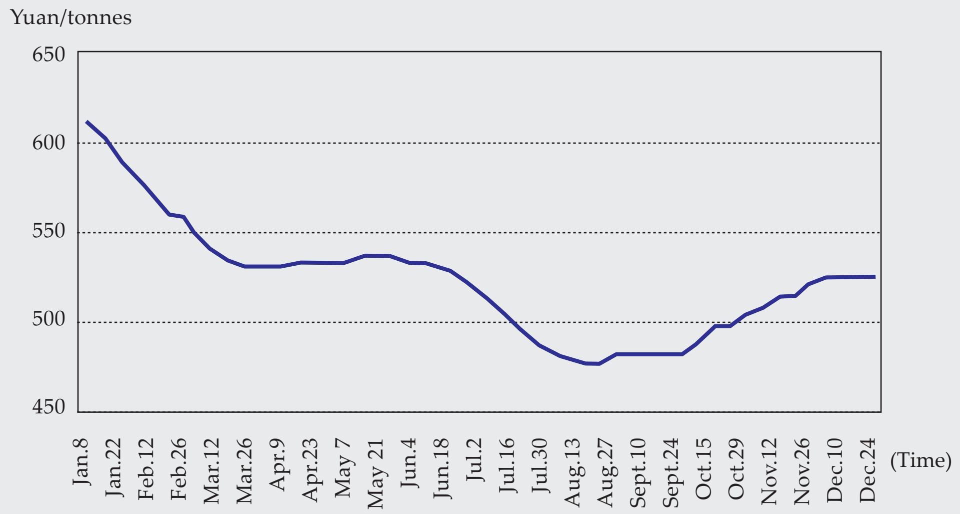
Source: Shanghai Clearing House.

Figure 8.12 Continuous Downward Movement of CIS Spot Price in 2014



Source: Shanghai Clearing House.

Figure 8.13 Downward Movement of the Focus Price of CSS Spot Price in 2014



Source: Shanghai Clearing House.

Since 2014, the rapid development of equity-related OTC derivatives gave rise to strong hedging demand. By end-November, 2014, the accumulative notional principal of equity-related OTC derivatives registered 474.958 billion yuan, 28 times of the number at the end of 2013. A total of 8,035 transactions have been concluded accumulatively, 15 times of that in 2013, and unclosed notional principal totaled 291.24 billion yuan.

The base of market participants became wider, and counterparty operation has been perfected. By end-November, 2014, 22 securities firms conducted OTC derivatives business under the master agreement framework of Securities Association of China (By August 2014, 20 securities firms have signed 517 master agreements with 332 counterparties). To illustrate, non-professionals other than financial institutions accounted for 79.2% of total counterparties, and their main trading purpose was leveraged financing and market cap management. Financial institutions made up 20.8% of total trading counterparties, with banks taking the lion's share. Insurance firms and custody institutions were not yet involved in such trading.

As products became more diversified, risk control demand of securities firms grew stronger. Currently, underlying assets for OTC derivatives conducted by securities firms included onshore stocks, index, convertible debts, close-end funds, ETF funds, segregated fund accounts, stock futures, and offshore stocks and indexes. Derivatives products mainly consisted of equity swaps and OTC futures. For equity swaps, 90% were Delta One liner products linked with stocks, and the main purpose was to meet low-cost financing need. The other 10% were non-liner equity swaps embedded with options to satisfy more sophisticated investment demands. OTC options were mainly composed of barrier options and binary options based on CSI 300 index between securities firms and institutional clients. With respect to development pace, for the first 11 months of 2014, accumulative equity swaps increased from 538 to 4,768 transactions, with notional principal of 384.851 billion yuan. The development of OTC options was very fast, growing form only 1 transaction at end-2013 to 666 transactions, with notional principal of 90.107 billion yuan. The size has expanded by more hundreds of times, and grew explosively.

4. Outlook for financial derivatives market development

4.1 Promote market innovation continuously

At present, China's financial derivatives market was still at relatively preliminary development stage, and development remained the prominent task. In line with the basic principal of "encourage innovation, develop market, strengthen supervision, and prevent risk", the innovative market can be developed in following aspects. First, improve market innovation mechanism. This mechanism should be good for the positive interaction between administrative management and market self-discipline and be an endogenous mechanism on the basis of market demands. Second, enrich product spectrum. Promote the diversification of structured financial derivatives in selective and staged steps, balance the relationship between "encourage innovation & develop market" and "prevent risk", and better play the role to serve the real economy.

4.2 Steady broaden the base of market participants

Considering the feature of high risk, investors with different risk profiles should be introduced to promote the rational allocation of market risks and the steady, healthy and sustainable development. First, further diversify market participants. At present, OTC derivatives were dominated by commercial banks. More efforts should be made to improve the trading system, enrich product spectrum, enhance the enthusiastic participation of securities firms, insurance companies and fund companies, expand the number of investors, and broaden the type of investors. Second, improve the risk management capability of market participants. Efforts should be made to improve the construction of qualified investors, encourage market participants to improve corporate governance, perfect risk management technique, and follow operational and risk management process. In this way, the trading risk of derivatives can be prevented at the root. Moreover, market self-discipline should be improved to enhance professional standard and code of conduct. Third, on the basis of controllable risks, non-financial institutions should be encouraged to participate in derivatives trading to meet their hedging needs, improve risk management channels and capabilities, and better serve the real economy.

4.3 Further improve financial market infrastructure

After the international financial crisis, lots countries committed to improve the infrastructure of OCT derivatives, establish central counterparty, information reporting and information filing system, lower systemic risks, and prevent market abuse behavior. In the future, for central counterparty clearing, more efforts should be made to improve supplementary policies, expand business scope, and absorb OTC derivates trading to this mechanism. At the same time, the information exposure mechanism for OTC derivatives should be established, and financial statements independently audited should also be introduced. In this way, both investors and supervisors can fully understand the value and risk level of these products, and thus establish relatively transparent market. Moreover, financial market infrastructure should both meet domestic demands and attract enough international investors. Under the framework of the *Principles for Financial Market Infrastructures*, infrastructure standards of financial derivatives should be improved further, and the serving capabilities of China's central clearing and informing reporting & filing institutions should also be promoted with reference to international standards.

Box 7 Further Expanding Pilot Credit Asset Securitization

Credit asset securitization is the natural product when financial innovation and financial market develop to certain stage. It is helpful to promote the balanced development of financial market, and is the natural requirement to promote the serving of real economy by financial sector. On August 28, 2013, the executive meeting of the State Council decided to further expand pilot credit asset securitization. Following this meeting, the PBC, together with relevant departments, seriously implemented meeting spirit, and actively promoted implementation. As a result, the administration of asset securitization was improved, investors became more diversified, market-based constraint mechanism gradually emerged, and the role to activate remnant credits and optimize the allocation function of financial resources has also appeared. Since this pilot program, by end-2014, financial institutions had issued 71 securities backed by credit assets, totaling 294.2 billion yuan, and the balance was 264.4 billion yuan.

1. Expansion of pilot grogram delivered positive results

The administration of credit asset securitization was further improved. Since the pilot program, the PBC together with other departments, released more than 10 ministerial regulations and standardization documents such as the Administrative Measures of Pilot Asset Securitization (PBC&CBRC Document [2005] No.7). These documents standardized issues like basic legal relationships, supervisory administration, securities issue and custody, risks self-retention, accounting management, taxation neutral principals and the change of housing mortgages. Since the expansion of pilot program in 2013, targeting problems such like excessively tight risk self-retention methods, and factors affecting banking financial institutions to release credit resources and active participation, the PBC and CBRC jointly released the PBC&CBRC Document [2013] No.21. This document further improved risk self-retention methods, making it clear that on the basis of their own needs, initiating institution can flexibly chose horizontal and vertical methods to realize risk self-retention. This was positive both for the prevention of moral hazard by initiating institutions, and for the enhancement of initiatives of participating institutions.

Investors became more diversified. Asset Securitization is a complex bond product with some features of derivatives. For the international market, institutional investors are the dominant buyers. Since the expansion of pilot program, credit asset securitization investors became more diversified with more optimized structure. By end-2014, there were 312 investors for credit asset supported securities, among which 47% were banking financial institutions, holding 68.3% securities, 53% were non-bank institutional investors and non legal person investors (169 investors) such as securities firms, insurance companies and fund companies, holding 31.7% securities, up 10.3% over the first-phase pilot period. The function of asset securitization to divert and transfer credit risk has gradually emerged. In parallel, the initiating institutions and underlying assets became more diversified. Initiating institutions covered all banking and *auto finance companies, asset management companies, financial leasing companies, and underlying asset expanded from ordinary corporate loans to international mainstream assets such like personal housing mortgages and personal auto loans.*

Market constraint mechanism gradually emerged. Since the launch of pilot program, the coordination group had been working on the improvement of institutional construction. The group followed product features, and put a high value on market constraint mechanism such as information exposure and credit rating. With respect to the performance of pilot program, the market was generally sound, and market constraint mechanism has gradually emerged. Products that had been issued performed on the sound basis, products that came due have all been honored in full value, and the yields of secondary-tranche securities were relatively good. For those that didn't come due, the payment of principals and interests were good, and the underlying assets for ordinary corporate loans remained zero NPL ratios. Moreover, asset securitization by commercial banks also promoted the improvement of their own credit asset management. For instance, due diligence by intermediaries helped to expose and improve compliance and mortgage management, and after-credit management was also promoted through regular information exposure.

Credit asset securitization has gradually played the role of activating credit stocks and optimizing financial resources allocation. At present, credit asset securitization was still at pilot stage, and overall size and effects were relatively small. However, for participating financial institutions, the role of asset securitization has gradually emerged. First, banking financial institutions have used asset securitization to release credit resources, lower capital consumption, and better serve the real economy. Second, non-bank financial institutions have used asset securitization to expand financing channels and lower financing cost. Third, securitization activated remnant banking credit, increased capital efficiency and liquidity, improved credit structure and optimized incremental credit. In this way, the reform and development of weak links (such as agricultural sector, rural area, farmers and microenterprises) as well as some key industries (such as railway and shipping) were supported.

2. Credit asset securitization is the natural product of financial deepening and market development

Banking credit is the important channel to satisfy the financing needs of real economy. But in the expanding process, maturity mismatch of balance sheet should be closely watched. Credit asset securitization is the bridge between direct and indirect financing, and provides a tool for banks to resolve maturity mismatch.

Credit asset securitization originated from the securitization of housing mortgages in the US, and developed very fast after the Savings & Loan (S&L) crisis in the 1980s. In the 1970s,driven by the strong purchasing demand of baby boomers after the Second World War, financing institutions have began to trade housing mortgage loans on the secondary market. In 1970, the issue of Mortgage Pass Through (MPT) signaled the beginning of asset securitization. After the

1970s, the US gradually relaxed interest rate control, deposit rate went higher, and interest rate spread narrowed. At that time, S&L institutions were one of the main players on the US housing market, and their main funding source was short-term demand deposit. The narrowing of interest rate spread exaggerated maturity mismatch risks and finally resulted in the S&L crisis. After the S&L crisis, the US actively promoted the development of asset securitization to resolve maturity mismatch problems. A series of legal documents such as The Secondary Mortgage Market Enhancement Act (SMMEA), Taxation Reform Law, and Financial Asset Securitization Invest Trust (FASIT) were released to provide legal support and tax preference. As a result, the securitization of housing mortgage developed very fast. In parallel, holders of other types of assets (credit cards, auto loans, student loans and house equity loans) also followed this development mode, and issued asset-backed securities. In 2005, the size of asset-backed securities exceeded T-bonds in the US, and ranked No.1 in the bond market.

At present, asset securitization is a mature financial product in developed economies like the US, Europe and Japan, and has become the main business of banking institutions. After the international financial crisis, developed economies like the US strengthened risk control over asset securitization. Generally speaking, the issue of this type of products has developed amid fluctuation, and market size rebounded rapidly. In 2013, the issue of securitized products in the US registered USD2.1 trillion, 1.3 times of that in 2008, accounting for 30% of bond issue at the same period. Outstanding securitized products totaled 9.9 trillion US dollars, 26.49% of total bonds outstanding.

With respect to international financial market, the main reason for asset securitization to become widely accepted products of the international market is to satisfy diversified multilayer financing needs. For banking financial institutions, asset securitization is helpful to flexibly adjust the structure of balance sheet, improve maturity mismatch of "borrowing short and lending long", transfer credit assets out of balance sheet, reduce capital occupying, and shift profitability method. For investors, credit asset securitization can transform illiquid asset with stable cash flow to highly liquid securities. This can provide new investment product, and it's conducive for investors to allocate financial assets rationally and diversify investment risks.

3. China's credit asset securitization bears great significance

At present, China's financial performance was generally sound, but the efficiency and tools of financial market to allocate resources don't meet the requirement of economic restructuring and update. The development of credit asset securitization bears great significance to activate remnant credit, take good use of incremental credit, promote stable economic development, adjust economic structure and shift development mode. Credit asset securitization is also helpful for the emergence of credit rate transmission mechanism driven by bond rate, enhance monetary policy transmission efficiency, alleviate capital supplementary pressure, diversify investment products, improve market mechanism, develop standardized asset transfer channels, strengthen financial supporting capabilities *of banks to key sectors, and change the profit-making methods.*

First, credit asset securitization helps to promote the emergence of price transmission mechanism that interest rate is driven by bond rate, and enhance the transmission efficiency of monetary policy. Credit asset securitization links credit market with securities market, and the yield rates of underlying asset and securitized products respond to lending rate and market rate respectively. Despite the full relaxation of control over lending rates, interest rate transmission mechanism is not well developed and lending rate does not change synchronously with market rates. The development of credit asset securitization contributes to the emergence of interest rate transmission mechanism driven by bond rates, the resolve of disconnection between these two markets, and better monetary policy transmission efficiency.

Second, credit asset securitization helps to alleviate capital supplementary pressure of banks, and better serve the real economy. For a certain period in the future, China's economy will maintain relatively high growth rate. As the reliance on indirect financing cannot be changed in the short term, real economy will highly depend on bank loans for capital source. Commercial banks in nature are companies that manage risks, and they need to use capital to shoulder risks from asset side and absorb relative risks. The expansion of bank loans will greatly add to capital depletion. In June 2012, China launched the Administrative Measures for the Capitals of Commercial Banks (for Trial Implementation), making stricter requirement over capital quality and capital adequacy ratio of commercial banks. If the growth rate and profit margin remain unchanged, and commercial banks maintain current capital accumulation level, in several years, capital loophole will become multiplied. Considering the poor management of some borrowing companies and banks' profit margin is not certain, capital loophole will become larger. Asset securitization helps commercial banks to flexibly adjust balance sheet structure, and transfer some credit assets out of balance sheet by means of securitization, reduce capital consumption, and alleviate the pressure of capital supplementation to the capital market.

Third, credit asset securitization helps to develop multilayer capital market, and give full play of the fundamental role of market in resource allocation. At present, the overreliance on bank lending for social financing is not good for the optimized allocation of resources and financial stability. With respect to international experiences, it is the trend to develop direct financing and to shift from single banking system to multilayer market system. Credit asset securitization provides new investment product and investors can indirectly invest in previously inaccessible fields such as infrastructure, housing loan and corporate loans. Moreover, the risk return feature and maturity structure of securitization differ greatly with stocks, funds, T-bonds, financial debts, and corporate debts, and securitization is good for investors to allocate financial assets rationally and promote the development of multilayer capital market. Securitization can also help investors to judge risks and determine asset price jointly, improve the role of market in credit risks identification and management, and diversify financial risks.

Fourth, credit asset securitization helps to explore standardized credit assets transfer channels and guide social funds into "standardized pool". In recent years, propelled by both investment and financing demands, lots of products processing both liquidity and credit transfer function emerged. They exert the intermediary function similar to banking institutions, but quite a lot are not supervised by regulations similar to banking institutions. There are several reasons. On the one hand, restricted by requirements like lending to deposit ratio and capital adequacy ratio, financial institutions are eager to achieve credit transfer through "innovation". On the other hand, lots of social capitals have strong demands for products of high returns, while investment channels are relatively narrow. These products to a certain extent satisfy some financing needs of the real economy, and diversify the investment channels of both citizens and companies. However, as they are neither transparent nor standardized, and are not reflected in the balance sheet, their potential risks should not be neglected. For instance, some financial institutions use wealth management products to shift risky assets, expand credit lending in disguised form, and some loans are extended to sectors restricted by the central government. All these are not good for implementation of national macro-management policies. As a result, in the long run, great efforts should be made to develop credit asset securitization and financial institutions should be provided with official channels to adjust asset and liability. In this way, financial institutions can both satisfy the financing needs of the real economy and prevent possible systemic risks. The development of securitization also provides investors an investment vehicle closely connected with real economy and guides social capital to float and allocate in line with basic return principle. This is helpful to relieve the disconnection of private capital with real economy, prevent money speculation and usury.

Fifth, credit asset securitization helps to lower loan concentration level, and strengthen financial support to the reform and development of key sectors. In line with the Guidance of Risk Management over Credit Authorization to Group Clients by Commercial Bank issued by CBRC, credit extended to single group client and single client cannot exceed 15% and 10% of equity capital respectively. In recent years, the financial industry followed the overall arrangement of the CPC central committee and the State Council, and actively used bank loans to meet the financing needs of key sectors. For some key sectors, the lending by major domestic banks has basically met or exceeded the ceiling of 10%. The excessive high credit authorization level restricted the lending capability of commercial banks, and certain banks even stopped new loan extension. Credit asset securitization can lower the loan concentration level by transferring certain loans out of balance sheet and improve the lending capability of commercial banks. On the other hand, remnant assets are activated. Commercial banks continue to expand their financial support to key sectors within the scope of current credit authorization.

Sixth, credit asset securitization helps to promote the shift of profit making mode of commercial banks, and satisfy multilayer financial needs of the real economy. China's *commercial banks have always relied on interest rate spread for major source of profit making, and their business development is featured with assets expansion. The reliance on the expansion of deposit and lending can easily result in problems like large loans, long loans and loans with high concentration level, and is difficult to satisfy multilayer financial needs of the real economy. With respect to international experiences, securitization can help commercial banks to enhance profit-making mode, and thus better serve the real economy. First, fund use efficiency will be improved. Securitization can activate credit asset without enough liquidity, and release capital to sectors with higher efficiency and higher rate of return. Second, securitization can help commercial banks get funds on more favorable terms, and thus lower overall financing cost. Third, securitization contributes to higher intermediary income. After securitization, financial institutions can get income from loan service, obtain investment return by holding asset-backed securities, and acquire commission fees from trading asset-backed securities. All these are good for higher rate of return on capital without higher occupation of funds. At present, securitization has become a mature product in developed economies like the US, Europe and Japan, and has evolved into one of the major businesses of commercial banks.*

4. Promote sustained and sound development of credit asset securitization. *At present, China is still at the preliminary stage of regular development of securitization. Efforts should be made to analyze the development mode and road map of various countries, draw on best practices and management, further improve management system, strengthen supervisory coordination and lay good foundation for the regular development of asset securitization. For the next step, relevant ministries will continue to implement the essence of the executive meeting of the State Council, and work with members of credit asset securitization coordination group to steadily push pilot program under current institutional framework. First, summarize the experience of pilot program, and analyze policy measures that are good for the development of asset securitization. Second, further improve supplementary management measures in line with the change of market development and macro policy environment. Third, strengthen supervisory coordination, and fully exert the coordination role of financial supervisory coordination mechanism and pilot program of credit asset securitization. Under current administrative framework, standardize registration and filing system, strengthen supervisory coordination and the share of information, emphasize the supervision of securitization process, and cultivate the combined power of market management and institutional administration. Fourth, simplify the issue and management process for credit securitization, fully implement the Announcement of the PBC [2015] No.7. Qualified entrusted and initiating companies are supported to apply for "one-stop" registration and issue asset-backed securities at their own initiatives. The efficiency and transparency of the administration over the issue of securities should be improved and market constraint mechanism such as compulsory information exposure should also be enhanced to promote the sound development of credit securitization.*

Box 8 The Launch of Standardized Products for RMB Interest Rate Derivatives

On November 3, 2014, standardized interest rate derivatives were launched at the X-sway system of National Interbank Funding Center. This is another milestone in the standardization of derivatives and electronic trading on China's interest rate derivatives. In retrospect, bond forwards, interest rate swaps, and forward rate agreements were launched in 2005, 2006 and 2007 respectively.

1. Specifications of standardized interest rate derivatives

Standardized interest rate derivatives made standardized specification over product fundamentals such as maturity date and tenor for interest rate swap and forward rate agreements etc.. For the first batch of 4 products, the main reference rates such as FR007, ShiborO/N and Shibor 3M are covered.

1.1 Definition of products

(1) 1-month standardized overnight indexed swap: Shibor O/N is referred as the floating rate, and this rate is set every day. The starting date of interest payment is the corresponding calendar day 1 month prior to the maturity date. Settlement rate is calculated on the maturity date and payment is delivered as net cash interest obligation.

(2) 3-month standardized Shibor 1W interest rate swap: Shibor 1W is referred as the floating rate, and this rate is set every week. The starting date of interest payment is the corresponding calendar day 13 weeks prior to the maturity date. Settlement rate is calculated on the maturity date and payment is delivered as net cash interest obligation.

(3) 3-month standardized 7-day repo rate swap: 7-day fixing repo rate is referred as the floating rate, and this rate is set every week. The starting date of interest payment is Shibor 3M. Settlement rate is calculated on the maturity date and payment is delivered as net cash interest obligation.

(4) 3-month Shibor3M forward rate agreement: Shibor 3M is referred as the floating rate, and the starting date of interest payment is the delivery date. Maturity date is the corresponding calendar day 3 months following the delivery date. Settlement rate is calculated on the delivery date and payment is delivered as discounted net cash obligation.

1.2 Trading methods and institutions

Standardized interest derivatives are traded anonymously on the X-swap system. The trading mechanism is bilateral and one-click trading. When the transaction is concluded, relevant trading institutions can confirm at the service platform of CFETS. Market members can either choose bilateral clearing or central counterparty clearing.

Members of interbank interest rate derivatives can all participate in above standardized trading. By end-2014, 118 institutions have been filed for interbank interest rate swap, and 57 for forward rate agreements, covering banking financial institutions, securities firms, insurance companies and other types of institutions.

2. Significance

Standardized interest rate derivatives standardize current interest rate derivatives, effectively improve product liquidity, and enhance risk management. As standardized products, they are more liquid, and are more efficient in price discovery and trading. Moreover, they provide market participants with better risk hedging instruments. Standardized interest rate derivatives differ from previous interest rate swaps mainly in fixed payment calculation cycle and delivery date. For previous products, they roll to maturity. Market participants can cover their net position by reverse transaction. However, if original and reverse transaction is not conducted on the same day, the delivery date of reverse transaction is later than the delivery date of original trading, and risk exposure of original trading cannot be fully covered. For standardized products, as the payment calculation cycle is fixed and contracts adopt standardized delivery date, risk exposure can be more easily covered, and it's convenient for investors to conduct more trading combination.

Standardized interest rate swaps conform to the supervisory trend of international derivatives. After the international financial crisis, with the aim to improve the transparency of OTC derivatives, and lower systemic risks, international supervisory authorities appealed for the reform of OTC derivatives, and reached a series of consensuses in standardization, electronic trading, the set-up of trading database and central counterparty clearing. Therefore, the launch of standardized interest rate swaps is a beneficial attempt to go with the supervisory trend and to promote the standardization of derivatives and electronic trading. Moreover, bilateral, anonymous, one-click trading on the electronic trading system of X-Swap helps to lower trading cost significantly, and greatly enhances trading efficiency and transparency.

3. Trading profile

Since the launch of standardized interest rate derivatives, market participants have been actively participated in derivatives trading. In 2014, 211 transactions have been concluded, totaling 41.3 billion yuan. In terms of trading product, the turnover for SS011M and SR073M registered 30.75 billion and 9.5 billion yuan, accounting for 74% and 23% respectively. With respect to trading institutions, Bank of Communications, Development Bank of Singapore, Deutsche bank, BNP PARIBAS, and Bank of America, Shanghai Branch are all very active. As for quotation types, the quotation for SS011M and SR073M stood at 2,574 and 1,845, accounting for 51.5% and 26.9% respectively. With respect to quotation institutions, Development Bank of Singapore, Bank of Communications, Bank of America, Shanghai Branch, China CITIC Bank, and Agriculture Bank of China all quoted actively. The brisk trading day with best quotation spread is 0, and light trading day averaged at 25-80BPs.

Box 9 Centralized Clearing of OTC Interest Rate Derivatives

1. Overview

Centralized clearing of RMB interest rate swaps refer to the process by which interest rate swaps transaction are cleared by Shanghai Clearing House, designated by the PBC. After confirming the rights and obligations of relevant trading parties, Shanghai Clearing House calculates the net interest payment on the same clearing date for clearing members in means of multilateral netting. During this process, Shanghai Clearing House is introduced as the central counterparty, acting as the seller of the buyer and the buyer of the seller, and Shanghai Clearing House also controls the commitment risks of trading parties.

Approved by the PBC, Shanghai Clearing House conduced pilot centralized clearing of RMB interest rate swaps as of January 2, 2014. In line with the Notice of the PBC on Issues Concerning the Centralized Clearing Mechanism of OTC Financial Derivatives and Centralized Clearing of RMB Interest Rate Swaps (PBC Announcement [2014] No.29), since July 1, 2014, new RMB interest rate swaps with reference to FR007, Shibor_ON and Shibor_3M and less than 5-year (including 5-year) maturity, if the participants and contract ingredients conform to the requirements of Shanghai Clearing House, they should be cleared by Shanghai Clearing House.

Shanghai Clearing House organized multilateral clearing, and adopted methods widely accepted by the market to calculate the settlement value. Thus, the probability of dispute in net payment was reduced, the whole process was simplified, and the quantity of financial products and funds involved in real submission and delivery decreased. In this way, credit authorization and accrued risk capital requirement under bilateral clearing were relaxed, and the efficiency of clearing and capital was also improved greatly.

Shanghai Clearing House adopted systemic arrangements like risk exposure limits, margin requirements, clearing fund, and risk requirement, and strictly management the risk of interest rate swaps. Therefore, risk management is conducted on standardized, transparent and fair basis, and systemic risks are effectively controlled and prevented.

2. Performance

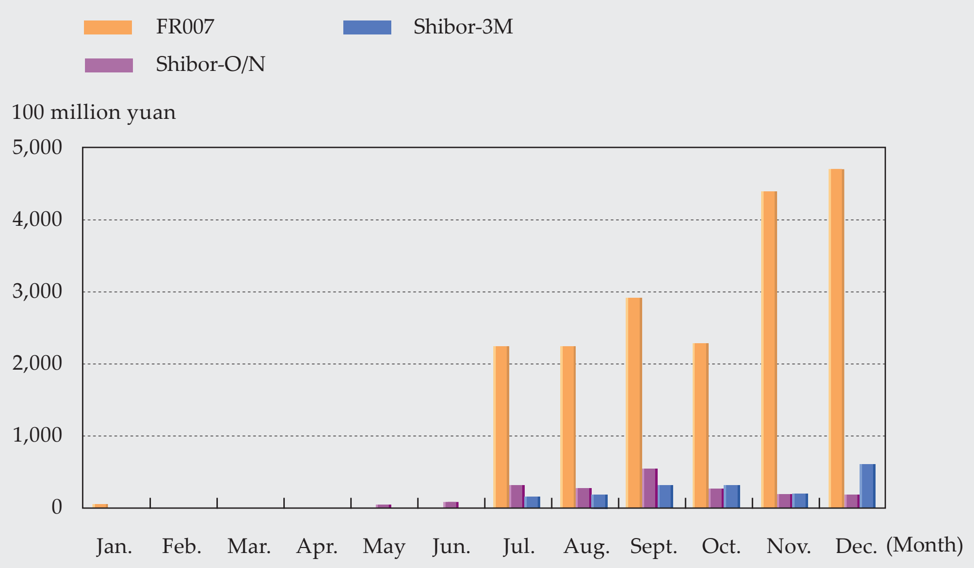
With reference to the statistics of CFETS in 2014, transactions that satisfy the requirements of the PBC Announcement [2014] No.29 accounts for 99.2% of interest rate swaps transactions, with notional principal making up 99.32% of the total. As a result, centralized clearing for swaps with reference to above three floating rates has basically covered the whole market, and centralized risk management for mainstream products has been achieved. In 2014, Shanghai Clearing House cleared 24,507 IRS transactions, with notional principal of 2,304.977 billion yuan. The trading volume cleared by central counterparty has increased rapidly since compulsory centralized clearing was officially implemented on July 1.

Transactions remained brisk since the implementation of compulsory centralized clearing. From January to June, concluded interest rate swaps averaged 2,989 transactions *per month, with notional principal of 279.879 billion yuan. Since the implementation of compulsory centralized clearing on July 1, concluded interest rate swap averaged 4,139 transactions per month, with notional principal of 389.405 billion yuan, an increase of 112.91% and 98.57% respectively.*

On the basis of successful launch of centralized clearing for RMB interest rate swaps, Shanghai Clearing House introduced agency clearing to guarantee compulsory centralized clearing. At the same time, measures were also adopted to improve serving capability and to activate transactions. For instance, since October 13, 2014, Shanghai Clearing House conducted real-time inspection to RMB interest rate swaps contracts submitted for centralized clearing, carried out real-time contracts replacement after the inspection was passed, achieved real time processing of contract submission, and simplified operational measures for market participants. Moreover, since October 2014, Shanghai Clearing House provided collateral management, and market members can submit qualified collaterals to sterilize part of margin requirement. This further exerted the coordination effect of central counterparty clearing and centralized deposit and management of securities, and lowered the funding cost of market participants.

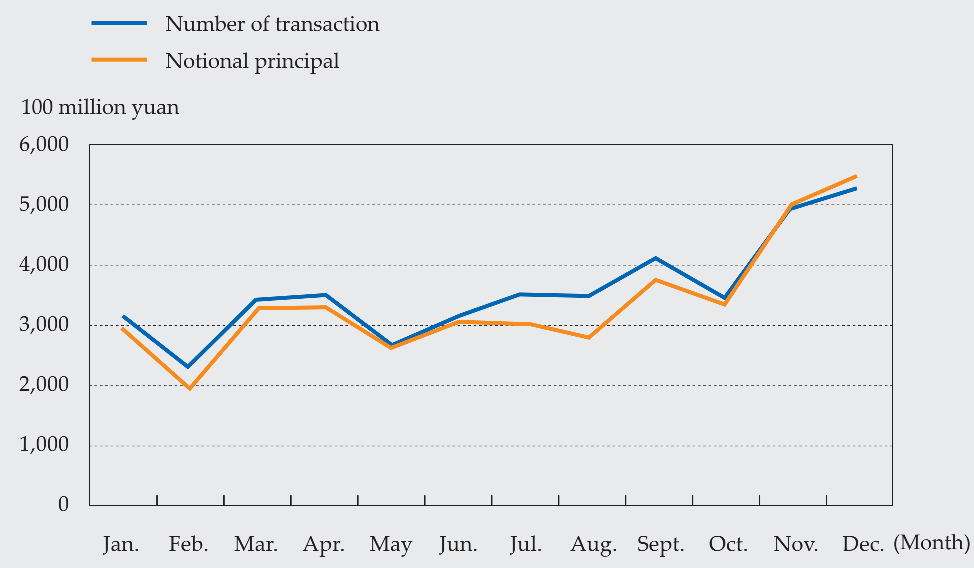
By end-2014, Shanghai Clearing House has approved 5 comprehensive members and 42 common members. Another 31 institutions were granted with trading qualifications, but were not approved as clearing members, among which 20 were foreign-funded institutions.

Figure 8.14 Change in Notional Principal Amount of RMB Interest Rate Swaps Cleared by Central Counterparty in 2014



Source: Shanghai Clearing House.

Figure 8.15 Brisk Trading After the Launch of Centralized Clearing of Interest Rate Swaps in 2014



Source: Shanghai Clearing House.

3. Significance

The implementation of compulsory centralized clearing of RMB interest rate swaps is both he commitment of China's government at the international arena and the demand of domestic OTC derivatives market. At present, China is the third country worldwide in implementing compulsory centralized clearing for interest rate derivatives, and walks ahead of many developed economies. Starting from interest rate swaps, centralized clearing with Shanghai Clearing House as the counterparty will be expanded to other OTC derivatives. This will become an important measure for China to fulfill its G20 commitment and to prevent OTC derivatives risk.

Since the official launch of RMB interest rate swaps on the National Interbank Market on February 9, 2006, the function of interest rate swaps in price discovery and risk management has been gradually appreciated and valued. The notional principal for the whole year of 2014 approached the threshold of 4 trillion yuan. As the most popular interest rate derivatives on China's OTC market, interest rate swaps gradually made the transition from bilateral trading to centralized clearing, and activated market trading by introducing central counterparty. This is very significant for market participants to expand the scope of trading counterparties, release credit authorization, simplify contract management process, and save risky capital.

Thanks to the simple, and relatively standardized structure of interest rate swaps, centralized clearing with these products *as the main object, are good for market to adjust to and accept such brand new trading method. In addition, it's also good for macro prudential authorities to gradually accumulate implementation experiences, thus providing good conditions for the launch of centralized clearing policies covering the whole OTC derivatives.*

Box 10 Rapid Development of Central Counterparty Clearing for Shipping and Commodities Derivatives

With reference to the experiences of international market, since 2012, Shanghai Clearing House has gradually launched central counterparty clearing for shipping and commodities derivatives. This not only filled the blank of domestic OTC financial derivatives market, satisfied the hedging demands of the real economy, but also promoted Shanghai's strive for international financial and shipping center, the establishment of RMB clearing center, as well the international pricing power of RMB. Shanghai Clearing House is the only central counterparty clearing institution of OTC commodities derivatives, and relevant business is well received by the market. This complemented domestic futures market and swaps market, and promoted the overall development of these markets.

Figure 8.16 RMB FFA Clearing Between 2013—2014

Source: Shanghai Clearing House.

1. Overview

1.1 CNY Forward Freight Agreement (CNY FFA)

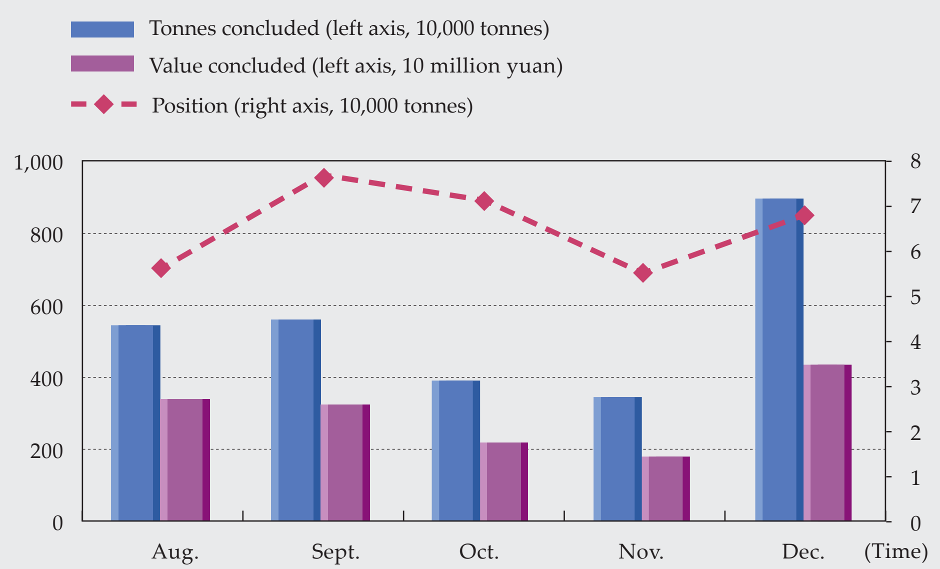
CNY FFA market maintained sound development. Affected by factors like big volatility of the spot market, increasing hedging demands, and faster inflow of investors, CNY FFA market developed very fast in the first phase. With the continuous slackness of the shipping market, the development of CNY FFA market also decelerated.

1.2 CNY Iron ore Swap (CIS) & CNY Steam coal Swap (CSS)

First, CIS and CSS were well received by the market and clearing amount increased steadily. The launch of CIS and CSS attached great market attention. At present, the turnover of iron ore maintain 5 million tonnes per month, equivalent to the clearing amount of 3.2 billion yuan, 14% of the clearing amount of the same type of product by Singapore Clearing House of the corresponding period. The turnover of steam coal also developed steadily. In October, the clearing amount reached 8.4 million tonnes, equivalent to the clearing amount of 4.4 billion yuan, 15 times of the clearing amount of the same type of product by Singapore Clearing House of the corresponding period.

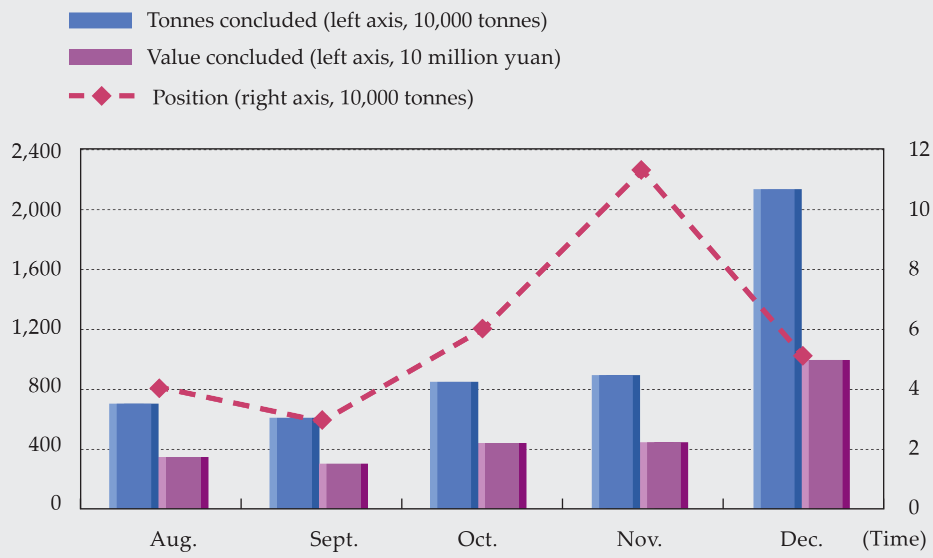
Second, near-end contracts were the most traded contracts and satisfied the hedging need of the real economy. With respect to the performance of first three months, near-end monthly contracts and quarterly contracts were the most traded products, and effectively satisfied the hedging need of companies. The trading cycle of these companies have the

Figure 8.17 Trading of RMB Iron Ore Swaps Since the Launch in 2014



Source: Shanghai Clearing House.

Figure 8.18 Trading of Steam Coal Since the Launch in 2014



Source: Shanghai Clearing House.

hedging demand for near-end contracts.

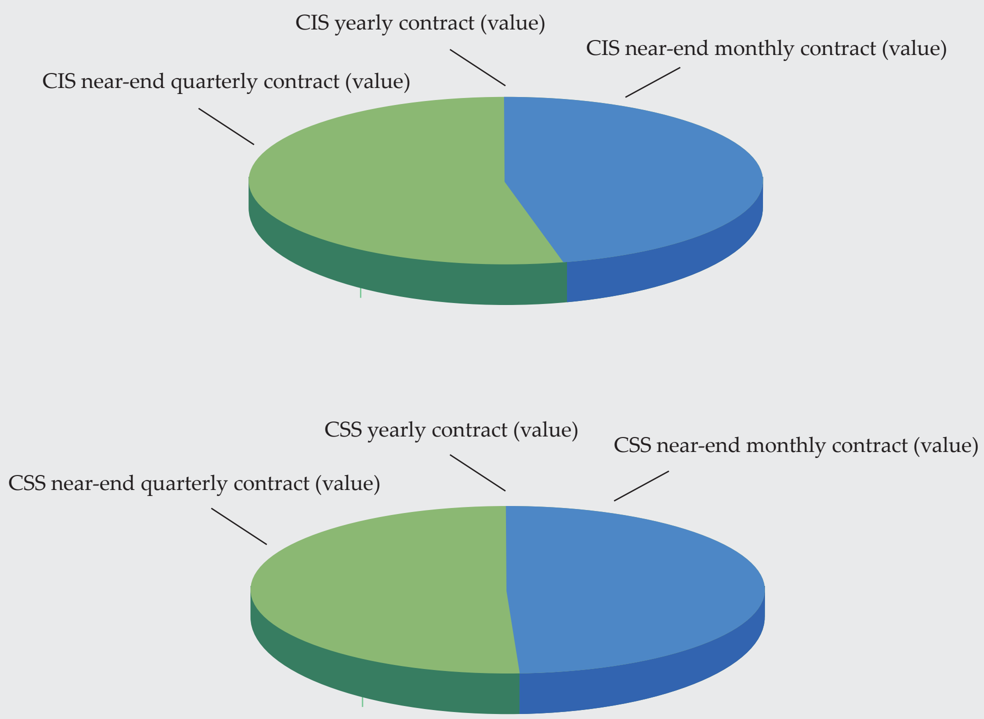
Third, liquidity provider actively participated in quotation and enhanced market liquidity. Shanghai Clearing House actively introduced big financial institutions such as CITIC Securities and China Merchant Securities to participate in OTC swaps. These liquidity providers actively participated in quotation, activated market, and enhanced market liquidity.

Fourth, develop cross-market arbitrage together with domestic futures and international swaps markets. As OTC swaps are both highly linked and differ somewhat with domestic futures as well as international swaps markets, empirical study indicated that cross-market arbitrage has also emerged. Traders have gradually participated in these markets and achieved cross-market hedging and arbitrage.

2. Significance

First, it cultivates the virtuous cycle of the common development between OTC market and exchange-traded market. The development of OTC derivatives market can improve the width and depth of financial sector to serve the real economy, accelerate the innovation and standardization of derivatives, and cultivate the trading and risk management capability of financial derivatives. In this way, current situation such as the excessively large proportion of private investors, too much speculation, and insufficient product innovation can be improved, and the virtuous cycle of the common development between OTC market and exchange-traded market will

Figure 8.19 Contracts Composition of CIS and CSS



Source: Shanghai Clearing House.

gradually emerge.

Second, it helps to improve the trading and pricing capability of domestic institutional investors. Both OTC and exchange-traded markets aim to centralize the trading and quotation of domestic institutional investors, and attract Chinese investors that trade on the offshore market to domestic market. In this way, the trading and pricing capability of Chinese institutional investors can be greatly improved on the international commodities market.

Third, it breaks the situation that commodities market is priced in US dollar, and helps increase RMB pricing power. The launch of OTC financial derivatives mainly adopted the RMB spot price index provided by the index complier of China's commodities price, and the medium and long-term price curve for commodities price in RMB also emerged through groups of quotation. This will break the situation that China is the important consumer of commodities, but relevant trading are priced in USD index provided by foreign index *compilers, and enhance the pricing power of Chinese yuan in spot and derivatives markets.*

Fourth, it contributes to better supervision and effective prevention of systemic risks. As a new factor market, the development of OTC commodities derivatives will provide comprehensive business development scope for China's financial institutions. In addition, this market is highly linked with money market. The establishment of unified central counterparty clearing platform helped supervisory institutions to get fundamental data on trading and clearing, strengthen supervision and analysis, prevent and resolve systemic risks promptly, and enhance supervisory efficiency.

Appendix I Highlights of China's Financial Market Development, 2014

On January 2, upon approval by the People's Bank of China (PBC), the Interbank Market Clearing House Co., Ltd. launched on a trial basis the central clearing of RMB interest rate swaps.

On January 7, upon approval by the State Council, the China Banking Regulatory Commission (CBRC), the National Development and Reform Commission (NDRC), the Ministry of Industry and Information Technology, the Ministry of Finance (MOF), the Ministry of Commerce, the PBC, the State Administration for Industry and Commerce, and the Legislative Affairs Office of the State Council jointly issued the *Circular on Regulating Non-Financing Guarantee Companies.*

On January 17, the PBC issued the *Notice on Carrying Out the Pilot Program of Standing Lending Facility Operations* (PBC Document [2014] No.19). According to the *Notice*, PBC branches in Beijing, Jiangsu, Shandong, Guangdong, Hebei, Shanxi, Zhejiang, Jilin, Henan and Shenzhen shall launch the pilot program, which is mainly aimed at tackling locally incorporated financial institutions' liquidity demand that complies with macroprudential requirements, stabilizing market expectations, and promoting the stable operation of the money market.

On January 26, the PBC Financial Market Department released the *Notice on Issues Concerning the Access of Commercial Banks' Wealth Management Products to the Interbank Bond Market* (PBC Financial Market Department Document [2014] No.1). The *Notice* specifies conditions for wealth management products' bond account opening and the custody of such products. This was the first time that detailed regulations were issued on the investment of banks' wealth management products in the bond market.

On January 28, the PBC released the *Notice on Issues Concerning the Establishment of a Central Clearing Regime for OTC Financial Derivatives and the Launch of Central Clearing of RMB Interest Rate Swaps* (PBC Document [2014] No.29). The *Notice* provides for the establishment of a central clearing regime for OTC financial derivatives, in a bid to promote the safe and efficient operation and the sound and regulated development of the OTC financial derivatives market.

On January 30, the PBC issued the *Notice on Adjustments to the Classification of Central Bank Lending* in a move to further improve macro regulation, define clearly the functions of central bank lending, give full play to the role of the central bank in managing liquidity and guiding financial institutions' credit structure optimization, and cater better for the central bank mandate. According to the *Notice*, central bank lending shall fall into four, instead of the former three, categories, i.e. the former liquidity lending shall be broken down into liquidity lending and credit policy-supported lending while financial liquidity lending and earmarked policy lending remain unchanged.

On February 20, authorized by the PBC, the PBC Shanghai Head Office issued the *Notice on Supporting Expanded Cross-Border RMB Use in the China (Shanghai) Pilot Free Trade Zone* (PBC Shanghai Head Office Document [2014] No.22) to pledge support for the pilot cross-border RMB business innovations and boost the cross-border use of the RMB.

On February 28, the Dalian Commodity Exchange (DCE) launched the trading of polypropylene futures.

On March 1, the PBC removed the upper limit on interest rates offered in the China (Shanghai) Free Trade Zone for small-amount foreign currency deposits.

On March 5, the PBC released the *Announcement* ([2014] No.3). According to the *Announcement*, commercial banks conducting OTC book-entry treasury bond businesses are allowed to increase their OTC bond varieties to include China Development Bank bonds, policy bank bonds and government-backed agency bonds such as those issued by the China Railway.

On March 12, with the PBC approval, the National Association of Financial Market Institutional Investors (NAFMII) released the *Announcement on Issues Concerning Centralized Book-building of Non-Financial Enterprises' Debt Financing Instruments* to regulate book- building offering via the centralized system.

On March 15, the PBC announced that the trading band of the RMB against the US dollar in the interbank spot foreign exchange market shall be widened from 1 percent to 2 percent, effective from March 17, 2014, and that the difference between the CNY/USD buying and selling rates offered by designated foreign exchange banks to their clients shall not exceed 3 percent, instead of 2 percent, of the central parity rate published on that day.

On March 18, authorized by the PBC, the China Foreign Exchange Trade System (CFETS) announced the launch of direct trading between the RMB and the New Zealand dollar in the interbank foreign exchange market.

On March 21, to implement the *Guiding Opinions of the State Council on Launching the Pilot Program of Preferred Shares* and push ahead with capital market reform and innovation, the China Securities Regulatory Commission (CSRC) issued the *Measures for the Administration of the Pilot Program of Preferred Shares*. On the same day, hot-rolled coil futures were listed on the Shanghai Futures Exchange.

On April 9, the PBC Financial Market Department released the *Notice on Issues Concerning Bond Tender Offers in the Interbank Bond Market*.

On April 10, to promote the development of capital markets in mainland China and Hong Kong, the CSRC and the Securities and Futures Commission of Hong Kong approved, in principle, the development of a pilot program for establishing a Shanghai-Hong Kong stock exchanges connectivity mechanism by the Shanghai Stock Exchange, the Stock Exchange of Hong Kong Limited, the China Securities Depository and Clearing

Corporation Limited and the Hong Kong Securities Clearing Company Limited.

On April 18, the CBRC and the CSRC jointly issued the *Guiding Opinions on the Offering of Preferred Shares by Commercial Banks to Replenish Tier 1 Capital*. On the same day, the CBRC issued the *Tentative Measures for the Administration of the Factoring Business of Commercial Banks*.

On April 22, the PBC decided to cut the RMB reserve requirement ratios for county-level rural commercial banks and county-level rural cooperative banks by 2 and 0.5 percentage points, respectively, effective from April 25, 2014. The move is aimed at implementing the decision of the State Council's executive meeting and Vice Premier Ma Kai's instructions at the teleconference on rural financial services, stepping up financial support for the agricultural sector, rural areas and farmers, broadening funding sources, encouraging agro-linked use of funds, and further improving the capacity and quality of rural financial services.

On April 24, the Department of Fiscal and Financial Affairs under the NDRC issued the *Guidelines for Book-building Offer and Tender Offer of Enterprise Bonds*.

On April 25, the PBC and the Reserve Bank of New Zealand renewed their bilateral local currency swap agreement. The size of the swap facility is 25 billion yuan, or NZD5 billion, and has a three-year maturity that can be extended if both parties agree.

On May 8, the PBC and the CBRC jointly issued the *Announcement* ([2014] No.8) to broaden the financing channels for consumer finance companies and other non-bank financial institutions, make reasonable adjustments to the conditions set for financial bond issuance by financial leasing companies and auto finance companies, and step up financial support for consumers.

On May 9, the PBC, CBRC, CSRC, the China Insurance Regulatory Commission (CIRC) and the State Administration of Foreign Exchange (SAFE) jointly issued the *Notice on Regulating Interbank Businesses of Financial Institutions* (PBC Document [2014] No.127). The *Notice* sets down 18 guidelines to regulate the classification and accounting treatment of interbank businesses, improve internal and external management of interbank businesses, and promote regulated innovation in asset/liability activities.

On May 30, the PBC utilized 400 million Korean won (approximately 2.4 million yuan) under the China-South Korea bilateral local currency swap agreement to support trade finance for the corporate sector. This was the first time that the PBC drew on the foreign currency fund under a bilateral local currency swap agreement. On the same day, the Shanghai Clearing House (SCH) released the *Announcement on Client Clearing of RMB Interest Rate Swaps*, announcing the launch of client clearing of RMB interest rate swaps as of July 1, 2014.

On June 9, the PBC decided to lower the RMB reserve requirement ratio by 0.5 percentage points, effective from June 16, 2014, for commercial banks (excluding those that were subject to the reserve requirement ratio reduction on April 25, 2014) that comply with prudential requirements and extend a certain share of loans to the agricultural sector, rural areas and farmers, or to micro and small enterprises. The 0.5 percentage point reduction also applies to finance companies, financial leasing companies and auto finance companies.

On June 11, the National Interbank Funding Center issued the *Provisions on Trial Market Making in the Interbank Bond Market*. This was the first time that regulations were set on trial market making.

On June 18, the PBC issued the *Announcement* ([2014] No.11) and the *Announcement* ([2014] No.12), designating the China Construction Bank (London) Ltd. and the Frankfurt branch of the Bank of China (BOC) as the RMB clearing bank in London and Frankfurt, respectively. On the same day, with the authorization of the PBC, the CFETS announced the launch of direct trading between the RMB and the British pound in the interbank foreign exchange market.

On June 19, the MOF, the PBC and the CSRC jointly issued the *Notice on the Pilot Program of When-Issued Trading of Key-Tenor Treasury Bonds*, expanding the pilot program of when-issued trading of seven-year book-entry treasury bonds to include all book-entry treasury bonds of key tenors, i.e. 1Y, 3Y, 5Y, 7Y and 10Y.

On June 23, the first bond tender offer by a local government was conducted. The Guangdong province municipal bond, with an issue size of 14.8 billion yuan, became the first municipal bond in China that local governments issue and repay on their own.

On June 27, in order to improve the regulations on banks' purchase and sale of foreign exchange and safeguard the stable operation of the foreign exchange market, the PBC released the *Administrative Rules on the Purchase and Sale of Foreign Exchange by Banks* (PBC Decree [2014] No.2) following amendments to the *Interim Rules on the Administration of the Purchase and Sale of Foreign Exchange by Designated Foreign Exchange Banks* (PBC Decree [2002] No.4). The new rules shall come into effect on August 1, 2014.

On July 1, to further improve the market-based RMB foreign exchange rate formation mechanism, the PBC released the *Notice on Issues Concerning the Administration of Exchange Rates in Interbank Foreign Exchange Market Transactions and Exchange Rates Quoted by Banks* (PBC Document [2014] No.188).

On July 4, the PBC issued the *Announcement* ([2014] No.14), designating the Seoul branch of the Bank of Communications as the RMB clearing bank in Seoul.

On July 8, late Indica rice futures were listed on the Zhengzhou Commodity Exchange (ZCE).

On July 11, in accordance with the *Measures for the Administration of Debt Financing Instruments of Non-Financial Enterprises in the Interbank Bond Market* and relevant self-regulatory rules for the interbank market, the NAFMII formulated and issued the *Guidelines on the Issuance of Project Revenue Bills by Non-Financial Enterprises in the Interbank Bond Market*. This was an effort to meet the requirements of the Third Plenary Session of the 18th CPC Central Committee for setting up a transparent and regulated system of urban construction investment and financing and for improving financing structure, and to prevent and defuse local government debt risks.

On July 18, the PBC and the Central Bank of Argentina renewed their bilateral local currency swap agreement. The size of the new swap facility is 70 billion yuan, or 90 billion Argentine pesos. The agreement has a three-year maturity and can be extended upon mutual consent.

On July 21, the PBC and the Swiss National Bank signed a bilateral local currency swap agreement. The size of the swap facility is 150 billion yuan, or 21 billion Swiss francs. The agreement is valid for three years and can be extended upon mutual consent.

On July 22, the Postal Savings Bank of China conducted successfully a tender offer of the first tranche of Youyuan 2014 mortgage-backed securitization products in the interbank bond market, signaling the resumption of mortgage loan securitization.

On July 25, the CBRC announced its approval of the setting up of three private banks, namely, Shenzhen Qianhai WeBank, Wenzhou Civil and Commercial Bank and Tianjin Jincheng Bank.

On July 28, the SCH launched the netting service for AUD/CNY spot OTC transactions. On the same day, the CBRC issued the *Interim Provisions on the Administration of Specialized Subsidiaries of Financial Leasing Companies*.

On August 6, upon approval by the CBRC and the PBC, the Shunde Rural Commercial Bank issued successfully in the interbank market the first tranche of its 2014 credit asset-backed securities, the first such issue by one of the small and medium-sized rural financial institutions in China.

On August 8, ferrosilicon and silicomanganese futures were listed on the ZCE.

On August 21, the PBC and the Bank of Mongolia renewed a bilateral local currency swap agreement. The size of the swap facility is 15 billion yuan, or 4.5 trillion Mongolian tugrik. The agreement is valid for three years and can be extended upon mutual consent.

On August 22, the CSRC issued the *Tentative Measures for the Supervision and Administration of Private Investment Funds*.

On September 1, in line with the overall arrangements of the PBC for setting up trial market making for interbank gold bilateral trading, the Shanghai Gold Exchange (SGE), in cooperation with the CFETS, launched trial market making for interbank gold bilateral trading. The move is aimed at increasing liquidity in the interbank bilateral gold market, contributing to price discovery, and effectively bringing into play the functions of the gold market.

In September, the PBC launched the Medium-Term Lending Facility (MLF) to provide medium-term base money for financial institutions that comply with macroprudential requirements. The interest rates on the MLF would serve as the medium-term policy rate to help reduce the social financing cost.

On September 5, the PBC issued the *Announcement* ([2014] No.15) and the *Announcement* ([2014] No.20), designating the BOC's Paris branch and the Luxembourg branch of the Industrial and Commercial Bank of China (ICBC) as the RMB clearing bank in Paris and Luxembourg, respectively.

On September 16, the PBC and the Central Bank of Sri Lanka signed a bilateral local currency swap agreement. The size of the swap facility is 10 billion yuan, or LKR225 billion. The agreement is valid for three years and can be extended upon mutual consent. On the same day, the Bank of Communications Financial Leasing Co., Ltd. conducted a tender offer of asset-backed securities worth about 1.012 billion yuan, and became the first financial leasing company in China to participate in the pilot program of asset securitization.

On September 18, the SGE launched its international board.

On September 28, to facilitate trade and investment, the General Administration Department of the PBC released the *Notice on Cross-Border RMB Settlement of Debt-financing Instruments Issued by Overseas Institutions in China* (PBC General Administration Department Document [2014] No.221).

On September 29, with the authorization of the PBC, the CFETS announced the start of direct trading between the RMB and the euro in the interbank foreign exchange market.

On October 2, the General Office of the State Council issued the *Opinions of the State Council on Strengthening the Administration of Local Government Debt*, the first time that the State Council issued a document to regulate comprehensively the administration of local government debt.

On October 20, the Securities Association of China issued the *Pilot Measures for Short-Term Corporate Bonds by Securities Companies*, giving approval to the issuance of short-term corporate bonds by securities companies through the Inter-institutional Quotation and Service System for Privately Offered Products.

On October 21, the UK government listed its first RMB-denominated sovereign bond on the London Stock Exchange.

On October 28, with the authorization of the PBC, the CFETS announced the start of direct trading between the RMB and the Singapore dollar in the interbank foreign exchange market.

On November 2, the PBC issued the *Announcement* ([2014] No.25), designating the ICBC's Doha branch as the RMB clearing bank in Doha.

On November 3, the PBC issued the *Announcement* ([2014] No.27), designating the ICBC (Canada) as the RMB clearing bank in Toronto. On the same day, the NAFMII released the *Notice of the PBC Financial Market Department on Issues Concerning the Access of Qualified Non-Financial Institutional Investors to the Interbank Bond Market*, allowing qualified non-financial institutional investors to trade bonds through a dedicated trading platform.

On November 4, the PBC and the CSRC released the *Circular on Issues Concerning the Pilot Project of Shanghai-Hong Kong Stock Exchanges Connectivity Mechanism* (PBC Document [2014] No.336).

On November 6, in accordance with the *Law of the People's Republic of China on the People's Bank of China* and the *Securities Law of the People's Republic of China*, the PBC and the CSRC decided to establish the *Regulations on Bond Statistics*, in an effort to reflect fully and accurately the development of the bond market and to monitor and assess comprehensively the influence of the bond market on monetary policy and financial stability.

On November 10, to promote the development of capital markets in mainland China and Hong Kong, the CSRC and the Securities and Futures Commission of Hong Kong approved the launch of a pilot program for establishing a Shanghai-Hong Kong stock exchanges connectivity mechanism (Shanghai-Hong Kong Stock Connect) by the Shanghai Stock Exchange, the Stock Exchange of Hong Kong Limited, the China Securities Depository and Clearing Corporation Limited and the Hong Kong Securities Clearing Company Limited. Stock trading under the program started on November 17, 2014.

On November 14, the PBC issued the *Announcement* ([2014] No.26), designating the BOC's Sydney branch as the RMB clearing bank in Sydney.

On November 20, the CBRC issued a circular, announcing that the approval-based administration of credit asset securitization shall become registration-based, and that the issues of securitization products shall no longer be reviewed and approved on a case-by-case basis.

On November 21, the PBC decided to cut RMB benchmark loan and deposit interest rates for financial institutions as of November 22, 2014. The one-year benchmark loan interest rate and deposit interest rate shall be lowered by 0.4 percentage points to 5.6 percent and by 0.25 percentage points to 2.75 percent, respectively. At the same time, the upper limit of the floating range for deposit interest rates shall be raised from 1.1 to 1.2 times the benchmark level in support of market-oriented interest rate reform. Adjustments are made correspondingly to benchmark interest rates on loans and deposits of other maturities. Maturity brackets are also duly reduced.

On December 1, the BOC and the China Development Bank (CDB) jointly issued to retail and non-financial institutional customers the first tranche of CDB bonds via BOC counters, offering more investment products to investors.

On December 3, in accordance with relevant provisions in the *Rules for Interbank Gold Bilateral Trading on the Shanghai Gold Exchange (Revised)*, the SGE and the CFETS amended the *Guidelines for Interbank Gold Bilateral Business Products* to regulate the market order for interbank gold bilateral trading on the SGE and protect the legitimate rights and interests of market participating institutions.

On December 5, the CSRC released the

Administrative Measures for the Issuance and Trading of Corporate Bonds (Consultation Draft), the *Administrative Measures for the Pilot Program of Stock Option Trading (Consultation Draft)* and the *Guidelines for the Participation of Securities and Futures Institutions in the Pilot Program of Stock Option Trading* to solicit public comments.

On December 9, in order to implement the guiding principles of the Third Plenary Session of the 18th CPC Central Committee, further streamline administration and delegate power, diversify market participants, and promote the development of the foreign exchange market, the SAFE issued the *Notice on Adjusting Policies Related to the Administration of Financial Institutions' Access to the Interbank Foreign Exchange Market* (SAFE Document [2014] No.48).

On December 12, to set up a market-based risk resolution mechanism for the trust industry, protect the legitimate rights and interests of parties concerned, prevent risks, and promote the sustainable and sound development of the trust industry, the CBRC and the MOF jointly formulated and issued the *Measures for the Administration of the Security Fund for the Trust Industry*. On the same day, the CSRC approved the launch of crude oil futures trading on the Shanghai International Energy Exchange.

On December 15, the CFETS launched regional trading between the RMB and the Kazakh tenge in the interbank market.

On December 18, to adapt to the demand for bilateral trading on the international board, protect the legitimate rights and interests of market participants, and prevent market risks, the SGE amended and issued the *Detailed Rules for Bilateral Trading on the Shanghai Gold Exchange*.

On December 19, corn starch futures were listed on the DCE.

On December 27, the PBC released the *Notice on Issues Concerning the Policies on Required Reserves and Interest Rate Administration After the Adjustment of Deposit Calculation Rules*. According to the *Notice*, some types of funds formerly counted as interbank deposits, such as securities funds and transaction settlement funds deposited with depository financial institutions and non-deposit interbank funds, shall be included in regular deposits.

On December 29, in accordance with the *Administrative Rules on the Purchase and Sale of Foreign Exchange by Banks*, the SAFE released the *Notice of the State Administration of Foreign Exchange on the Issuance of the Detailed Rules for the Implementation of the Administrative Rules on the Purchase and Sale of Foreign Exchange by Banks* (SAFE Document [2014] No.53) to facilitate banks' purchase and sale of foreign exchange.

On December 30, the SGE amended and issued the *Detailed Rules for Gold Lending Transactions on the Shanghai Gold Exchange* to support the launch of bilateral businesses on the SGE's international board, regulate the gold lending market order, and protect the legitimate rights and interests of market participating institutions.

On December 31, the CBRC, MOF, PBC, CSRC and CIRC jointly issued the *Regulatory Measures for Financial Asset Management Companies*, setting rules in terms of the regulatory framework for comprehensive management and control in asset company groups.

Appendix II China Financial Market Statistics

Table 1 Major Macroeconomic and Financial Indicators, 1998—2014 (Year-End Balance)

Item	1998	1999	2000	2001	2002	2003	2004
GDP	84,402	89,677	99,215	109,655	120,333	135,823	159,878
Growth rate	7.8	7.6	8.4	8.3	9.1	10	10.1
Exports & imports (USD100 million//100 million yuan)	3,239.3	3,607	4,743	5,097.7	6,208	8,512	11,547
Growth rate	-0.4	11.3	31.5	7.5	21.8	37.1	35.7
Exports (USD100 million)	1,837.6	1,949	2,492	2,661	3,256	4,384	5,934
Imports (USD100 million)	1,401.7	1,658	2,251	2,436.1	2,952	4,128	5,614
Foreign exchange reserves (USD100 million)	1,450.0	1,546.8	1,655.7	2,121.7	2,864	4,033	6,099
Foreign direct investment (USD100 million)	454.6	404	408	468.5	527	535	606
Fiscal revenue	9,876	11,444.1	13,380.1	16,371	18,914	21,691	26,355.9
Fiscal expenditure	10,798.2	13,187.7	15,879.4	18,844	22,012	24,607	28,360.8
Deficit/surplus	-922.2	-1,743.6	-2,499.3	-2,473	-3,098	-2,916	-2,004.9
Money supply (M2)	104,499	119,898	134,610.3	158,301.9	185,007	221,222.8	254,107
Growth rate	15.3	14.7	12.3	17.6	16.9	19.6	14.9
Money supply (M1)	38,953.7	45,837.2	53,147.2	59,871.6	70,822	84,118.6	95,969.7
Growth rate	11.9	17.7	15.9	12.7	18.3	18.8	14.1
Money supply (M0)	11,204.2	13,455.5	14,652.7	15,688.8	17,278	19,746	21,468.3
Growth rate	10.1	20.1	8.9	7.1	10.1	14.3	8.7
Per capita disposable income of urban residents (yuan)	5,245	5,854	6,280	6,859.6	7,703	8,500	9,422
Real growth rate	5.8	9.3	6.4	8.5	13.4	9	7.7
Net income of rural residents (yuan)	2,163.6	2,210	2,253	2,366	2,475.6	2,622	2,936
Real growth rate	4.3	3.8	2.1	4.2	4.8	4.3	6.8
Total deposits with financial institutions	95,697.9	108,779	123,804.4	143,617.2	170,917.4	208,055.6	241,424.3
Growth rate	16.1	13.7	13.8	16.0	19.0	21.7	16.0
Total loans by financial institutions	86,524.1	93,734.3	99,371.1	112,314.7	131,293.9	158,996.2	178,197.8
Growth rate	15.5	8.3	6.0	13.0	16.9	21.1	12.1
CPI	-0.8	-1.4	0.4	0.7	-0.8	1.2	3.9

Notes: 1. Past data have been adjusted according to latest statistical releases.
2. From 2009 onwards, the value of exports, the value of imports, and the total value of exports and imports are denominated in RMB.

Sources: National Bureau of Statistics of China, the People's Bank of China and Ministry of Finance of the People's Republic of China.

Units: 100 million yuan, %

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
184,937	216,314	265,810	314,045	340,903	408,903	484,124	534,123	588,019	636,463
10.4	12.7	14.2	9.6	9.2	10.6	9.5	7.7	7.7	7.4
14,221	17,607	21,738	25,616	22,073	201,723	236,402	244,160	258,168	264,335
23.2	23.8	23.5	17.8	-13.9	34.7	17.2	3.2	5.7	2.39
7,620	9,690	12,205	14,307	12,016	107,023	123,241	129,359	137,131	143,912
6,601	7,915	9,561	11,326	10,059	94,700	113,161	114,801	121,037	120,423
8,189	10,663	15,282	19,460	23,992	28,473	31,811	33,116	38,213	38,430
603	694.7	747.7	924	900	1,057	1,160	1,117	1,176	1,196
31,628	38,760.2	51,304	61,330	68,518	83,102	103,874	117,254	129,210	140,350
33,708.1	40,222.7	49,565.4	62,593	76,300	89,874	109,248	125,953	140,213	151,662
-2,080.1	-1,462.5	1,738.6	-1,263	-7,782	-6,772	-5,374	-8,699	-11,003	-11,312
296,040.1	345,577.9	403,401.3	475,166.6	606,223.6	725,851.79	851,590.9	974,148.8	1,106,524.98	1,228,374.81
16.5	16.7	16.7	17.8	27.6	19.7	13.5	14.4	13.6	11
107,279.9	126,028.1	152,519.2	166,217.1	220,004.5	266,621.54	289,847.7	308,664.2	337,291.05	348,056.41
11.8	17.5	21.0	9.0	32.4	21.2	7.9	6.5	9.3	3.2
24,032.8	27,072.6	30,334.3	34,218.96	38,245.97	44,628.17	50,748.46	54,659.77	58,574.44	60,259.53
11.9	12.6	12	12.8	11.8	16.7	13.8	7.7	7.1	2.9
10,493	11,759	13,786	15,781	17,175	19,109	21,810	24,565	26,955	28,844
9.6	10.4	12.2	8.4	9.8	7.8	8.4	12.6	9.7	6.8
3,255	3,587	4,140	4,761	5,153	5,919	6,977	7,917	8,896	9,892
6.2	7.4	9.5	8	8.5	10.9	11.4	13.5	9.3	11.2
300,208.6	348,015.6	401,051.4	478,444.2	612,005.1	733,382.03	826,701.35	943,102.27	1,070,587.72	1,173,734.59
24.3	15.9	15.2	19.3	27.9	19.8	12.7	14.1	13.5	9.6
206,838.5	238,279.8	277,746.5	320,048.7	425,622.6	509,225.95	581,892.5	672,874.61	766,326.64	867,867.89
16.1	15.2	16.6	15.2	33.0	19.6	14.3	15.6	13.9	13.3
1.8	1.5	4.8	5.9	-0.7	3.3	5.4	2.6	2.6	2

Table 2 Composition and Growth of RMB and Foreign Currency Deposits and Loans, 1998—2014 (Year-End Balance)

Item	1998	1999	2000	2001	2002	2003	2004
Total deposits with financial institutions	95,697.9	108,778.9	123,804	143,617.2	170,917.4	208,055.6	241,424.3
YoY growth	16.1	13.7	13.8	16.0	19.0	21.7	16.0
Of which: Deposits of urban & rural residents	53,407.5	59,621.8	64,332.4	73,762.4	86,910.7	103,617.7	119,555.4
YoY growth	17.1	11.6	7.9	14.7	17.8	19.2	15.4
Corporate deposits	32,486.6	37,182.4	44,093.7	51,546.6	60,028.6	72,487.1	84,669.5
YoY growth	13.4	14.5	18.6	16.9	16.5	20.8	16.8
Total loans by financial institutions	86,524.1	93,734.3	99,371.1	112,314.7	131,293.9	158,996.2	178,197.8
YoY growth	15.5	8.3	6.0	13.0	16.9	21.1	12.1
Of which: Short-term loans	60,613.2	63,887.6	65,748.1	67,327.2	76,822.4	87,397.9	90,808.3
YoY growth	9.4	5.4	2.9	2.4	14.1	13.8	3.9
Medium- and long-term loans	20,717.8	23,968.3	27,931.2	39,238.1	51,731.6	67,251.7	81,010.1
YoY growth	33.9	15.7	16.5	40.5	31.8	30.0	20.5

Note: Starting from 2011, monetary aggregates have included deposits of housing provident fund centers and non-depository financial institutions' deposits with depository financial institutions.
Source: The People's Bank of China.

Units: 100 million yuan, %

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
300,208.6	348,015.6	401,051.4	478,444.21	612,005.1	733,382.03	826,701.35	943,102.27	1,070,587.72	1,173,734.59
24.3	15.9	15.2	19.3	27.9	19.8	12.7	14.1	13.5	9.6
147,053.7	166,616.2	176,213.3	221,503.47	264,756.9	307,166.39	357,901.58	415,549.87	471,090.18	512,790.14
23.0	13.3	5.8	25.7	19.5	16.0	16.5	16.1	13.4	8.9
101,750.6	118,851.7	144,814.1	164,385.79	224,360	252,960.27	423,086.61	478,730.2	541,793.87	591,069.28
20.2	16.8	21.8	13.5	36.5	12.7	67.3	13.2	13.2	9.1
206,838.5	238,279.8	277,746.5	320,048.68	425,622.6	509,225.95	581,892.5	672,874.61	766,326.64	867,867.89
16.1	15.2	16.6	15.2	33.0	19.6	14.3	15.6	13.9	13.3
91,157.5	101,698.2	118,898	128,571.47	151,390.7	171,236.64	217,480.1	268,152.19	311,771.97	336,371.27
0.4	11.6	16.9	8.1	17.7	13.11	27	23.3	16.3	7.9
92,940.5	113,009.8	138,581	164,160.42	235,591.3	305,127.55	333,746.51	363,894.22	410,345.5	471,818.36
14.7	21.6	22.6	18.5	43.5	29.5	9.4	9	12.8	15

Table 3 Outstanding Loans, Outstanding Bonds and Stock Market Capitalization As Percentage of GDP, 2006—2014

Units: 100 million yuan, %

Year	GDP	Outstanding loans	Outstanding loans /GDP	Outstanding bonds	Outstanding bonds /GDP	Stock market capitalization	Stock market capitalization /GDP
2006	216,314	238,280	110.2	92,740	42.9	89,404	41.3
2007	265,810	277,747	104.5	124,470	46.8	327,140.9	123.1
2008	314,045	320,049	101.9	151,648	48.3	121,366.4	38.6
2009	340,903	425,623	124.9	176,430	51.8	243,939.12	71.6
2010	397,983	509,226	128	205,481	51.6	265,422.59	66.7
2011	471,564	581,893	123	223,786	47.5	214,758.1	45.5
2012	519,470	672,875	130	262,058	50.4	230,357.6	44..3
2013	568,845	766,327	135	296,165	52.1	239,077.2	42
2014	636,463	867,868	136	349,783	55.0	372,546.92	59

Notes: 1. *Outstanding loans* refers to the outstanding amount of all RMB and foreign currency loans of financial institutions.
2. *Outstanding bonds* includes bonds in custody in the interbank market and on the stock exchange.
Sources: The People's Bank of China, China Central Depository & Clearing Co., Ltd., China Securities Depository & Clearing Corp., Ltd. and China Securities Regulatory Commission.

Table 4 Composition of All-System Financing, 2010—2014

Units: 100 million yuan

Year	Financing aggregate	RMB loans	Foreign currency loans	Entrusted loans	Trust loans	Undiscounted bank acceptances	Net bond financing by enterprises	Domestic equity financing by non-financial enterprises	Others
2010	13.94	7.86	0.49	0.88	0.39	2.34	1.11	0.58	0.29
2011	12.83	7.47	0.57	1.3	0.2	1.03	1.37	0.44	0.45
2012	15.76	8.20	0.92	1.28	1.28	1.05	2.26	0.25	—
2013	17.29	8.89	0.58	2.54	1.84	0.78	1.8	0.22	—
2014	16.46	9.78	0.36	2.51	0.52	-0.13	2.43	0.44	—

Notes: 1. *Net bond financing by enterprises* excludes bonds issued by financial enterprises.
2. *Others* includes insurance claim payments, insurance companies' investment properties, etc..
Source: The People's Bank of China.

Table 5 Interbank Funding and Bond Repo Trading, 1997—2014

Unit: 100 million yuan

Year	Interbank funding	Pledged repo trading	Outright repo trading
1997	8,298	310	—
1998	1,978	1,021	—
1999	3,291	3,957	—
2000	6,728	15,785	—
2001	8,082	40,133	—
2002	12,107	101,885	—
2003	24,113	117,203	—
2004	14,556	93,105	1,263
2005	12,783	156,784	2,223
2006	21,503	263,021	2,892
2007	106,466	440,672	7,253
2008	150,492	563,830	17,376
2009	193,505	677,007	25,891
2010	278,684	846,533	29,402
2011	334,412	966,650	27,885
2012	467,044	1,366,174	50,966
2013	355,190	1,519,757	61,882
2014	376,626	2,124,191	120,035

Source: China Foreign Exchange Trade System.

Table 6 Change in Interbank Funding Market Participants, 1997—2014

Year	Banks	Securities companies	Insurance companies	Trust companies	Finance companies	Leasing companies	Rural credit unions	City credit cooperatives	Asset management companies	Auto finance companies	Others	Total
1997	59	—	—	—	—	—	—	—	—	—	37	96
1998	165	—	—	—	—	—	—	—	—	—	2	167
1999	187	7	—	—	—	—	99	—	—	—	3	296
2000	232	14	—	—	20	—	148	—	—	—	3	417
2001	246	18	—	—	25	—	198	—	—	—	3	490
2002	261	41	—	—	25	—	202	4	—	—	3	536
2003	289	56	—	—	32	—	229	10	—	—	1	617
2004	309	64	—	—	35	—	236	11	—	—	1	656
2005	323	66	—	—	38	—	239	12	—	—	1	679
2006	339	53	—	—	46	—	250	15	—	—	0	703
2007	326	56	—	3	49	—	267	16	—	—	0	717
2008	340	58	—	16	55	4	298	13	2	2	0	788
2009	348	65	6	26	68	6	320	9	3	3	0	854
2010	347	68	6	30	72	11	338	8	3	5	0	888
2011	347	70	7	38	77	11	369	7	4	6	1	937
2012	359	77	7	39	81	16	422	7	5	8	1	1,022
2013	368	82	9	45	98	16	482	7	5	9	1	1,122
2014	349	87	10	54	129	17	547	7	5	13	1	1,219

Source: National Interbank Funding Center.

Table 7 Bill Market, 1998—2014

Unit: 1 trillion yuan

Year	Cumulative value of bills drawn	Cumulative value of bills discounted
1998	0.38	0.27
1999	0.51	0.25
2000	0.74	0.64
2001	1.28	1.55
2002	1.61	2.31
2003	2.77	4.44
2004	3.42	4.71
2005	4.45	6.75
2006	5.43	8.49
2007	5.87	10.11
2008	7.09	13.51
2009	10.27	23.16
2010	12.2	48.6
2011	15.1	25.0
2012	17.9	31.6
2013	20.3	45.7
2014	22.1	60.7

Source: The People's Bank of China.

Table 8 Bond Market Trading, 2006—2014

Unit: 100 million yuan

Year	Inter-bank bond market				Stock exchange treasury bond market				OTC market	
	Spot trading	YoY change (%)	Repo trading	YoY change (%)	Spot trading	YoY change (%)	Repo trading	YoY change (%)	Turnover	YoY change (%)
2006	102,558.6	70.55	265,912.71	67.23	1,977.83	—	16,299.25	—	42.8	-34.86
2007	156,038.21	52.15	447,924.95	68.45	2,051.75	3.74	18,615.47	14.21	35.7	-16.59
2008	371,082.7	137.82	581,205.24	29.76	4,294.73	109.32	24,306.77	30.57	30.4	-14.85
2009	472,646.43	27.37	702,898.6	20.94	4,659.86	8.50	35,975.19	48.00	62.8	106.58
2010	640,418.98	35.50	875,935.55	24.62	5,832.26	25.16	70,053.21	94.73	41.7	-33.60
2011	636,422.9	-0.62	994,534.79	13.54	6,839.9	17.28	209,509.63	199.07	27.89	-33.12
2012	751,952.83	18.15	1,417,140.3	42.49	9,852.7	44.05	393,550.94	87.84	14.99	-46.25
2013	416,106.44	-44.66	1,581,639.6	11.61	17,387.6	76.48	661,023	67.96	18.72	24.88
2014	403,565.2	-3	2,244,225.5	41.89	27,874.4	60.31	907,166.25	37.24	71.7	283.01

Note: *Repo trading* includes pledged repo trading and outright repo trading.
Sources: The People's Bank of China, Shanghai Stock Exchange and Shenzhen Stock Exchange.

Table 9 Bond Market in 2014

Unit: 100 million yuan

Month	Interbank bond market			Stock exchange market			OTC market	
	Spot trading	YoY change (%)	Interbank aggregate bond index	Spot trading	YoY change (%)	Stock exchange treasury bond index	Turnover	YoY change (%)
Jan.	19,144.8	-76.08	111.03	1,671.2	27.5	139.58	1.45	79
Feb.	21,018.0	-58.7	112.42	1,510.2	45	139.9	1.08	-18.18
Mar.	30,728.2	-63.86	111.84	2,007	27.9	140.54	1.6	-20.4
Apr.	34,436.2	-49.3	112.53	1,851.1	30	140.8	0.79	-55.62
May	36,435.8	35.49	113.82	1,593.7	4.5	141.54	2.28	23.24
Jun.	33,561.5	183.48	114.21	2,048.3	61.8	142.02	2.57	61.64
Jul.	36,582.3	184.65	113.53	2,485.7	75.4	142.3	27.77	2,103.97
Aug.	34,171.9	149.64	113.9	2,095.2	58.3	142.74	3.71	7.85
Sept.	39,893.7	183.78	114.76	2,258.9	35.8	143.6	4.08	296.12
Oct.	36,556.7	151.42	116.42	2,231.6	95.9	144.49	2.9	90.79
Nov.	38,485.8	114.71	117.54	3,062.1	82	145.37	13.6	1,171.03
Dec.	42,550.4	118.72	116.49	5,059.4	149.8	145.68	9.9	851.92
Total	403,565.2	-3	—	27,874.4	44.5	—	71.73	283.01

Note: *Spot trading* is valued using the full price. The *interbank aggregate bond index* is a clean price index.
Sources: The People's Bank of China, China Central Depository & Clearing Co., Ltd., Shanghai Stock Exchange and China Foreign Exchange Trade System.

Table 10 Bond Market Issuance, 2004—2014

Unit: 100 million yuan

Year	Government debentures			Financial bonds				Corporate debentures							
	Treasury bonds	Local government bond	Sub-total	CDB and policy bank bonds	Short-term financing bonds of securities companies	Other financial bonds	Sub-total	Debt financing instruments of non-financial enterprises	Enterprise bonds	Corporate bonds	Sub-total	Credit asset-backed securities	Government-backed agency bonds	Central bank bills	Total
2004	7,318.8	0.0	7,318.8	4,348.0	0.0	748.8	5,096.8	0.0	326.0	209.0	535.0	0.0	0.0	17,037.3	29,988.0
2005	7,042.0	0.0	7,042.0	6,051.7	29.0	1,036.3	7,117.0	1,424.0	654.0	0.0	2,078.0	41.8	0.0	27,882.0	44,160.8
2006	8,883.3	0.0	8,883.3	8,980.0	0.0	525.0	9,505.0	2,919.5	995.0	142.9	4,057.4	115.8	0.0	36,573.8	59,135.3
2007	23,483.4	0.0	23,483.4	10,931.9	0.0	972.7	11,904.6	3,349.1	1,720.0	407.3	5,476.4	178.1	0.0	40,721.3	81,763.8
2008	8,546.3	0.0	8,546.3	10,809.3	0.0	974.0	11,783.3	6,075.5	2,367.0	976.5	9,419.0	302.1	0.0	42,960.0	73,010.6
2009	16,213.6	2,000.0	18,213.6	11,678.1	0.0	3,071.0	14,749.1	11,509.7	4,252.0	715.0	16,476.7	0.0	0.0	39,740.0	89,179.4
2010	17,778.2	2,000.0	19,778.2	13,192.7	0.0	979.5	14,172.2	11,863.0	3,627.0	1,320.3	16,810.3	0.0	1,090.0	46,608.0	98,458.6
2011	15,397.9	2,000.0	17,397.9	19,972.7	0.0	3,528.5	23,501.2	18,503.2	2,473.5	1,707.4	22,684.1	0.0	1,000.0	14,140.0	78,723.2
2012	14,360.4	2,500.0	16,860.4	21,399.0	561.0	4,233.7	26,193.7	26,547.2	6,499.3	2,722.8	35,769.3	192.6	1,500.0	0.0	80,515.9
2013	16,945.0	3,500.0	20,445.0	20,760.3	2,995.9	1,321.0	25,077.2	28,357.9	4,752.3	4,081.4	37,191.6	157.7	1,900.0	5,362.0	90,133.5
2014	17,047.3	4,000.0	21,047.3	22,900.5	4,246.9	5,459.5	32,606.9	41,217.6	6,952.0	3,483.8	51,653.4	2,793.5	1,850.0	0.0	109,951.1

Notes: 1. *Debt financing instruments of non-financial enterprises* includes commercial papers, super short-term commercial papers, medium-term notes, collective notes, private placement notes, collective notes issued by promising regional SMEs, asset-backed notes issued by non-financial enterprises, etc..

2. *Corporate bonds* includes corporate bonds, convertible bonds, detachable convertible bonds, SME private placement bonds, etc..

Source: The People's Bank of China.

Table 11 Bond Custody, 2006—2014

Unit: 100 million yuan

Year	Government debentures			Financial bonds				Corporate debentures				Credit asset-backed securities	Government-backed agency bonds and others	Central bank bills	Interbank custody	Exchange custody	Total custody
	Treasury bonds	Local government bonds	Total	CDB and policy bank bonds	Short-term financing bonds of securities companies	Other financial bonds	Total	Debt financing instruments of non-financial enterprises	Enterprise bonds	Corporate bonds	Total						
2006	29,048	0	29,048	22,836	0	2,552	25,388	2,667	2,832	288	5,786	188	30	32,300	88,910	3,830	92,740
2007	46,503	0	46,503	28,784	0	3,486	32,270	3,203	4,422	1,131	8,756	324	30	36,587	120,102	4,368	124,470
2008	48,753	0	48,753	36,720	0	4,255	40,975	5,875	6,803	539	13,218	551	30	48,121	148,100	3,548	151,648
2009	55,411	2,000	57,411	44,498	0	6,454	50,952	13,196	10,971	1,135	25,301	399	40	42,326	172,476	3,954	176,430
2010	62,628	4,000	66,628	51,604	0	6,662	58,266	20,271	14,511	3,584	38,366	182	1,130	40,909	199,019	6,462	205,481
2011	67,839	6,000	73,839	64,778	0	9,785	74,563	29,047	16,799	6,023	51,869	95	2,130	21,290	214,260	9,526	223,786
2012	74,236	6,500	80,736	78,582	295	13,126	92,003	40,327	19,310	7,441	67,078	269	8,532	13,440	250,014	12,044	262,058
2013	83,165	8,615	91,780	88,720	810	13,535	103,064	51,483	23,359	10,553	85,394	354	10,067	5,522	276,788	19,377	296,165
2014	91,450	11,624	103,073	99,874	1,134	17,213	118,221	67,901	29,513	12,335	109,749	2,751	11,706	4,282	323,808	25,975	349,783

Notes: 1. *Debt financing instruments of non-financial enterprises* includes commercial papers, super short-term commercial papers, medium-term notes, collective notes, private placement notes, collective notes issued by promising regional SMEs, asset-backed notes issued by non-financial enterprises, etc..

2. *Corporate bonds* includes corporate bonds, convertible bonds, detachable convertible bonds, SME private placement bonds, etc..

Source: The People's Bank of China.

Table 12 Issuance and Redemption of Treasury Bonds, 2006—2014

Unit: 100 million yuan

Year	Issuance	Redemption	End-period outstanding
2006	8,883.3	4,163	29,048
2007	23,483.4	4,090	46,503
2008	8,546.3	4,930	48,753
2009	16,213.6	7,570	55,411
2010	17,778.2	8,605	62,628
2011	15,397.9	8,578	67,839
2012	14,360.4	6,340	74,236
2013	16,945.0	6,606	83,165
2014	17,047.3	7,140	91,450

Note: *Redemption* includes redemption before maturity and at maturity.
Sources: The People's Bank of China and China Central Depository & Clearing Co., Ltd..

Table 13 Number of Interbank Bond Market Participants, 2000—2014

Year	Banks	Securities companies	Funds	Insurance institutions	Non-banking institutions	Credit cooperatives	Others	Enterprises	Total
2000	159	2	32	11	7	102	2	0	315
2001	156	2	41	11	15	254	2	1	482
2002	182	25	78	20	52	423	2	32	814
2003	198	87	192	38	97	575	3	1,889	3,079
2004	231	95	361	63	117	665	11	2,755	4,298
2005	271	103	500	91	121	680	13	3,729	5,508
2006	295	107	613	104	136	711	23	4,450	6,439
2007	308	112	688	113	142	762	30	4,940	7,095
2008	341	117	1,053	128	154	801	24	5,681	8,299
2009	391	123	1,589	131	164	843	16	5,990	9,247
2010	445	123	2,170	135	175	869	19	6,299	10,235
2011	483	128	2,890	144	188	903	55	6,371	11,162
2012	557	133	3,991	154	192	916	97	6,375	12,415
2013	546	130	4,147	140	159	568	128	257	6,075
2014	591	129	4,667	145	175	522	202	250	6,681

Note: *Funds* includes fund companies and non-incorporated entities such as securities investment funds, corporate annuities, social security fund, foundations, sector funds, insurance products, trust schemes, specific asset management portfolios of fund companies, and asset management schemes of securities companies.
Source: China Central Depository & Clearing Co., Ltd..

Table 14 Interbank Bond Market Settlement Agents, 2014

Serial number	Institution	Serial number	Institution
1	Industrial and Commercial Bank of China	25	Fudian Bank
2	Agricultural Bank of China	26	Harbin Bank
3	Bank of China	27	Jinshang Bank
4	China Construction Bank	28	Bank of Guiyang
5	Bank of Communications	29	Bank of Xi'an
6	China Merchants Bank	30	Fujian Haixia Bank
7	China CITIC Bank	31	Qishang Bank
8	China Everbright Bank	32	Qilu Bank
9	Industrial Bank	33	Urumqi City Commercial Bank
10	China Minsheng Bank	34	Bank of Dongguan
11	Huaxia Bank	35	Bank of Chengdu
12	Shanghai Pudong Development Bank	36	Baoshang Bank (Suspended)
13	Ping An Bank	37	Bank of Changsha
14	China Guangfa Bank	38	Bank of Hebei
15	Evergrowing Bank	39	Xiamen Bank
16	Bank of Beijing	40	Bank of Qingdao
17	Bank of Shanghai	41	Shanghai Rural Commercial Bank
18	Bank of Nanjing	42	Changshu Rural Commercial Bank
19	Bank of Tianjin	43	HSBC Bank (China) Co., Ltd.
20	Bank of Hangzhou	44	Shunde Rural Commercial Bank
21	Hankou Bank	45	Deutsche Bank (China) Co., Ltd.
22	Bank of Dalian	46	Standard Chartered Bank (China) Ltd.
23	Bank of Chongqing	47	BNP Paribas (China) Ltd.
24	Bank of Ningbo		

Source: National Association of Financial Market Institutional Investors.

Table 15 Interbank Bond Market Makers

China Development Bank	Bank of China
China Construction Bank	Hankou Bank CITIC Securities Co., Ltd.
China Merchants Bank	China Minsheng Bank
China CITIC Bank	China Everbright Bank
Bank of Beijing	Bank of Hangzhou
Evergrowing Bank	Agricultural Bank of China
Bank of Shanghai	Shanghai Pudong Development Bank
Hankou Bank	China International Capital Corp., Ltd.
Bank of Communications	Industrial Bank
Bank of Nanjing	Guotai Junan Securities Co., Ltd.
Industrial and Commercial Bank of China	China Guangfa Bank
JPMorgan Chase Bank (China) Co., Ltd.	Standard Chartered Bank (China) Ltd.
Citibank (China) Co., Ltd.	

Source: China Foreign Exchange Trade System.

Table 16 Participating Banks in OTC Bond Trading

Industrial and Commercial Bank of China	China Merchants Bank
Agricultural Bank of China	China Minsheng Bank
Bank of China	Bank of Beijing
China Construction Bank	Bank of Nanjing

Source: The People's Bank of China.

Table 17 Primary Dealers for Open Market Operations, 2014

Agricultural Bank of China	Bank of China
Industrial and Commercial Bank of China	Bank of Communications
China Construction Bank	China Development Bank
China Merchants Bank	China Everbright Bank
China Minsheng Bank	Shanghai Pudong Development Bank
China CITIC Bank	Industrial Bank
Postal Savings Bank of China	China Guangfa Bank
Hankou Bank	Bank of Shanghai
Fujian Haixia Bank	Bank of Beijing
Fudian Bank	Bank of Nanjing
Bank of Hangzhou	Evergrowing Bank
Ping An Bank	Qishang Bank
Bank of Guangzhou	Harbin Bank
Bank of Jiangsu	Huishang Bank
Xiamen Bank	Bank of Hebei
Bank of Tianjin	Bank of Dalian
Bank of Guiyang	Bank of Luoyang
Shanghai Rural Commercial Bank	Bank of Xi'an
HSBC Bank (China) Co., Ltd.	Beijing Rural Commercial Bank
Standard Chartered Bank (China) Ltd.	Citibank (China) Co., Ltd.
First Capital Securities Co., Ltd.	CITIC Securities Co., Ltd.
China International Capital Corp., Ltd.	Guotai Junan Securities Co., Ltd.
Guangzhou Rural Commercial Bank	Bank of Ningbo

Source: The People's Bank of China.

Table 18 Stock Market Statistics, 1997—2014

Year	Number of listed companies	Listed share capital (100 million shares)	Market cap (100 million yuan)	Free-float Market cap (100 million yuan)	Total capital raised on the A-share market (100 million yuan)	Turnover (100 million yuan)	Average turnover ratio (%)		Average P/E ratio (%)		Investor accounts (10,000)
							Shanghai	Shenzhen	Shanghai	Shenzhen	
1997	745	1,942.7	17,529.2	5,204.4	—	30,721.8	701.8	817.4	39.9	39.9	3,480.3
1998	851	2,526.8	19,505.6	5,745.6	—	23,527.3	453.6	406.6	34.4	30.6	4,259.9
1999	949	3,089.0	26,471.2	8,214.0	—	31,319.6	471.5	424.5	38.1	36.3	4,810.6
2000	1,088	3,791.7	48,090.9	16,087.5	—	60,826.6	492.9	509.1	58.2	56.0	6,123.2
2001	1,160	5,218.0	43,522.2	15,228.8	—	38,305.2	269.3	227.9	37.7	39.8	6,898.7
2002	1,224	5,875.5	38,329.1	12,484.6	737.23	27,990.5	214.0	198.8	34.4	37.0	6,841.8
2003	1,287	6,428.5	42,457.7	13,178.5	665.07	32,115.3	250.8	214.2	36.5	36.2	6,981.2
2004	1,377	7,149.4	37,055.6	11,688.6	642.78	42,333.9	288.7	288.3	24.2	24.6	7,215.7
2005	1,381	7,629.5	32,430.3	10,630.5	339.03	31,663.1	274.4	320.6	16.3	16.4	7,336.1
2006	1,434	14,897.6	89,403.9	25,003.6	2,335.22	90,468.7	541.1	671.3	33.4	33.6	7,854.0
2007	1,550	22,416.9	327,140.9	93,064.4	7,791.57	460,556.2	927.2	1,062.1	59.2	72.1	9,280.6
2008	1,625	24,522.85	121,366.44	45,213.9	2,619.71	267,113.0	392.5	—	14.86	17.13	10,449.7
2009	1,718	26,162.85	243,939.12	151,258.7	3,894.53	535,986.7	—	—	28.73	46.01	12,037.7
2010	2,063	33,184.35	265,422.59	193,110.41	8,954.99	545,633.54	—	—	21.61	44.69	13,391.04
2011	2,342	36,095.52	214,758.10	164,921.3	5,073.07	421,649.72	—	—	13.4	23.11	14,050.37
2012	2,494	38,295.0	230,357.62	181,658.26	1,380.42	314,667.41	—	—	12.3	22.01	14,054.91
2013	2,489	40,569.08	239,077.19	199,579.54	2,802.76	46,8728.6	—	—	10.99	27.76	13,247.15
2014	2,613	43,610.13	372,546.96	315,624.31	4,856.43	743,912.98	—	—	15.99	34.05	14,214.68

Notes: 1. *Total capital raised on the A-share market* excludes capital raised by listed companies on the bond market via convertible bonds and detachable convertible bonds, etc..
2. *Average turnover ratio* covers A shares and B shares.
3. *Average P/E ratio* refers to static P/E ratios.
4. *Investor accounts* is year-end valid accounts.
5. Some statistics have been adjusted according to latest CSRC releases.

Sources: China Securities Regulatory Commission, Shanghai Stock Exchange and Shenzhen Stock Exchange.

Table 19 Change in Stock Market Turnover and Indices, 1997—2014

Unit: 100 million yuan

Year	Turnover	Average daily turnover	SSE composite index				SZSE component index			
			Open	High	Low	Close	Open	High	Low	Close
1997	30,721.8	126.42	914.06	1,510.18	870.18	1,194.1	326.33	517.91	305.81	381.29
1998	23,527.3	97.1	1,200.95	1,422.98	1,043.02	1,146.7	382.85	441.04	317.1	343.85
1999	31,319.6	131.04	1,144.89	1,756.18	1,047.83	1,366.58	343.29	525.14	310.65	402.18
2000	60,826.6	254.5	1,368.69	2,125.72	1,361.21	2,073.48	402.71	654.37	414.69	635.73
2001	38,305.2	159.6	2,077.08	2,245	1,515	1,645.97	636.62	664.85	439.36	475.94
2002	27,990.5	118.1	1,643.49	1,748.89	1,339.2	1,357.65	475.14	512.38	371.79	388.76
2003	32,115.3	133.25	1,347.43	1,649.6	1,307.4	1,497.04	386.61	449.42	350.74	378.63
2004	42,333.9	174.21	1,492.72	1,783.01	1,259.43	1,266.5	377.93	470.55	315.17	315.81
2005	31,663.1	130.84	1,260.78	1,328.53	998.23	1,161.06	313.81	333.27	237.18	278.75
2006	90,468.7	375.39	1,163.88	2,698.9	1,161.91	2,675.47	278.99	710.14	278.99	706.01
2007	460,556.2	1,903.12	2,728.19	6,092.06	2,612.54	5,261.56	555.26	1,567.74	547.89	1,447.02
2008	267,113.0	1,085.82	5,265	5,497.9	1,706.7	1,820.81	1,450.33	1,584.39	452.33	553.08
2009	535,986.7	2,196.67	1,849.02	3,478.01	1,844.09	3,277.139	560.09	1,234.12	560.1	1,201.34
2010	545,633.54	2,254.68	3,289.75	3,306.75	2,319.74	2,808.08	1,207.33	1,412.64	890.24	1,290.87
2011	421,649.72	1,728.06	2,825.33	3,067.46	2,134.02	2,199.42	1,298.59	1,316.19	828.83	866.65
2012	314,667.41	1,294.93	2,212.00	2,460.69	1,959.77	2,269.13	871.93	1,020.29	724.97	881.17
2013	468,728.6	1,969.45	2,289.51	2,434.48	1,950.01	2,115.98	887.37	1,106.27	815.89	1,057.67
2014	743,913	3,036.38	2,112.13	3,239.36	1,974.38	3,234.68	1,055.88	1,504.48	1,004.93	1,415.19

Note: Some statistics have been adjusted according to latest CSRC releases.
Sources: China Securities Regulatory Commission, Shanghai Stock Exchange and Shenzhen Stock Exchange.

Table 20 Market Makers for RMB Trading in the Interbank Spot Foreign Exchange Market

Industrial and Commercial Bank of China	Agricultural Bank of China
Bank of China	China Construction Bank
Bank of Communications	China CITIC Bank
China Merchants Bank	China Everbright Bank
Huaxia Bank	China Guangfa Bank
Ping An Bank	Industrial Bank
China Minsheng Bank	China Development Bank
Postal Savings Bank of China	Bank of Shanghai
Bank of Nanjing	Bank of Ningbo
BNP Paribas (China) Ltd.	Shanghai Pudong Development Bank
DBS Bank (China) Ltd.	Bank of America, Shanghai Branch
HSBC Bank (China) Co., Ltd.	Bank of Montreal (China) Co., Ltd.
Citibank (China) Co., Ltd.	Standard Chartered Bank (China) Ltd.
Sumitomo Mitsui Banking Corp. (China) Ltd.	Deutsche Bank (China) Co., Ltd.
Mizuho Bank (China), Ltd.	Bank of Tokyo-Mitsubishi UFJ (China), Ltd.

Source: China Foreign Exchange Trade System.

Table 21 Foreign Exchange Market and Foreign Exchange Reserves, 1994—2014

Units: USD100 million, yuan

Year	Foreign exchange reserves	USD100/CNY	EUR100/CNY	JPY/CNY	HKD100/CNY	GBP100/CNY	CNY100/MYR (ringgit)	CNY100/RUB (ruble)	AUD100/CNY	CAD100/CNY	NZD100/CNY	SGD100/CNY
1994	516.2	844.91	—	7.78	112.66	—	—	—	—	—	—	—
1995	735.97	831.79	—	8.0703	107.6	—	—	—	—	—	—	—
1996	1,050.49	829.92	—	7.1613	107.19	—	—	—	—	—	—	—
1997	1,398.9	827.98	—	6.3627	106.81	—	—	—	—	—	—	—
1998	1,449.59	827.87	—	7.1719	106.78	—	—	—	—	—	—	—
1999	1,546.75	827.93	—	8.0933	106.51	—	—	—	—	—	—	—
2000	1,655.74	827.81	—	7.2422	106.06	—	—	—	—	—	—	—
2001	2,121.65	827.66	—	6.3005	106.06	—	—	—	—	—	—	—
2002	2,864.07	827.73	863.6	6.9035	106.11	—	—	—	—	—	—	—
2003	4,032.51	827.69	1,033.83	7.7263	106.57	—	—	—	—	—	—	—
2004	6,099.32	827.65	1,126.27	7.9701	106.37	—	—	—	—	—	—	—
2005	8,188.72	807.02	957.97	6.8716	104.03	—	—	—	—	—	—	—
2006	10,663.44	780.87	1,026.65	6.563	100.467	1,532.32	—	—	—	—	—	—
2007	15,282.49	730.46	1,066.69	6.4064	93.638	1,458.07	—	—	—	—	—	—
2008	19,460.3	683.46	965.9	7.565	88.189	987.98	—	—	—	—	—	—
2009	23,992.0	682.82	979.71	7.3782	88.048	1,097.8	—	—	—	—	—	—
2010	28,473.38	662.27	880.65	8.126	85.093	1,021.82	46.649	462.05	—	—	—	—
2011	31,811	630.09	816.25	8.1103	81.07	971.16	50.279	508.6	640.93	617.77	—	—
2012	33,116	628.55	831.76	7.3049	81.085	1,016.11	48.865	485.28	653.63	631.84	—	—
2013	38,213	609.69	841.89	5.7771	78.623	1,005.56	54.141	539.85	543.01	572.59	—	—
2014	38,430	611.9	745.56	5.1371	78.887	954.37	56.737	905.36	501.74	527.55	480.34	463.96

Note: Listed in the table are central parity rates on the last trading day of the year.
Sources: The People's Bank of China and State Administration of Foreign Exchange.

Table 22 Futures Market Trading, 1993—2014

Units: 100 million yuan, 10,000 lots

Year	Commodity futures market		Financial futures market	
	Trading value	Trading volume	Trading value	Trading volume
1993	5,521.99	890.69	—	—
1994	31,601.41	12,110.72	—	—
1995	100,565.3	63,612.07	—	—
1996	84,119.16	34,256.77	—	—
1997	61,170.66	15,876.32	—	—
1998	36,967.24	10,445.57	—	—
1999	22,343.01	7,363.91	—	—
2000	16,082.29	5,461.07	—	—
2001	30,144.98	12,046.35	—	—
2002	39,490.16	13,943.26	—	—
2003	108,389.03	27,986.42	—	—
2004	146,935.31	30,569.76	—	—
2005	134,448.38	32,284.75	—	—
2006	210,046.34	44,947.41	—	—
2007	409,722.43	72,842.68	—	—
2008	719,141.94	136,388.71	—	—
2009	1,305,107.20	215,742.98	—	—
2010	2,269,852.69	304,194.19	821,397.94	9,147.66
2011	937,503.93	100,372.53	437,659.55	5,041.62
2012	952,862.59	134,546.42	758,406.78	10,506.18
2013	1,264,695.8	186,827.38	1,410,066.21	19,354.93
2014	1,279,712.5	228,343.25	1,640,169.73	21,758.1

Notes: Starting from 2011, futures trading volumes are single counted. Data in the table exclude Exchange for Physical transactions.
Source: China Securities Regulatory Commission.

Table 23 Gold Market Trading, 2003—2014

Units: 100 million yuan, tonnes

Year	Trading value	Trading volume
2003	459.2	470.7
2004	731.0	665.3
2005	1,069.8	906.4
2006	1,947.5	1,249.6
2007	3,164.9	1,828.1
2008	8,683.9	4,457.6
2009	10,288.8	4,710.8
2010	16,157.8	6,051.5
2011	24,772.2	7,438.5
2012	21,506.3	6,350.2
2013	32,133.8	11,614.5
2014	45,891.6	18,486.7

Source: Shanghai Gold Exchange.

Table 24 OTC Gold Businesses of Commercial Banks, 2007—2014

Business type		Account gold		Brand gold			Others								
Product (Units)		USD-denominated gold (10,000 oz, USD100 million)	RMB-denominated gold (tonne, 100 million yuan)	Proprietary (tonne, 100 million yuan)	Agent (tonne, 100 million yuan)	Gold accumulation and regular investment (tonne, 100 million yuan)	Gold leasing (tonne, 100 million yuan)	Gold leasing (tonne, 100 million yuan)	Gold pledging (tonne, 100 million yuan)	Onshore USD gold forwards (10,000 oz, USD100 million)	Onshore USD gold options (10,000 oz, USD100 million)	Onshore USD gold swaps (10,000 oz, USD100 million)	Onshore RMB gold forwards (tonne, 100 million yuan)	Onshore RMB gold swaps (tonne, 100 million yuan)	Onshore RMB gold options (tonne, 100 million yuan)
2007	Trading volume	157.68	352.71	6.09	3.96	—	33.11	1.20	—	204.93	8.48	—	—	—	—
	Trading value	11.08	607.05	11.20	7.16	—	56.40	2.31	—	11.84	0.60	—	—	—	—
2008	Trading volume	293.09	1,332.55	33.12	4.13	—	73.99	11.40	—	574.85	6.28	—	—	—	—
	Trading value	25.37	2,546.30	66.68	8.18	—	141.50	20.16	—	54.44	0.58	—	—	—	—
2009	Trading volume	579.96	1,381.16	40.73	3.43	0.54	91.29	7.56	—	162.06	2.29	—	—	—	—
	Trading value	57.34	2,923.48	89.90	7.64	1.30	191.98	15.09	—	15.98	0.22	—	—	—	—
2010	Trading volume	418.67	1,205.15	80.40	3.06	12.27	155.80	10.63	0.27	257.82	1.74	—	3.09	—	—
	Trading value	51.47	3,227.49	222.90	8.53	35.29	413.25	28.85	—	32.75	0.21	—	8.78	—	—
2011	Trading volume	447.20	1,864.40	129.50	6.16	30.30	301.30	31.99	4.56	407.04	6.06	17.99	5.09	—	—
	Trading value	72.21	6,271.71	428.50	21.49	102.18	970.55	104.92	—	64.69	0.90	2.74	17.59	—	—
2012	Trading volume	424.35	1,458.89	126.20	10.55	59.85	465.01	54.80	7.43	1,331.50	61.46	49.93	20.95	—	—
	Trading value	70.71	4,947.18	443.70	41.20	205.82	1,583.70	187.23	—	222.01	10.17	8.35	70.91	—	—
2013	Trading volume	497.26	1,864.54	198.63	24.89	298.24	947.65	407.23	39.85	991.99	146.88	524.56	29.76	18.63	—
	Trading value	70.39	5,159.69	618.25	87.76	838.09	2,656.29	1,094.43	78.96	136.48	20.39	75.63	79.86	60.86	—
2014	Trading volume	250.37	910.78	91.36	25.16	594.24	1,370.69	474.80	17.14	1,735.95	40.87	341.08	197.29	10.35	0.03
	Trading value	31.59	2,289.79	250.76	94.19	1,483.77	3,438.19	1,180.97	32.83	218.64	5.18	43.68	496.33	26.01	0.07

Table 25 Interest Rate Derivatives Trading, 2006—2014

Unit: 100 million yuan

Year	Interest rate swaps		Bond forwards		Forward rate agreements	
	Number of trades	Notional principal amount	Number of trades	Notional principal amount	Number of trades	Notional principal amount
2006	103	355.7	398	664.5	—	—
2007	1,978	2,186.9	1,238	2,518.1	14	10.5
2008	4,040	4,121.5	1,327	5,005.5	137	113.6
2009	4,044	4,616.4	1,599	6,556.4	27	60
2010	11,643	15,003.4	967	3,183.4	20	33.5
2011	20,202	26,759.6	436	1,030.1	3	3.0
2012	20,945	29,021.4	56	166.1	3	2
2013	24,409	27,277.8	1	1.01	1	0.5
2014	43,009	40,347.2	—	—	—	—

Source: China Foreign Exchange Trade System.