网上书店：www.chinafph.com

上架类别◯金融市场

定价: 100.00元

2012 CHINA FINANCIAL MARKET DEVELOPMENT REPORT

中国金融出版社

2012
CHINA FINANCIAL MARKET DEVELOPMENT REPORT

PBC Shanghai Head Office
China Financial Market Development Report Committee

中国金融出版社
China Financial Publishing House

2012
CHINA FINANCIAL MARKET DEVELOPMENT REPORT

PBC Shanghai Head Office
China Financial Market Development Report Committee

中国金融出版社
China Financial Publishing House

责任编辑：吕冠华
责任校对：李俊英
责任印制：毛春明

图书在版编目(CIP)数据

2012中国金融市场发展报告(2012 Zhongguo Jinrong Shichang Fazhan Baogao)：英文/中国人民银行上海总部《中国金融市场发展报告》编写组编.—北京：中国金融出版社，2013.7

ISBN 978-7-5049- -

I.①2… II.①中… III.①金融市场－研究报告－中国－2012－英文 IV.①F832.5

中国版本图书馆CIP数据核字(2013)第 号

出版
发行 中国金融出版社
社址 北京市丰台区益泽路2号
市场开发部 (010)63266347，63805472，63439533 (传真)
网上书店 http://www.chinafph.com (010)63286832，63365686 (传真)
读者服务部 (010)66070833，62568380
邮编 100071
经销 新华书店
印刷 天津银博印刷技术发展有限公司
尺寸 210毫米×285毫米
印张 9.5
字数 208千
版次 2012年7月第1版
印次 2012年7月第1次印刷
定价 100.00元
ISBN 978-7-5049- －/F.
如出现印装错误本社负责调换 联系电话 (010)63263947

2012 China Financial Market Development Report Committee

Chief Committee Member:
LING Tao

Deputy Chief Committee Member:
XIE Duo

Members (listed in alphabetical order):
CHEN Xiaosheng DU Yaozhong FENG Runxiang GU Mingde
GUO Wei HUANG Yanming LIU Fan LIU Jianhong
QI Guozhong SHEN Wei SHI Wenchao SONG Yuqin WANG Bing
WANG Zhenying YANG Nong ZHANG Xiaogang ZHANG Yi

Reviewers of the Chinese Version:
CHEN Xiaohong LIU Yan YE Kesong YAN Yongjia
XIANG Xianghua JI Huisong ZHENG Yuling ZOU Qiong

Authors (listed in alphabetical order):
CAO Yuanyuan CHEN Guangxin CHEN Hua GAO Fei
GUO Fang HU Yingchun HUANG Lingyan HUANG Yan
HUANG Zhi JIANG Jianrong KONG Yan LI Jianyun LI Jishen
LI Li LI Lin LIU Yu LU Zunhua MA Jianyang NIU Shaofeng
QIAN Kangning RONG Yihua TANG Lie TANG Weijun
TONG Jun WANG Banxing WANG Jin WANG Jungang
WANG Wenzhu WANG Xianxing WANG Xuejun WANG Ying
WANG Yu XING Yingying YAN Lijuan YAN Xiaomei
YANG Jie ZENG Lingmei ZENG Ziliang ZHANG Ainong
ZHANG Junchao ZHANG Shengju ZHOU Qingwu
ZHOU Qiuling ZHU Yonghang ZOU Jiang ZOU Lan

Reviewer of the English Version:
Division of Foreign Banking in International Department, PBC Shanghai Head Office

Translators (listed in alphabetical order):
CAI Yun CHEN Song CHEN Suyan LI Yuqing LIU Ziqun
LU Leilei ZHANG Qin ZHOU Ping

Contents

Part I Overview

In 2012, the global economy showed slow growth, and the recovery in major economies was uneven and characterized by an obvious divergence. The U.S. economy recovered moderately, the euro area was broadly plagued by anemic growth, the Japanese economy was still sluggish, and growth of emerging market economies decelerated. The international financial market witnessed big fluctuations amid growing uncertainties in global recovery and mounting risks. Confronted with complicated and challenging world economic environment, China properly handled the relationships between maintaining sound and steady economic growth, adjusting economic structure and managing inflation expectations, implemented proactive fiscal policy and prudent monetary policy, and intensified policy fine-tuning and preemptive adjustment. As a result, China's economy and financial sector performed steadily overall, providing a stable macro environment for financial market development. Against this backdrop, the size of China's financial market continued expansion with direct finance growing fast, the development of a multi-tiered capital market achieved remarkable effects as the variety of issuers and investors on the financial market was increasingly diversified, financial market's institutional framework for enhancing coordination, promoting self-discipline, pushing forward market-based reform and protecting investors' interest was improved continuously, and the pace of financial market opening up quickened, which further highlighted the important role of financial market in national economic and social development. In the future, China's financial market would make new breakthroughs amid steady, sustainable and sound economic development.

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

1.1 International economic and financial environment

1.1.1 Recovery in advanced economies lacked steam, while growth of emerging market economies slowed down

In 2012, global economic growth decelerated broadly. The U.S. economy recovered moderately, but was still troubled by the issue of debt ceiling. The broad picture of the euro area was characterized by anemic growth as the resolution of European debt crisis experienced ups and downs. The Japanese economy was still sluggish as Japan ran a trade deficit repeatedly amid shrinking international demands. Growth of emerging market economies decelerated, accompanied by increasing external risks.

1.1.1.1 Recovery in advanced economies lacked momentum

Although the U.S. economy recovered modestly, the issue of debt ceiling posed uncertainties. For the first three quarters in 2012, the annualized quarter-on-quarter growth in the U.S. was 2.0%, 1.3% and 3.1%. Growth in the third quarter was mainly attributed to the rise in consumption of durables, government spending and real estate investment. Unemployment improved slowly as the unemployment rate declined to 7.8% in the fourth quarter. In addition, the consumer price index (CPI) retreated steadily in the U.S. in 2012, rising 1.89%, 1.7% and 1.89% year on year in the second, third and fourth quarter respectively, all below the 2% target set by the U.S. Federal Reserve (Fed). Currently, the U.S. economy had temporarily escaped from the risk of falling off the "fiscal cliff", but uncertainties lingering in the issue of debt ceiling, coupled with European debt crisis, made the outlook for U.S. recovery precarious.

Affected by sovereign debt crisis, growth in the euro area was weak in general. Positive progress was made in resolving the European debt crisis in 2012, as Greece stayed in the euro area and the Spanish banking crisis was mitigated temporarily. In March, 25 member states of the European Union (EU) signed the fiscal compact, a major step towards fiscal integration; in June, the European Commission proposed that the single supervisory mechanism for European banking system should be set up as soon as possible; in July, the European Central Bank (ECB) expressed its resolve to defend the single currency; and in September, the ECB unveiled unlimited Outright Monetary Transactions (OMT). However, the European debt crisis still exerted a severe negative impact on real economy. In 2012, growth in the euro area was negative consecutively in the second and third quarter, while the unemployment rate rose persistently, reaching 11.5% in the third quarter, a new record high since the outbreak of crisis. The year-on-year growth of the CPI in the euro area was relatively stable in 2012, staying between 2.3% and 2.7%, higher than the 2% target set by the ECB.

Japan's economy was still sluggish as it ran a trade deficit continuously. In the first half of 2012, Japan's current account surplus slumped 45% year on year, a record low since 1985 when comparable data were available. Trade deficit, which was reported from July to December, posted 641.5 billion yen in December. Japan's economy was still sluggish, as the quarter-on-quarter growth of gross domestic product (GDP) fell sharply in the second quarter compared with the first three months, and dipped into the negative territory in the third quarter amid dwindling exports, consumer expenditure and public investment. On top of that, the year-on-year growth of the CPI had been negative since June, indicating that Japan's economy was still suffering from deflation.

1.1.1.2 Growth of most emerging market economies slowed down amid mounting external risks

In 2012, growth of emerging market economies continued to decelerate as a result of inadequate external demands and structural problems at home. In October, the International Monetary Fund (IMF) revised down the projection for the annual growth of emerging market economies in 2012 to 5.3%, 0.9 percentage point lower than the actual growth in 2011. In the meantime, emerging market economies were faced with rising external risks. Precarious European debt crisis, coupled with potentially vulnerable recovery in the U.S., caused emerging markets to face higher volatility in cross-border capital flows. Accommodative monetary policy adopted by advanced economies would probably further push up international commodity prices, imposing a fresh round of imported inflationary pressure on emerging market economies.

1.1.1.3 Growth of global trade and cross-border direct investment decelerated

In 2012, global trade grew at a slower pace, as demands in international market shrank due to weak recovery in advanced economies. The World

Trade Organization (WTO) estimated that global trade would increase 2.5% in 2012, only half of that in 2011. Specifically speaking, exports and imports would add 1.5% and 0.4% respectively in developed countries, and 3.5% and 5.4% in developing countries. Besides, according to statistics by the United Nations Conference on Trade and Development (UNCTAD), global cross-border direct investment posted US$667.6 billion in the first half of 2012, losing 8.4% from the previous year. It was expected that the full-year foreign direct investment in 2012 would at most be on a par with that of 2011, which was US$1.58 trillion with the growth rate far lower than 8% in 2011.

1.1.2 International financial markets fluctuated tremendously with obviously uneven performance

In 2012, international financial markets were largely driven by changes in global economic situation, development in the resolution of European debt crisis, adjustment of economic policies around the world and catastrophic climate worldwide. Under accommodative monetary conditions, the funding rates on the Eurodollar and the euro went down steadily. Government bond yields in developed countries kept on making a new record low, whereas those in five debt-ridden euro area member states remained at high levels. International foreign exchange market underwent fluctuations, and the volatility of exchange rates increased. Compared with advanced economies, most emerging market economies witnessed poor stock market performance. In addition, catastrophic climate around the globe contributed to the spike in the price of some agricultural products, but the price of other agricultural products like cotton and rubber dropped substantially on rising supply and weakening demand.

1.1.2.1 Funding rates on the Eurodollar and the euro declined steadily as the monetary policy was eased continuously

In December 2011, the U.S. Fed joined hands with other five central banks in pumping dollar liquidity into the international market, namely, the ECB, the Bank of Canada, the Bank of England, the Bank of Japan, and the Swiss National Bank. At the same time, the ECB announced in December the long-term refinancing operation (LTRO) aimed at providing massive liquidity to financial institutions. In 2012, the Fed unveiled the third and fourth round of quantitative easing (QE3 and QE4) in September and December respectively, the ECB announced the OMT, and the Fed would keep federal funds rate at 0-0.25% till mid-2015, extended from the second half of 2014. Under accommodative monetary conditions, funding rates on the Eurodollar and the euro fell steadily, with the three-month dollar Libor edging down from 0.58% in early 2012 to 0.31% in late December, and the average euro Libor dropping from 1.29% earlier in the year to 0.13% at end-December.

1.1.2.2 Government bond yields in developed countries made record lows repeatedly, while those in five debt-ridden euro area member states stayed at high levels

In 2012, due to relatively solid economic fundamentals, accommodative monetary conditions, and growing risk aversion in international market, government bond yields in the U.S., Japan, Germany, the U.K. and France trended downwards on the whole, with repeated record lows. For instance, the yield on five-year government bonds in the U.S., the U.K., France and Germany made an all-time low of 0.54%, 0.45%, 0.73% and 0.24% on July 24, August 2, July 19 and July 20 respectively. Despite a downgrade from “AA-” to “A+” by the Fitch Ratings in May, the yield on Japanese government bonds also moved downwards, hitting 0.16% on August 3, an all-time low since June 2003.

July was the watershed in the movement of government bond yields in euro area debt-ridden countries. During the first half of 2012, yields on five-year Spanish and Italian government bonds moved upwards persistently, reaching 6.3% and 7.5% respectively in late July, but retreated afterwards as the European debt crisis moderated. Similarly, as debt crisis eased, the yield on five-year Portuguese government bonds, once surging to 21.78% on January 30, fell back to the range of 5% to 10% after July. On July 26, Ireland returned to the international market for medium and long-term government bond issuance, becoming the first in the euro area to come back to international capital market after an international bailout program. The yield on newly-issued five-year government bonds was 5.9%, while that on eight-year government bonds was 6.1%.

1.1.2.3 International foreign exchange market underwent ups and downs, and volatility of exchange rates increased

In 2012, the movement of exchange rates was largely driven by changes in the expectation for world economic growth, the recurrence and aggravation of European debt crisis, diverging recovery in different countries, and further easing in monetary policy worldwide. In the first quarter of 2012, the euro and currencies of emerging market economies broadly appreciated against the U.S. dollar, but depreciated in the second quarter while the U.S. dollar and Japanese yen strengthened, as international risk-averse capitals flowed from the euro area and emerging economies to the U.S. and Japan amid persistent economic downturn in the euro area, slowdown in the growth of emerging market economies and pessimism about the European debt crisis. In the third quarter when the ECB voiced its determination to defend the euro and advanced economies including Japan, the U.S. and Europe unveiled a string of measures to ease monetary policy, the euro and currencies of emerging market economies stopped depreciating and started to appreciate, while the U.S. dollar and Japanese yen began to weaken. As of end-December, exchange rates of the euro and currencies of emerging market economies vis-à-vis the U.S. dollar, after moving from appreciation to depreciation and then back to appreciation, basically returned to the level in early 2012.

1.1.2.4 Stock markets saw considerable gains in advanced economies, but performed badly in emerging market economies

During the first three quarters of 2012, performance of stock markets around the world showed some consistency generally characterized by an increase in the first quarter, a fall in the second quarter and a gain in the third quarter, but diverged in the fourth quarter. As of end-December, German DAX30 jumped 29.06% across the year, ranking first among advanced economies. France's SBF250, British FTSE, the U.S. Dow Jones Industrial Average, and Japan's Nikkei 225 gained 18.73%, 8.24%, 7.26% and 18.40% respectively. Stock markets in most emerging market economies performed badly except that in India. The Indian Bombay Stock Exchange 100 index, Russia's INDEXCF and Brazil's BVSP added 29.96%, 5.44% and 7.40% respectively.

1.1.2.5 Growth of commodity prices diverged with the price of some agricultural products experiencing an obvious hike

Global cotton supply was sufficient in 2012 as plantation increased, but international demand for cotton weakened. Consequently, cotton price continued the losing streak in 2011. As of end-December, cotton price slashed 18.81%

throughout the year. Likewise, rubber price moved on a trajectory similar to that of cotton price, shedding 11% in 2012 due to unbalanced supply and demand. Affected by catastrophic climate worldwide, the price of agricultural products moved up steadily in 2012. In particular, prices of wheat, corn and soybeans spiked in the aftermath of large areas of drought in the U.S. in June. Compared with June 1, the price of wheat, corn and soybeans traded on the Chicago Mercantile Exchange soared 41%, 44% and 23% within only two months. Afterwards, the price of wheat remained elevated, while that of corn and soybeans retreated somewhat. As of end-December, the price of these three products climbed up 21.42%, 7.42% and 22.91% respectively. The full-year growth of cocoa price was relatively slow at 2.3%. The price of metals traded on the London Metal Exchange (LME), such as aluminum, copper, lead, nickel, tin and zinc, dropped continuously after a rise in early 2012, and did not rebound until after September. As of end-December, the full-year growth in the price of above-mentioned metals was 2.62%, 4.18%, 15.19%, -9.22%, 22.1% and 12.12%. The price of Brent crude oil edged up in 2012 by merely 3.15%, but fluctuated sharply, jumping from US$106.59 per barrel at the start of the year to US$128.22 per barrel in early March, and then falling to US$88.69 per barrel in late June. Precious metal price moved in a way similar to crude oil price. At end-December, the spot price of gold and silver stood at US$1674.95 per ounce and US$30.23 per ounce, advancing 7.07% and 9.57% respectively in 2012.

1.1.3 Impact of international economic and financial environment on China

First, sagging global economic recovery in 2012 led to an obvious slowdown in China's exports. As of end-December, the year-on-year growth of China's exports in each month averaged 8.64% in 2012, lower than the growth of 13.54% in 2011. In particular, the average year-on-year growth of monthly exports to the EU saw the biggest loss, dropping from 15.02% in 2011 to -3.95% in 2012, while that of exports to the U.S. fell from 18.39% in 2011 to 7.85% in 2012. Inadequate external demand continuously weakened the role of exports in powering China's economy.

Second, ups and downs in international financial markets added to the external risk that China was faced with in running its economy and financial sector. As uncertainties in world economic recovery increased and risks piled up, investors' risk appetite changed constantly, which trigged disorderly and unstable cross-border capital flows, and increased the volatility of renminbi spot exchange rate. As a result, the exchange rate risk faced by Chinese export and import enterprises rose considerably. Meanwhile, some advanced markets transferred risks to emerging markets by taking advantage of their competitive edge in financial sector, which aggravated the instability of global financial markets. Volatility of China's financial market might also increase accordingly.

Third, large swings in the price of primary products and resources in international financial markets imposed an imported pressure on China, which has a strong demand for international commodities. On the one hand, price movements of international commodities would directly affect the performance of relevant financial markets in China; on the other hand, big increases in the price of agricultural products, such as wheat, corn and soybeans, would add to China's inflationary pressure through imports, and consequently affect China's macro economy and financial market. Apart from that, a string of quantitative easing measures announced by advanced economies would probably bring imported inflationary pressure to China.

Efforts should be made to accurately understand and take stock of world economic developments and the impact on China's economy and financial market, to fully recognize the complexity and variability of external economic environment, to effectively address complicated situation and challenges via timely measures, and to follow the trend while making active moves when appropriate. China should strive to pursue more stable conditions for development in constantly changing international environment and maintain sound, steady and coordinated financial market development through continuously deepening financial market reform, speeding up financial market development, further intensifying institutional building and actively preventing systemic financial risks.

1.2 Domestic macro economic and financial environment

In 2012, faced with complicated and grim economic situation at home and broad, China properly handled the relationships among maintaining steady but relatively fast economic growth, adjusting economic structure and managing inflation expectations, gave higher priority to ensuring growth, implemented proactive fiscal policy and prudent monetary policy, and stepped up policy fine-tuning and preemptive adjustment. As a result, domestic economy and financial sector performed steadily overall, providing a stable macro environment for financial market development.

1.2.1 Economic performance stabilized and rebounded

In 2012, as the policy on ensuring growth took effect gradually, China's economy showed signs of stabilization amid moderate growth, while economic restructuring gained speed.

1.2.1.1 Economic growth stabilized somewhat

First, the GDP growth rate tended to stabilize. In 2012, China's GDP grew 7.8% year on year. In the process of economic restructuring, China's economy demonstrated strong flexibility and a high internal momentum to expand. Overall, the economic growth was stable in 2012, as the quarter-on-quarter GDP growth posted 1.5%, 2.0%, 2.1% and 2.0% in the four quarters respectively.

Second, growth of price decelerated gradually. In 2012, the picture of agricultural production was rosy, as the full-year grain production totaled 589.57 million tons, adding 18.36 million tons from last year, or 3.2%. Grain production enjoyed harvest for nine years in a row, which provided a strong support for persistently stabilizing prices. In December, the CPI rose 2.5%, falling two percentage points from the beginning of the year; the producer price index (PPI) dipped 1.9%, down 2.6 percentage points from the start of the year. In terms of month-on-month growth, the price of vegetables increased a lot at the year-end due to climate factor, causing the CPI to edge up 0.8% month on month in December.

Third, aggregate demand showed a tendency to expand. Currently, economic rebound largely relied on government investment. In 2012, national fixed asset investment (excluding rural households) reached 36.5 trillion yuan, surging 20.6% from last year. As international economic and financial situation stabilized, exports grew at a steady pace. In 2012, the total value of exports exceeded US$2 trillion, a year-on-year gain of 7.9%. Relatively fast increase in households' income contributed to a steady growth in consumption. In 2012, social retail sales of consumer goods totaled 20.7 trillion yuan, jumping 14.3% year on year, and 12.1% on inflation-adjusted basis.

1.2.1.2 Economic restructuring accelerated

In 2012, China achieved positive effects in transforming economic growth pattern and adjusting economic structure while making efforts to stabilize growth.

First, upgrading of industrial structure was sped up. In 2012, the value-added of tertiary industry took up 45.3% of GDP, up 1.2 percentage points compared with the corresponding period of last year. New and high-tech sectors developed rapidly, while growth of high energy-consuming sectors persistently lagged behind the overall development of the industry. Energy conservation and emission reduction efforts saw remarkable progress, as the energy consumption per unit of GDP dropped in 2012 by 3.6% compared with last year.

Second, regional development tended to balance. In recent years, the development gap between regions was further narrowed, as the consistency and coordination of regional development strengthened, pace of industrial shift quickened, and major economic indicators in west and central regions outperformed the national average. In 2012, investment in east, central and west regions jumped 17.8%, 25.8% and 24.2% year on year respectively, while the respective year-on-year growth of industrial value-added of statistically large enterprises in these three regions posted 8.8%, 11.3% and 12.6%.

Third, urban and rural development was more reasonable. In 2012, rural households' income grew faster than urban households' income, as the per capita net income of rural residents went up 10.7% in real terms, while the per capita disposable income of urban residents gained 9.6% in real terms. Driven by income rise, retail sales of consumer goods in rural areas soared 14.5% year on year, 0.2 percentage point higher than the growth of retail sales of consumer goods in urban areas.

Fourth, development of real estate market was generally stable. Measures for curbing real estate market remained effective. In December, among70 big and medium-sized cities, price of new commodity housing dropped year on year in 26 cities, remained flat in four cities, and went up in 40 cities, but not more than 2.4%. During the year, area of national commodity house sales added 1.8% year-on-year, up 11.8 percentage points compared with the first half-year.

1.2.2 Financial environment was generally stable

In 2012, the People's Bank of China (PBC), in line with the overall arrangement of the State Council, continued to implement prudent monetary policy, focused on making policy more preemptive, better targeted and more flexible, and properly conducted policy fine-tuning as well as preemptive adjustment when appropriate so as to facilitate steady economic and financial performance.

1.2.2.1 Macro financial environment was moderately accommodative

First, money supply grew at a modest pace. At end-2012, outstanding broad money supply (M2) stood at 97.41 trillion yuan, up 14.4% year on year; outstanding narrow money supply (M1) climbed up 6.5% from last year to 30.87 trillion yuan; and outstanding currency in circulation (M0) rose 7.7% year on year to 5.47 trillion yuan. Growth of money supply rebounded obviously under the combined effects of a slew of policy instruments, including open market operation, reserve requirement ratio, central bank lending, rediscount, interest rate and counter-cyclical macro prudential management. Broadly accommodative monetary conditions would help shore up the steady and relatively fast growth of national economy.

Secondly, deposit growth at financial institutions accelerated. At end-2012, outstanding local and foreign currency deposits at all financial institutions (including foreign-funded financial institutions, the same below) amounted to 94.31 trillion yuan, up 14.1% year on year, a bit faster than the growth of 12.7% in the corresponding period of last year. Outstanding RMB deposits advanced 13.3% year on year to 91.47 trillion yuan with the full-year new RMB deposits being 10.81 trillion yuan, up 1.17 trillion yuan compared with the previous year. Outstanding foreign currency deposits surged 47.8% from last year to US$406.5 billion, adding US$131.4 billion during the year.

Third, growth of lending by financial institutions remained stable. At end-2012, outstanding local and foreign currency loans of all financial institutions hit 67.29 trillion yuan, soaring 15.6% from a year earlier, almost on a par with the growth of 14.3% in the corresponding period of last year. Outstanding RMB loans jumped 15.0% from 2011 to 62.99 trillion yuan. The full-year growth of RMB loans was 8.20 trillion yuan, 732 billion yuan more than that in 2011. Outstanding foreign currency loans went up 26.9% year on year to US$683.6 billion, adding US$145.1 billion across the year. Loans played a big role in supporting economic growth, as financial institutions' willingness to lend remained strong.

Fourth, all-system financing aggregate expanded considerably. According to preliminary statistics, the full-year all-system financing aggregate reached 15.76 trillion yuan in 2012, 2.93 trillion yuan more than that in 2011. This was mainly due to the growth in RMB loans, trust loans, and enterprise bonds after May, whose combined volume posted 11.74 trillion yuan during the year, a year-on-year increase of 2.71 trillion yuan.

1.2.2.2 Financial system developed in a steady and sound manner

In 2012, financial institutions worked in tandem with competent authorities to strengthen the monitoring and assessment of systemic risks in banking, securities and insurance sectors in a bid to prevent systemic and regional risks, sharpen financial sector's ability to attain sustainable development, and beef up financial support for real economy.

First, the financial sector grew steadily. The asset size of banking institutions continued to rise amid improving profitability and asset quality. As of end-December 2012, local and foreign currency assets of China's banking institutions added up to 131.27 trillion yuan, surging 17.7% year on year, while local and foreign currency liabilities jumped 17.5% from the previous year to 122.63 trillion yuan. By the end of the third quarter, net profits of commercial banks posted 981 billion yuan, up 20.03% year on year; outstanding non-performing loans (NPL) stood at 478.8 billion yuan, while the NPL ratio was 0.95%; and the capital adequacy ratio (CAR) reached 13.03%. In particular, the core CAR was 10.58%. The overall size of securities and futures institutions maintained slight growth, but profitability dropped persistently. Figures released by the Securities Association of China (SAC) showed that as of end-2012, assets of 114 securities companies totaled 1.72 trillion yuan, adding 9.55% over the same period of last year, while net assets and net capital posted 694.346 billion yuan and 497.099 billion yuan. The full-year operating revenues reached 129.471 billion yuan, while net profits stood at 32.930 billion yuan, sliding 16.37% compared with 39.377 billion yuan in the same period of last year, but at a slower pace compared with the drop of 28.86% in the same period of 2011. Among it, 99 companies made a profit, accounting for 86.84% of the total. Total assets and premium income of the insurance sector grew steadily. As of end-December 2012, the cumulative premium income gained 8.01% compared with 2011, reaching 1.55 trillion yuan; payment of claims and benefits surged 20.03% year on year to 471.632 billion yuan; and total assets of the insurance sector amounted to 7.35 trillion yuan, a year-on-year increase of 22.29%.

Second, financing structure was further optimized. At end-2012, RMB loans took up 52.1% of all-system financing aggregate, down 6.1 percentage points year on year; foreign currency loans 5.8%, up 1.3 percentage points from the previous year; entrusted loans 8.1%, dipping 2.0 percentage points year on year; trust loans 8.2%, rising 6.6 percentage points from a year earlier; undiscounted banker's acceptance 6.7%, shedding 1.3 percentage points from 2011; domestic equity financing by non-financial enterprises 1.6%, sinking 1.8 percentage points from the previous year; and enterprise bonds 14.3%, jumping 3.7 percentage points year on year. The share of direct financing increased noticeably, as financing through enterprise bonds grew rapidly. Credit structure was further optimized in a bid to beef up support for weak economic sectors, including agriculture, rural areas and farmers as well as small and medium-sized enterprises (SMEs), which properly addressed the need for funds of the real economy, and stepped up financial support for national economic development.

Third, reform of financial institutions was deepened. Overseas business of large commercial banks witnessed significant progress, and the initiative to set up an Agro-linked Business Department within the Agricultural Bank of China (ABC) was carried forward steadily. The Industrial and Commercial Bank of China (ICBC) acquired Bank of East Asia (U.S.), the ABC was given the green light by the U.S. regulator to set up New York Branch and the Bank of China (BOC) was allowed to open Chicago Branch, and the ICBC's application to set up a subsidiary in Brazil was approved by Brazilian National Monetary Committee. The ABC issued in May 2012 the *Notice on Regularly Clearing Returns on Deducted Reserves as an Incentive for Agro-linked Business*, which further enhanced the county-level sub-branches' incentive to provide services to agriculture, rural areas and farmers. Reform of rural credit cooperatives proceeded smoothly, as asset quality improved considerably, business scale expanded notably, and agro-linked credit supply grew by a large margin. By the end of the third quarter of 2012, the number of newly-established rural credit cooperatives with the county (city) as the single legal person, rural commercial banks and rural cooperative banks amounted to 1859, 276 and 163 respectively. The reform and transformation of asset management companies was promoted steadily. On September 25, a conference was held in Beijing to mark the founding of China Huarong Asset Management Co., Ltd., which has put in place a modern shareholding company governance structure comprising shareholders' meeting, board of directors, board of supervisors and the management.

Fourth, financial reform at local levels continued. In March 2012, the State Council approved the *Overall Plan for Launching Pilot Comprehensive Financial Reform in Wenzhou of Zhejiang Province*. It came as the State Council decided to promote all-round financial reform on a trial basis in Wenzhou. The pilot program aimed at developing a pilot area for comprehensive financial reform through focusing on fostering a financial service center for SMEs and a wealth management center for private funds. In May 2012, the PBC and the People's Government of Zhejiang Province jointly published the *Circular on Launching a Pilot Rural Financial Reform in Lishui of Zhejiang Province*. The pilot rural financial reform in Lishui is expected to center upon developing a credit reference system in rural area and promoting loans collateralized by forest ownership. In May 2012, the Fujian provincial government unveiled the *Circular of the People's Government of the Fujian Province on Eleven Measures for Boosting Real Economy through Financial Services*, clearly pointing out that efforts should be made to promote the development of Quanzhou national pilot area for comprehensive reform aimed at providing financial services to real economy, and support the development and opening up of Pingtan comprehensive pilot area, in a bid to let financial services play a bigger role in bolstering the scientific and leap-frog development in Fujian. In June 2012, the State Council issued the *Reply of the State Council Concerning the Support for Policy on Development and Opening up of Shengang Modern Service Industry Cooperation Zone in Qianhai of Shenzhen*, allowing Qianhai to take the lead in financial reform and innovation through trial and error and build itself into an exemplary place for China's financial opening up. In the same month, led by the PBC, several government departments jointly promulgated the *Overall Plan for Building a Comprehensive Pilot Area for Financial Reform and Innovation in Pearl River Delta by Guangdong Province*, a pioneering move that has promoted the development of pilot areas for financial reform and innovation.

Fifth, the RMB settlement volume in cross-border trade and investment maintained relatively fast growth as the institutional framework for cross-border RMB business was improved further. In March 2012, the PBC and other departments concerned jointly issued the *Circular on Issues concerning the Administration of Enterprises Using Renminbi to Settle Goods Trade in Export*, which played a significant role in facilitating balanced development of RMB settlement in cross-border trade. By now, Chinese enterprises engaged in the import and export of goods, services, and other current account items are able to choose renminbi as the invoicing, settlement and payment currency. In 2012, the full-year RMB settlement for cross-border trade hit 2.94 trillion yuan cumulatively, while that for direct investment 280.2 billion yuan. Preliminary statistics showed that the value of cross-border goods trade, service trade and other current account items, outbound direct investment and foreign direct investment settled in renminbi stood at 2.06 trillion yuan, 875.2 billion yuan, 29.2 billion yuan and 251 billion yuan. The share of RMB settlement in total exports and imports is rising rapidly. Besides, Hong Kong offshore market grew fast, and the renminbi was increasingly used in neighboring regions. New progress was made in developing cross-Straits currency clearing mechanism, as monetary authorities from both sides of the Straits signed the *Memorandum on Cross-Straits Currency Clearing Cooperation* on August 31, which played a positive role in promoting cross-Straits investment and trade facilitation as well as closer economic and trade ties across the Straits.

Sixth, important steps were made in the interest rate market-based reform. On June 8, the PBC gave the green light to financial institutions to float the deposit rate upwards, and the floating range was widened from the benchmark rate to 110% of the benchmark. On July 6, the floating floor for lending rate at financial institutions was adjusted to 70% of the benchmark. The floating of both deposit and lending rates provided bigger room for financial institutions to price funds independently, which would prompt them to speed up the improvement of pricing mechanism, enhance their capacity for independent pricing, and facilitate the transformation of business model from homogeneity to diversity.

Generally speaking, China's national economy continued to advance towards the direction desired by the macro adjustment and control, fundamentals of economic and social development would improve in the long run, domestic markets boasted immense potential, social productivity had a solid foundation and the capacity for scientific and technological innovation was enhanced. China's economy, in general, presented a desirable picture characterized by relatively fast growth, stabilizing prices, and high efficiency, with people's livelihood improved, which provided a hard-won opportunity and a strong impetus for the development of China's financial market. However, it should be noted that unbalanced, uneven and unsustainable development still remain a thorny issue in China's economic growth, downside risk to the economy and upward pressure on price coexist, some enterprises are afflicted by business difficulties, and the economic and financial sectors also face some potential risks that cannot be neglected. Thus, we should stay sober-minded, tighten risk assessment, and take timely measures to effectively mitigate risks of all kinds.

As China is in the process of industrialization, urbanization, internationalization and marketization, there is extensive demand in domestic market. Unbalanced growth calls for industrial and regional restructuring, speeding up urbanization requests more investment in infrastructure in rural and urban areas, and improving standard of living and upgrading consumption would generate new demands for better living environment and high-quality products. All this cannot be done without massive investment of funds. In this respect, financial market can play a big role. Efforts should be made to expedite financial market reform and innovation, vigorously expand market depth and width, and continuously enhance the role of financial market in supporting real economy so as to make bigger contributions to economic restructuring as well as the transformation of economic growth pattern.

2. Main features of China's financial market performance in 2012

In 2012, China's financial market developed faster amid reform and innovation while playing an increasing role in national economy and financial system. The overall size of financial market kept a steady growth momentum despite a year-on-year decline in trading volume on stock and gold markets. The function of financial market continued to grow in depth as direct financing was developed further. As issuers and investors on financial market became increasingly diversified, the fostering of a multi-tiered capital market was advanced steadily. Institution building on financial market was improved persistently so as to strengthen coordination, promote self-discipline, push forward market-based reform and protect investors. Besides, financial market opening up accelerated noticeably. Overall, stable and sound financial market performance contributed to the rapid growth of financial assets and enabled financial market to play a more fundamental role in resource allocation, which vigorously promoted ongoing financial market reform and innovation, effectively reinforced the foundation of real economy, and played a significant role in speeding up economic restructuring and transformation of economic growth pattern as well as promoting sustainable and sound economic growth.

2.1 Overall size of financial market continued to grow

In 2012, overall size of trading on China's financial market maintained steady growth. As financial market continued to grow in depth and width, performance of different types of markets diverged notably.

Trading on money market, bond market and futures market continued growth. In 2012, trading volume on money market, including interbank funding, pledged repurchase (repo) and outright repo, reached 188.41 trillion yuan, surging 40.71% year-on-year. Cumulative trading on interbank bond market gained 18.67% from last year, posting 75.20 trillion yuan. Bond custody totaled 25.44 trillion yuan. Among it, bond custody on interbank bond market rose 17.20% year-on-year to 24.19 trillion yuan, accounting for 95.10% of the total. In 2012, trading on futures market reached 1.445 billion lots unilaterally, involving a total amount of 171.12 trillion yuan, adding 37.60% and 24.44% respectively compared with last year. Among it, trading of commodity futures hit 1.345 billion lots, totaling 95.29 trillion yuan, a year-on-year increase of 34.05% and 1.64% respectively. Trading of stock index futures was 105 million lots, with a total value of 75.84 trillion yuan, up 108.41% and 73.29% respectively from last year.

Trading on stock and gold markets dwindled a bit. In 2012, trading of stocks, funds and warrants on Shanghai and Shenzhen stock exchanges added up to 32.27 trillion yuan, sliding 25.21% from 2011. By breakdown, trading of A and B shares totaled 31.47 trillion yuan, shedding 25.30% from a year earlier, while cumulative trading of funds on Shanghai and Shenzhen stock exchanges hit 812.361 billion yuan, up 27.61% year-on-year. With regard to financing on securities market, total financing through A shares on Shanghai and Shenzhen stock exchanges posted 312.754 billion yuan, slashing 38.35% from last year. Among it, financing through initial public offerings (IPOs) tumbled 63.39% compared with last year, reaching 103.432 billion yuan. In 2012, trading volume and value of major products on the Shanghai Gold Exchange (SGE) both dropped somewhat. Specifically speaking, cumulative trading volume of gold products posted 6350.2 tons with a total value of 2.15 trillion yuan, down 14.63% and 13.18% respectively year-on-year; trading of silver products stood at 208.9 thousand tonnes, totaling 1.36 trillion yuan, slumping 15.46% and 29.9% respectively from last year.

2.2 Direct financing played a more obvious role in boosting economy and promoting structural adjustment

In 2012, financing pattern underwent positive changes as direct financing grew fast. Financial market played a bigger role in resource allocation, as bond market, in particular, played an ever-important role in promoting economic growth through issuing more corporate debenture bonds and bolstering economic transformation via new products. Share of indirect financing in China decreased from 91% in 2006 to 80.9% in 2012, and the share of bond financing in direct financing increased from 60% to 90%.

Breakdown of direct financing showed that the share of corporate debenture bonds (including enterprise bonds, medium-term notes, short-term financing bills, privately-placed bonds by SMEs, corporate bonds, private placement notes, SME collective notes II and asset-backed notes) issued by enterprise institutions in 2012 continued to rise in total securities issuance. Take interbank market for instance, among bond issues for funding purpose excluding central bank bills, financing by corporate debenture bonds posted 3.60 trillion yuan, surging 60.1% year-on-year, much higher than the 4.17% growth of RMB bond issues.

In 2012, all-system financing aggregate was 15.76 trillion yuan. Among it, indirect financing, such as local and foreign currency loans and undiscounted bankers' acceptance, accounted for 80.9% of the aggregate, dipping 1.5 percentage points year-on-year; direct financing, including enterprise bonds and stock financing on domestic market by non-financial enterprises, took up 19.1%, edging up 1.5 percentage points from last year. In particular, the share of enterprise bonds in the aggregate went up 3.7 percentage points compared with last year to 14.3%.

In addition, the value of futures market in supporting national economy became increasingly tangible. For instance, the price of copper futures on the Shanghai Futures Exchange (SFE) became the pricing benchmark not only for spot sales, procurement of raw materials and trade as well as distribution by copper producers, consumers and distributors, but also for copper business at international copper enterprises. The SFE has been internationally acknowledged as one of the three global pricing centers for copper futures.

2.3 Remarkable effects were achieved in fostering a multi-tiered financial market system

2.3.1 Issuers and investors on bond market were further diversified

With regard to the variety of issuers, bond market became accessible to more and more types of enterprises. First, issuers of short-term financing bills diversified. In 2012, enterprises with ratings below AA accounted for 38.25% of the total number of issuers, up 4.6 percentage points from last year. Short-term financing bills issued by these enterprises comprised 35.01% of the total issue, rising 1.36 percentage points from last year. Second, the debut of privately-placed SME bonds made it possible for more SMEs to access bond financing. In the second quarter, the China Securities Regulatory Commission (CSRC), the Shanghai Stock Exchange and Shenzhen Stock Exchange, and the SAC actively promoted the pilot program of privately-placed SME bonds. As of end-2012, the number of privately-placed SME bonds under the custody of the China Securities Depository and Clearing Corporation Limited (CSDCC) reached 81, with funds raised totaling 9.375 billion yuan, 116 million yuan per bond on average.

With regard to the variety of investors, non-incorporated institutions such as funds increased investment in bond market. In 2012, businesses like wealth management by banks, securities investment fund and asset management by securities companies all developed vigorously, while regulatory authorities launched an intensive revision of measures concerning the asset management business of financial institutions, which promoted the participation of non-incorporated institutions in financial market both in depth and width. As all types of asset management businesses boomed, market demand for short-term financing bills increased considerably. A large number of non-incorporated institutions opened accounts with the Shanghai Clearing House (SCH) and increased their holdings remarkably, which effectively weakened the dominant role of commercial banks on interbank bond market and optimized investor structure.

2.3.2 The expansion of the new third board on stock market sped up the development of over-the-counter market

The development of new third board, characterized by over-the-counter (OTC) transactions, is a critical step in fostering a multi-tiered capital market in China. On the one hand, the OTC market, where access to financing is easier, provides a new platform for SMEs to raise funds; on the other hand, the expansion of new third board and improvement of market liquidity would also provide easier exit for private equity and venture capital, strengthen the role of venture capital investment in underpinning industrial development, and, in the meantime, ease funding strains on the main board caused by monotonous stock financing. As of end-2012, the number of enterprises listed on the new third board increased from 97 at end-2011to 200, a big gain of 103.

2.3.3 Number of institutional investors in stock index futures market rose persistently

In line with the *Provisions on Trading Stock Index Futures with Insurance Funds*, insurance institutions legally founded on the Chinese mainland, such as insurance group (shareholding) companies, insurance companies and insurance asset management companies, are eligible to trade financial futures contracts listed on the China Financial Futures Exchange (CFFEX) with stock price index as the underlying asset.

Besides, relevant regulatory authorities also proposed that institutional investors, such as social security fund, enterprise annuities and insurers, should be encouraged to step up investment in capital market and efforts should be made to actively promote the investment of long-term funds in stock market, including national pension fund and housing provident fund, so as to gradually improve the structure of institutional investors, activate market's endogenous power and secure health market development in the long run.

2.4 Financial market's institution building proceeded steadily

For bond market, first of all, an inter-ministry coordination mechanism was put in place for corporate debenture bonds. The mechanism, spearheaded by the PBC and joined by the National Development and Reform Commission (NDRC) and the CSRC, would help generate a combined force for bond market development, and would play a significant role in promoting debenture bond market, expanding direct financing and better meeting enterprises' financing needs. Second, relevant authorities unveiled a string of rules and regulations to ensure regulated and highly efficient bond market performance. Under the guidance of the PBC, the National Association of Financial Market Institutional Investors (NAFMII) issued the *Self-regulatory Disciplinary Rules for the Debt Financing Instrument Market of Non-financial Enterprises*, which ensured the fairness and completeness of self-regulatory disciplinary procedures through developing a systematic rule system, mapped out the *2012 Interbank Market Financial Derivatives Transactions Definition Document*, which laid a solid legal foundation for the further development of China's OTC financial derivatives market, and developed the Debt Capital Market Filing Analysis Notification System (known as DCM-FANS for short) for disclosing registration documents and working procedures related to debt financing instrument in order to accept market supervision, which further enhanced registration transparency.

For stock market, first all of, a third round of IPO reform was kicked off. The CSRC promulgated on April 1 the *Guiding Opinions for Further Deepening the Reform of Initial Public Offering System (Consultative Document)*, which further downplayed administrative intervention and made offering rules on stock market more market-based. Second, refinancing was launched on a trial basis. On August 30, the CSRC officially started the pilot refinancing program with 11 securities firms chosen as the first batch of pilot institutions. The availability of refinancing would expand the size of margin trading and securities lending, enabling it to play a substantive role in improving market mechanism. Third, dividend tax was adjusted. In November 2012, the CSRC announced an adjustment in dividend tax starting from the New Year's Day of 2013, which increased investors' dividend yield, and would prompt investors to make long-term investment in stocks and encourage listed companies to pay dividends. Fourth, delisting arrangements were improved. In the second half of 2012, the Shanghai Stock Exchange and Shenzhen Stock Exchange issued a couple of rules, such as the *Detailed Implementation Rules for Business in the Period of Delisting and Reorganizing on Shanghai Stock Exchange and the Interim Measures on Equity Transfer of Delisted Companies*, which would enable Chinese stock market to play a bigger role in keeping the fittest, discovering price and effectively allocating resources. Fifth, the clean-up of exchanges was basically completed. A cross-ministry joint conference mechanism, led by the CSRC, was developed in line with the approval of the State Council dated January 10. On the one hand, opinions were given to provinces with regard to the establishment of exchanges; on the other hand, efforts were made to identify illegal transactions on securities and futures market, and eliminate disguised equal share allocation, stock trading, and futures as well as derivatives trading, in a bid to ensure that all types of exchanges would operate in a legal and regulated way.

With regard to gold market, the PBC promulgated in December 2012 the *Notice on Issues Concerning the Enhancement of the Administration of Gold Market Business at Banking Financial Institutions* (PBC No.238 [202]), calling for a file-keeping system for gold market business and further improvement in statistics on and monitoring of gold market business, which has significant implications for regulating commercial banks' gold business and promoting orderly development of both exchange and OTC gold market.

For futures market, the State Council announced in November 2012 the *Decision of the State Council to Amend the Administrative Rules for Futures Transactions*, which further spelt out clearly the legal basis for supervising futures industry and cleaning up illegal transactions on futures market and provided room for more innovation and further development of futures industry. The CFFEX unveiled the *Administrative Measures for Hedging and Arbitrage*, which further strengthened the administration of hedging, simplified working procedures and launched arbitrage, a move likely to improve the quality of market performance.

2.5 Financial market innovation remained persistently active

On bond market, first of all, asset-backed notes (ABNs) by non-financial enterprises were issued. In August 2012, the NAFMII issued the *Guidance on Issuance of Asset-backed Notes by Non-financial Enterprises on Interbank Bond Market*, allowing non-financial enterprises to issue ABNs, and in particular, setting down rules on ABN issuance, including the type of eligible assets, isolation of risk, trading structure, information disclosure, and the rights and obligations of trading parties. On August 8, 2012, the first batch of one to five-year ABNs with a coupon rate of 4.88% to 5.85% was issued by non-financial enterprises through private placement, totaling 2.5 billion yuan. Second, privately-placed SME bonds were issued on a trial basis. In May 2012, stock exchanges in Shanghai and Shenzhen announced simultaneously the *Measures for the Pilot Issuance of Private Placement Bonds by Small and Medium-sized Enterprises*, officially setting in motion the pilot issuance of privately-placed SME bonds. Bonds eligible for the pilot program were above one year (including one-year bonds) and issuers were unlisted non-real estate financial company limited or corporation that met SME criteria set by the Ministry of Industry and Information Technology. On June 8, the first privately-placed SME bond was listed on the exchange. Third, special financial bonds targeting small and micro businesses were issued. The PBC actively supported the issuance of special financial bonds by commercial banks for the benefits of small and micro businesses, as funds raised were earmarked for loans to small and micro enterprises. As of end-2012, the PBC gave the green light to a total of 19 commercial banks to issue up to 240.5 billion yuan worth of special financial bonds aimed at providing loans to small and micro enterprises. The launch of this product connected credit market with bond market, which played a positive role in easing the funding pressure on small and micro businesses.

On futures market, the SFE successfully added silver futures to its trading platform in May 2012, which primarily developed a gold-silver precious metal trading series, and unveiled futures price index for non-ferrous metals in December. In May, the Dalian Commodity Exchange (DCE) launched simulated commodity futures and options trading. In December, the Zhengzhou Commodity Exchange (ZCE) officially launched glass futures, rapeseed futures and rapeseed meal futures, which further enriched the variety of commodity futures on China's futures market. With regard to financial futures market, innovation centering upon stock index futures never stopped in 2012 with innovative financial instruments launched one after another, including hybrid stock index futures index funds, index enhancement funds, structured products with principal insured, products generating absolute returns and transferable alpha products. Trading strategies on stock index futures markets diversified, while product innovation became increasingly individualized. Institutions gradually shifted from traditional high-risk investment to a diversified business model built upon a market neutral strategy and featuring low risk and stable returns.

On gold market, approved by the PBC with file-keeping, the SGE kicked off the interbank gold price inquiry business on a trial basis on December 3, 2012, which would cater to the varying needs of gold market investors, further enrich market trading models, continuously deepen market function and help foster a multi-tiered gold market trading system.

2.6 Financial market opening up continued to advance steadily

For bond market, first of all, the number of overseas institutions granted access to interbank bond market continued to increase. In August 2010, three types of overseas institutions were allowed to invest in interbank bond market on a trial basis. In 2012, 57 overseas commercial institutions invested in interbank bond market. In April 2012, the International Bank for Reconstruction and Development and International Development Association were given access to China's interbank bond market, first of its kind in China's interbank bond market. Second, efforts were made to further regulate the issuance of RMB bonds in Hong Kong by domestic enterprises. In 2012, domestic financial institutions continued to issue RMB bonds in Hong Kong. Originally, policy banks were the only issuers, but later large state-owned shareholding commercial banks and joint-equity banks joined the ranks of issuers. The Ministry of Finance also continued the issuance of government bonds in Hong Kong. In May, the NDRC regulated the issuance of RMB bonds in Hong Kong by non-financial institutions through clearly stipulating qualifications for issuing bonds in Hong Kong, procedures of issuance and detailed criteria for other relevant matters. The diversification of issuers and growth of RMB bond issuance in Hong Kong, along with the tightening of issuance arrangements would be conducive to developing RMB bond market in Hong Kong and facilitating the cross-border use of RMB.

For stock market, first of all, the application for qualified foreign institutional investors (QFIIs) and the inward remittance of funds accelerated noticeably. In 2012, the number of newly-approved QFIIs was 66 with the investment quota approximating US$12 billion. Currently, the total number of QFIIs has exceeded 200, with the overall share of stakes held by QFIIs rising notably. In July 2012, the CSRC issued the *Rules for Issues Concerning the Implementation of the Administrative Measures for Investment in Domestic Securities Market by Qualified Foreign Institutional Investors,* which greatly relaxed the qualification requirements for QFIIs and increased the upper limit of stake holding. QFIIs were allowed to invest in interbank bond market as well as privately-placed SME bonds, and the share of stakes held by all overseas investors was increased from 20% to 30%. Second, the investment quota for RMB QFIIs (RQFIIs) rose substantially. At the beginning of the year, the investment quota jumped to 70 billion yuan from 20 billion yuan. In November 2012, approved by the State Council, the CSRC, the PBC and the State Administration of Foreign Exchange (SAFE) decided to add another 200 billion yuan to the RQFII investment quota, which brought the total quota for pilot RQFII program to 270 billion yuan. Third, the issuance and listing of cross-border exchange-traded funds (ETF) made a breakthrough. In February 2012, the CSRC officially accepted the application for EFT tracking Hong Kong stock market and 300 ETF tracking Shanghai and Shenzhen stock markets. On July 18, the Huaxia-Hangseng ETF and Efunds-Hangseng China Enterprise ETF were launched for the first time, marking that China's cross-border issuance and listing of EFT had entered a new stage. Fourth, restrictions on foreign funds taking stakes in securities companies were further relaxed. The CSRC published the *Rules for Establishing Securities Companies with Foreign Equity and the Provisional Measures for the Establishment of Subsidiaries by Securities Companies*. Cap on stakes held by overseas shareholders in foreign-invested securities companies was increased from one third to 49%, and narrowed the years of business operation required of securities companies with foreign equity attempting to expand business from five years to two years.

On foreign exchange (FX) market, first, the daily floating band for RMB exchange rate vis-à-vis the U.S. dollar on the interbank spot FX market was widened to 1%. On April 12, 2012, the PBC issued a public announcement on broadening the floating range of exchange rates on spot FX market, which would give bigger play to market supply and demand in the movement of exchange rates. Second, direct trading between the RMB and the Japanese yen was launched. The availability of direct CNY/JPY trading on interbank FX market would reduce the cost of transaction between these two currencies, lower the settlement risk faced by financial institutions, enhance RMB's role in overseas market and make the RMB more acceptable in the world. Third, the Hong Kong Exchanges and Clearing Limited (HKEx) launched RMB futures, which played a positive role in boosting the demand for RMB in international settlement, helping foreign trade enterprises hedge against exchange rate risk, and further building Hong Kong into an RMB offshore center. Fourth, with the acquisition of the LME, the HKEx played a bigger role in reaching out to international markets and investors.

Looking into 2013, international economic situation will remain complicated with many uncertainties and unstable factors, the world economy will probably continue slow growth momentum, all forms of protectionism may rise again, potential upward pressure on inflation as well as asset price is increasing, and the world economy has already evolved from high growth prior to the crisis to a transitional period featuring deep structural adjustment. China will continue to implement proactive fiscal policy and prudent monetary policy, focus on improving the quality and efficiency of economic growth, and grasp the general principle of seeking progress from steady growth. In general, China's development is still at the critical strategic juncture. To seize the opportunity, efforts should be made to deepen reform, boost domestic demand, enhance the capacity for innovation, and promote the transformation of economic growth pattern. As the financial sector is an important means to shoring up economy and facilitating economic restructuring, China will stick to the fundamental requirement, which is to let financial market support the development of real economy, and continue to develop financial market in a steady, sound and coordinated manner. Overall size of the financial market will grow continuously, market structure will be optimized persistently, product innovation and institution building will proceed steadily, and financial market itself will develop in a stable and sound fashion while promoting sustainable and sound economic growth and facilitating the transformation of growth pattern.

Part II Money Market

In 2012, the money market's scale expanded steadily with interest rate witnessing modest decline. The trading volume of the interbank funding market increased dramatically with interest rate declining and market participants diversified. Short-term products of the bond repurchase market took a larger market share and debenture bonds remained the most important underlying assets of bond repurchases. State-owned commercial banks and policy banks' market share as net lenders saw a substantial increase. The issuance volume of the short-term financing bill market expanded continuously, issuance rate became more market-based and the market stock making historical new highs.

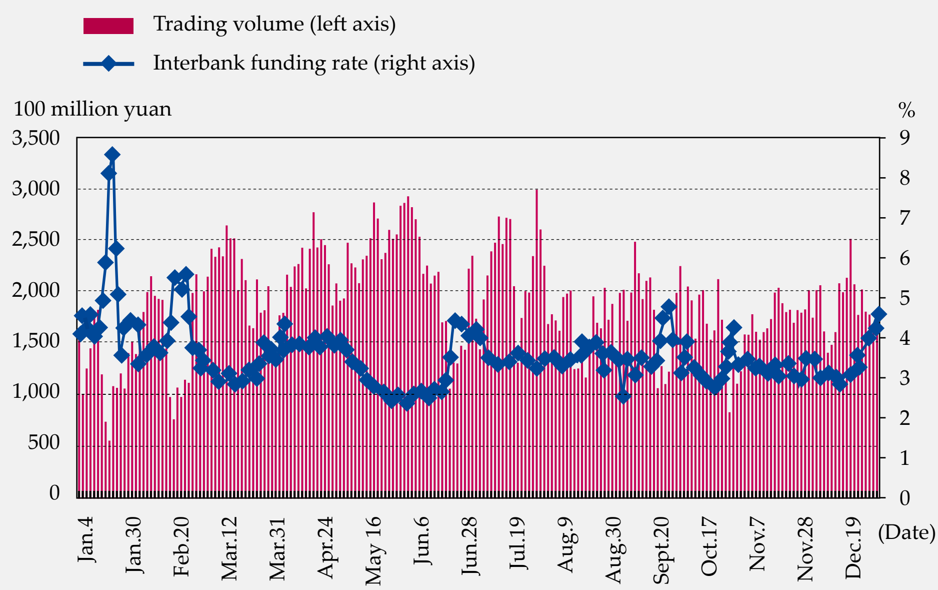
1. Interbank funding market

In 2012, against the backdrop of prudent monetary policy, the interbank funding market maintained sound development momentum. The market size expanded fast and interest rates declined. In the meanwhile, the market participants became more diversified and the market function of liquidity management was brought into full play.

1.1 Performance of the interbank funding market

In 2012, the cumulative turnover of the interbank funding market reached 46.70 trillion yuan with an average daily turnover of 186.2 billion

Figure 2.1 Turnover and Interest Rates of the Interbank Funding Market in 2012



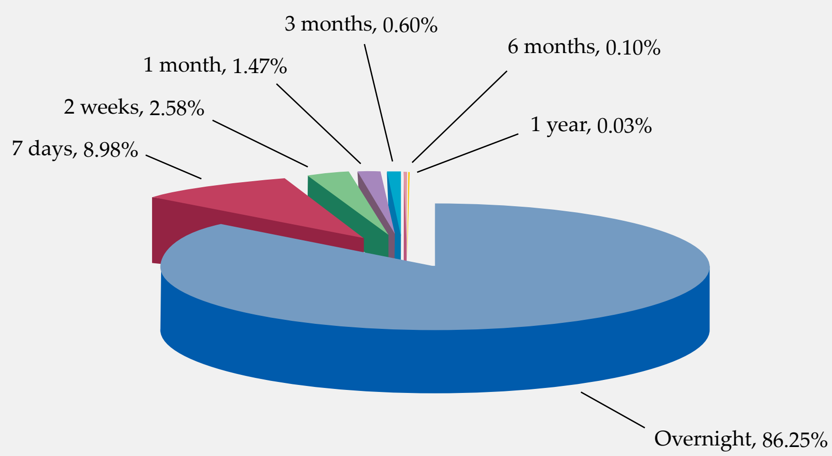
Source: National Interbank Funding Center.

yuan, increasing 39.27% over 2011. The weighted average interbank funding rate[1] was 3.43%, 54 basis points (bps) lower than 2011. The maximum and minimum rates were 8.51% on January 18 and 2.16% on May 31, 53 bps lower and 17 bps higher than those of 2011 respectively. The annual spread was 635 bps, 70 bps narrower than that of 2011. Generally speaking, the interbank funding rate remained stable across the year with substantially smaller fluctuations as compared with the previous year. Short-term volatility occurred only on specific occasions, i.e. the rate underwent a substantial increase and decrease before and after the Spring Festival respectively and climbed up by a small margin at the end of each quarter.

In 2012, most of the interbank funding transactions remained short-term. Transactions within 7 days took a lion's market share of 95.23%. In particular, overnight trading represented 86.25% of the overall market transactions, up 5 percentage points over the previous year. The volume of transactions with a term of over one month posted 2.19% of the overall market transactions, 1.5 percentage points lower as compared with 2011.

In 2012, banking institutions still dominated the interbank funding market. Specifically, joint-stock commercial banks, state-owned commercial banks and urban commercial banks took up 41.85%, 14.9% and 12.93% of the overall market trading volume respectively. The above-mentioned institutions represented a market share of 86.99% accumulatively. The trading volume of non-banking institutions represented 13.01% of the whole market, 4% more over the previous year. In particular, securities companies and finance companies of conglomerates were also active market participants, taking up a market share of 4.11% and 3.69% respectively, while trust companies, auto financing companies and asset management companies were less active, with a small market share of less than 0.1% respectively.

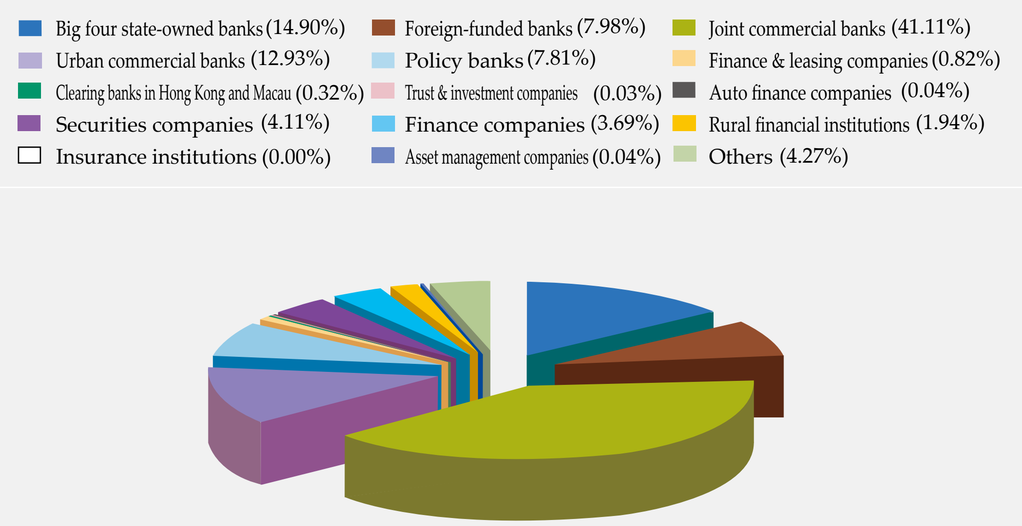
Figure 2.2 Terms of Interbank Funding Market Transactions in 2012



Source: National Interbank Funding Center.

1 The funding rate mentioned in this part all refers to the typical 7-day rate unless indicated otherwise.

Figure 2.3 Market Participants of the Interbank Funding Market in 2012



Note: *Others* includes Postal Savings Bank of China and China Bond Insurance Co., Ltd..
Source: National Interbank Funding Center.

1.2 Main features of the interbank funding market's performance

1.2.1 Market size continued to expand steadily

In 2012, market participants were more actively involved in liquidity management by means of money market with growing competence. The interbank funding market enjoyed fast development with both market size and average daily turnover hitting historical new highs. The market size increased to 46.7 trillion yuan from 1 trillion yuan in 2002, an annual growth rate of 44.10%. In particular, the market size in 2012 was 13.26 trillion yuan larger than that of the previous year, 2.4 times of growth rate of 2011. The year of 2012 also witnessed the largest market size expansion in the past ten years with a daily turnover around 200 billion yuan. Market participants were more inclined to managing liquidity through money market instruments, boosting the market's function of liquidity adjustment.

1.2.2 Interbank funding rate declined with noticeably seasonal climb-up

Against the backdrop of prudent monetary policy in 2012, the interbank funding rate remained stable with modest decline, ranging from 2.5% to 4.0%. The fluctuation of the rate was smoothed with narrower volatility band. The weighted average rate posted 3.43%, 54 bps lower than that of 2011, which still remained at a high level as compared to 2% in previous years.

In 2012, the interbank funding rate remained stable with smaller fluctuation due to the People's Bank of China's (PBC) monetary policies of cutting benchmark interest rate, lowering the Required Reserve Ratio (RRR) and conducting reversed repo transactions on the open market. The only exception was on the eve of the Spring Festival, when exploding liquidity demand pushed the rate to the year's highest level. The 7-day interbank funding rate skyrocketed from 4% at the beginning of the year to 8.5% at the New Year's Eve, a wide increase of 450 bps. Seasonal climb-ups of the rate were also noticeably spotted at the ends of March, June, September and December respectively with a smoother growth of 100 bps. In terms of the market rate movement in 2012, the effectiveness of reversed repo transactions on the open market was obvious on adjusting market liquidity and ironing out market volatility.

1.2.3 Big-four state-owned commercial banks became net lenders while the borrowing capabilities of non-banking financial institutions enhanced

In 2012, large-scaled banks were the market's net lenders while urban commercial banks, rural financial institutions and non-banking financial institutions remained net borrowers. Specifically, joint-stock commercial banks were the largest lenders with an accumulative annual net lending of 5.39 trillion yuan, which was followed by policy banks with an annual net lending of 4.26 trillion yuan. The big-four state-owned commercial banks, after transforming into the largest borrowers in 2011, regained their position as market lenders, albeit making a small net lending of only 747.3 billion yuan.

As for the fund flow, net borrowing of non-banking financial institutions grew dramatically. In 2012, non-banking financial institutions outweighed banking institutions and contributed a net borrowing of 6.58 trillion yuan cumulatively, representing 57.08% of the market's net borrowing and 26.49% more than that of 2011 which stood at 30.59%. To be specific, securities companies became the largest borrowers with a cumulative annual net borrowing of 3.63 trillion yuan. Finance companies of conglomerates also contributed an annual net borrowing of 2.92 trillion yuan. Banking institutions altogether made a net borrowing of 4.95 trillion yuan, 42.92% of the net borrowing of the overall market.

1.3 Outlook for the interbank funding market

In Recent year, with the gradual improvement

Table 2.1 Net Lendings and Net Borrowings of Different Market Participants of the Interbank Funding Market

Units: 100 million yuan, %

Institutions	Net lending	Percentage	Institutions	Net lending	Percentage
Joint-stock banks	53,901.20	46.77	Securities companies	36,265.34	31.47
Policy banks	42,606.73	36.97	Urban commercial banks	33,675.20	29.22
Big-four state-owned banks	7,473.31	6.48	Finance companies of conglomerates	29,194.18	25.33
Others	6,106.42	5.30	Rural financial institutions	7,729.45	6.71
Finance & leasing companies	4/897.64	4.25	Foreign-funded banks	7,309.75	6.34
Asset management companies	270.00	0.23	Clearing banks in Hong Kong and Macau	746.05	0.65
			Trust & investment companies	182.04	0.16
			Auto finance companies	153.30	0.13
			Insurance companies	0.00	0.00
Total	115,255.30	100	Total	115,255.30	100.00

Source: National Interbank Funding Center.

of market administration and regulation, the market structure of the interbank funding market has undergone proper adjustment with diversified market participants and expanding market size. New market participants got access to the market, adding up to the number of market participants, and market players boasted diversified financing demands and higher demand for liquidity management, all of which provided sound development momentum for the interbank funding market. It is foreseeable that the market will continue to enjoy stable growth. In the meanwhile, information disclosure and self-discipline were gradually enhanced, which helped reduce information cost of market players, improved market transparency and boosted the orderly development of the interbank funding market.

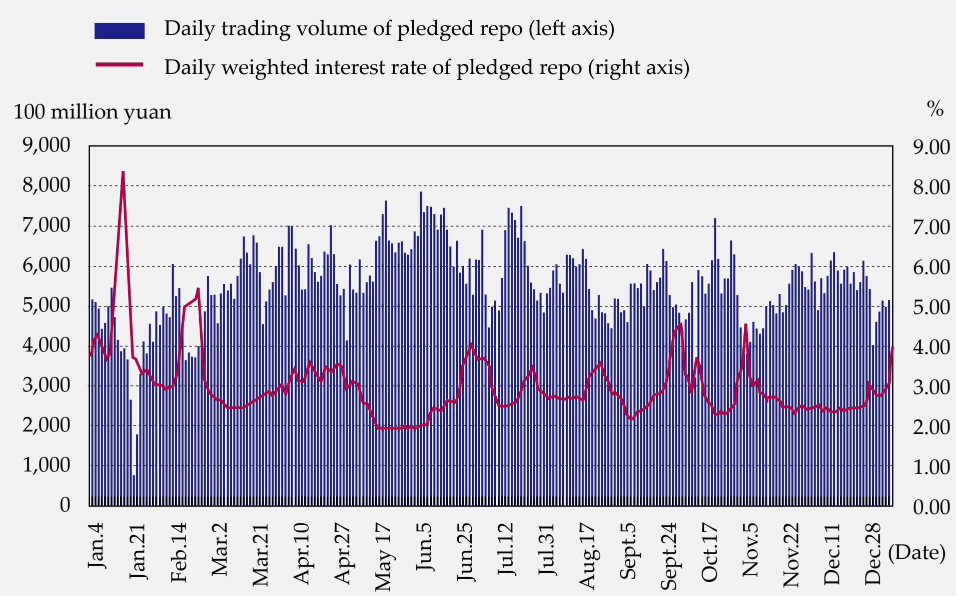
2. Bond repo market

In 2012, the trading size of the bond repo market grew by a large margin, short-term products took a larger market share and the repo rate declined. Debenture bonds still remained the most important underlying assets of bond repo transactions. State-owned commercial banks and policy banks' role as net lenders has been strengthened.

2.1 Performance of the bond repo market

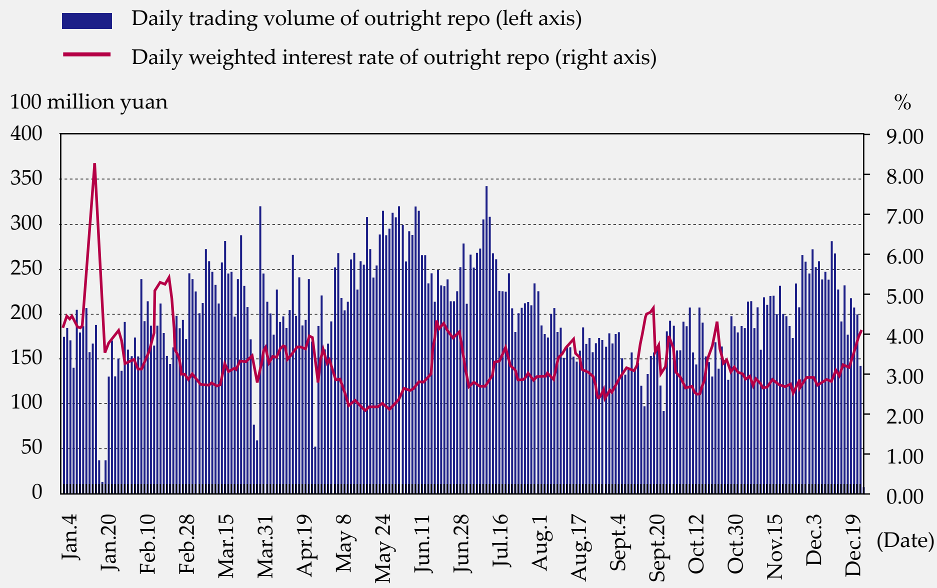
In 2012, the cumulative turnover of the repo transactions in the interbank bond market hit 141.71 trillion yuan, a year-on-year increase of 42.48%. In particular, the cumulative turnover of the pledged repo grew 41.34% from 2011 to 136.62 trillion yuan while the cumulative turnover of

Figure 2.4 Turnover and Interest Rates of the Pledged Repos in 2012



Source: www.chinamoney.com.cn.

Figure 2.5 Turnover and Interest Rates of the Outright Repos in 2012



Source: www.chinamoney.com.cn.

the outright repo reached 5.10 trillion yuan, an increase of 82.68% over that of 2011. In 2012, the weighted average interest rate of the pledged repo declined 55 bps year-on-year to 2.91%. The maximum and minimum rates reached 8.34% on January 18 and 1.92% on May 22 respectively with an annual spread of 642 bps. The weighted average interest rate of the outright repo dropped 62 bps from 2011 to 3.22%. In 2012, the interest rate of the pledged repo maintained the same movement trend with that of the outright repo. Generally speaking, the market rate was lower than that of 2011 with great fluctuation.

2.2 Main features of the bond repo market

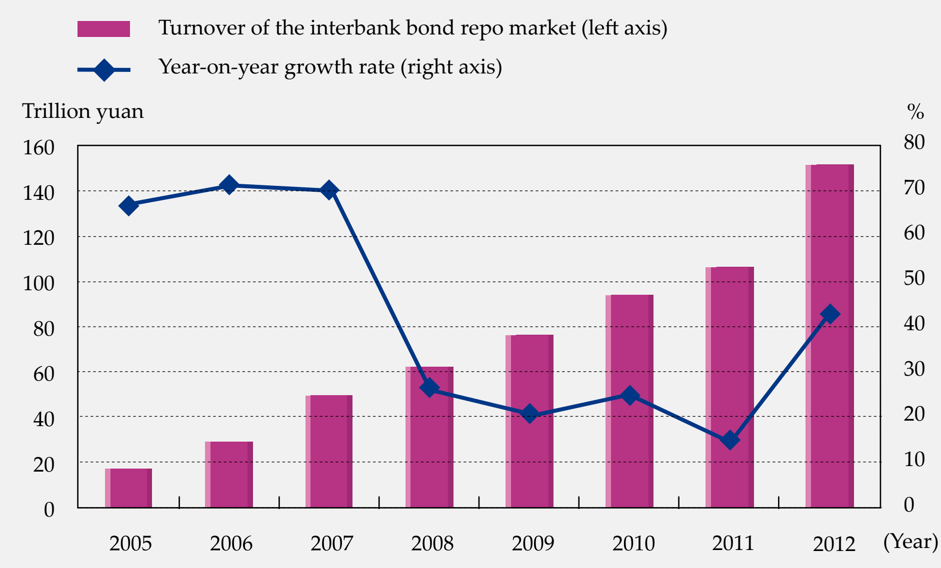
2.2.1 Market size of the bond repo market rose by a large margin

In 2012, turnover of the interbank bond repo market increased by 42.48% to 141.71 trillion yuan, an acceleration of 42.25 trillion yuan year-on-year, 28.94 percentage points higher than the growth rate of the previous year and second only to the growth rate of 2007 which stood at 69.99%. The fast expansion of the bond repo market indicated that the market's function of short-term financing and liquidity management was brought in to full play.

2.2.2 Maturity of bond repo transactions shortened

In terms of the term structure, less-than-7-day products accounted for 93.80% of the overall pledged repo transactions, 2.17 percentage points higher than that of 2011. Specifically, overnight products continued to trade briskly with an annual turnover of 110.93 trillion yuan, 81.20% of the total and 5.81 percentage points higher than that of 2011. 7-day products represented 12.60% of the total, down 3.64 percentage points over that of the previous year. Products with a term over 14 days saw a modest decline in market share, with

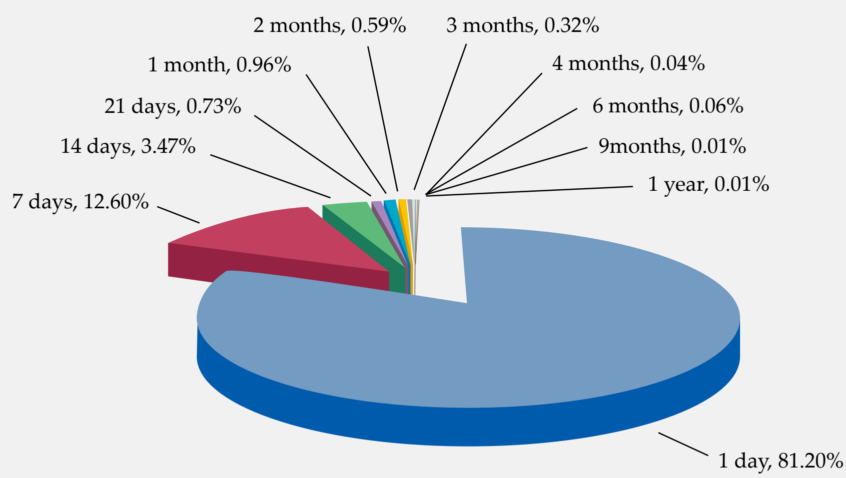
Figure 2.6 Market Size and Growth Rate of the Bond Repo Market, 2005—2012



Source: www.chinamoney.com.cn.

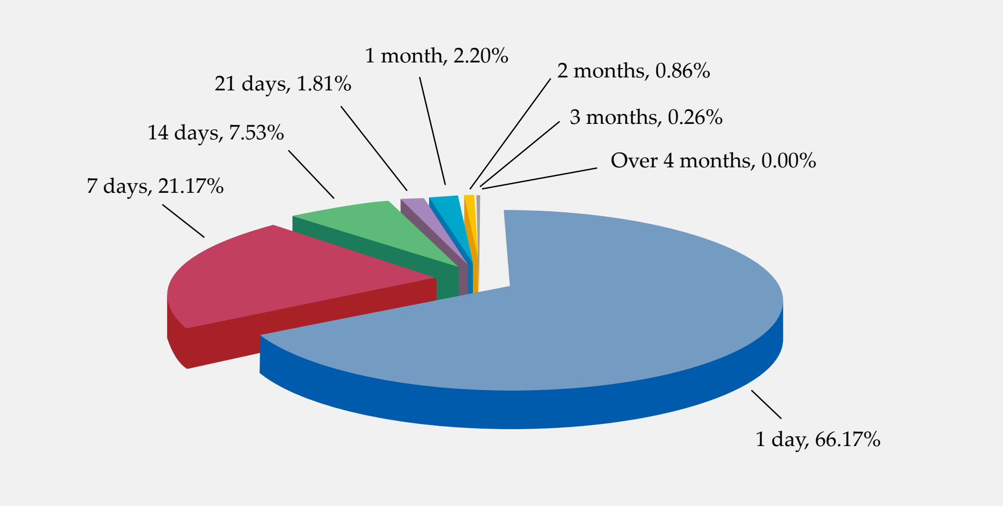
the proportion of the turnover of 14-day products and more-than-14-day products posting 3.47% and 2.73% of the overall pledged repo transactions respectively, down 1.06 and 0.76 percentage point over that of 2011 respectively. The maturity of outright repo transactions shortened after

Figure 2.7 Term Structure of Pledged Bond Repo Transactions in 2012



Source: www.chinamoney.com.cn.

Figure 2.8 Term Structure of Outright Bond Repo Transactions in 2012



Source: www.chinamoney.com.cn.

prolonging in the previous year. Less-than-7-day products took up 87.34% of the total outright repo transactions, increased by 1.62 percentage points over 2011.

2.2.3 Government bonds remained the main underlying assets of repo transactions

In 2012, treasury bonds, central bank bills and policy financial bonds accounted for 77.72% of the underlying bonds in pledged repo, 2.88 percentage points less than that of 2011. Specifically, the proportion of central bank bills as underlying assets in repo transactions decreased from 17.83% in 2010 to 10.25%, maintaining the declining trend that started from 2009, whereas the proportion of short-term financing bills, mid-term notes, small and medium-sized enterprise collection notes and corporate bonds increased to 18.25%, up 0.89 percentage point over 2011. Debenture bonds have been widely accepted as repo collaterals.

In 2012, the underlying bonds for the outright repo witnessed remarkable structural transformation. Government bonds surpassed debenture bonds to become the main underlying bonds again. The proportion of treasury bonds, central bank bills and policy financial bonds increased from 48.31% in 2011 to 54.64%, whereas that of short-term financing bills, mid-term notes, small and medium-sized enterprise collection notes and corporate bonds decreased from 48.74% in 2011 to 42.21%. Specifically, the trading volume of outright repo with policy financial bonds as underlying bonds saw a substantial growth, with its proportion increasing from 34.55% to 42.59%, which was followed by that of outright repo with central bank bills as underlying bonds, climbing from 2.49% to 4.17%, whereas the proportion of corporate bonds declining from 21.06% to 18.89%.

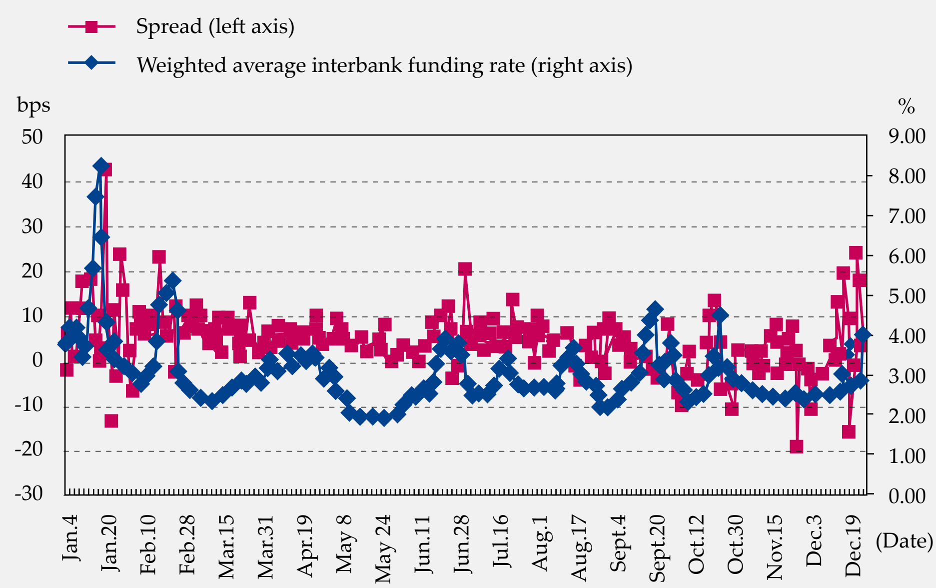
2.2.4 State-owned commercial banks and policy banks took a larger share in the repo market as a net lender

In terms of the fund flow of the pledged repo market in 2012, domestic financial institutions were net lenders while foreign-funded and joint-stock financial institutions were net borrowers. Particularly, state-owned commercial banks, policy banks and joint-stock commercial banks were the top three lenders with an annual net lending of 35.13 trillion yuan, 21.20 trillion yuan and 9.29 trillion yuan respectively, which accumulatively took up 96.17% of the market. The top three borrowers were urban commercial banks, rural credit unions as well as rural commercial banks and credit cooperatives with a net borrowing of 24.20 trillion yuan, 11.01 trillion yuan and 10.33 trillion yuan respectively and all accounted for 66.83% of the market. In terms of the structural change of the repo market, the market share of state-owned commercial banks and policy banks as net lenders surged 11.46 and 7.31 percentage points over the previous year respectively, while that of rural commercial banks and credit cooperatives as net borrowers climbed 2.90 percentage points year-on-year. The market share of other market players remained more or less the same.

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

In 2012, the correlation coefficient between the daily weighted average rate of pledged repo and the interbank funding rate was 0.9969. The repo rate and the funding rate were highly synchronized in movement, indicating that the bond repo, as a money market instrument, was affected by the same factor as the interbank funding market. Besides, the average spread of the two rates decreased from 10.11bps of the previous year to 7.83 bps, reflecting the declining short-term deviation of these two rates.

Figure 2.9 Change in the Spread between the Repo Rate and the Funding Rate in 2012



Source: www.chinamoney.com.cn.

2.3 Perspectives on the future development of the bond repo market

The bond repo market has enjoyed fast expansion in market size with enriched products and diversified market players. It has been imperative to enhance market regulation and risk control. On December 3 2012, the PBC issued the No. 17 Announcement of 2012, stipulating that the *Master Agreement of Bond Repo Transactions on the Interbank Market (2013 edition) (Master Agreement)* would be promulgated. Based on the current practice of the bond repo market, in line with the principles of continuity, adaptability and preemptiveness, the new edition of *Master Agreement*, is actually a revision to the existing two *Master Agreements, i.e. Master Agreement of Pledged Bond Repo Transactions on the Interbank Market 2000 and Master Agreement of Outright Bond Repo Transactions on the Interbank Market 2004. Master Agreement* was more detailed and comprehensive in terms of framework structure, key mechanism arrangement, resolution of risk events and signing procedures as compared with the previous two editions, introducing such innovative mechanisms as replaceable pledged bonds, mark-to-market and dynamic adjustment of repo bonds, fast resolution of collaterals, single contract and net value at termination, etc. *Master Agreement* also set aside an interim period of 12 months to insure s stable and orderly transition. In the following stage, the PBC will amend the related administrative measures on bond repo transactions, insuring the compliant implementation of the innovative mechanisms brought in by the newly-issued *Master Agreement*. The promulgation and implementation of *Master Agreement*, as a fundamental institutional arrangement of the bond repo market, will help perfect the trading mechanism of bond repo transactions, enhance market liquidity and boost the credit risk management capabilities of market players. *Master Agreement* will also safeguard the legal rights of market participants and lay a solid foundation for the regulated, sustainable and sound development of the bond repo market.

3. Short-term financing bill market

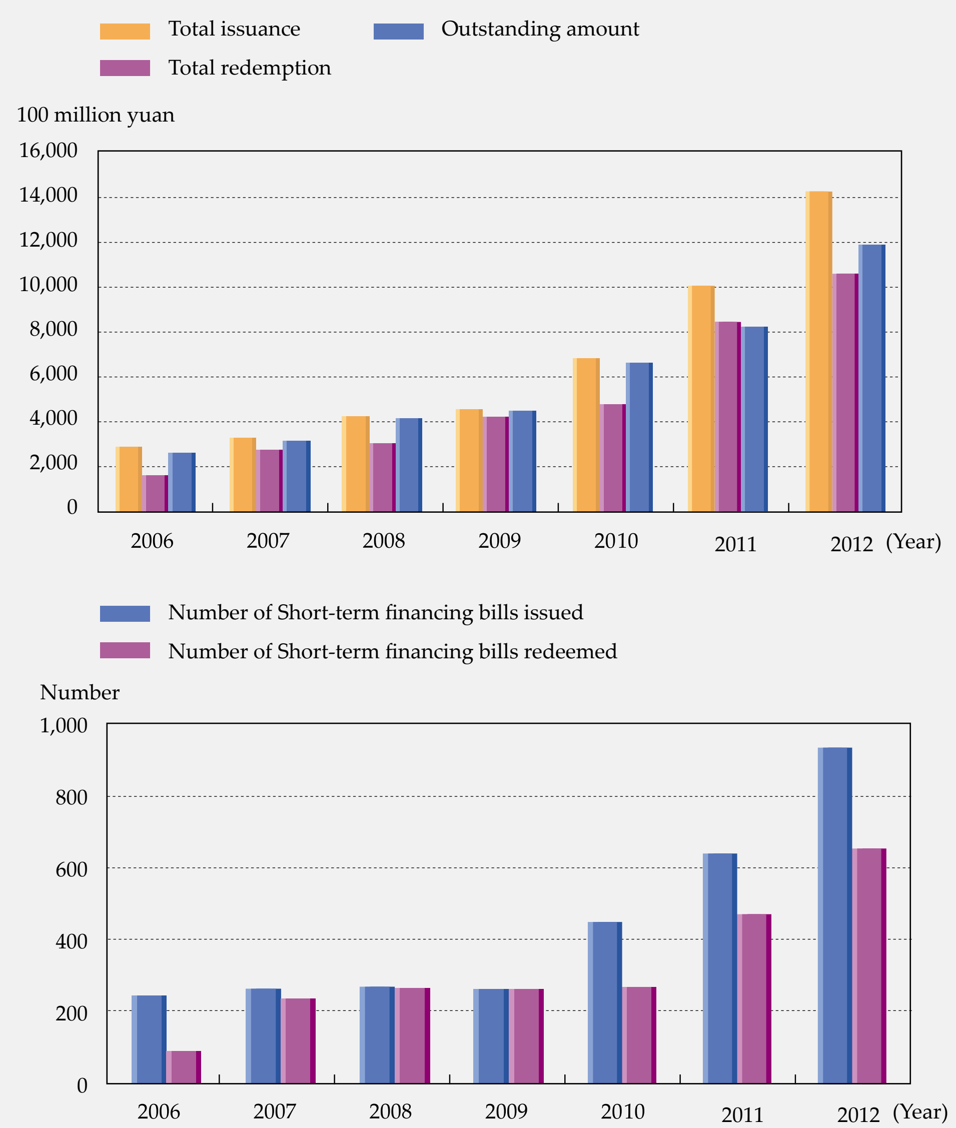
In 2012, the short-term financing bill market maintained rapid and sound growth momentum. On the primary market, the issuance volume continued to grow and the rate formation regime became more market-based. The secondary market boasted brisk trading and the yield climbed up after an initial decline. The market stock continued to expand, making a record high.

3.1 Performance of the short-term financing bill market[1]

In 2012, a total of 638 non-financial enterprises issued cumulatively 934 short-term financing bills, 298 more than that in 2011, with the face value growing 40.16% year-on-year to 1418.147 billion yuan (Specifically, a total of 125 super short-term financing bills were issued with a face value of 582.2 billion yuan). Among them, 645 bills were redeemed with a face value of 1063.48 billion yuan, which gave an annual net issuance of 354.667 billion yuan. At end-2012, the outstanding short-term financing bills amounted to 1185.797 billion yuan, a year-on-year increase of 42.67% (Specifically, the outstanding super short-term financing bills posted 353.1 billion yuan). In 2012, the average issuance volume of each short-term

1 Apart from publicly issuing short-term financing bills and super short-term financing bills, non-financing enterprises are also eligible to issuing short-term financing bills to designated parties. In 2012, a total of 60 above-mentioned short-term financing bills were issued to designated parties, with a total value of 60.7 billion yuan. The analysis of this report is only based on short-term financing bills issued to the public.

Figure 2.10 Issuance and Redemption of Short-term Financing Bills, 2006—2012



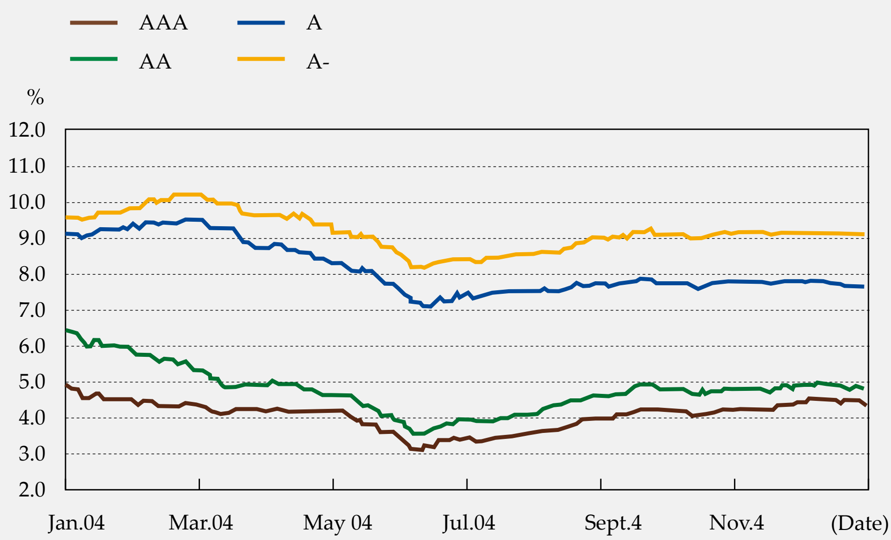
Source: National Association of Financial Market Institutional Investors (NAFMII).

financing bill hit 1.518 billion yuan, 73 million yuan less as compared with 2011.

The trading on the secondary market of short-term financing bills remained brisk. The annual spot trading volume increased 49.44% year-on-year to 8.69 trillion yuan and the average turnover ratio of spot short-term financing bills hit 861.52%, 85.91 percentage points higher than that of the previous year.

In 2012, yields of short-term financing bills on the secondary market experienced a V-shape trend. With the continuous relief of inflationary pressure and bottom-out of the economy, fund supply on the interbank funding market was on the rise,

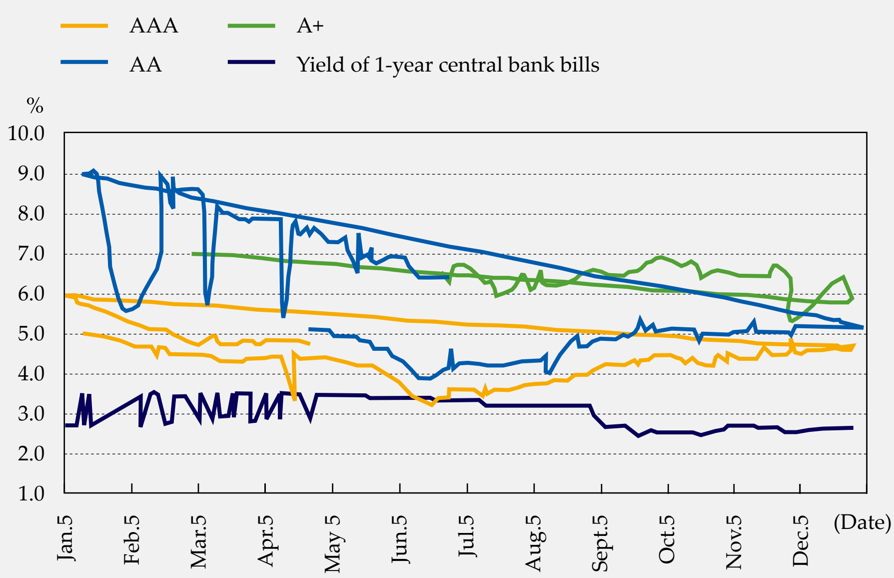
Figure 2.11 Change of the Yield of One-year Short-term Financing Bills on the Secondary Market in 2012



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

driving up the risk appetites of market players. Improved liquidity conditions on the market further pushed down the yields of short-term financing bills with high credit ratings, which had been declining since the second half of the previous year. The same trend has also been felt in the yields of short-term financing bills of medium and low credit ratings. On May 12, the PBC cut

Figure 2.12 Change of Issuance Rates of One-year Short-term Financing Bills in 2012



Source: National Association of Financial Market Institutional Investors and China Central Depository & Clearing Co., Ltd..

back on the RRR and the yields on the secondary market descended in a fast manner. Ever since July, fund on the interbank funding market was tight yet balanced and the yields on short-term financing bills crawled up steadily. At end-2012, yields of short-term financing bills with the credit ratings of AAA, AA and A were 46 bps, 161 bps and 143 bps lower than those at the beginning of the year respectively.

The issuance rates of short-term financing bills on the primary market moved almost in the same way with the yields on the secondary market. In the first half of 2012, with the inflationary pressure falling and the PBC's cutting back on the RRR, the market liquidity tension was relieved. As a result, the yields of one-year central bank bills declined and so did the issuance rate of short-term financing bills. In the second half of the year, due to the growing demand for liquidity prior to the National Day Holiday and the regulatory authorities' evaluation of commercial banks' performances at the end of each quarter, the money market rate shored up and the issuance rate of short-term financing bills spiraled up slowly.

Commercial banks and funds were still the main holders of short-term financing bills with their holdings increasing and their market shares converging. In contrast, the market share of such non-banking institutions as securities companies,

Table 2.2 Holdings of Short-term Financing Bills by Institutional Investors

Units: 100 million yuan, %

	Holding balance (2012)	Percentage	YoY change (over 2011)	Holding balance (2011)	Percentage	YoY change (over 2010)
Policy banks	446.90	3.77	50.37	297.20	3.58	99.87
Commercial banks	5,340.69	45.04	23.18	4,325.95	52.11	25.10
Nationwide commercial banks[1]	4,634.33	39.08	24.74	3,715.13	44.75	29.76
Foreign-funded banks	143.40	1.21	94.31	73.80	0.89	80.79
Urban commercial banks	286.51	2.42	-29.87	408.52	4.92	6.80
Rural commercial banks	254.06	2.14	111.72	120.00	1.45	-5.06
Rural cooperative banks	20.89	0.18	145.76	8.50	0.10	-78.56
Credit cooperatives	231.94	1.96	2.40	226.50	2.73	57.19
Non-banking institutions	53.68	0.45	-50.69	108.87	1.31	21.60
Securities companies	252.01	2.13	-32.28	372.16	4.48	27.60
Insurance companies	196.52	1.66	-23.41	256.59	3.09	-30.17
Funds	5,204.96	43.89	99.36	2,610.89	31.45	30.95
Non-financial institutions	21.90	0.18	-54.88	48.53	0.58	30.47
Others	109.37	0.92	98.85	55.00	0.66	—

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

insurance companies, trust companies, finance companies of conglomerates and credit unions was declining and so was that of non-financial institutions (See Table 2.2).

3.2 Major features of short-term financing bill market

3.2.1 The short-term financing bill market witnessed fast development

In 2012, China's economy enjoyed stable and fast development and maintained sound development momentum, with enterprises' demand for fund raising soaring. The total issuance volume and number of short-term financing bills issued hit a historical new high. The Super short-term financing bills, ever since its launch at the end of 2010, enjoyed rapid development in 2011 and has become an effective tool for liquidity management for businesses. In 2012, a total of 48 enterprises issued super short-term financing bills, 40 more than that of the previous year, with an issuance volume of 582.2 billion yuan, a year-on-year increase of 178.56%.

3.2.2 Credit ratings of issuers saw a modest decline

In 2012, credit ratings of short-term financing bill issuers saw a modest decline with the number, issuance volume and value of issuers below AA rating climbing up. In 2012, among the 638 short-term financing bill issuers (18 of which have undergone credit rating adjustment), there were 281 issuers with credit ratings below AA, taking up 42.84% of the total, up 4.6 percentage points year-on-year. The cumulative issuance volume of issuers below AA rating hit 327, representing 35.01%of the total, a growth of 1.36 percentage points over 2011. The cumulative issuance value of issuers below AA rating reached 113.987 billion yuan, 8.04% of the market and leveling off compared with the previous year.

3.2.3 Securities companies restarted the issuance of short-term financing bills

In order to expand the financing channel of securities companies and support the development of the capital market, the PBC, in collaboration with the China Securities Regulatory Commission (CSRC), restarted the issuance of short-term financing bills in 2012. On May 31, China Merchants Securities successfully concluded the first issue of short-term financing bills in 2012 through the bond issuance system of the PBC, with an issuance value of 4 billion yuan and a maturity of 91 days. Ever since the securities companies restarted the issuance of short-term financing bills, related institutional arrangements including management of issuance and information disclosure have undergone further improvement, with the scope of qualified issuers expanding and issuance volume rising steadily.

In line with the principle of advancing gradually in due order, those securities companies with regulatory ratings of AA and plus for two consecutive years were granted market access at the initial stage of the market. In the meantime, in order to enhance market regulation and transparency and based on *Administrative Rules of Securities Companies Issuing Short-term Financing Bills* (PBC Announcement [2004] No. 12), the PBC, taking into account the performance and regulation of the interbank bond market, released *Notice on Issues about the Issuance Management and Information Disclosure of Securities Companies Issuing Short-term Financing Bills* (PBC Financial Market Management Department [2012] No. 19). The document stipulated the requirements of issuance management and information disclosure, providing institutional guarantee for the issuance and transaction of short-term financing bills by securities companies.

The market enjoyed stable performance half year after the securities companies restarted the issuance of short-term financing bills. In November, securities companies with regulatory ratings of BBB and plus in the previous year were also granted the market access. As of end-2012, a total of four securities companies, i.e. China Merchants Securities, CITIC Securities, Guotai Jun'an Securities and GF Securities, issued 15 short-term financing bills with a cumulative issuance value of 53.1 billion yuan and an outstanding balance of 26.5 billion yuan.

The restart of short-term financing bill issuance by securities companies helped expand their financing channel and meet their demand for liquidity and at the same time supported the sound development of the capital market. With the growing development of innovative businesses of securities companies, their issuance volume of short-term financing bills will undergo further expansion.

3.2.4 Such Non-legal entity institutions as funds increased their holdings of short-term financing bills by a large margin

In 2012, wealth management businesses of banking institutions, investment funds and asset management businesses of securities companies maintained sound development momentum. In light of that, regulatory authorities made and revised a series of administrative rules on the asset management businesses of financial institutions, further boosting the healthy development of the asset management market. In terms of the asset management businesses of securities companies, the CSRC issued *Tentative Administrative Rules on Client Asset Management Businesses of Securities Companies and Administrative By-laws on Collective Asset Management Businesses of Securities Companies* and *Administrative By-laws on Privately-placed Asset Management Businesses of Securities Companies*, all of which reflected that the supervisory authority's intention of regulating the development of securities companies' asset management businesses. As for the asset management businesses of funds, *Tentative Administrative Rules on Privately-placed Asset Management Businesses of Funds* has been promulgated at end-September and put into force starting November 1, 2012. In terms of the funds of the insurance companies, the China Insurance Regulatory Commission (CIRC) has issued a total of 13 documents soliciting opinions in the regulation on the application of funds of the insurance companies. Eight new regulations have been launched, including *Tentative Rules on Investment of Bonds by Insurance Companies*. The booming asset management businesses drive up the market demand of short-term financing bill market. A large amount of non-legal entity institutions opened up accounts with Shanghai Clearing House with their holdings of short-term financing bills noticeably increasing, contributing to an optimized investor structure.

3.3 Outlook for short-term financing bill market development

3.3.1 Market size will continue to grow steadily

In 2012, China's economy enjoyed stable and fast development against the backdrop of a perplexed global economy. The economic growth model of China has been transformed from government-stimulated to autonomous growth, driving up enterprises' demand for direct financing.

In 2012, the Central Economic Work Conference was held which emphasized that proactive fiscal policy and prudent monetary policies will continue to be implemented to ensure the sound and fast development of the economy. Since its launch in 2005, short-term financing bill has enjoyed fast development and has grown into a mature instrument for raising liquid funds for non-financial institutions, which contributed to the development of the real economy and adjustment of industrial structure. The ongoing industrial structure upgrading and urbanization has boosted the market demand for short-term financing bills and the overall market size will continue to grow steadily.

3.3.2 Market self-discipline will be further enhanced

Since 2005, the short-term financing bill market has maintained sound and fast development momentum. With the fast expansion of market size, the National Association of Financial Market Institutional Investors (NAFMII) stepped up efforts in enhancing self-discipline in issuance mechanism, follow-up management and investor protection of debt financing instruments, investigating the construction of related mechanisms and exploring the long-term mechanism in regulating the interbank bond market. In an attempt to regulate the information disclosure of non-financial institutions' issuance of debt financing instruments on the interbank bond market, urge the due diligence of agent institutions and protect the legal rights of investors. The NAFMII promulgated *Table System of Registration Documents of Non-financial Institutions Issuing Debt Financing Instruments (Table System) and Registration Information System of Non-financial Institutions Issuing Debt Financing Instruments (System of Peacock Spreading its Tails)*[1] on August 1st. The Launch of Both the Table System and the System Peacock Spreading its Tails will help improve the registration procedure of short-term financing bills, boost the market self-discipline and promote the stable and sound development of the short-term financing bill market.

4. Bill market

In 2012, the bill market witnessed sound development momentum on the whole. Financing institutions were more eager than ever before to participate in the trading of bill businesses, with bill acceptance expanding continuously and bill financing scale crawling up. The trading on the interbank discounting market was brisker and repurchase transactions were warmly welcomed by the market. The interbank discounting rate stabilized in the second half of the year after tumbling in the first half of the year. The electronic commercial draft system enjoyed smooth operation with the trading volume of various electronic commercial drafts increasing substantially year-on-year.

4.1 Bill market performance

In 2012, 17.9 trillion yuan worth of commercial drafts were issued on China's bill market, a year-on-year increase of 18.8%. The cumulative discount volume stood at 31.6 trillion yuan, a year-on-year increase of 26.4%. As of end-December, the balances of undue acceptance bills and discounting bills reached 8.3 trillion yuan and 2.0 trillion yuan, up 25.4% and 35.1% respectively. At end-2012, the bill financing balance was 0.5 trillion yuan more than that at the beginning of the year, accounting for 3.24% of outstanding loans, and up 0.48 percentage point over that of the previous year.

1 In light of the practices of such mature capital markets as European capital market and American capital market and based on the past experience, the Table System and the System of Peacock Spreading its Tails are an update to the current debt financing instruments. The Table System stipulates the minimum information disclosure requirements. Therefore, enterprises, principal underwriters and related agent institutions fill in the tables and write down their professional opinions in accordance with different requirements, which later constitute the registration documents. The System of Peacock Spreading its Tails demonstrates to the public the registration documents and procedures of debt financing instruments issuance so as to receive public surveillance.

The interest rate on the bill market fluctuated downwards in the first half of the year and rebounded and stabilized in the second half of the year. In the first quarter, the interbank discount rate fell from 8.7% at the first week of the year to 6.2% at the last week of the quarter. In the second quarter, the bill rate continued to fluctuate downwards by a narrower margin. At end-June, the weighted average interbank discount rate declined to 4.5%. In the third quarter, the interbank discount rate rebounded and the buy rate exceeded 5% again in the second half of September. In the forth quarter, the bill rate continued to climb up slowly. At the year-end, the interbank discount rate lingered around 5.5%.

As of end-December 2012, there were altogether 341 institutions that have got access to the Electronic Commercial Draft System (ECDS), which enjoyed stable performance over the year. A total of 1.35 million electronic commercial draft businesses were processed through the system with a value of 4.2 trillion yuan, accounting for 53.7% and 56.8% of the total amount and total value of businesses processed since the system launched in November 2009. The trading volume of electronic commercial drafts witnessed significant increase. In terms of regional distributions of electronic commercial draft issuance, Shandong, Guangdong, Hubei, Shanghai, Zhejiang and Beijing were the top six regions in terms of issuance volume and value.

4.2 Main features of bill market performance

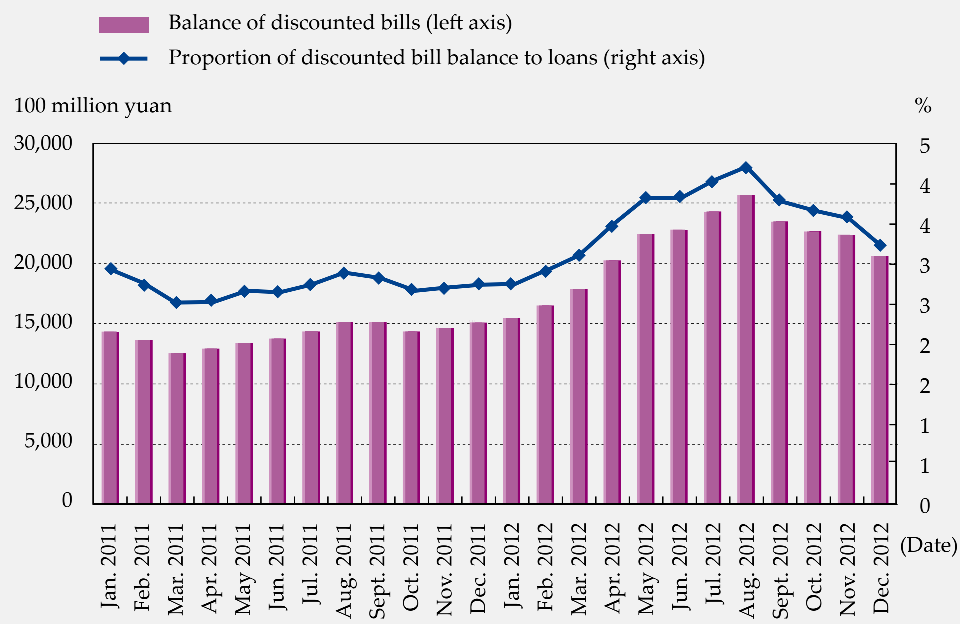
4.2.1 Amount of bill financing declined after an initial surge and witnessed a year-on-year growth by a small margin

In the first eight months of 2012, amount of bill financing continued the rebounding momentum that had started in the second half of 2011, a growth of over 1 trillion yuan as compared with beginning of the year and accounting for 16.4% in newly-added loans, indicating a noteworthy credit expansion. Except that the growth of bill financing amount was less than 10 billion yuan in January, all of those of the following four months, i.e. February, March, April and May, exceeded 100 billion yuan. As a result of half-annually structural adjustment of credit injection, the month of June witnessed a declining bill financing amount, which came to 34 billion yuan at the month-end. The monthly increase of bill financing amount surpassed 100 billion yuan again in July and August. In September, in order to prevent the banks' inclination for credit injection rush at the end of each season, the businesses of bill discounting were suspended in some of the banks, resulting in a negative monthly growth of bill financing amount for the first time in the year. Quarterly speaking, the first three quarters saw an increase in the amount of bill financing of 257.55 billion yuan, 506.7 billion yuan and 67 billion yuan respectively, a quarter-on-quarter increase of 16.9%, 28.6% and 2.94% respectively, whereas the bill financing amount dropped by 300.9 billion yuan in the fourth quarter, down 12.83% over that at the end of previous quarter. As of end-December, balance of discounted bills hit 2.04 trillion yuan nationwide, 0.53 trillion yuan more over that at and-2011. The proportion of discounted bill balance to loans stood at 3.24%, 0.48 percentage point higher than that at the end of the previous year.

4.2.2 Banker's acceptance businesses continued to expand, playing a positive role in facilitating the fund-raising of small and medium-sized enterprises (SMEs)

In 2012, with the interest rate on the bill market declining, market demand for reducing financing cost and accelerated capital turnover was driven

Figure 2.13 Balance of Discounted Bills and Proportion of Discounted Bill Balance to Loans, 2011—2012



Source: PBC.

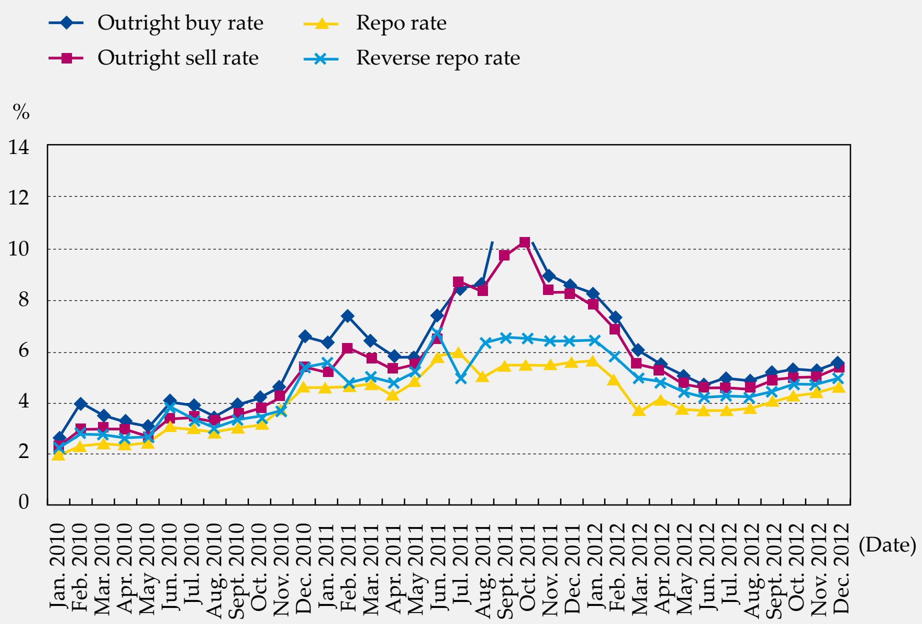
up. As a result, enterprises were more willing to issue commercial drafts, leading to a continuous expansion of the banker's acceptance businesses. In 2012, although the cumulative volume of commercial draft issuance grew by 18.8% year-on-year, which was lower than that of 2011, which stood at 26.03%, the commercial draft businesses maintained rapid development momentum on the whole.

Breaking down by sectors, most of the issuers of commercial bills of exchange were manufacturers, wholesalers and retailers. In terms of the scale of issuers, the issuance by SMEs represented two thirds of the total. The continuous stable growth of bill acceptance boosted the financing support of the real economy, SMEs in particular.

4.2.3 Bill market rates fluctuated downwards, resulting in decelerating decline

In the first quarter of 2012, as credit supply was relatively sufficient at the beginning of the year, especially after the Spring Festival when a large amount of funds returned to the banking system, financial institutions' willingness in purchasing bills was pushed higher. Consequently, repurchase transactions grew substantially and the interest rates of outright and repurchase bill businesses dropped at a faster pace. The second quarter saw a decelerating decline of bill market rates, with the trading volume of bill transactions surging in the mid-year. In the third quarter, since the market expectation for interest rate cuts waned and the money market rates climbed up after stabilizing, the bill market rates leveled off,

Figure 2.14 Movement of Quotation Rates on China Commercial Paper Website, 2010—2012



Source: www.chinacp.com.cn.

rebounding slowly in September. In the fourth quarter, the bill market rates fluctuated upwards continuously. In December, the average weighted interbank discounting buy rate, sell rate, repo rate and reverse repo rate quoted on www.chinacp.com.cn stood at 5.51%, 5.29%, 4.64% and 4.95% respectively, a year-on-year decline of 304, 303, 93 and 140 bps respectively.

4.2.4 Supervision on the bill market was continuously strengthened

In February 2012, the China Banking Regulatory Commission (CBRC) promulgated *Announcement on Issues regarding to Bill Discounting Trust businesses of Trust Companies*, stipulating that trust companies were forbidden from conducting bill-related asset transfer businesses with commercial banks. In June, the CSRC stipulated that its Beijing, Shanghai and Shenzhen branches enhance its supervision on securities companies' collaboration with banks in bill businesses and reinforce its examination on draft acceptance businesses by investment banks reported by securities companies as part of their collective wealth management businesses. In July, the PBC issued *Provisions on Enhancing Regulation on Bill Businesses (Exposure Draft)*, stipulating that the approval rights of the sub-branches be forfeited, the trade background of bill businesses strictly examined and the information registration system of bill businesses set up in a bid to enhance regulation on bill businesses. In October, the CBRC issued *Notice on Enhancing the Supervision on Banker's Acceptance Businesses*, specifying that banking institutions enhance the supervision on uniform credit line management of banker's acceptance businesses and credit line of bill businesses of a specific client be scientifically defined so as to prevent the bill issuance that exceeded the credit line of a specific client and the malpractices of bill trading in disguise.

4.3 Outlook for the bill market development

4.3.1 Bill businesses are expected to enjoy sustainable and rapid development

In 2013, the external economic environment remained grim and domestic economic structural problems are still to be settled. Consequently, efforts should be made in enhancing the monetary policies' pertinence and preemptiveness, apart from maintaining prudent. Against this backdrop, turnover of commodities are likely to be extended and hence the enterprises' demand for issuing bills soared. Since the bill market boasts the obvious advantage of low cost, enterprises' passion in bill financing is driven up. In the meanwhile, as for commercial banks, bill acceptance and discounting still remain an effective way in absorbing deposit and expanding credit supply. In case of sluggish mid and long-term credit demand, commercial banks' reliance in bill businesses is ever-increasing. Therefore, it is expected that the bill businesses will enjoy sound and fast development in 2013.

4.3.2 Competition on the bill market grew fiercer and greater importance is attached to business innovation

In 2013, competition on the bill market transformed from the single competition of price to a diversified one of price, service and business innovation. Small and medium-sized financial institutions pay more attention to absorbing deposits and expanding client base by means of banker's acceptance businesses whereas medium and large-scaled commercial banks prefer to conducting discounting and outright interbank discounting businesses so as to adjust credit scale through bill financing. In terms of acceptance and discounting, financial institutions are more prone to lowering margin ratio for acceptance, cutting discount rates and innovating business modes to cater to the requirements of clients. As for the interbank discounting market, commercial banks are more actively involved in product and service innovation. Efforts are to be made in hunting for new trading partners and collaborating with non-banking institutions in a bid to develop bill financing products.

4.3.3 Supervision on bill businesses is to be enhanced

The fast development of banker's acceptance businesses brought about risk accumulation with risk events occurring once in a while, leading to continuous enhancement of market regulation. *Provisions on Enhancing Regulation on Bill Businesses (Exposure Draft) issued by the PBC and the Notice on Enhancing the Supervision on Banker's Acceptance Businesses* promulgated by the CBRC reflect that the supervisory focus has shifted from general compliance regulation to a comprehensive one that pays more attention to management and institution building. It is foreseeable that the operation mode of bill businesses will be more intensified and the compliance operation will contribute to the stable development of businesses.

Box1 Enhancing the Construction of the Interbank Funding Market and Promoting the Benchmark Interest Rate System of Shibor

In January 2007, in a bid to promote the *market-based interest rate formation regime and cultivate China's money market benchmark interest rate system, the PBC launched the Shanghai Interbank Offered Rate (Shibor). After years of construction and cultivation, the quotation* *quality of Shibor has undergone continuous improvement with expanding application scope. Shibor has preliminarily established itself as the benchmark interest rate of money market, laying a solid foundation for the advancement of market-based reform of interest rate formation regime and improvement of the operating mechanism of financial institutions. In contrast to the Libor system that was negatively impacted by market manipulation, the Shibor system boasted late-development advantage. On one hand, based on the experience of the Libor system, the Shibor system catered to the Chinese market through tailor-made operating mechanism. The PBC specified the quotation, formation and operation of the Shibor system with strict regulation. The cultivation of the OTC Shibor quoting banks was combined with the elimination of unqualified Shibor quoting banks with explicit rewards and punishments and in this way the accuracy and reliability of the Shibor quotation was continuously enhanced and the manipulation risk of the Shibor quotation was lowered. On the other hand, the regulated, transparent and sound development of the interbank funding market also played a key role in the construction of the Shibor system.*

Firstly, the interbank funding market plays a vital role in the formation of the Shibor. The interbank offered rate is the benchmark rate of the financial market as a whole and also makes the breakthrough in the market-based reform of interest rate formation regime. The launch of the market based reform of the interbank funding rate in June 1996 marked the kick-off of market-based reform of China's interest rate formation regime and also laid a solid foundation for the future reform. In January 2007, Shibor was officially unveiled. Shibor was the arithmetic average interest rate calculated from the interbank offered rates autonomously quoted by the bank group consisting of banks with high credit ratings. Specifically, the establishment of the Shibor system was actually to select highly representative institutions and ask them to make quotations of interbank borrowing/lending rate. Therefore, the transactions of interbank funding plays a fundamental role in the market participants' quotation, the latter of which embodies the quoting institutions' expectation for funding cost, market demand and supply and the monetary policy stance as well. Besides, the trading volume and influence of banks on the money market are important indexes in the selection of quoting banks of the Shibor system. As of end-2012, a total of 18 members comprised the quoting bank group of the Shibor system, including state-owned banks, joint-stock banks, urban commercial banks and foreign-funded banks, all of which had been vital or important market participants of the interbank funding market. Consequently, the Shibor system was built on the interbank funding market and the curve of the Shibor movement reflects the market's most important participants' judgment of the market rate.

In practice, with the fast expansion of the interbank funding market, especially the brisker trading of less-than-14-day products, the relevance between the Shibor and the interbank funding rate continued to rise. Ever since 2010, the 1-day and 7-day products of the Shibor system converged with those of the interbank funding rates with a correlation coefficient of over 0.99. In particular, the two yield curves of 1-day products coincided.

Secondly, the regulated administration of the interbank funding market safeguards the fundamental environment of the formation of the Shibor system. After over ten years' construction and stable development of the Shibor system, *in July 2007, the PBC made vital adjustment regarding the administration of the interbank funding market.* ***Administrative Measures on the Interbank Funding*** *promulgated by the PBC in 2007 (PBC Decree [2007] No. 3) played a positive role in enhancing market administration. In line with the principle of pushing forward by steps, making adjustment at appropriate times, setting policy priorities and reinforcing supervision, the new administrative rules adopted "three loosenings, two enhancements and one transformation". To be specific, the administrations on market access, maturity and quota will be loosened, while such market-based administrative measures as transparency management and ex post facto supervision and examination will be enhanced, in which way the transformation of market administration from government-oriented to market-based will be realized and market self-discipline and regulated development promoted. First, the scope of qualified market participants will be expanded. Six kinds of non-banking financial institutions are granted market access. Second, the maximum period of interbank funding is lengthened. Third, the control on the interbank funding quota is loosened. Fourth, market self-discipline and transparency management are reinforced. During the same year,* ***Evaluation Rules on such Six Kinds of Non-banking Institutions as Insurance Companies Getting into the Interbank Funding Market*** *(PBC Shanghai Head Office Decree [2007] No. 5) and* ***Announcement of Issues regarding Information Disclosure of Finance Companies affiliated to Conglomerates on the Interbank Funding Market*** *(PBC Shanghai Head Office Decree [2007] No. 4) were promulgated, laying the foundation for the institutional framework of interbank funding management.*

Thirdly, diversified market participants and fast growth of market size laid a solid foundation for the Shibor transactions. Ever since the promulgation of ***Administrative Measures on the Interbank Funding Market*** *in 2007, the market participants on the interbank funding market have been enriched and market size has undergone fast expansion. Up till now, a total of 16 financial institutions have got market access, including all the banking institutions and such non-banking financial institutions as trust companies, financial asset management companies, financial leasing companies, auto finance companies, insurance companies and the asset management firms affiliated to insurance companies. The diversification of market players also promoted the brisk market transactions and provided a broader trading base for Shibor transactions. In 2007, the interbank funding market made great-leap-forward development with market size quadrupled in the year. The trading volume of 2007 exceeded 10 billion yuan for the first time and the annual growth of trading volume in the following years approximated 5 billion yuan. In 2012, the trading volume of the interbank funding market hit 46.7 trillion yuan with a daily trading volume of 186.2 billion yuan, a year-on-year increase of 39.27% and accounting for 24.8% in the overall trading volume of the money market. In contrast, the Libor transactions are faced up with the difficulty of diminishing trading volume. Since the international financial crisis broke out, credit-based funding decreased dramatically. Most of commercial banks resort to collateralized funding or Europe Central bank for financing. As a result, the Libor system is lack of real trading as its quoting base and hence cannot mirror the actual market conditions in terms of liquidity supply and demand.*

Fourthly, enhanced market transparency *contributed to the improvement of the operating environment of the Shibor system. The advancement of market transparency has always been the principle of the PBC in its promotion of the interbank funding market's development. The* ***Administrative Measures on the Interbank Funding Market*** *promulgated in 2007 has a chapter dedicated to information disclosure management, stipulating the obligations, fundamental principles, platforms as well as responsibilities of information disclosure. Besides, special regulation on information disclosure of securities companies and finance companies were issued. Information disclosure of trust companies, insurance companies, financial leading companies and auto finance companies were also made on a pilot basis. Corresponding by-laws regarding the interbank funding center as a platform for information disclosure was released as well.*

On the basis of institutional regulation, the PBC also attached importance to the daily regulation of market information disclosure. First, stepped-up efforts were made in publicity and communications in a bid to promote the establishment of information disclosure mechanism by financial institutions and insure its effective implementation. Second, laws and regulation governing the interbank funding market were strictly implemented. The regulatory authorities will have inciting conversations with financial institutions and related agencies with malpractices in information disclosure to urge them to take rectified actions and in this way to insure the mechanism's seriousness.

On one hand, the information disclosure mechanism of the interbank funding market will help guard against credit risks and reinforce market selection. The effective interbank funding market insures the formation of the Shibor system. On the other hand, market players are encouraged to enhance internal management and market-based operation, leading to the buildup of market credit system and the improvement of the external environment of the Shibor system.

Fifthly, centralized and transparent trading information provides an effective tool to testify the accuracy of Shibor. The existing market administrative rules specify that most of the interbank funding transactions be conducted through the trading platform of the interbank funding center. The trading information needs to be filed at the same platform regarding the OTC transactions as well. As a centralized and uniform trading and price quoting platform, the interbank funding center has all the trading data about interbank funding and bond repurchase at its disposal. Base on that, the center monitors the daily quotation of Shibor and makes timely and accurate analysis to insure that Shibor quotations be accurate and can make the market's benchmark rate. In contrast, the interbank funding market of the Europe is lack of market transparency and a centralized trading platform. Therefore, the Libor quotations are only the quoting banks' estimations of their own funding rates, whose accuracy cannot be testified by trading prices.

Part III Bond Market

In 2012, China's bond market maintained steady and sound growth momentum, and played a bigger role in propping up real economy, as it actively supported the implementation of economic policies aimed at ensuring growth, expanding domestic demand, adjusting structure and benefiting the people. In general, size of bond market continued to grow, market structure was optimized continuously, and corporate debenture bonds developed rapidly; bond price went up first and then retreated, while market trading became increasingly brisk; market innovation was accelerated, the variety of investors became increasingly diversified, and market infrastructure was improved.

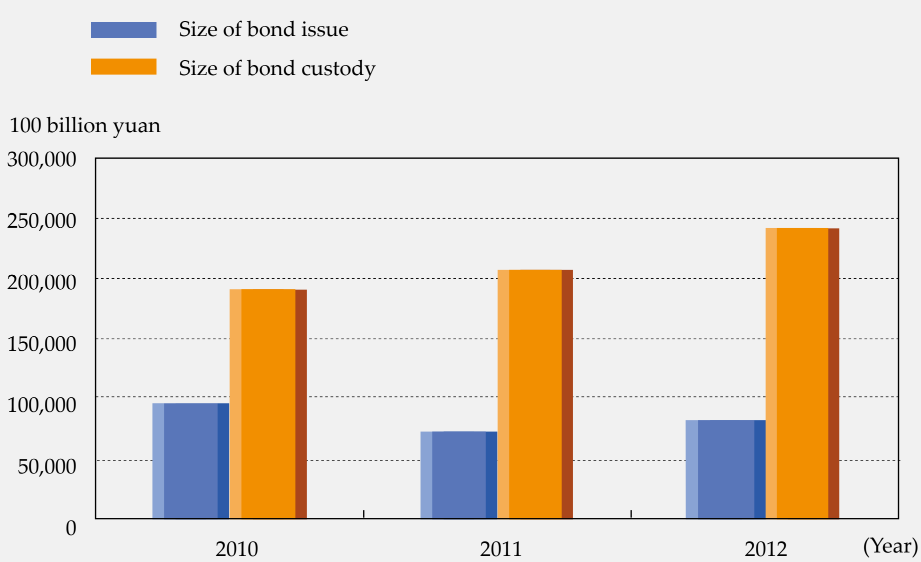
1. Overview of bond market performance

1.1 Performance of bond issuance market

1.1.1 Structure of bond issuance was optimized and market stock increased

In 2012, bonds issued on national bond market totaled 8.0319 trillion yuan in value, a year-on-year increase of 313.4 billion yuan over last year, or 4.06%. Among it, the number of new bond issues registered with interbank bond market was 2,896 with a total value of 7.7596 trillion yuan, rising 2.81% year-on-year, and accounting for 96.61% of the total issuance. The number of corporate bonds and privately-placed bonds

Figure 3.1 Changes in the Size of Bond Issue and Custody on the Interbank Bond Market, 2010—2012



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

by small and medium-sized enterprises (SMEs) issued on the exchange stood at 268 in total with the value reaching 256.633 billion yuan, taking up 3.19% of the total.

Breakdown by variety of bonds, among the newly-issued bonds, enterprise bonds posted 647.431 billion yuan, skyrocketing 160.49% year-on-year; policy bank bonds hit 2.18 trillion yuan, a year-on-year increase of 180.43 billion yuan or 9.32%; and commercial banks bonds added 11.8% compared with last year, reaching 393.37 billion yuan, among which subordinated debt was 225.37 billion yuan, down 28.87% from last year, while common financial bonds posted 168 billion yuan, up 380% from a year earlier. The issuance of government bonds in 2012 was 1.20328 trillion yuan, shedding 3.32% from 2011. Policy bank bonds, government bonds, short-term financing bills and medium-term notes took up a large share in total bond issuance.

By end-December 2012, stock of national bond market reached 25.44 trillion yuan, adding 3.96 trillion yuan from the previous year, or 18.41%. Among it, stock of interbank bond market went up 17.20% year-on-year to 24.19 trillion yuan, accounting for 95.10% of the total, while stock of bonds on exchange-traded market surged 47.79% compared with last year to 1.24 trillion yuan, comprising 4.87% of the total, and stock of over-the-counter (OTC) market soared 34.24% from last year to 307.146 billion yuan, taking up 1.21% of the total.

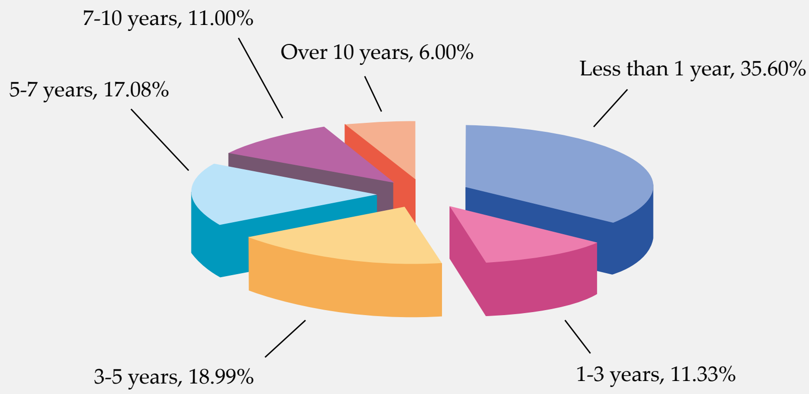
1.1.2 Issuance of corporate debenture bonds increased overall

In 2012, the issuance of corporate debenture bonds on the interbank bond market jumped 55.19% from the previous year to 3.78 trillion yuan. Among it, enterprise bonds posted 647.431 billion yuan, a year-on-year growth of 1.6 times; short-term financing bills and super short-term commercial paper stood at 1.418147 trillion yuan in total, surging 40.10% from 2011; medium-term notes hit 842.33 billion yuan, advancing 15.87% from last year; financial bonds by commercial banks climbed about 11.8% compared with the same period of last year to 393.37 billion yuan; privately-placed debt financing instruments rose by 291.43 billion yuan from 2011, or 314.94%; and collective notes by regional promising SMEs added 1.526 billion yuan over last year, or 109.86%. In addition, the issuance of five innovative financial products on bond market, either newly launched or resumed, totaled 91.062 billion yuan in 2012. Among it, short-term financing bills by financial enterprises (securities companies, and securities and finance companies) posted 56.1 billion yuan, asset-backed notes (ABNs) by non-financial enterprises 5.7 billion yuan, credit asset-backed securities (ABS) 19.262 billion yuan and financial bonds by asset management companies 10 billion yuan.

1.1.3 Share of medium and long-term bonds increased in the term structure of bond issuance, while that of short-term and long-term bonds decreased

With regard to the term structure of new bond issues on the interbank bond market, share of 3 to 10-year medium and long-term bonds went up nearly 8 percentage points over last year to 47.07%, while that of short-term (0-3 years) and long-term (over 10 years) bonds stood at 46.93% and 6% respectively, sliding 6% and 2% from 2011.

Figure 3.2 Term Structure of Bonds Issued on the Interbank Bond Market in 2012



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.

1.2 Performance of bond trading market

1.2.1 Total volume of bond trading increased notably

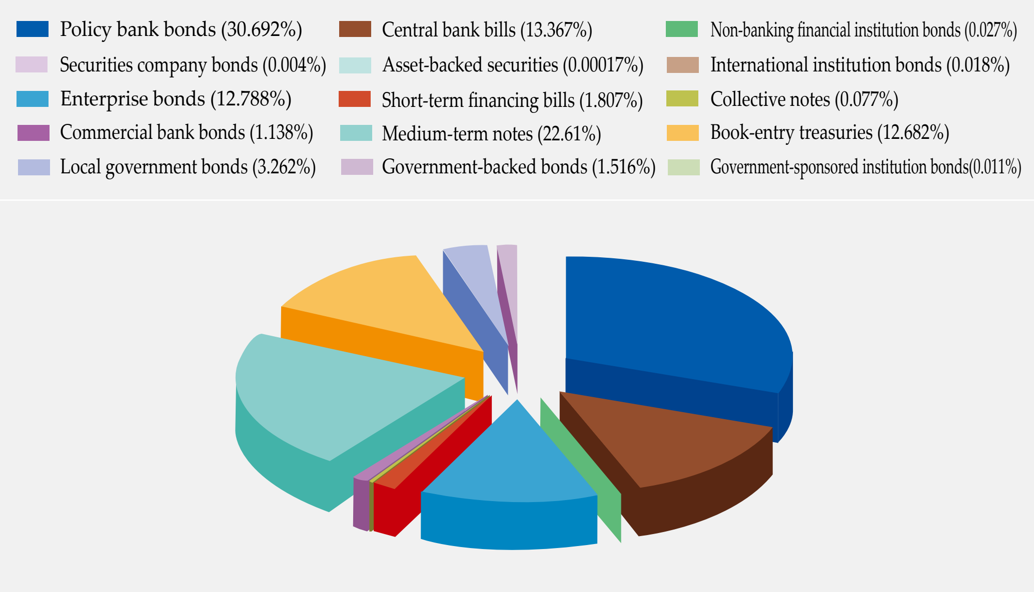
In 2012, settlement of transactions on bond market added up to 268 trillion yuan, surging 32.67% year-on-year. Settlement on the interbank bond market climbed 27.07% from the previous year to 230 trillion yuan. Among it, settlement of spot bond trading went up 14.98% compared with last year to 78.58 trillion yuan, that of bond repurchase transactions (repos) jumped 35.03% year-on-year to 151.72 trillion yuan, and that of bond forwards reached 14.03 billion yuan. Settlement of bond trading on the exchange-traded market totaled 37.44 trillion yuan, including 0.59 trillion yuan of spot bond trading and 36.85 trillion yuan of repos.

Breakdown of spot bond trading by types of bonds showed that corporate debenture bonds[1] took the lion's share of 44.59% with the settlement volume rising 32.44% from a year earlier, settlement of policy bank bonds gained 15.19% from last year with the share in total spot bond trading climbing to 28.99%, settlement of central bank bills slashed 33.33% from last year and accounted for 10.58% of the total, and settlement of treasuries and local government bonds extended growth, advancing 29.63% year-on-year and taking up 15.79% of the total.

In 2012, the turnover ratio of bonds on the interbank market was 324.85%, losing 7.76% compared with last year. By breakdown, turnover ratio of short-term financing bills continued to rise over last year, hitting 942.84%. Medium-term notes, international institution bonds and central bank bills proved to be most liquid with the turnover ratio being 646.21%, 638% and 618.55% respectively, followed by government-backed

1 Debenture bonds include enterprise bonds, medium-term notes, collective notes, commercial bank bonds, short-term financing bills, super short-term commercial paper, privately-placed financing instruments by non-financial enterprises, collective notes by regional promising SMEs, credit asset-backed securities, short-term financing bills by financial enterprises, asset-backed notes by non-financial enterprises and financial bonds by asset management companies.

Figure 3.3 Spot Trading As Percentage of Trading of New Bonds Registered with China Central Depository and Clearing Co., Ltd. in 2012



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

Table 3.1 Comparison of Turnover Ratio on the Interbank Bond Market in 2012 and 2011

Units: 100 million yuan, %

Types of bonds	2011	2012	YOY change
Book-entry treasuries	133.85	129.19	-4.66
Local government bonds	108.51	323.84	215.33
Central bank bills	585.7	618.55	32.85
Policy bank bonds	305.19	289.8	-15.39
Government-sponsored institution bonds	23.6	12.22	-11.38
Government-backed bonds	253.59	461.73	208.14
Commercial bank bonds	75.34	59.24	-16.10
Non-banking financial institution bonds	100.92	69.65	-31.27
Enterprise bonds	332.27	406.72	74.45
Asset-backed securities	1.94	1.31	-0.63
Medium-term notes	725.14	646.21	-78.93
Collective notes	498.83	363.98	-134.85
International institution bonds	629.5	638	8.50
Short-term financing bills	725	943	218
Average turnover ratio of bonds under the custody of interbank market	332.61	324.85	-7.76

Sources: China Central Depository & Clearing Co., Ltd., China Foreign Exchange Trade System and Shanghai Clearing House.

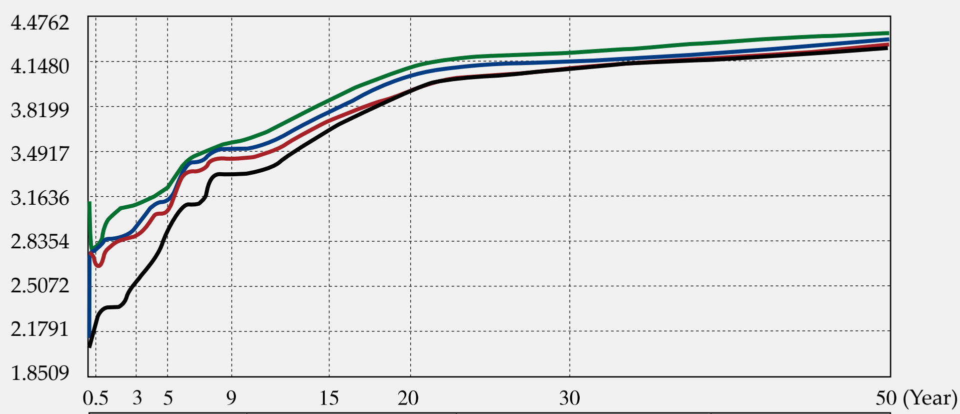
bonds (461.73%), enterprise bonds (406.72%), collective notes (363.98%), local government bonds (323.84%), policy bank bonds (289.8%) and treasuries (129.19%).

1.2.2 Bond market price index rose first but retreated later, while the yield curve went up after a decline

In 2012, price on the interbank bond market remained basically stable in the first quarter, then rose sharply from early May to late June, but was back on a downward path from July to the end of 2012. Overall, the ChinaBond Index went up first and then retreated. As of end-December 2012, the ChinaBond Composite Index (Net Price Index) was 100.7547, edging down 0.49% from 101.2478 at end-December 2011.

In 2012, bond yield curve fluctuated on the whole. In the first quarter, the ChinaBond Yield Curve fluctuated amid correction, with yield on interbank fixed-rate treasury bonds and policy financial bonds respectively moving up 7.45 and 12.53 basis points (bps) on average, while yield on enterprise bonds (AAA) and short and medium-term notes (AAA) dropping on average 22.84 and 61.78 bps respectively. In the second quarter, the ChinaBond Yield Curve was mainly characterized by a downward movement, as the average yield on interbank fixed-rate treasury bonds, policy financial bonds, enterprise bonds (AAA), and short and medium-term notes (AAA) slid 31.62, 38.09, 44.33 and 48.56 bps respectively from the previous quarter. In the third quarter, under the combined effects of rate cuts, central bank's reverse repurchase operations and expectations of a third round of quantitative easing, the ChinaBond Yield Curve trended downwards after a rise. Regardless of overnight yield, the yield on key-term interbank fixed-rate treasury bonds, policy bank bonds, enterprise bonds (AAA), and short and medium-term notes (AAA) climbed on average 36.46, 33.02, 40.25and 54.28 bps respectively compared with the end of

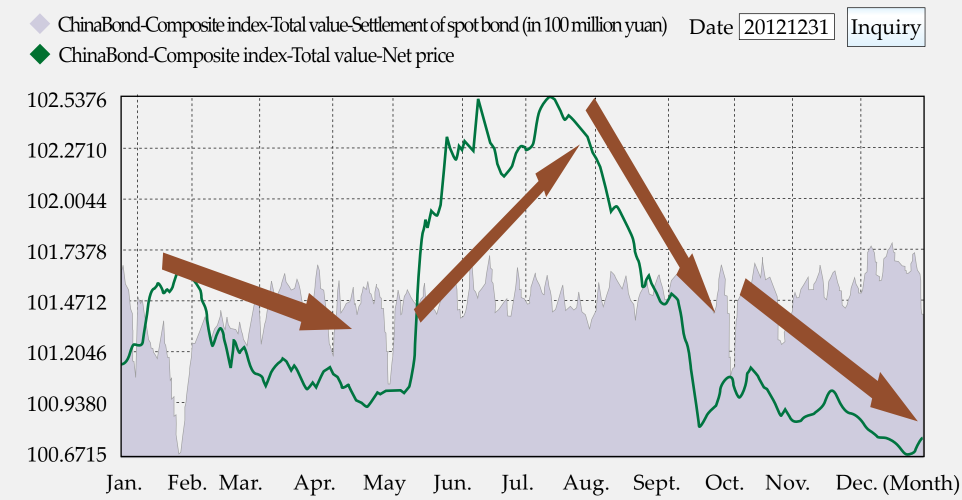
Figure 3.4 The Yield Curve of Interbank Fixed-rate Treasury Bonds in 2012



Color	Date	Remaining maturity (year)	Yield
	2012-01-04	0.0	2.3431
	2012-03-30	0.0	1.9759
	2012-06-29	0.0	2.5454
	2012-12-31	0.0	3.2706

Source: www.chinabond.com.cn.

Figure 3.5 Movement of ChinaBond Composite Index (Net Price) in 2012



Source: www.chinabond.com.cn.

previous quarter.

In the fourth quarter, macro economy showed a clear rebound due to low base effect in macroeconomic data, and inflation rose again on seasonal factors. Against this backdrop, the ChinaBond Yield Curve flattened moderately and moved up, with the yield on 10-year. treasury bonds adding 12 bps to 3.57% at end-2012.

1.2.3 Bond trading on the over-the-counter market dwindled

In 2012, the number of book-entry treasury bonds traded over-the-counter amounted to 110, 4 more compared with 2011, covering key maturities from one year to fifteen years. The cumulative OTC trading of book-entry treasury bonds posted 1.499 billion yuan in 2012, plunging 46.25% from the same period of last year. Market demand for OTC savings treasury bonds was strong, as most savings bonds were sold out on the day of issue.

2. Main features of bond market performance

2.1 Corporate debenture bond market grew rapidly

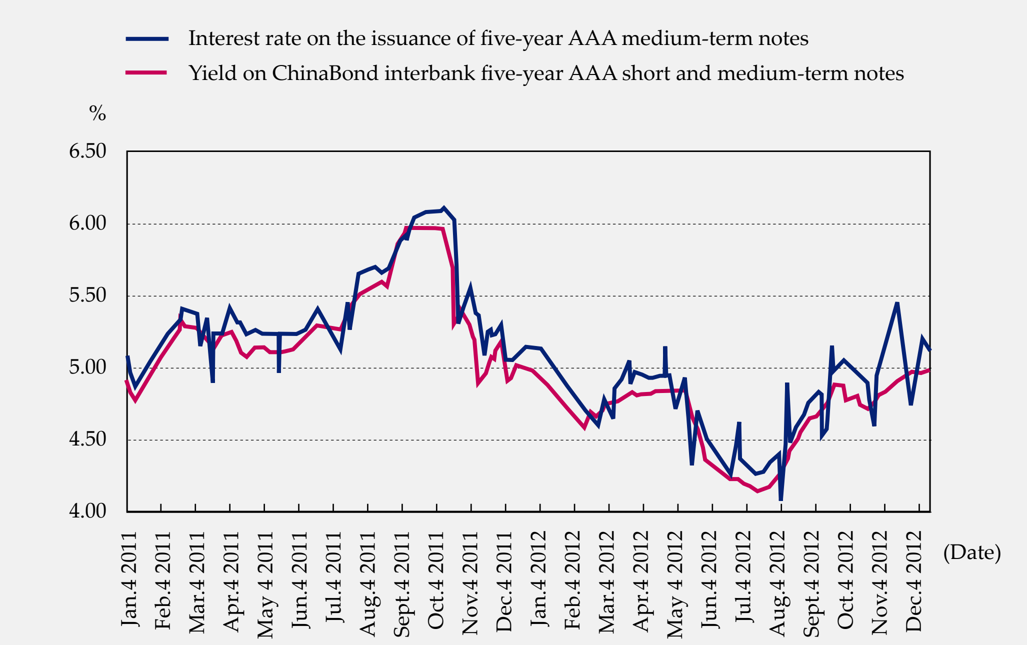
In 2012, bond market development continued to stick to the target set by the *12th Five-Year Plan for the Development and Reform of Financial Sector*, with financial sector witnessing marked progress in structural adjustment and corporate debenture bond market growing rapidly. The full-year issuance of corporate debenture bonds on national interbank bond market posted 3.78 trillion yuan, far more than that of government bonds, which stood at 1.61 trillion yuan. As of end-2012, stock of corporate debenture bonds accounted for 30.55% of the total, a growth of more than five percentage points compared with end-2011, which provided a strong support for the development of real economy. In terms of settlement volume of bond transactions, the full-year spot trading volume of debenture bonds reached 34.01 trillion yuan in 2012, a substantial increase of 28.47% year-on-year, taking up 43.28% of total spot bond trading on China's bond market. In terms of liquidity, enterprise bonds, medium-term notes and short-term financing bills were top performers on national interbank bond market, as their turnover ratios were considerably higher than the market average. As bond market deepens and the multi-tiered financial market system improves, enterprise financing models would diversify gradually.

2.2 Cost of bond issuance dropped slightly

Under the guidance of prudent monetary policy, there had been, in general, no funding strains on national interbank bond market since 2012, and size of bond financing expanded rapidly, accompanied by increasingly buoyant market investment demands. Take the five-year product for instance, the interest rate on the issuance of AAA medium-term notes in recent two years and the yield on ChinaBond interbank short- and medium-term notes (AAA) with same maturities indicated an overall downward trend.

Affected by trading on secondary market, the interest rate on five-year AAA medium-term notes issued in recent two years and the yield on ChinaBond interbank five-year short- and medium-term notes (AAA) moved in a similar way and, in general, were above the ChinaBond yield curve. Statistics showed that interest rate on the issuance of five-year AAA medium-term notes gradually went up from 5.35% in early 2011 to the peak of 7.99% in July, and fell back to 5.83% at the year-end. It rose slightly in the first half of 2012 before touching the yearly low of 4.09% in August, with the average level a bit lower than that in 2011. Last year, the yield on ChinaBond interbank five-year short- and medium-term notes moved up gradually from 4.74% at the start of the year to the yearly high of 5.97% in September,

Figure 3.6 Interest Rate on the Issuance of Five-year Medium-term Notes and Yield on ChinaBond Interbank Five-year Short and Medium-term Notes in 2011 and 2012



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

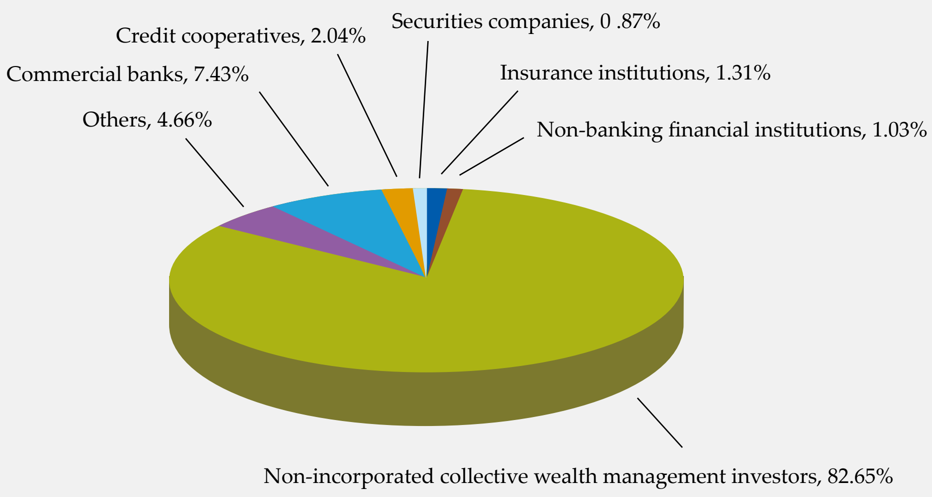
and then retreated to 4.93% at the year-end. It rose moderately to 4.85% in May 2012 before tumbling to the trough of 4.11% in June, and rebounded in the second half-year to around 5%. According to statistics, the average interest rate on the issuance of five-year AAA medium-term notes was 5.35% in 2011, but dipped 57 bps year-on-year to 4.78% in 2012.

2.3 Variety of investors diversified

In terms of the number of investors, as of end-2012, the number of bond holders' accounts[1] on interbank market reached 3,373, an increase of 667 over last year, or 24.65%. Among them, financial institutional investors (including commercial banks, credit cooperatives, fund companies, securities companies, insurance institutions and non-banking financial institutions) totaled 3151, surging 26.19% compared with last year, more than one percentage point higher than the growth of total number of accounts. The share of accounts held by financial institutional investors in total investor accounts also edged up more than one percentage point. The number of non-incorporated investor accounts for collective wealth management amounted to 2095, an increase of 567 over last year, or 37.11%. The year-end bond custody under these accounts jumped 39.85% compared with end-2011 to 2.36 trillion yuan, accounting for nearly 10% of the total, up more than two percentage points. The number of accounts held by overseas institutions soared 40.54% over last year with the size of custody adding 17.2% compared with end-2011 to 415.97 billion yuan at end-2012, comprising 1.95% of the total. The above-mentioned figures pointed to the growing diversification of bond market investors in recent years.

Breakdown by regions showed that the majority of the bond holders' accounts on national

Figure 3.7 Breakdown of New Investor Accounts in 2012



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

1 The figure is based on the number of accounts opened with the China Central Depository & Clearing Co., Ltd. and showing no zero balance at the end of past two years.

interbank bond market were held, as usual, by investors from Beijing, Shanghai and Guangzhou in 2012. Witnessing a growth of 26.85%, accounts held by investors from these three cities took up 59.5% of the total, up more than one percentage point compared with last year. Accounts held by investors from provinces in South and Southwest China grew 28.1% year-on-year to 839, while investor accounts in Northwest China and regions where ethnic groups reside accounted for a small share of the total, but also witnessed a slight increase. This pointed to higher interconnectedness between regional economic growth and bond market development, and rapid growth of bond investors outside Beijing, Shanghai and Guangzhou in 2012.

The national interbank bond market had already become a major financing and investment platform for governments, financial institutions and enterprises, as well as an important platform for implementing monetary policy. As the development of multi-tiered bond market deepens and financial innovation continues, more and more types of institutions would get actively involved in bond transactions, and the national interbank bond market is bound to play a bigger role in effectively allocating financial resources, ensuring the effectiveness of monetary policy transmission and safeguarding sound macroeconomic performance.

2.4 Net clearing of spot bond trading developed rapidly

Central counterparty net clearing was launched for spot bond trading on national interbank bond market on December 19, 2011, which was a major milestone in the development of national interbank bond market. The move would play a significant role in honoring China's commitment to international community, boosting the efficiency of clearing on national interbank bond market, improving market functions and cutting market cost, stepping up economic and social efficiency, preventing systemic risk, and promoting the drive of developing Shanghai into an international financial center. After preliminary operation in 2011, net clearing of spot bond trading developed rapidly in 2012. In general, net clearing of spot bond trading enjoyed a sound growth momentum, as the volume and amount of net clearing both jumped considerably, the number of clearing members increased steadily, fund netting and bond netting rates went up amid stable performance, monthly business volume maintained sable growth, and the coverage of products expanded gradually. As of end-2012, the number of institutions participating in this business reached 53, up 60.61% compared with the end of last year. During the year, the Shanghai Clearing House (SCH) handled 8860 cases of net clearing for spot bond transactions involving 1762.228 billion yuan, and the amount settled reached 100.122 billion yuan with netting efficiency hitting 94.32%. The penetration rate of net clearing increased month by month, staying persistently above 60% for the time being. Since the launch of net clearing for spot bond trading, the SCH had improved both social and economic efficiency and won universal acknowledgement from market players.

2.5 Rising share of bond financing effectively supported the development of real economy

Financial services are expected to prop up real economy. Increasing the share of financing by enterprises on bond market was a major measure to echo the outline of the 12th Five-Year Plan and accelerate the fostering of a multi-tiered financial market system. The prevailing products on national interbank bond market in 2012 were corporate debenture bonds (including enterprise bonds, medium-term notes, short-term financing bills, debt financing instruments by non-financial enterprises, collectively notes by regional promising SMEs, ABNs and the like) issued by enterprise institutions. The number of above-mentioned products reached 2328, accounting for 80.39% of the total of 2896 bonds issued, rising about four percentage points from 76.4% in 2011. Excluding central bank bills, size of financing by governments and enterprises on bond market added up to 3022.065 billion yuan in 2012 (size of financing equals size of bond issues minus the amount redeemed in the same year). In 2012, the number of enterprises that had issued enterprise bonds, medium-term notes and short-term financing bills stood at 1370, an increase of 529 compared with 2011. From 1999 to end-2012, the number of enterprises that had issued enterprise bonds, medium-term notes and short-term financing bills on national interbank bond market amounted to 2150, witnessing a total of 5052 issues of enterprise bonds, medium-term notes and short-term financing bills.

In terms of all-system financing aggregate, it registered 15.76 trillion yuan in 2012. Among it, net financing by enterprise bonds stood at 2249.819 billion yuan, loanable funds raised through new bond issues by commercial banks and policy banks approximated 1459.033 billion yuan, and commercial banks issued 225.37 billion yuan of subordinated debt, which had boosted banks' lending capacity by around 1878.083 billion yuan if calculated with a 12% capital adequacy ratio (CAR). In general, the combined direct and indirect impact of bond market on the all-system financing aggregate was about 35%.

3. Product innovation on bond market

3.1 Credit asset securitization resumed

In line with the requirements of the State Council and experience from previous pilot program, the People's Bank of China (PBC) promulgated jointly with the China Banking Regulatory Commission (CBRC) and the Ministry of Finance in May 2012 the *Notice on Issues Concerning Further Expanding the Pilot Program of Credit Asset Securitization*, officially resuming the pilot credit asset securitization with an initial pilot quota of 50 billion yuan. In 2012, five institutions issued about 19 billion yuan worth of credit asset-backed securities in total. In particular, the finance company of Shanghai Automotive Industry Corporation was the first of its kind to issue credit asset-backed securities. Apart from expanding the scope of participating institutions, this round of pilot credit asset securitization also broadened the coverage of underlying asset pool to include eligible loans to national key infrastructure projects and loans obtained through local government financing vehicles, which provided a new source of funds to infrastructure construction and local government finance. In the light of prudential regulation, two major risk prevention measures were adopted for this new round of pilot program, namely, double credit ratings and 5% risk retention. Compared with administrative measures in previous pilot program, the resumed securitization set down detailed and better principles for capital requirements, accounting, information disclosure, requirements for investors, and intermediary services. The resumption of pilot credit asset securitization would not only transfer the risk in banking system and reduce the pressure on banks' capital replenishment under new capital requirements, but also benefit non-financial enterprises and ease SME funding difficulties, thanks to the participation of non-banking financial institutions like trust companies.

3.2 ABNs by non-financial enterprises launched

In August 2012, the National Association of Financial Market Institutional Investors (NAFMII) officially published the *Guidance on the Issuance of Asset-backed Notes by Non-financial Enterprises on Interbank Bond Market* (hereinafter referred to as the *Guidance on Asset-backed Notes*), allowing non-financial enterprises to issue ABNs. On August 8, 2012, the first batch of three ABNs to the tune of 2.5 billion yuan, ranging from one year to five years, was issued by non-financial enterprises through private placement with the coupon rate staying between 4.88% and 5.85%. The ABNs, a new type of debt financing instrument, has special arrangements for isolation of risk, information disclosure and investor protection. It could improve the utilization efficiency of enterprises' asset stock, widen their financing channels, shore up more civil construction projects and facilitate China's urbanization, as ABNs could tap marketable assets in existing infrastructure through financial engineering and pool future cash flows generated by these assets. The Guidance on Asset-backed Notes made stipulations on issues pertaining to ABNs, mainly focusing on the type of assets, isolation of risk, trading structure, information disclosure, and rights and obligations of all parties. It put in place a proper protection mechanism for ABNs investors, but did not designate the trading structure. Instead, it put forward inclusive regulations on the type of underlying assets and design of trading structure so as to leave space for follow-up innovation. The launch of ABNs was a move catering to market demands and aimed at promoting market innovation, and a major measure to boost utilization efficiency of enterprises' asset stock, expand their financing channels and deepen the development of debt financing instruments.

3.3 Short-term financing bills by securities companies resumed

Under the impact of the cross-ministry coordination mechanism for corporate debenture bonds, regulators rolled out new measures to support the innovation at securities companies. With confirmation from the PBC after file-keeping, the China Merchants Securities issued through tender 4 billion yuan worth of short-term financing bills on May 31, 2012, marking the resumed issuance of short-term financing bills by securities companies after seven years of suspension. As outstanding short-term financing bills confirmed by the PBC through file-keeping by securities companies rose sharply after resumption, the issuance witnessed a big jump in 2012. Five securities companies issued a total of 56.1 billion yuan worth of short-term financing bills in 16 issues, rising more than 18-fold compared with 2.9 billion yuan of issuance prior to the resumption. In particular, short-term financing bills issued by the China Securities Finance Corporation Limited made it possible to channel interbank funds to stock market through providing funds to securities companies, which connected interbank market with stock market. The resumed issuance of short-term financing bills by securities companies expanded financing channels available to securities companies and enabled them to replenish liquidity through low-cost debt financing. Thanks to compliant operation in recent years, the number of eligible securities companies has increased and the net capital of these companies is also on the rise. Given that, the size of short-term financing bills issued by securities companies is expected to continue growth in the future.

3.4 Financial bonds issued by asset management companies launched

Approved by the PBC and CBRC, the China Cinda Asset Management Co., Ltd. issued 10 billion yuan worth of financial bonds on national interbank bond market through book-building on October 29, 2012, the first financial bond issued by a financial asset management company on national interbank bond market. The issue included 5 billion 3-year and 5 billion 5-year fixed-rate AAA bonds with coupon rates being 4.35% and 4.65% respectively. The launch of financial bonds issued by asset management companies has not only provided asset managers with new funding channels for purchasing non-performing assets and mitigating financial risks, but also diversified products on national interbank bond market.

3.5 Independent debt issues by local governments promoted steadily

In 2012, certain progress was made in the pilot independent debt issues by local governments, as debt issues totaled 28.9 billion yuan, surging 26.2% from 2011, with its share in newly-issued local government debt rising slightly. The pilot program was not expanded to cover more regions in 2012, but pilot local governments were given more leeway in debt issues as products of longer maturities, namely, seven-year bonds, were added to the pilot program, which improved the maturity match of local governments' assets and liabilities. Pilot municipalities and provinces, including Shanghai, Zhejiang, Guangdong and Shenzhen, all chose to issue five- and seven-year bonds. Compared with 2011, bid rates on independent debt issues by local governments were more reasonable in 2012, all higher than those on government bonds of the same term.

3.6 Special financial bonds targeting small and micro businesses advanced steadily

Since the CBRC unveiled the *Notice on Supporting Commercial Banks to Further Improve Financial Services for Small Enterprises* and the *Supplementary Notice on Supporting Commercial Banks to Further Improve Financial Services for Small and Micro Businesses*, commercial banks had been enthusiastic about issuing special financial bonds for small and micro businesses. In 2012, the total number of this type of special financial bonds issued by commercial banks stood at 20, with a total value of 166.5 billion yuan, and funds raised were all used as loans to small and micro businesses in a bid to support their business development.

3.7 Private placement bonds by SMEs officially launched on a trial basis

In May 2012, the Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE) issued respectively the *Measures of the Shanghai Stock Exchange for the Pilot Business of Private Placement Bonds by Small and Medium-sized Enterprises and the Measures of the Shenzhen Stock Exchange for the Pilot Business of Private Placement Bonds by Small and Medium-sized Enterprises* (hereinafter both referred to as the *Measures for the Pilot Business*) , which marked the official start of the pilot program of SME private placement bonds.

The *Measures for the Pilot Business* clearly stipulated that SME private placement bonds refer to corporate bonds of one year or above issued by SMEs and micro businesses through private placement with interest rates being not more than three times the corresponding benchmark bank lending rates. File-keeping is adopted for the issuance of SME private placement bonds, and stock exchanges are responsible for checking the completeness of documented materials. Investors could transfer private placement bonds not only on the SZSE's comprehensive agreement transactions platform and the SSE's comprehensive electronic platform of fixed income securities, but also through securities companies.

The pilot program of SME private placement bonds was launched first in six cities and provinces where most SMEs are located, and then was expanded to thirteen cities and provinces. The first SME private placement bond was listed on the exchange market on June 8, 2012. As of end-November, a total of 66 SME private placement bonds were issued to the tune of 7.253 billion yuan, with the maturity and coupon rate averaging 2.34 years and 9.04% respectively. The launch of SME private placement bonds enabled capital market to play a bigger role in propping up real economy and enhanced the link between direct finance and SMEs, which would provide new effective ways to ease SME financing strains and inject new vitality into capital market innovation as well.

3.8 Bond index funds developed further

Underpinned by market demands and relevant policies, funds on bond market enjoyed rapid development. In particular, bond index funds had witnessed substantial growth in recent two years. As of end-November 2012, statistics showed that the number of domestic bond index funds had increased to 14 in total since May 17, 2011 when China Southern CSI 50 Bond Index Fund, the first publicly-placed domestic bond index fund, was launched. In particular, the combined asset size of four listed bond index funds posted 4.8 billion yuan. Bond index funds feature diversified risks, high transparency, low dependency on fund managers, low fees, large coverage of sample bonds, high market representativeness, and convenience in allocation for investors. On the other hand, it raised high requirements for the quality of valuation. As the internationalization of bond market accelerates, index-linked bond funds would become more widely accepted on mature overseas market. Thus, emerging bond index funds should be able to become an important part of financial product innovation.

4. Bond market infrastructure

4.1 Cross-ministry coordination mechanism for corporate debenture bonds established

On March 18, 2012, the cross-ministry coordination mechanism for corporate debenture bonds, spearheaded by the PBC and joined by the National Development and Reform Commission (NDRC) and the China Securities Regulatory Commission (CSRC), was put in place and convened its first meeting, on which the *Rules of Procedure of the Cross-ministry Coordination Mechanism for Corporate Debenture Bonds* was endorsed and in-depth discussions were held on issues pertaining to further reform and development of corporate debenture bond market. Agreement was reached on such specific issues as promoting regulatory coordination and setting up a mechanism for sharing data and information. The meeting stressed that efforts should be made to adhere to the requirements of providing financial services for real economy, focus on expanding direct finance, promoting the adjustment of financing and economic structures and better meeting financing needs of various enterprises, and further strengthen coordination and cooperation under the cross-ministry coordination mechanism by following bond market development rule so as to jointly promote sound corporate debenture bond market development.

The establishment of cross-ministry coordination mechanism for corporate debenture bonds would help generate and develop a consolidated force on bond market and promote the growth of corporate debenture bond market, which embodied the requirement of boosting direct finance and better meeting enterprises' financing needs.

4.2 *Disciplinary Rules on Self-regulation of Non-financial Enterprise Debt Financing Instrument Market* unveiled

While size of non-financial enterprise debt financing instrument market expanded continuously, variety of innovative products kept on growing, and market players diversified gradually, violation of self-regulatory disciplines increased somewhat, as awareness of integrity and compliance was weak in some institutions. The existing self-regulatory disciplinary rules were no longer able to meet the inherent needs of promoting market self-regulation. To enhance self-regulation of interbank market, maintain market order, protect the lawful rights of investors as well as issuers, and promote sound interbank market development, the NAFMII worked in tandem with members to formulate *Disciplinary Rules on Self-regulation of Non-financial Enterprise Debt Financing Instrument Market* (hereinafter referred to as the *Disciplinary Rules on Self-regulation*) and released it on June 18, 2012. As an institutional guarantee and fundamental arrangement for the NAFMII to exercise self-regulation, the *Disciplinary Rules on Self-regulation* sets down stipulations on working procedures and deliberation mechanism for self-regulatory disciplines and would help enhance the institutional foundation for self-regulation as well as persistently promote stable and sound market development.

The *Disciplinary Rules on Self-regulation* sticks to a market-based philosophy, focuses on maintaining the balance of original self-regulatory system, ensures fairness and completeness of self-regulatory disciplinary procedures by putting in place a systematic and sound system of regulations, and covers more effective and moderate self-regulatory disciplinary rules, with attention given to both efficiency and feasibility. Made up of 31 articles falling into five parts, namely, general provision, deliberation mechanism for self-regulatory discipline, investigation, decision-making for self-regulatory discipline and supplementary provision, the *Disciplinary Rules on Self-regulation* clearly stipulates that a deliberation arrangement should be adopted for self-regulatory disciplines, under which market experts conduct joint review of non-compliance at meetings and make decisions or recommendations on disciplinary actions. It has defined the remit and obligations of executive board, self-regulatory disciplinary meetings, and the ad hoc office of the secretariat of the NAFMII in exercising self-regulatory disciplinary actions, set down regulations on major working procedures, including preliminary investigation, decision-making on disciplinary actions and review, and listed all disciplinary actions from least harsh to most harsh, including reputational and behavioral actions. It has not only consolidated the existing self-regulatory disciplinary system, diversified disciplinary actions and regulated procedures for exercising disciplinary actions, but also adapted to a deepening market, as it would ensure that disciplinary actions could be objective, fair and efficient, and fully exercise checks and balances as well as share of responsibility.

4.3 New breakthroughs made in the reform of registration system

As market developed rapidly, the registration system centering on information disclosure and characterized by due diligence on the part of intermediaries and assumption of risk by investors was deeply rooted in people's mind. Market players paid more and more attention to the content, coverage and timeliness of information disclosure by issuers and intermediaries concerned. To further improve the transparency of registration procedures, better ensure equality, fairness and openness and promote the transformation of financial market management mode to a market-based one, the NAFMII reformed and optimized current registration system for debt financing instruments on the basis of experience from mature capital markets in the U.S. and Europe as well as past experience in market development. After research, it released the *System of Tables for Registration Documents in Issuing Non-financial Enterprise Debt Financing Instruments* (known as the Table System for short) and the Debt Capital Market Filing Analysis Notification System (known as the DCM-FANS for short). The former further specified minimum information disclosure requirements. Enterprises, lead underwriters and intermediaries concerned could provide registration documents accordingly. They could draft registration documents by filling tables and offer professional opinions. The latter would display publicly registration documents and working procedures for debt financing instruments, open to market oversight.

The registration reform for debt financing instruments was a significant move in promoting China's debt capital market. First, it would facilitate the reform of China's bond issuance management pattern and fully carry out the market-based philosophy. Second, it would give play to market oversight and construct an integrity system in debt capital market. Third, it would improve market efficiency and the quality of registration. Fourth, it would enhance institution building for information disclosure in capital market and better protect the rights and interests of investors. The Table System and the DCM-FANS were outcomes of combining experience in developing registration from international mature markets with practices of developing China's debt financing instrument market. They were important measures for further strengthening self-regulatory registration of debt financing instruments, and would bring China's debt financing instrument market to a new level.

4.4 Direct link with the ChinaBond comprehensive business system launched

On May 8, 2012, the comprehensive bond business system of the China Central Depository and Clearing Co., Ltd. (hereinafter referred to as CCDC) was linked directly (hereinafter referred to as direct link) with systems of settlement members on interbank market. Marking the official promotion of straight-through-processing of bond settlement on interbank market, it was an effective measure for boosting China's bond market development and the stability of national financial system as well as a concrete move to meet the requirement of the national financial work conference held in early 2012, which called for the strengthening of financial infrastructure and improvement of registration, custody, payment and clearing.

Through the direct link with systems of market players, the CCDC could provide core business services and a wide variety of ChinaBond information products, in particular, key and differentiated services tailored to the needs of financial institutions. For market players, the direct link, on the one hand, made it possible for them to employ an integrated and electronic system for managing internal systems, covering bond transactions, approval, risk control, bond settlement and fund transfer, and enabled relevant departments to share business data. On the other hand, it achieved seamless connections between different systems and fast processing of business data, while market players' internal systems were controlled electronically, which effectively lowered occurrence of operational risk, moral hazard, market risk and settlement risk, and was important for market oversight.

As of end-2012, 26 market institutions had completed direct link, while another 17 institutions were either developing or testing systems. Participants in the direct link included national commercial banks, policy banks, urban commercial banks, rural commercial banks, securities companies, foreign-funded banks and asset management companies, which further attested to the extensiveness of the application of direct link.

The direct link between market players' systems and ChinaBond comprehensive business system is a recommended standard for securities industry set by international securities organization. It adopts reporting standards that meet international criteria, which will enable China's bond custodians to officially provide a connected system to market players and even international peers. It has not only improved the level of infrastructure on China's bond market, but also created room and platform for bond market innovation in the next phase.

4.5 Innovation of market information products continued

To drive forward financial market reform and innovation and prevent as well as mitigate financial risks, front- and back-office institutions on interbank bond market all beefed up innovation of information products.

In 2012, the CCDC accelerated the innovation of ChinaBond price indicator system made up of a series of bond price and risk indicators, such as ChinaBond yield curve, ChinaBond valuation, ChinaBond index and ChinaBond VaR. First, the CCDC unveiled in 2012 ChinaBond New Composite Index, ChinaBond Credit Bond Aggregate Index, ChinaBond New Medium-term Note Aggregate Index, ChinaBond Corporate Debenture Bond Index and ChinaBond High Grade New Wealth Index. Second, in May 2012, ChinaBond composite VaR was launched on a trial basis. It can serve as a risk management tool for market institutions, as it, for the time being, calculates the VaR and CVaR of bond portfolios for over 500 accounts daily. Third, to adapt to new developments on bond market and provide more comprehensive reference to competent regulatory authorities, issuers and investors regarding macro decision-making, market-based pricing, risk management and control and book-keeping, the CCDC newly launched policy financial bond yield curve (the China Development Bank) and local government bond yield curve, and added the valuation of corporate bonds, privately-placed debt financing instruments, short-term financing bills issued by securities companies, SME private placement bonds, subordinated debt by insurance companies and ABNs by non-financial enterprises. Currently, the number of yield curves issued every day is 205, covering yield-to-maturity, spot and forward yield, and that of bond valuation is 7047, with the combined data size exceeding 330 thousand, a year-on-year increase of about 40% and covering almost all types of bonds on interbank and exchange markets. The SCH also continuously sped up the expansion and innovation of bond valuation service, which covered major fixed income products registered with and under the custody of the SCH, including super short-term commercial paper, short-term financing bills, short-term financing bills issued by securities companies, ABSs, ABNs, privately-placed debt financing instruments and financial bonds by asset management companies. At present, the SCH issues 14 spot and forward yield curves every day and more than 1000 pieces of bond valuation information. In the meantime, the SCH developed automatic bond valuation system, which improved the efficiency and accuracy of bond valuation via adding special scientific calculation modules. It persistently optimized the case pool of valuation adjustment of individual bonds while focusing on digging out historical data, which has contributed to the continuous improvement of valuation quality.

4.6 Market-based risk sharing mechanism given full play

In 2012, credit risk accumulated slowly as debenture bond market developed rapidly. Although several risk events took place across the year, no actual default events were reported, as most bonds were supported by credit enhancement measures such as guarantees and some even supported by government's special risk mitigation measures. At the beginning of the year, the Beijing DG Telecommunications Equipment Co. Ltd. was unable to redeem collective notes, the first of its kind. On November 15, the Beijing Konte Ehio Electronics Co., Ltd. triggered again the terms of redeeming collective notes through guarantor and the Beijing Capital Investment and Guarantee Co., Ltd. paid the principal and interest instead. On December 19, Huijiabei issued a notice, saying the company faced a big redemption pressure in the short term due to tight cash flows and debt service might be done by the guarantor. On December 24, the Changzhou Golik Colour Coated Steel Manufactory Co., Ltd. said in its statement that its assets were frozen and operation halted as overdue connected loans got involved in a lawsuit, and the China Bond Insurance Co., Ltd., the guarantor, promised to pay principal and interest instead. On December 27, Chaorisolar debt exposed credit risk amid worsening financial conditions. With no guarantee, it might become the first case of default on bond market. In October 2007, the CBRC required banks to stop providing guarantees for financing projects such as enterprise bonds. Currently, most debenture bonds are guaranteed by non-banking third party, collaterals/pledges, or local governments' fiscal revenue. Therefore, the default risk of debenture bonds is small. However, to prevent credit risk on bond market, supporting measures for corporate debenture bond market should be improved. First, efforts should be made to strengthen transparency of information disclosure, improve means of disclosure of issuers' financial data, and tighten information disclosure requirements for corporate debenture bonds. Second, bidding may be introduced to the issuance of corporate debenture bonds. Third, an effective external supervision and administration mechanism should be put in place for ratings agencies, while independent and fair third-party valuation should be adopted to check rating outcomes.

4.7 Pace of opening up quickened

New progress was achieved in the opening up of bond market in 2012. First, more and more international investors participated in interbank bond market. In May 2012, the PBC announced to sign agreements with the World Bank at Washington D.C., namely, the *Agreement on Investing in China's Interbank Bond Market by the People's Bank of China on behalf of the International Bank for Reconstruction and Development (IBRD)*, and the *Agreement on Investing in China's Interbank Bond Market by the People's Bank of China on behalf of the International Development Association (IDA)*. In July, Bank Indonesia started to invest in China's interbank bond market. Currently, there are 107 overseas institutions investing in interbank bond market after another 43 overseas institutions were granted market access in 2012. The growing number of overseas financial institutions in interbank bond market would expand RMB flow-back channels and promote RMB settlement in cross-border trade. In the meantime, it would diversify investors on China's bond market and facilitate sound and sustainable market development.

Second, the first RMB bond was issued in London. On April 18, 2012, the HSBC issued the first RMB bond in London to the tune of 2 billion yuan, mainly targeting investors in the U.K. and European continent. The move actually marked the debut of another off-shore RMB bond market in addition to Hong Kong. It would facilitate the use of RMB in cross-border trade and investment as well as make RMB more widely accepted by international market.

Third, the issuance of RMB bonds in Hong Kong by financial institutions was further regulated. On May 2, 2012, the NDRC released the *Notice on Issues Concerning the Issuance of RMB Bonds by Domestic Non-financial Institutions in the Hong Kong Special Administrative Region* (hereinafter referred to as the *Notice*), aiming to further boost the bond market in Hong Kong, regulate RMB bond issues by domestic non-financial institutions in Hong Kong, and effective ward off external debt risk. The *Notice* requires domestic non-financial institutions to get approval from the NDRC before issuing RMB bonds in Hong Kong and makes specific clear-cut stipulations on the criteria for enterprises attempting to issue bonds in Hong Kong, procedures for bond issues and other related matters. The release of the *Notice* would encourage more domestic enterprises to issue bonds in Hong Kong, which would not only open fresh financing channels for domestic enterprises, but also facilitate the development of off-shore RMB market in Hong Kong.

5. Outlook on bond market development

During the past year, the impact of financial crisis and European sovereign debt crisis persisted, China's growth slowed down gradually, and size of bond issues went up slightly while total custody maintained steady growth. The report of the 18th National Congress of the Communist Party of China (CPC) identified improving demand structure, optimizing industrial structure, boosting coordinated regional development and advancing urbanization as key tasks in promoting the strategic adjustment of economic structure and the transformation of economic growth pattern. The Central Economic Work Conference held at the end of 2012 noted that urbanization had the biggest potential for boosting domestic demand, thus calling for efforts to actively and steadily push forward urbanization as well as focus on improving the quality of urbanization. In 2013, bond market would play a bigger role in propping up real economy, with bias towards growth of domestic demand, urbanization and people's livelihood, and would facilitate the improvement of consumption structure as well as household income. As the size of China's bond market continues to grow and the opening up of interbank bond market deepens, greater achievements would be made in expanding the market size, improving institutions, enhancing liquidity and conducting product innovation.

5.1 Size of bond market will expand steadily

At present, China's economy is in a critical period of strategic importance and undergoing structural adjustment. How to carry out the requirement of the central government for providing financing services to real economy is top priority in bond market development. Bond market and the closely related capital market are expected to play a bigger role in China's economic restructuring and transformation of growth pattern. At end-2012, stock of China's bond market had hit 26.21 trillion yuan, but the ratio of bond financing to gross domestic product still has a lot of room for further increases. The *12th Five-Year Plan for the Development and Reform of the Financial Sector* clearly pointed out several major tasks in actively promoting bond market development, including improving the administration arrangements for bond issuance, steadily expanding bond market size, boosting product innovation and diversification and strengthening market infrastructure, which signified that the size of China's bond market would jump to a new level.

In terms of driving factors for bond market expansion, as global economy recovers gradually in 2013, China's economy would pick up steadily and marketization as well as urbanization would speed up substantially under the requirement of the CPC Central Committee to seek progress from stability. Bond market would be given full play in driving economy amid economic restructuring and adjustment of financing structure. In 2013, efforts will be made to boost product innovation, institution innovation, and fostering of players on bond market. Bond market will shore up real economy through providing financial services as the market size is expected to rise steadily to meet the needs of economic development as well as structural transformation, in particular, the corporate debenture bond market. On the basis of meeting demands of the real economy, efforts should be made to expand direct debt financing and continuously enhance the flexibility and inclusiveness of direct debt financing market so as to make financial support available to different innovation-oriented enterprises with different features and in different stages of development.

5.2 Bond market will make bigger contributions to social financing

In recent years, financing through China's bond market showed a fast developing momentum amid buoyant financing needs of real economy and relatively inadequate bank credit. Share of indirect finance[1] dropped from 92% in 2006 to 85% in 2012, while share of bond financing in direct finance rose from 39.97% in 2006 to 86.39% in 2012. During the past year, stock of non-financial enterprise debt financing instruments issued after registration with the NAFMII exceeded 4.27 trillion yuan, up 1.24 trillion yuan compared with end-2011, accounting for about 8% of all-system financing aggregate. The share of enterprise bond market in social financing moved up steadily. Bond market is playing an increasingly obvious role in boosting economic growth and facilitating structural adjustment, and its fundamental role in resource allocation is also becoming increasingly noticeable.

In 2013, while structure of social financing will undergo adjustment, China's bond market will maintain steady growth momentum. In particular, corporate debenture bond market will continue rapid growth. At the same time, in terms of means of financing, structured products featuring both indirect and direct financing as well as bond and equity financing would become one of the future trends. As product structure on bond market continues to diversify and the share in social financing rises, parties concerned will still

1 Indirect finance data include RMB loans, foreign currency loans (RMB equivalent), entrusted loans, undiscounted bankers' acceptance bills.

make accelerating bond market development the focus of work, increase the share of direct finance through concerted efforts, further prop up real economy both in depth and width, optimize social financing structure and improve the capacity of financial sector to support real economy.

5.3 Product innovation will be stepped up

Product innovation and differentiation are the inexhaustible source for bond market development. Over the past year, the launch of SME private placement bonds and the resumption of ABSs were the focus of bond market in 2012. In the future, the core competitiveness of China's bond market will remain dependent on product innovation and follow-up institutional arrangements. After the adoption of new capital requirements, financial institutions like commercial banks still have strong demands for optimizing asset-liability structure through asset securitization. Given that, the scope of asset securitization is expected to broaden, while the size of ABS and ABN are likely to make breakthroughs. For SME private placement bonds, existing barriers such as high funding cost and lack of liquidity are likely to be addressed in multiple ways, including expanding the scope of investors and improving infrastructure such as credit rating, which would contribute to sizable growth. Meanwhile, innovation of other types of bonds is also to be beefed up in a bid to provide more and better choices to market investors.

5.4 Market players will continue to diversify

Players on bond market include issuers and investors. For the diversification of investors, China's interbank bond market accelerated opening up in 2012, allowing overseas financial institutions, such as the IBRD and IDA, and central banks like Bank Indonesia to invest in China's interbank bond market. For the diversification of issuers, focus was put on increasing the share of bond issues by non-state-owned enterprises and SMEs and promoting the transition of bond issuance management to registration-based.

In the future, players on China's bond market will continue to diversify. With further opening up of China's interbank bond market, more investors from home and abroad will invest in bond market, which would not only boost China's financial market opening up and the development of RMB bond market, but also optimize resource allocation on bond market. In addition, the diversification of issuers will contribute to product diversification on China's bond market, improve SME financing channels, and consequently provide support for economic restructuring.

5.5 Internationalization of bond market will deepen

Internationalization of China's bond market has deepened continuously, as the renminbi plays a larger role in international market. With regard to the going-out strategy, off-shore RMB bond market has reached a certain scale after years of development with off-shore RMB bonds becoming major products on Hong Kong bond market. For the attraction of overseas players, restrictions of foreign participation in China's bond market have been lifted gradually. Size of overseas investment in domestic bond market remains small and products available for foreign investment are limited despite an obvious growth of overseas investors in interbank bond market over the past year. Besides, approval procedures for issuance of panda bonds on domestic bond market are to be optimized.

In the future, China's bond market will become increasingly internationalized. On the one hand, focus should be put on fostering institutional investors in the gradual opening up of bond market. Efforts should be made to actively encourage qualified foreign institutional investors to bring rational investment philosophy, international advanced capital management experience and regulated investment behaviors to China's bond market so as to promote the fostering of qualified institutional investors in China and steadily make China's bond market more internationalized and rule-based. On the other hand, off-shore RMB bond market should be pushed forward steadily, qualified domestic institutional investors should be encouraged to issue bonds on overseas market and invest in foreign currency-denominated bonds in order to expand investment channels for domestic market players and develop domestic economy with foreign funds, and a more comprehensive financial system should be put in place.

5.6 Institution building will improve further

As the corner stone of bond market development, institution building is an indispensable task in developing a unified, safe, efficient and open bond market. After persistently rapid growth, many old institutional problems faced by China's bond market have been solved, but new institutional requirements accompanying innovation are to be met. For instance, with regard to issuance, efforts should be made to continuously improve credit risk information disclosure arrangements, strengthen rating requirements and information transparency of urban investment debt, enterprise private placement bonds and ABSs, and enhance investors' risk management capacity. For bond transactions, work should be done to continuously improve market making arrangements, strengthen the innovation of repurchase and securities lending mechanisms, boost market makers' incentive to play its role in activating market and discovering price so as to provide liquidity to market, and diversify the guarantee mechanism for bond issues by SMEs.

5.7 Cross-ministry coordination mechanism for corporate debenture bonds will continue to take effect

Improving quality of market administration and supervision so as to promote innovation-driven market development has always been the focus of work for bond market regulators and self-regulatory organizations. Procedures for enterprise bond issues were simplified, efficiency of issuance improved and supervision over the duration of bonds tightened. The assessment and approval for corporate bonds and stocks were separated, and product development as well as innovation was accelerated considerably. Self-regulatory organizations on interbank market gave play to market mechanism, increased registration efficiency, and put in place a scientific registration process, aiming to advance debt financing instrument market through institution building and innovation. Development has become a consensus. Driven by relevant departments, China's corporate debenture bond market has seen a big jump in the pace and efficiency of market development in recent years. At end-2011, the State Council identified the PBC as the competent authority of credit rating industry, putting an end to overlapping supervision of China's rating sector and signaling further coordinated development of bond market. Relevant regulatory authorities of bond market will comply with rules of bond market development, fulfill their respective mandates and shoulder respective responsibilities under the cross-ministry coordination mechanism for corporate debenture bonds, improve administration mechanism for bond issuance, and strengthen information sharing and policy coordination so as to generate a combined driving force for bond market. They will steadily expand bond market size, promote product innovation and diversification, increase the share of direct finance, and optimize social financing structure in a bid to better meet enterprises' financing needs. Efforts should be made to stick to market-based development, focus on fostering business integrity, intensifying market constraint and risk-sharing mechanisms, and improve the transparency of market performance in an attempt to create a favorable institutional environment for bond market development.

Box2 The Role of Interbank Bond Market in Supporting Real Economy Enhanced Considerably

Providing services to real economy is the fundamental driving force for financial market development. In recent years, under the proper guidance of national economic and financial policies, China's bond market, the interbank bond market in particular, witnessed the debut of non-financial enterprise debt financing instruments, such as short-term financing bills, medium-term notes and SME collective notes, which were launched amid active promotion of product, mechanism and institution innovation. Size of issuance of these debt instruments showed a fast growth momentum since the launch. The role of bond market in propping up real economy was enhanced substantially as bond products helped make remarkable achievements in ensuring growth, adjusting economic structure and benefiting people's livelihood.

First, bond market played a bigger role in providing financing for real economy. Economic growth is, in essence, a process of investing and allocating productive factors, such as labor, capital and technology. As China is a labor-rich country, capital plays a much more important role in economic growth. In recent years, China's interbank bond market has become a major driving force for economic development, as it continues to develop both in depth and width, optimize social financing structure, and expand low-cost financing channels for all types of enterprises. The launch of non-financial enterprise debt financing instruments has contributed to the fast growth of China's corporate debenture bond market. Since 2005 when short-term financing bills were launched, the variety of credit products has been diversified continuously, which has expanded financing channels for enterprises of different types, sizes and from different industries. Issuance of non-financial enterprise debt financing instruments rose from 139.25 billion yuan in 2005 to 2653.109 billion yuan in 2012, with the annual growth rate hitting 258%. In 2011, issuance of corporate debenture bonds on interbank bond market posted 2.09 trillion yuan, overtaking government bonds and central bank bills for the first time. The share of bond financing by real economy in the all-system financing aggregate continued to increase, jumping from 6.7% in 2005 to 24.2% in 2012. Bond financing accounted for 92% of direct finance in 2012, up from 86% in 2005. Non-financial enterprise debt financing instruments took up 74% of social direct finance[1] in 2012, an increase from 60% in 2005. Meanwhile, the share of non-financial enterprise debt financing instruments in

1 Social direct finance refers to financing by non-financial enterprises through issuing debt financing instruments on interbank bond market and exchange market combined with equity financing on A-share market. Specifically speaking, it includes short-term financing bills (super short-term commercial paper included), medium-term notes, SME collective notes, non-financial enterprise debt financing instruments like asset-backed securities, enterprise bonds, corporate bonds, convertible bonds, bonds with attached warrant, SME private placement bonds and equity financing on A-share market.

social direct debt financing[1] also saw a jump, from 69% in 2005 to 81% in 2012. As of end-2012, a total of 3,432 enterprises raised 832 million yuan on interbank bond market, which provided a strong support for the growth of real economy.

Besides, bond issues on interbank bond market effectively lowered the financing cost of enterprises, especially those with high credit ratings. Take AAA bonds whose issuance was the biggest in 2012 for instance, the issuance of 6-month, 1-year, 3-year, 5-year and 10-year bonds stood at 116.6 billion yuan, 420.2 billion yuan, 209 billion yuan, 293.6 billion yuan and 31.7 billion yuan respectively, with corresponding interest rates averaging 4.03%, 4.14%, 4.89%, 4.77% and 5.28%, 1.57 bps, 1.86 bps, 1.26 bps, 1.63 bps and 1.27 bps lower than the corresponding benchmark lending rates, which stood at 5.6%, 6.0%, 6.15%, 6.4% and 6.55% respectively on July 7, 2012. Therefore, the issuance of non-financial enterprise debt financing instruments cut enterprises' financing cost by tens of billions of yuan.

Second, bond market provided a strong support for pillar industries pertaining to national economy and people's livelihood. Leading enterprises in energy, transportation and other industries pertaining to national economy and people's livelihood persistently remained major issuers of non-financial enterprise debt financing instruments. Since 2005 when short-term financing bills made its debut, pillar industries pertaining to national economy and people's livelihood, including energy, transportation, metals, telecommunications, manufacturing, agriculture and automobiles, continuously accounted for over 70% of the total annual issuance of non-financial enterprise debt financing instruments. In particular, the share of energy sector, including coal, power, petrol and natural gas, in total financing stayed at 30%, while that of transportation sector, including railways, road, aviation, ocean shipping, ports and airports, stayed above 10%. For instance, in 2012, cumulative issuance of short-term financing bills by pillar industries, such as energy, transportation, metals, raw materials and telecommunications, took up 72.2% of the annual total, hitting 603.2 billion yuan. By breakdown, issuance by energy sector posted 260.282 billion yuan, comprising 31.1% of the total, while that by transportation sector amounted to 101.34 billion yuan, taking up 12.1% of the total. Pillar industries, including energy, transportation, large-scale manufacturing, government investment and financing platforms and metals, accounted for 78.4% of the annual issuance of medium-term notes. By breakdown, issuance by energy sector stood at 266.51billion yuan, comprising 31.6% of the total, while that by transportation sector posted 144.01 billion yuan, taking up 17.1% of the total. Interbank bond market provided massive support for the development of pillar industries pertaining to national economy and people's livelihood.

Third, bond market vigorously promoted strategic emerging industries. Expediting the fostering and development of strategic emerging industries, such as energy conservation and environment protection, new generation of information technology, biology, high-end equipment manufacturing, new energy, new materials and new energy vehicles, and promoting pillar and leading industries that can underpin sustainable economic and social development is a major strategic decision in transforming China's growth pattern and

1 Social direct debt financing refers to financing by non-financial enterprises through issuing debt financing instruments on interbank bond market and exchange market.

maintaining steady, relatively rapid and sustainable growth. Experience from developed countries has shown that a multi-tiered capital market plays a critical role in pushing forward the transition of national economy as well as the development of strategic emerging industries. Compared with traditional industries, strategic emerging industries are generally characterized by high share of intangible assets, sizable initial investment, unstable cash flows and uncertain returns on investment. At the initial stage in particular, strategic emerging industries may find it very hard to get adequate loans from banks with low risk appetite. Interbank bond market has effectively eased financing difficulties faced by strategic emerging industries by launching debt financing instruments, such as short-term financing bills and medium-term notes, and putting in place various institutional arrangements including credit enhancement. As of 2012, interbank bond market had provided 2,921.719 billion yuan to strategic emerging industries, including 1,592.475 billion yuan through short-term financing bills, 378.2 billion yuan through super short-term commercial paper, 796.42 billion yuan through medium-term notes, 150.6 billion yuan through private placement instruments and 4.024 billion yuan through SME collective notes, injecting massive funds into enterprises from different sectors and of varying sizes.

Fourth, bond market continuously boosted financial support for weak sectors. As a global conundrum, SME financing difficulties is also an issue in China's economic development. Given that, SME short-term financing bills were launched in 2008 on interbank bond market, SME collective notes in 2009, and collective notes by regional promising SMEs in 2011. Top SMEs supported by national industrial policies were introduced to interbank market. Consequently, SME financing channels were broadened, where funding cost was lowered. As of end-2012, cumulative issuance of SME short-term financing bills stood at 890 million yuan, SME collective notes 18.243 billion yuan, benefiting 274 SMEs, and collective notes by regional promising SMEs 4.304 billion yuan, benefiting 57 SMEs and micro businesses.

When earthquake hit regions like Sichuan, green channels for direct debt financing were available on interbank bond market, which was aimed at assisting the reconstruction of disaster-stricken enterprises. As of 2012, guided by national macroeconomic adjustment policy, interbank bond market gave top priority to bond issues by enterprises in Tibet and Xinjiang with funds raised adding up to 370.78 billion yuan, while financing provided to 12 provinces in West China totaled 725.44 billion yuan.

In addition, interbank bond market raised a total of 3,571.208 billion yuan for national rejuvenation of key industries, 172.813 billion yuan for culture industry and 1,954.759 billion yuan for modern service sector.

Fifth, bond market promoted sectors related to people's livelihood, such as social housing, which is an important project to benefit the people in the 12th Five-Year Plan. According to the Plan, China is going to build 36 million units of social housing and increase the coverage of social housing to around 20% at the end of 12th Five-Year Plan period. The national interbank bond market played a positive role, as construction of social housing was confronted with a sizable funding gap. In 2011, national interbank bond market launched privately placed non-financial enterprise debt financing instruments and medium-term notes *aimed at raising funds for social housing projects, which vigorously facilitated the development of national social housing projects. As of end-2012, 31.93 billion yuan was raised for social housing projects through private placement instruments and medium-term notes.*

Apart from that, interbank bond market also provided fund support through the issuance of non-financial enterprise debt financing instruments to other fields pertaining to people's livelihood, including development of new rural areas, ecology and environment protection, resource conservation and hydraulic engineering. In doing so, it provided an important driving force for the development of these sectors and played a positive role in building a harmonious society.

Part IV Stock Market

In 2012, with the opening up and innovation speeding up, China's stock market made headway in institution building and infrastructure construction. Greatly affected by the economic and financial situation both at home and abroad, new share issue dropped somewhat and the raised fund declined considerably. With the stock index fluctuating, the trading value decreased radically and industry sectors diverged remarkably.

1. Stock market performance

1.1 New share issue and financing

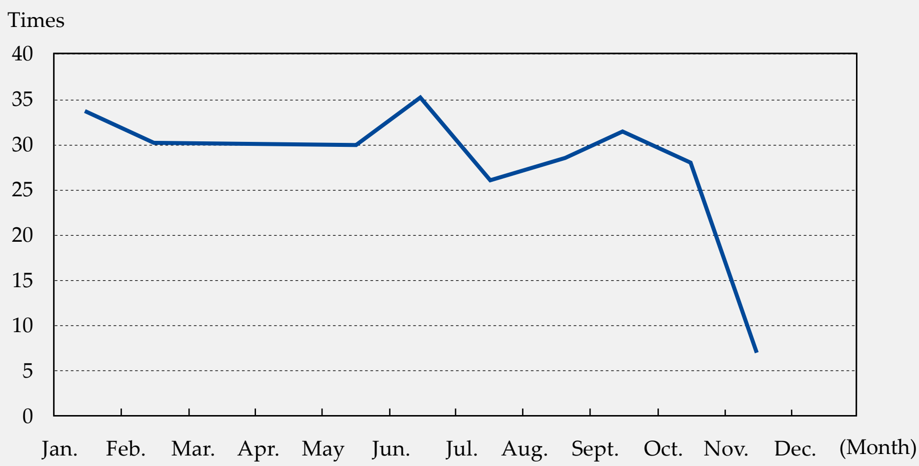
1.1.1 The issuing price of new shares stabilized yet with some decline

In 2012, there were 154 companies making initial public offerings (IPOs) on the A-share market of Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE), of which 55 got listed on SZSE Small and Medium Enterprise Board (SME Board), 74 on SZSE Growth Enterprise Board (GEB) and 25 on SSE Main Board. The price to earnings (P/E) ratio of new shares was basically stable yet with some decline, and broadly fluctuated around 30 times.

1.1.2 Fundraising scale shrank substantially

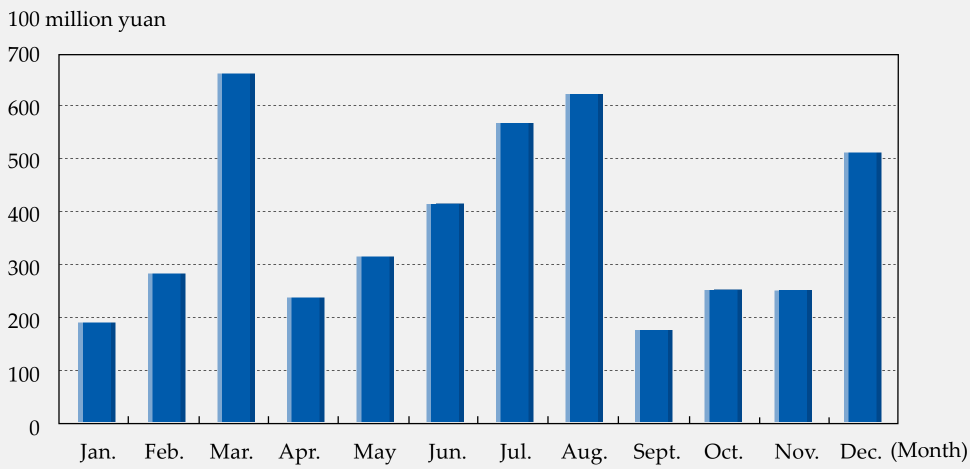
In 2012, as the market remained weak, fundraising on the A-share market shrank substantially. Throughout the year, the figure stood at 328.459 billion yuan accumulatively, down 40.48% over the year before, of which IPO financing registered 103.432 billion yuan, down 63.39%, accounting for 31.49% of the total, nearly 20 percentage points less than the share in 2011, which was 51.19%; refinancing registered 209.322 billion yuan,

Figure 4.1 Monthly IPO P/E ratio on the A-share Market in 2012



Sources: China Securities Regulatory Commission and Guotai Jun'an Securities Research Institute.

Figure 4.2 Monthly A-share Fundraising in 2012



Note: Monthly funding data does not include the refinancing by private placement (asset), and the fund raised by corporate bonds and privately-offered bonds.
Source: CSRC.

down 6.89%, accounting for 63.73% of the total, over 20 percentage points more than the share in 2011, which was 40.74%. In particular, fund raised by public and private placement (cash) hit 197.222 billion yuan, and fund raised by rights issue registered 12.1 billion yuan. There was no exercise of warrant. Fund raised by convertible bonds recorded 15.705 billion yuan, and no equity warrant bond was issued, with the two shrinking by 64.72% over the year before, accounting for 4.78% of the total.

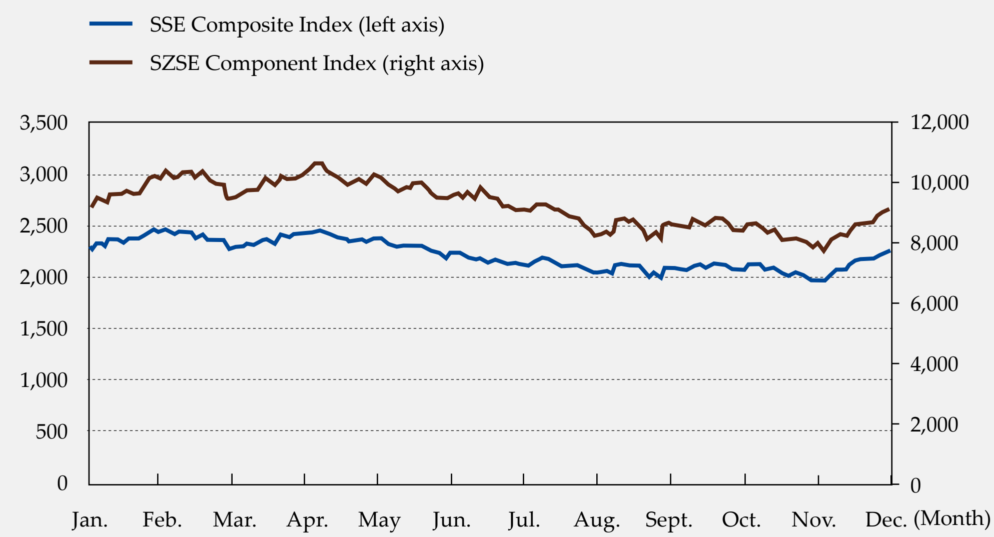
1.2 Stock index and trading

1.2.1 Stock index fluctuated, market capitalization grew and float share ratio continued to rise

In terms of stock index movement, both Shanghai and Shenzhen market moved downward amid fluctuation first in 2012, and then rebounded at the end of the year. At the end of 2012, SSE Composite Index closed at 2,269.13 points, up 3.17% over the end of 2011; SZSE Component Index closed at 9,116.48 points, up 2.22% over the end of 2011. In terms of stock valuation, the average SSE P/E ratio stood at 12.30 as of end-2012, down 8.21% over end-2011; the average SZSE P/E ratio stood at 22.01, down 4.76% over end-2011.

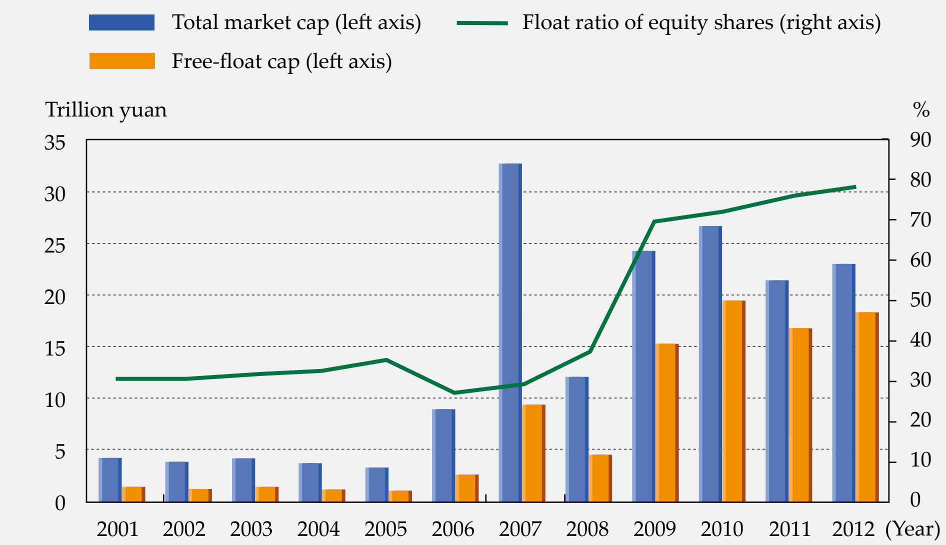
As of end-2012, there were 2,494 companies listed on Shanghai Stock Exchange and Shenzhen Stock Exchange, an increase of 152 from end-2011. Market capitalization (cap) stood at 23.04 trillion yuan, increasing by 1.56 trillion yuan from end-2011, up 7.26%. Free-float cap registered 18.17 trillion yuan, an increase of 1.67 trillion yuan from end-2011, up 10.15%. Issued equity shares totaled 3.8395 trillion (including H shares issued by domestic listed companies), of which float shares registered 3.13396 trillion, with float ratio rising from 79.93% as of end-2011 by 1.69 percentage points to 81.62%.

Figure 4.3 Stock Index Movements on Shanghai and Shenzhen A-share Markets in 2012



Source: SSE and SZSE.

Figure 4.4 Cap Growth of Stock Market, 2001—2012



Source: CSRC.

Table 4.1 Best Performing Sectors and Worst Performing Sectors on A-share Market in 2012

Unit: %

Best performing sectors	Rise	Worst performing sectors	Rise
Real estate industry	34.39	Information technology	-17.28
Building industry	24.23	Textile & garment	-10.23
Timber & furniture	18.09	Culture & Communication	-9.56
Financial service industry	15.20	Commerce & Trade	-8.62
Bio-pharmaceutical industry	10.50	Farming, Forestry, Animal Husbandry & Fishing	-4.84

Note: Sectors in this table are primary sectors under the classification of CSRC.
Sources: Wind Info and Guotai Jun'an Securities Research Institute.

1.2.2 Industry sectors diverged in performance and trading value declined remarkably

In 2012, the performance of A-share market diverged from sector to sector. Of the primary sectors under the classification of China Securities Regulatory Commission (CSRC), real estate industry, building industry, timber and furniture, financial service and bio-pharmaceutical industry grew over 10%, while information technology, textile & garment industry dropped over 10%.

In 2012, the trading value of Shanghai and Shenzhen markets registered 31.47 trillion yuan accumulatively, down 25.38% on a year-on-year basis. Specifically, the trading value on Shanghai and Shenzhen market stood at 16.46 trillion yuan and 15.01 trillion yuan respectively, down 30.74% and 18.42% over the previous year.

2. Main features of stock market performance

2.1 SME Board and GEB played a major role in fundraising, with industry sectors diverging remarkably

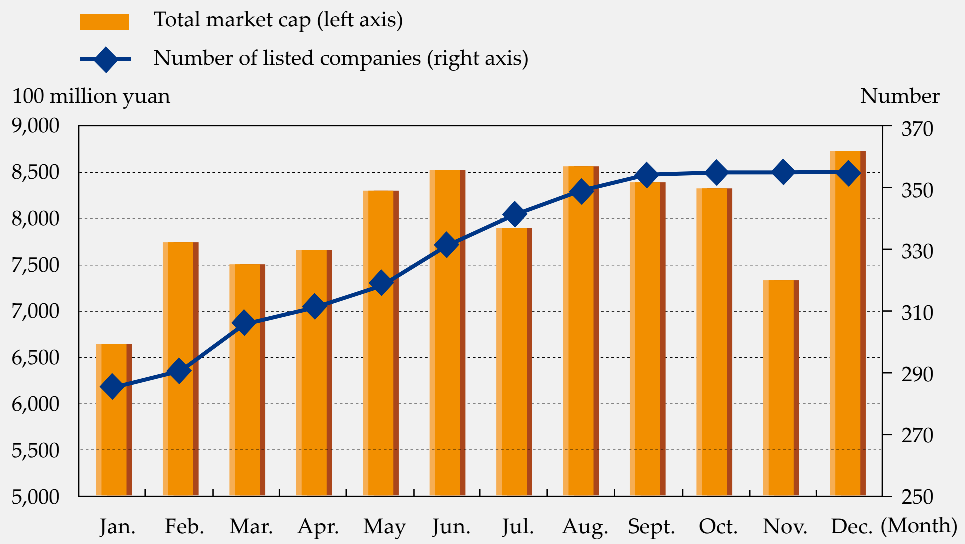
In 2012, SME Board and GEB continued to be major fundraising venues on the stock market. Throughout the year, the IPOs on the SZSE SME Board and GEB accounted for 83.8% of the total on the A-share market, with their fundraising accounting for 67.7% of the total by IPOs. In particular, GEB market maintained rapid development momentum in 2012. The number of listed companies on the GEB grew from 281 at end-2011 to 355 at end-2012, and the market cap grew from 743.379 billion yuan to 873 billion yuan. Meanwhile, the share of GEB on the A-share market grew from 2.97% to 3.26% in terms of market cap. In 2012, the fund raised by IPOs on GEB registered 35.149 billion yuan, accounting for 33.98% of the total on the A-share market.

The industry sectors diverged remarkably in fundraising, with most declining while a few maintaining growth. In particular, big declines happened to the industry of insurance, real estate, food, energy, auto and auto parts. Compared with 2011, consumer service industry was the sector that witnessed fastest growth in fundraising, while the industries of media, bio-pharmaceuticals, life science, medical care equipment and service, and public utility enjoyed year-on-year growth.

2.2 Sector composition of the stock market cap changed slightly while valuation changed dramatically

In 2012, sector composition of the A-share

Figure 4.5 Growth of GEB Market in 2012



Sources: Wind Info and Guotai Jun'an Securities Research Institute.

Table 4.2 Sector Composition of Market Cap on the A-share Market

Unit: %

Sector	Share of market cap at end-2012	Share of market cap at end-2011	Share change
Manufacturing	32.19	32.98	-0.79
Finance and insurance	30.14	29.13	1.01
Mining	14.62	15.89	-1.27
Transportation and warehousing	3.24	3.52	-0.28
Real estate	4.64	3.46	1.18
Information technology	2.69	3.31	-0.62
Production and supply of electricity, gas and water	3.05	2.82	0.23
Wholesale and retail trading	2.42	2.77	-0.35
Building	2.75	2.04	0.71
Comprehensive	1.05	1.12	-0.06
Social service	1.64	1.43	0.21
Farming, forestry, animal husbandry & fishing	0.73	0.84	-0.11
Culture and communication	0.82	0.67	0.15

Sources: Wind Info and Guotai Jun'an Securities Research Institute.

Table 4.3

	Overall P/E Ratio		Overall price to book value (P/B) ratio	
	End-2012	End-2011	End-2012	End-2011
A-share market	13.88	12.86	1.77	1.92
Metal & non-metal	78.54	17.32	1.66	1.67
Pharmaceuticals & biotechnology	31.03	25.61	3.38	3.35
Electronics	35.13	37.96	2.63	2.67
Information technology	37.48	37.74	2.28	2.8
Food & beverage	20.61	30.38	4.39	5.46
Building	12.20	11.35	1.45	1.37
Real estate	17.26	13.67	2.29	1.93
Financial service	7.78	7.94	1.39	1.5
Social service	24.93	29.74	2.94	2.99

Sources: Wind Info and Guotai Jun'an Securities Research Institute.

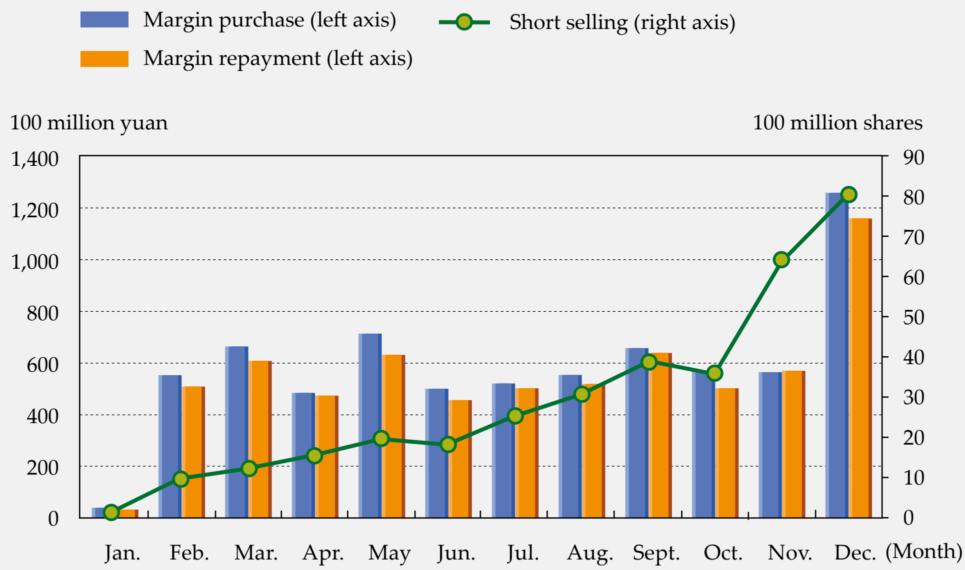
market cap changed little compared with 2011. The industries of finance, insurance and mining continued to top the list by big margins, whose valuation accounted for 76.95% of the total on the A-share market, a little bit lower than in 2011. The market cap of real estate industry grew 1.18 percentage points over 2011, representing the biggest growth of all sectors. The sectors whose market cap share declined included manufacturing, mining, transportation, warehousing, information technology, wholesale and retail trading, and farming, forestry, animal husbandry & fishing. In particular, the share of mining industry market cap dropped 1.27 percentage points, representing the biggest decline.

In 2012, the valuation of all sectors on the A-share market changed. In terms of P/E ratio on the whole, metal, non-metal, electronics, information technology, pharmaceuticals and biotechnology maintained the leading position. In particular, metal and non-metal industries enjoyed biggest growth, while food & beverage and social service industries suffered substantial decline compared with 2011.

2.3 Institutional investors kept growing in number and trading structure continued to optimize

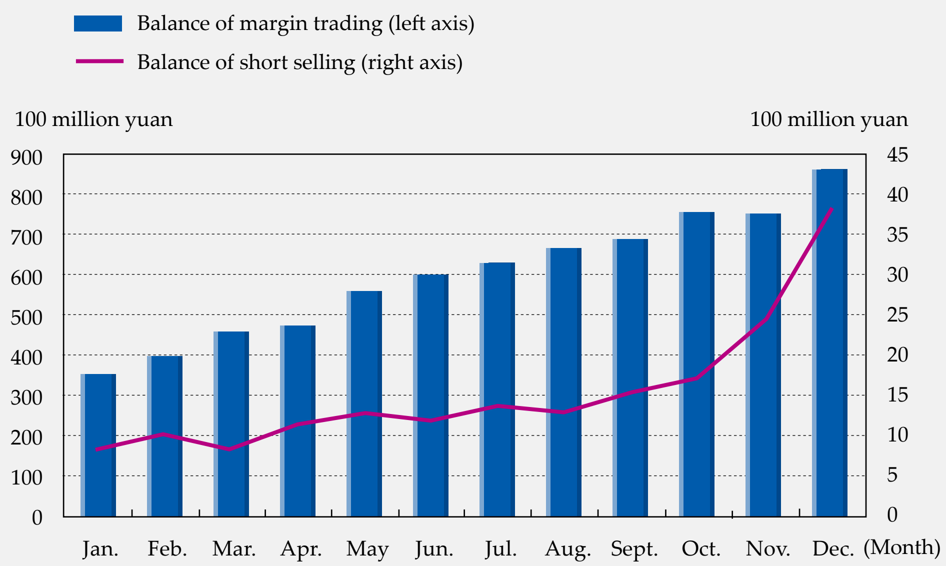
The year of 2012 continued to witness a diversified development of investor structure on the A-share market. According to the statistics from China Central Depository & Clearing Co., Ltd., as of end-2012, stock accounts on Shanghai and Shenzhen markets totaled 170.6448 million, of which valid accounts totaled 140.4592 million. A-share accounts on Shanghai and Shenzhen markets totaled 168.1142 million, representing a growth of 3.17% over end-2011. Specifically, natural person accounts registered 167.4851 million, ordinary institution accounts 508.6 thousand, securities company proprietary accounts 96.3 thousand, trust investor accounts 12.1 thousand, enterprise annuity accounts 5,055 and fund company accounts 2010. The accounts of trust investor, enterprise annuity and fund company continued to grow in number, hence institutional investors

Figure 4.6 Monthly Trading of Margin Trading and Short Selling in 2012



Sources: Wind Info and Guotai Jun'an Securities Research Institute.

Figure 4.7 Monthly Balance of Margin Trading and Short Selling in 2012



Sources: Wind Info and Guotai Jun'an Securities Research Institute.

kept increasing.

In 2012, the business of margin trading and short selling as well as stock index futures continued to optimize the trading structure on the market. The balance of margin trading and short selling on Shanghai and Shenzhen stock markets increased rapidly and reached 89.52 billion yuan as of the end of the year, 2.34 times that at end-2011. Stock index futures enjoyed substantial growth in trading volume, with the accumulated volume throughout the year registering 105.0618 million, daily volume recording 432.4 thousand, up 109.3%.

3. Institution and infrastructure building

3.1 Market system building sped up

3.1.1 The launch of "new three board" accelerated the construction of over-the-counter (OTC) market

It is an important part of improving the multi-level capital market in China to develop the "new three board" characterized by OTC market. On the one hand, the OTC market, where the threshold of financing was lower, can provide small and medium-sized enterprises (SMEs) with new financing channels. On the other hand, the launch of "new three board" and the enhancement of market liquidity can provide PE and VC with better exiting channels, so as to strengthen the support of venture capital to the real economy. In early August 2012, the first batch of parks to be expanded was determined, including Shanghai Zhangjiang Hi-Tech Park, Wuhan East Lake New Technology Development Zone and Tianjin Binhai Hi-Tech Park. As of the end of 2012, listed companies on "three new board" totaled 200, more than doubling compared with 97 at the end of 2011. The National Equities Exchange and Quotations Ltd., the national trading platform for OTC capital market building and day-to-day operating agency, was established on January16, 2013.

3.1.2 Initial results were achieved in the clean-up and rectification of exchanges

Under the approval of the State Council, the CSRC led 23 ministries and established inter-ministerial joint conference system to clean up and rectify trading venues of various types, with a view to solving the problems of blind development in the establishment of exchanges in some areas, increasingly serious illegal trading activities, ill-defined regulatory responsibility and institutional boundary. Opinions were expressed on province's (autonomous regions and municipalities) approval of the establishment of exchanges. Meanwhile, work was done to identify the nature of suspected illegal securities and futures trading, so as to put an end to disguised engagement of equal shares, stock trading, futures and derivatives trading. At the end of November 2012, clean-up and rectification has been completed and passed for inspection in some provinces (autonomous regions and municipalities), and the working report and related materials have been submitted to the joint meeting. Based on the study made by the member units of the joint meeting, and with reference to the on-site examination in some provinces (autonomous regions and municipalities), Zhejiang, Hubei, Chongqing, Guizhou, Tibet, Gansu, Qinghai, Shenzhen were in the first batch to complete the clean-up and rectification and to pass the inspection of the joint meeting.

3.2 Basic institution building advanced in an all-round way

3.2.1. The third round of IPO reform started

On April 1, the CSRC issued the *Guidance on Further Deepening IPO Reform (Exposure Draft)*, thereby starting the third round of IPO reform. Compared with the previous two rounds of reform, the current round was more extensive and intensive. First, requirements were increased on information disclosure and regulation. Second, partial adjustments were made to some segments of issuance. For instance, the issuer was clarified to be the person shouldering the utmost responsibility for information disclosure, participants were expanded for offline placement, the three-month lock-up period offline was removed, and secondary offerings were attempted. This would exert great influence on new share price inquiry and pricing, subscription behaviors of pricing inquiry body and even the performance of new shares. In addition, IPO hype and investor education was also covered. On the whole, the IPO reform advanced smoothly, as the P/E ratio of new shares declined notably and the trading price on the first day dropped around 20% over the previous year.

3.2.2 The launch of refinancing business enlarged market capacity

At the end of 2011, the CSRC decided to get the margin trading and short selling to be daily business rather than pilot program. Meanwhile, specific institutions were established for refinancing business. On August 30, 2012, upon the completion of the preparatory work, refinancing business was officially launched on a pilot basis and 11 securities companies were in the first batch as pilot firms. In terms of business development, margin trading refinancing was to be introduced first, and short selling refinancing would wait until the conditions are ripe. This asymmetric institution arrangement fully considered and circumvented market risk. The launch of refinancing business would change the defects of margin trading and short selling that scale is limited, and make it play a real role in improving market mechanism. Meanwhile, institutional investors would embrace new development opportunities in the expansion of credit transactions.

3.2.3 Adjustment was made to "dividend tax" to implement preferential tax policy

On November 16, 2012, upon the approval of the State Council, CSRC announced to make adjustment to dividend taxation proportion from January 1, 2013. To be specific, tax imposed on investors holding shares more than one year dropped from 10% to 5%, tax on investors holding shares from 1 month to 1 year remained unchanged at 10%, and tax imposed on investors holding shares less than one month rose from 10% to 20%. This policy increased the dividend returns to investors, not only favorable to long-term capital investment, but also helpful in encouraging dividend paying of listed companies. At the same time, differentiated dividend taxation was meant to cultivate long-term investors and the awareness of listed companies to pay returns to investors, which would contribute to the smooth operation of the market.

3.2.4 Exchanges improved delisting system and implementation rules

In November 2012, SSE and SZSE promulgated a series of regulations, including *Implementation Rules for Delisting Finishing Business*, *Interim Measures for Share Transfer of Delisted Companies*, *Interim Measures for Stock Trading on Risk Warning Board*, *Implementation Measures for Relisting of Delisted Companies*, and *Trading Rules*. This indicated the delisting mechanism that respected market autonomy would be injected into the stock market. SZSE and SSE made innovations to the delisting system on GEB and the main board, introducing to the market the mechanism that the fittest survived. Fund will flow to well-run enterprises that are innovative and flexible in institution, so that the social resources will be better allocated and the stock market more effective. The further improvement of the delisting system will also change the phenomenon that emphasis is laid on financing rather than returns on China's stock market and prompted companies to rethink about the costs of various financing methods.

3.2.5 Sponsor business regulation was further strengthened

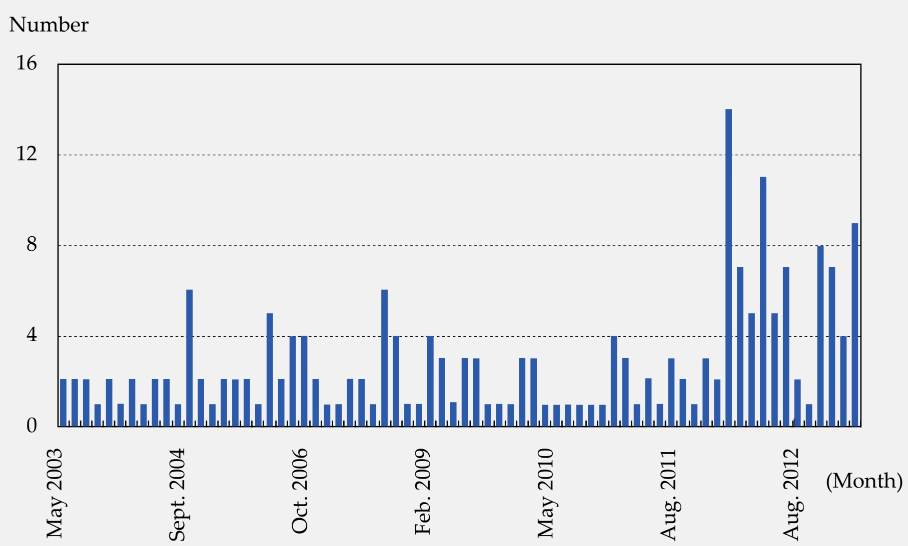
In early 2012, CSRC formally relaxed the control of projects signed by sponsor representatives. It meant the investment bank sponsors will increase in number, which was conducive to the expansion of investment banking. Later, the Securities Association of China (SAC) drafted *Guidelines for Sponsor Representative Qualification Management (Draft)*. SAC will be responsible for organizing competence examinations for sponsor representatives, managing sponsor representative registrations, and other day-to-day management including registration changes and punishment. In addition, the threshold for sponsor representative registration will be lowered.

3.3 New progress was made in market opening-up

3.3.1 QFII application and approval sped up

Since December 2011, CSRC and the State Administration of Foreign Exchange (SAFE) have implemented a series of measures to expand opening-up so as to speed up QFII approval. In July 2012, CSRC issued *Rules on Issues Concerning the Implementation of the Administrative Measures for Domestic Securities Investment by QFII* (hereinafter referred to as *Rules*), which lowered QFII qualification requirements dramatically and increased the maximum stakes. According to Rules, QFII was allowed to invest in the interbank bond market and SME private debt, and the stakes held by foreign investors was increased from 20% to 30%. Rules also clarified the electronic

Figure 4.8 Rapid Increase in the Number of Approved QFIIs



Sources: CSRC, Wind Info and Guotai Jun'an Securities Research Institute.

submission method for QFII qualification application documents, which simplified the application documents. The changes were applauded by foreign investors. Since 2012, 72 investment institutions have been approved as QFII, which made the total number of QFIIs reach 207 at the end of the year. The total quota registered US$80 billion, of which nearly US$40 billion has been approved.

3.3.2 RQFII quota further expanded

The pilot RQFII program, which was launched in December 2011, won positive feedback from the market. In 2012, in order to further promote the opening up of the domestic securities market, to broaden offshore RMB investment channels, and to meet the investment needs of foreign investors in domestic securities market, CSRC, PBC and SAFE increased RQFII investment quota twice by 250 billion yuan in total based on the approval of the State Council. At the end of the year, the pilot RQFII investment quota totaled 270 billion yuan, of which about 70 billion yuan has been approved.

3.3.3 Cross-border ETF issuance and listing made breakthrough

In February 2012, CSRC formally accepted the production reporting of ETFs on the H-share market. On July 18, Huaxia Heng Seng ETF and E-fund Heng Seng Chinese enterprise ETF were launched, marking a breakthrough in China's cross-border ETF issuance and listing. At present, China is still faced with some challenges in cross-border ETF fund management. For instance, the cross-border ETF operation process was complex, as the host country and the issuer differed in trading hours, trading rules and issued currency, therefore, a lot of technical details needed to be improved through policy arrangements.

3.3.4 Restrictions were reduced on securities companies with foreign equity participation

On October 16, 2012, CSRC officially released the *Rules for Establishing Securities Companies with Foreign Equity Participation and the Trial Regulations on Establishing Subsidiaries of Securities Companies.* Accordingly, the maximum proportion of shares held by overseas shareholders was raised from 1/3 to 49%, and required operating period for business scope expansion application reduced from five years to two years for securities companies with foreign equity participation.

3.4 Institutional investor building entered deepening stage

3.4.1 Research was made to attract long-term investment fund

Since 2012, CSRC has made it clear to encourage institutional investors, such as social security funds and enterprise annuities to increase investment proportion in the capital market. Efforts were made to actively promote long-term capital investment in the market, such as the national pension fund and housing provident fund, so as to gradually improve the structure of institutional investors, to stimulate the endogenous force of the market and to consolidate long-term healthy development of the market. Entrusted by CSRC, some securities companies and fund management companies carried out research on the program of investing housing provident fund on the A-share market. National Council for Social Security Fund signed agreements with some provinces to make diversified investment of pension fund. CSRC and the Ministry of Housing and Urban-rural Development made joint research on how to improve the management and investment operation of housing provident fund.

3.4.2 Regulation was relaxed to promote securities company innovation

On August 27, CSRC issued *Opinions and Measures to Promote the Reform, Opening up and Innovative Development of Securities Companies*, introducing four new policies. Firstly, work should be done to encourage the business of asset custody, settlement, agency, etc. Secondly, related products of securities firms should be allowed to transfer and circulate on the OTC market. Thirdly, support should be extended to private capital in entering the field of securities, investment consulting and the like. Fourthly, securities firms should be allowed to make decisions on the organization form and business scope of branches on their own. On October 15, CSRC announced that continued efforts would be made on the follow-up work of removal the adjustment of administrative approval items and on the transitional arrangements, so as to ensure the removed and decentralized items were properly handled in a timely manner. Since the beginning of the year, various innovation policies have been put forward to facilitate the business development of the securities companies.

Table 4.4 Major Innovation Policies Introduced in 2012

	Policies	Date	Main contents
First, enhancing securities companies' ability to innovate wealth management products	*Administrative Measures for Client Asset Management Business of Securities Companies*, *Implementation Rules for Collective Asset Management Business of Securities Companies* and *Implementation Rules for Specific Asset Management Business of Securities Companies*	Oct.19	1. Medium-term notes,, commercial bank wealth management products characterized by guaranteed earnings and commercial bank wealth management products characterized by guaranteed principal and floating earning were added into the scope of big collection. Small collection allows for investment in the products traded on futures exchanges, in the products traded on the interbank market and in the financial products approved by or registered with regulatory authorities for issuance. Targeted asset management allowed investors to negotiate with securities companies and decide on investment scope by agreement. 2. Collective asset management schemes and specific asset management schemes were allowed to participate in margin trading and short selling. Their equities can be lent to securities finance companies as underlying securities. 3. The shares of collective schemes can be graded based on their risk and earnings profile. 4. In the duration of collective schemes, the clients of securities companies and agent institutions can transfer collective scheme shares with each other through the trading platform approved by CSRC, such as securities exchanges.
Second, speeding up the process of innovating new business and new products	*Administrative Measures for Client Asset Management Business of Securities Companies*	Oct.19	For collective asset management schemes, approval system has been changed into filing with SAC within 5 days after issuance.

Table 4.4 Major Innovation Policies Introduced in 2012

	Policies	Date	Main contents
Third, relaxing restrictions on business scope and investment method	Expansion of agreed repo business	May to September	1. Agreed repo business was expanded from institutions to individual investors; 2. 7 pilot securities companies were added in 2 batches; 3. Trading period was lengthened to 1 year, and 5% share holding requirement and high management restrictions were removed.
	Merger and acquisition (M&A) fund	June to September	CITIC Securities and GF Securities established M&A Funds one after another.
	Alternative investment subsidiaries	May to October	CITIC Securities, Haitong Securities, China Merchant Securities and Everbright Securities established alternative investment subsidiaries one after another.
	Refinancing	Aug. 21	Refinancing was formally launched. Accordingly, securities companies can borrow from securities finance companies to extend loans to clients.
Fourth, expanding the scope of selling financial products as agent by securities companies	*Administrative Rules for Sales of Financial Products by Securities Companies as Agent (Draft)*	Aug. 23	The scope of proxy sales of financial products was expanded to the products that were approved or registered for domestic issuance by the state authorities, such as CSRC, China Banking Regulatory Commission (CBRC), China Insurance Regulatory Commission (CIRC) or other authorities.

Source: Guotai Jun'an Securities Research Institute.

3.4.3 The investment scope of insurance fund was broadened

On June 1, CIRC issued the *Notice of the Issues Concerning Issuance of Subordinated Convertible Bonds by Listed Insurance Companies*, which allowed listed insurance companies to issue subordinated convertible bonds, in order to broaden their financing channels and improve their solvency management. In October, CIRC promulgated the *Notice of the Issues Concerning Insurance Asset Management Companies*, which expanded the business of insurance asset management to the establishment of asset management products of various types, thereby further lowering investment threshold for insurance assets. At the same time, the *Rules on the Participation of Insurance Funds in the Stock Index Futures Trading* was promulgated, which allowed insurance funds to participate in stock index futures trading. The introduction of the above-mentioned channel-broadening and investment-diversifying policies promoted insurance agencies to upgrade asset allocation and investment management capability on the basis of innovating products and speeding financing, hence helping them become more active institutions on the capital market.

3.5 Product innovation boomed

3.5.1 Cross-market ETFs were launched

On April 26, CSI 300ETF launched by SSE and SZSE jointly with Harvest Fund Management and Huatai-PineBridge Investment got approved and established in early May, which marked the official launch of cross-market ETF after years of preparation. The scale of the two CSI 300ETFs upon launch registered 19.333 billion yuan and 32.969 billion yuan respectively. Both of them got listed on SSE and SZSE on May 28, and became underlying products for margin trading and short selling on June 4. As of the end of the year, the scale of Harvest CSI 300ETF and Huatai-PineBridge CSI 300ETF stood at 23.662 billion yuan and 16.29 billion yuan respectively. At the end of the year, China AMC CSI 300ETF was also issued. It was established on December 25, with the scale recording 603 million yuan. As the first cross-market ETF in the domestic market, CSI 300ETF enriched instrument products in China's capital market, which had a far-reaching impact on the fund industry and further enriched CSI 300 index products.

3.5.2 Pilot quoted repurchase business expanded

Ever since the promulgation of *Guidance on Pledge Style Bond Repurchase (Trial) and Implementation Rules for Pledge Style Bond Repurchase and Graded Settlement*, the quoted repurchase business advanced in a regulated way, especially in 2012. Stock exchanges supported pilot securities firms to expand their business scale and specified that all Class A securities companies could apply for the pilot business of quoted repurchase. The expansion of pilot quoted repurchase business was conducive to diversifying the business and revenue structure of securities firms, thereby an important manifestation of product innovation of securities firms.

3.5.3 Pilot agreed repurchase business deepened

Since 2012, stock exchanges have taken a series of measures to promote agreed repurchase. Firstly, the pilot scope for agreed repurchase business was expanded and corresponding qualification requirements relaxed. In particular, the trading period was lengthened to one year, the requirements for 5% share holding and restrictions on directors and high management was removed. Secondly, the client scope was expanded from institutional clients to individual clients of securities firms. Lastly, client-to-client agreed repurchase trading was actively promoted on the basis of quoted repurchase and agreed repurchase. The further development of the pilot business of agreed repurchase would help securities firms to broaden financing channels and to increase returns on invested capital.

3.5.4 Record filing was adopted for asset management business of securities companies

On October 19, CSRC officially released the revised *Administrative Measures for Client Asset Management Business of Securities companies, Implementation Rules for Collective Asset Management Business of Securities Companies and Implementation Rules for Specific Asset Management Business of Securities Companies*. It was clarified that administrative approval was abolished for collective asset management schemes of securities companies and was replaced by filing with SAC within 5 days after issuance. At the same time, the investment scope was expanded for various types of collective asset management schemes. Specific asset management schemes allowed investors and securities companies to make an agreement on investment scope based on negotiation. Collective asset management schemes and specific asset management schemes were allowed to participate in margin trading and short selling.

Their equities can be lent to securities finance companies as underlying securities. With the removal of policy restriction, asset management business of securities companies will expand and grow, customers with be provided with a wide range of wealth management services, the ability of securities companies to serve the real economy will enhance, so will their core competitiveness.

3.5.5 Support was extended to securities companies for research and development of cash management plan

In 2012, SSE and SZSE extended support to securities companies for research and development of cash management plan. Cinda Securities became the first of its kind to get reply from SZSE on cash management plan for client margin. Since March 1, the number of its business offices promoting “cash treasure” products increased from 6 to 68, with the product size limit rising drastically from 1.5 billion to 7 billion yuan. On November 16, Everbright Securities got the first qualification for consumer payment innovation and signed a framework agreement with China Unionpay, which realized the function of consumer payment by binding securities fund account with China Unionpay. It indicated that the securities fund account would no longer be limited to stock and bond investment. This innovation will ease the problem that the clients' assets under brokerage system of securities companies fluctuate with market ups and downs, thereby helping to strengthen the management of securities trading margin.

3.5.6 Research and development was advanced for graded asset management scheme of securities companies

In 2012, CSRC promoted the implementation of graded asset management scheme of securities companies. On the one hand, CSRC supported securities companies to issue graded asset management schemes containing different levels of risks, with the low risk referring to fixed-yield investment while high risk referring to high-risk securities investment, such as high-yield bonds and SME bonds. On the other hand, CSRC provided securities companies and investors with share transfer service and supportive market maker system for asset management schemes through integrated business platform. Therefore, the shares of asset management schemes can be transferred among clients of securities companies, and market makers were introduced to provide liquidity offer. On October 19, CSRC issued related regulations and rules, allowing for classification of collective scheme shares according to risk-return characteristics. It helped securities companies to design graded products based on risk preferences and risk-bearing capacity of clients, thus enriching the product type and meeting customer needs. On November 22, the first graded collective wealth management product of securities companies was officially launched.

4. Outlook for stock market development

Looking ahead to 2013, deepening the reform will continue to be the theme of the stock market. First, efforts will be made to accelerate the development of multi-level capital market through promoting pilot OTC business and further expanding “new three board” market. Second, job will be done to further deepen the reform of issuance and delisting system, so as to enhance the quality of listed companies. It is also imperative to strengthen information disclosure, to standardize corporate governance and other infrastructure building, so as to improve investor protection mechanisms. Third, attention will be focused on cultivating institutional investors, promoting innovative development of securities institutions, and promoting innovation and cooperation of participating institutions so as to further enhance the discourse right of institutional investors. Fourth, continued efforts will be made to actively and steadily push forward the opening up to the outside world and to attract long-term strategic capital through multiple channels, so as to improve the overall operating efficiency of the market and serve the real economy better.

Part V Foreign Exchange Market

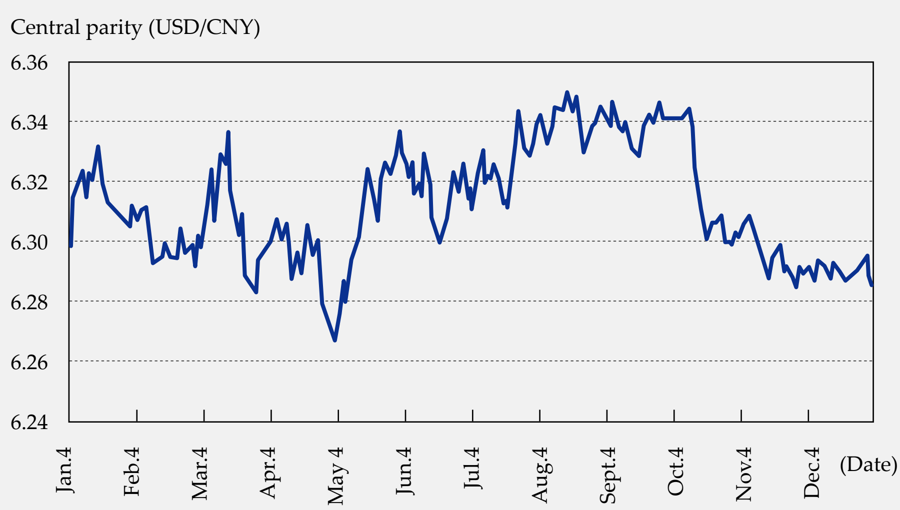
In 2012, turnover in China's foreign exchange (FX) market slip a bit. RMB/USD central parity trended upward, with deviation from the central parity markedly widening. RMB shifted from depreciation to appreciation against U.S. dollar, while the fluctuation of actual trading rate and the central parity steadily moderated. Transactions between RMB and non-USD foreign currencies took up a dramatically increased market share, and market participants continued to expand. In addition, institutional construction further advanced in China's FX market. Floating band for USD/CNY trading was widened to 1%, banks' synthetic position by settlement and sale of foreign exchange was subjected to a management interval where the lower bound is negative whereas the upper bound is positive, lower bound was removed regarding banks' position on a cash basis, and JPY/CNY direct trading was launched. All these new developments contributed to an enhanced role of RMB in global FX market.

1. Foreign exchange market performance

1.1 The USD/CNY central parity generally presented an ascending trend

As of end-2012, the central parity of USD/CNY stood at 6.2855 yuan, up 154 bps or 0.25% from the end of 2011. Throughout the year, the central parity of USD/CNY fluctuated by

Figure 5.1 USD/CNY Central Parity Movement in 2012



Source: www.chinamoney.com.

825 bps. Since the RMB exchange rate regime reform in July 2005 to the end of 2012, the cumulative appreciation against U.S. dollar reached 31.68%.

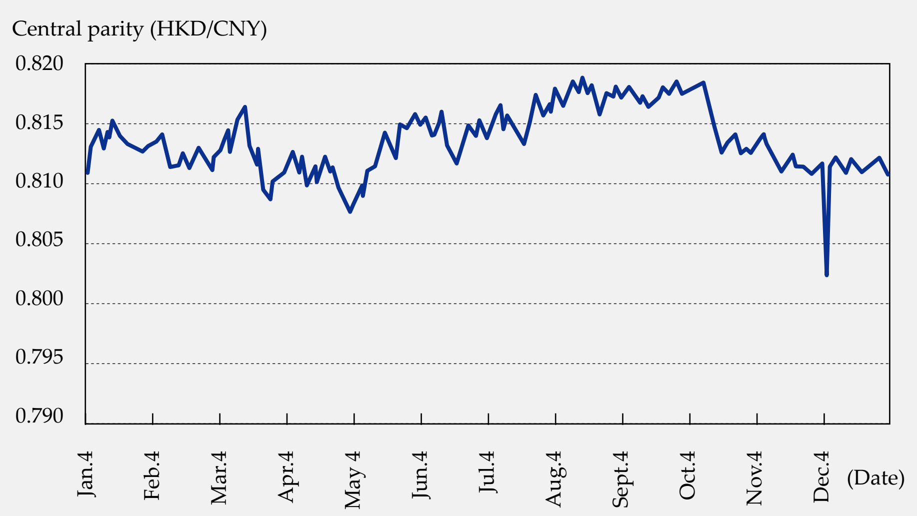
1.2 RMB fluctuated sharply against non-USD currencies

In 2012, the central parities of RMB vs. non-USD currencies saw ups and downs in the interbank FX market amid much larger fluctuations. The central parity of HKD/CNY registered 0.81112 yuan at the beginning of 2012 and closed at 0.81085 yuan at the year-end. RMB depreciated against Hong Kong dollar by 0.02%, contrasting an appreciation of 5% in 2011. The central parity of HKD/CNY fluctuated by 160 bps across the year. As of end-2012, RMB appreciated cumulatively against Hong Kong dollar by 31.2% since the exchange rate regime reform in July 2005.

The 100JPY/CNY central parity registered 8.2198 yuan at the beginning of 2012 and closed at 7.3049 yuan at year-end. RMB gained 11.0% against the Japanese yen in 2012, accelerating 10.8 percentage points compared with the previous year. The JPY/CNY central parity fluctuated by 10,212 bps across 2012. A cumulative appreciation of 0.1% was recorded against Japanese yen since the RMB exchange rate regime reform in July 2005.

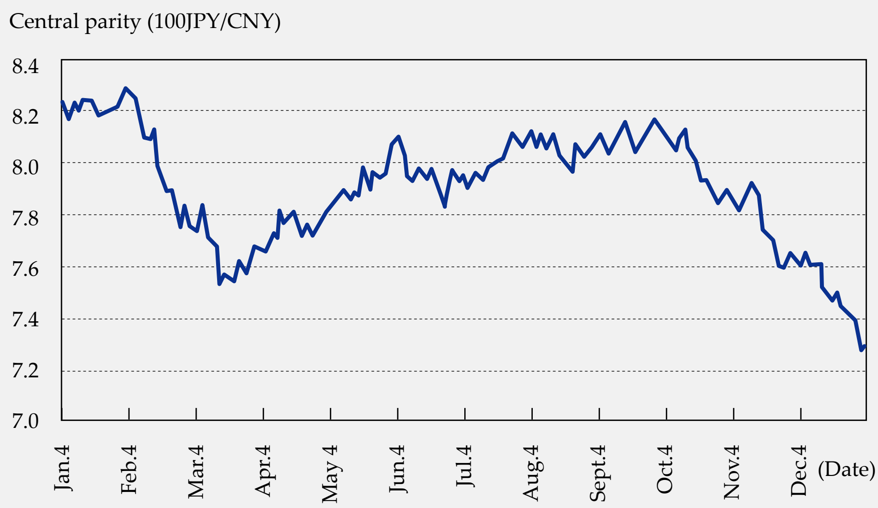
In early 2012, the central parity of EUR/CNY moved from 8.2204 yuan and closed at 8.3176 yuan at year-end. RMB depreciated against euro by 1.9%, whereas it appreciated by 7.9% in the previous year. The central parity fluctuated by 8,326 bps across the year. A cumulative appreciation of 20.1% was recorded against euro since the RMB exchange rate regime reform in July 2005.

Figure 5.2 HKD/CNY Central Parity Movement in 2012



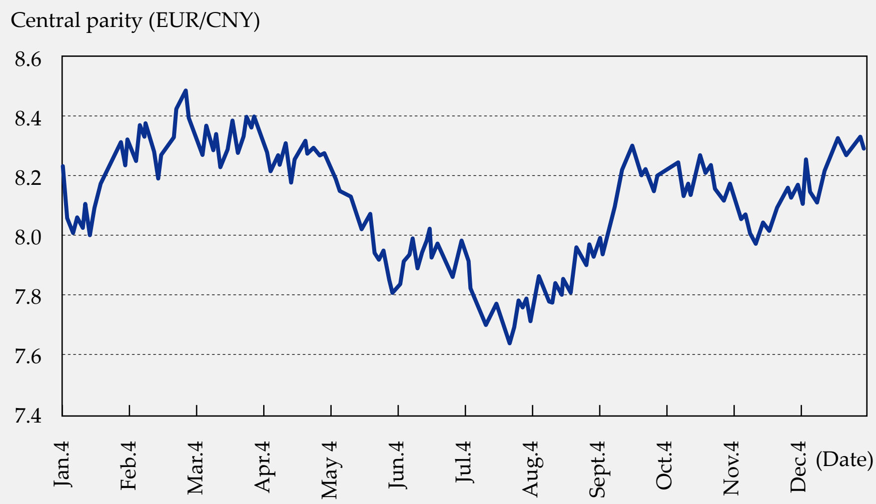
Source: www.chinamoney.com.

Figure 5.3 JPY/CNY Central Parity Movement in 2012



Source: www.chinamoney.com.

Figure 5.4 EUR/CNY Central Parity Movement in 2012



Source: www.chinamoney.com.

The central parity of GBP/CNY started from 9.8537 yuan in early 2012, and closed at 10.1611 yuan at year-end. RMB depreciated 4.4% against pound in 2012, whereas it appreciated 5.2% during 2011. The central parity fluctuated by 6,078 bps across the year.

In 2012, the central parity of CNY/MYR moved from 0.49851 ringgit at the beginning and closed at 0.48865 ringgit at year-end, RMB depreciating 2.8% against ringgit. The depreciation was 4.4 percentage points lower than the previous year. The central parity fluctuated by 309 bps across 2012.

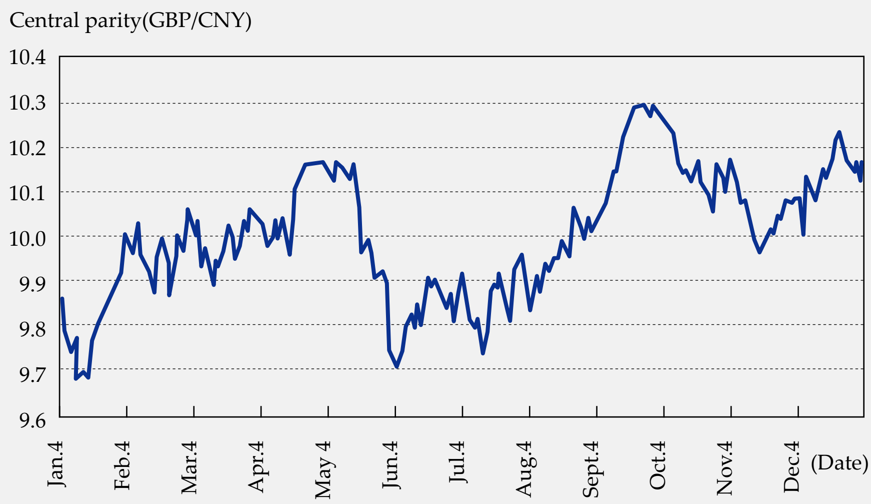
In early 2012, the central parity of CNY/RUB stood at 5.0383 ruble, and closed at 4.8528 ruble at year-end. RMB depreciated 4.6% against ruble during the year, 4.6 percentage points less compared with the previous year. The central parity fluctuated by 7325 bps across the year.

1.3 The RMB/FX spot market transactions fell slightly

In 2012, the turnover of RMB/FX spot market declined slightly by 5.6%. There were 10 currency pairs trading in this market, including USD/CNY, HKD/CNY, JPY/CNY, EUR/CNY, GBP/CNY, AUD/CNY, CAD/CNY and CNY/MYR, CNY/RUB, CNY/THB. Turnover of USD/CNY currency pair fell 9.2% year-on-yea. Among non-USD currencies, in spite of the drop of 4.3% in CNY/RUB transactions, other currency pairs saw rising turnover.

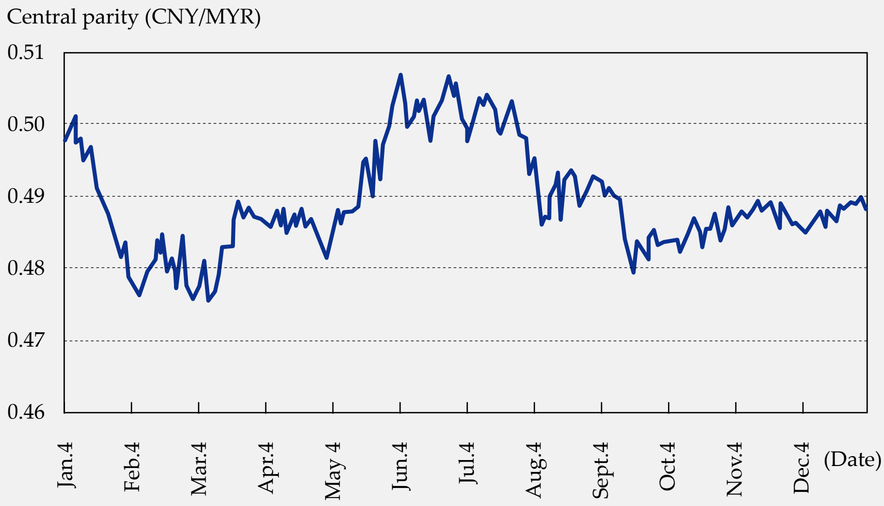
The lower RMB/FX spot market turnover was mainly due to the deceleration of import and export growth as well as larger market volatility. This marked the first decline since 2000. Especially in November 2012, the USD/CNY rates frequently touched daily limits amid large fluctuations, market liquidity therefore was significantly suppressed, and turnover plummeted over 30% year-on-year.

Figure 5.5 GBP/CNY Central Parity Movement in 2012



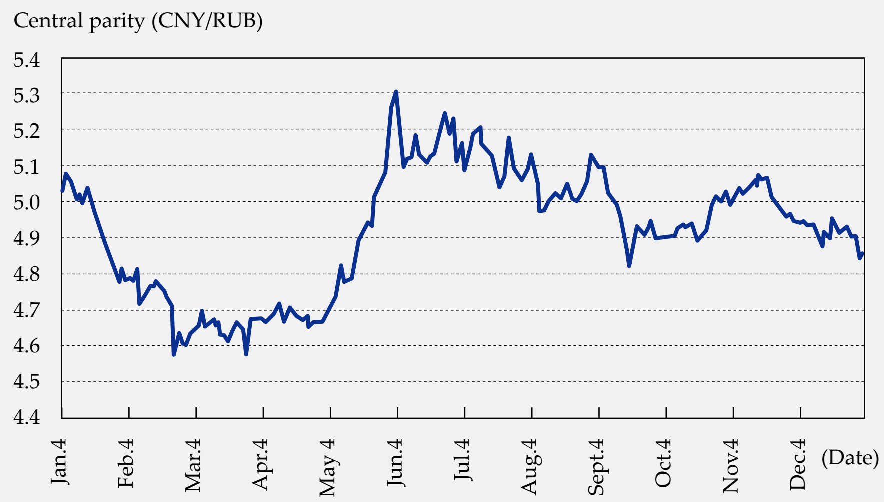
Source: www.chinamoney.com.

Figure 5.6 CNY/MYR Central Parity Movement in 2012



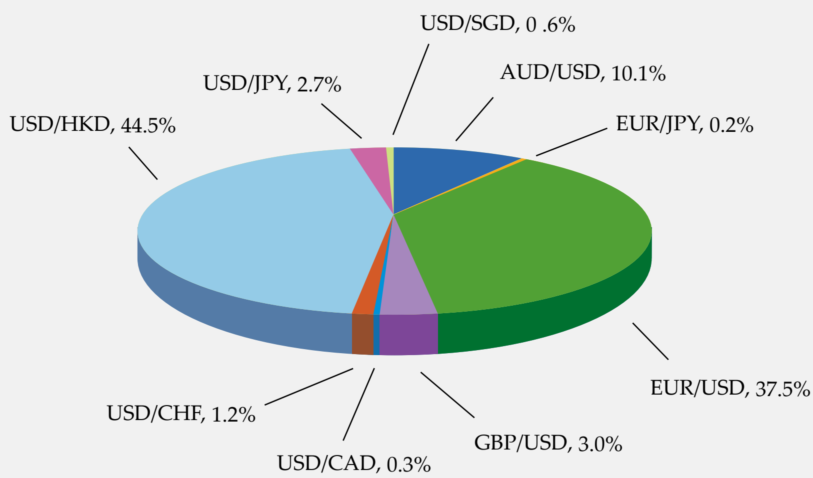
Source: www.chinamoney.com.

Figure 5.7 CNY/RUB Central Parity Movement in 2012



Source: www.chinamoney.com.

Figure 5.8 Breakdown of Foreign Exchange Pairs Spot Market in 2012



Source: www.chinamoney.com.

1.4 Foreign currency pair spot market turnover dropped

As for foreign currency pair spot market, turnover reached an equivalent of US$62.2 billion, down 27.4% year-on-year. In 2012, the market saw 9 foreign currency pairs for trading, i.e. AUD / USD, EUR / JPY, EUR / USD, GBP / USD, USD / CAD, USD / CHF, USD / HKD, USD/ JPY and USD / SGD. Among those, USD/HKD and EUR/USD turnover reached US$27.6 billion and US$17.2 billion respectively, down 27.6% and 46.5% year-on-year. AUD / USD turnover went up to US$13.1 billion, up 51.1% year-on-year. Those three currency pairs accounted for 93.0% of total transactions involving 9 currency pairs.

2. Features of FX market performance

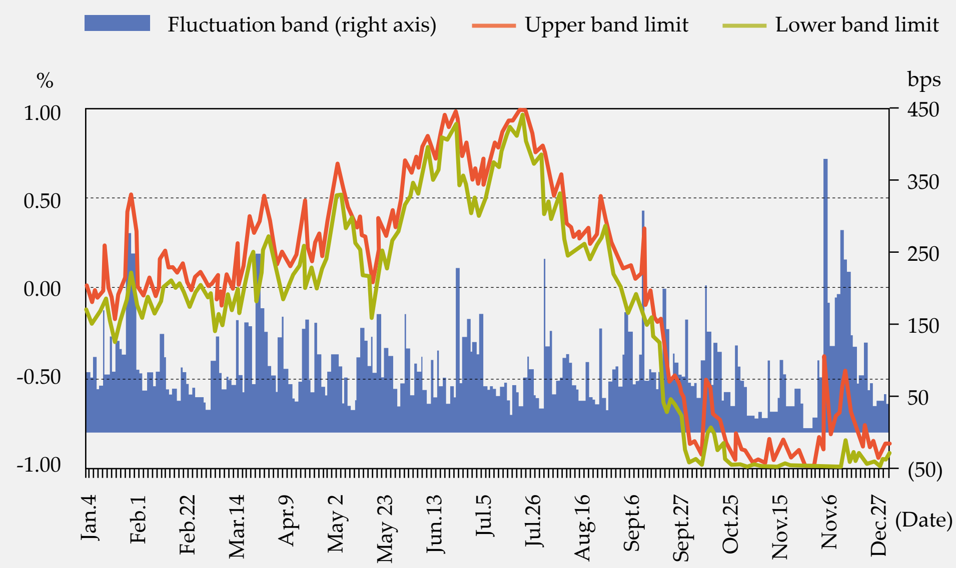
2.1 USD/CNY trading prices deviated from the central parities markedly

Since the central bank announced that the floating band of USD/CNY spot trading was widened from 0.5% to 1% starting from April 16, the deviation of USD/CNY trading prices from the central parity became larger. In 178 trading days from April 16 to the end of 2012, there were 121 trading days in which the intraday exchange rates fluctuated more than 0.5%. Among those, fluctuation of over 0.9% was observed in 70 trading days, and fluctuation reached the upper limit of 1% in 15 trading days.

2.2 USD/CNY rates and central parities were generally stable with less fluctuation

In 2012, moderation was observed in both USD/CNY intraday fluctuations and the central parity day-to-day fluctuations. The average intraday fluctuations of USD/CNY rates were 100bps, 91bps, 87bps and 84bps in four quarters respectively, presenting a downward trend. The day-to-day fluctuations of the central parities remained stable in the first half of the year, and declined steadily in the second half of the year, namely 53bps, 57bps, 39bps and 28bps in each quarter.

Figure 5.9 Intraday USD/CNY Fluctuations in 2012



Source: www.chinamoney.com.

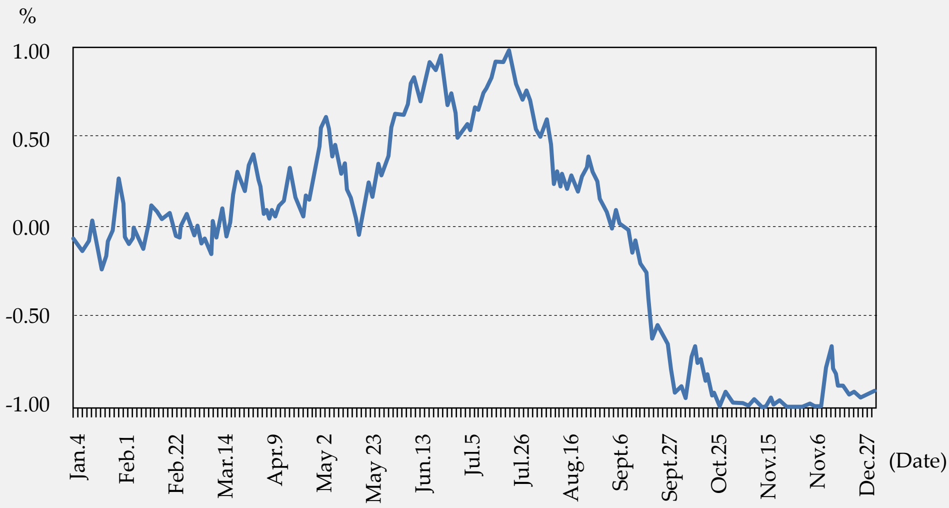
2.3 USD/CNY rates shifted from devaluation to appreciation relative to the central parities

In 2012, the USD/CNY weighted trading prices deviated from the central parities in the direction of depreciation at first and reverted to depreciation later on, against the backdrop of changing domestic and international market environment. At the beginning of the year, the USD/CNY rates slightly fluctuated around the central parities. Thereafter, affected by the continuing impact of European debt crisis, weakness of domestic economic data, and the narrowing of trade surplus, the USD/CNY central parities became weaker in the shock, and the deviation of trading prices relative to the central parities continued to expand in the direction of depreciation, which reached 0.97% on July 20. Since then, the USD/CNY rates turned stronger, rose steadily from 6.39 at late-July to around 6.22 in December with the sharp narrowing of trading price deviation, due to factors of realization of expectations on the third and fourth round of quantitative easing policy, the bottoming up of domestic economy and the de-dollarization of domestic institutions. After the USD/CNY rate went down below the central parity on September 10, it remained in the direct of appreciation relative to the central parity, standing at around -1% lower limit level after late-October.

2.4 The market share of RMB vs. non-USD currencies transactions increased significantly

In 2012, transactions involving non-USD currencies in the spot market were very active, with a total turnover of US$160.5 billion, an increase of 3.6 times year-on-year. The corresponding market share rose sharply from 1% to 4.8%. In June, after the introduction of JPY/CNY direct trading, more participants were attracted, market liquidity was improved, and turnover expanded significantly. Therefore, positive effects were evidenced in the retail market. In that

Figure 5.10 Deviation of USD/CNY Weighted Trading Prices Relative to the Central Parities in 2012



Source: www.chinamony.com.

month, the JPY/CNY turnover hit US$11.3 billion, exceeding the total turnover of the previous 5 months and the previous year. The annual JPY/CNY turnover totaled US$120.6 billion, increased 25.7 times year-on-year, making it the most actively traded among non-USD currencies. As for the new currency pairs such as AUD/CNY, CAD/CNY, CNY/MYR, and CNY/THB, the turnover also increased sharply. The AUD/CNY and CAD/CNY turnover recorded US$1.04 billion and US$70 million respectively, representing a significant year-on-year growth of 62.8 times and 16.7 times; the CNY/MYR and CNY/THB turnover registered US$170 million and US$290 million respectively, representing an increase of 4.5 times and 6.4 times year-on-year.

2.5 Market participants continued to expand

As of the end-2012, there were 359 members in the RMB/FX spot market, 41 more than that at end-2011. Among them, Chinese-funded banks and Chinese-funded non-banking financial institutions accounted for 210 and 35 respectively. The remaining consisted of 112 foreign financial institutions and 1 non-financial institution. As for the foreign currency pair spot market, members increased by 6 to 112, among which 18 were market makers, up 1 from the end of the previous year.

3. Institution building in the interbank FX market

3.1 USD/CNY trading band was widened to 1%

The People's Bank of China made an announcement in April, saying that the floating band of USD/CNY spot trading was widened from 0.5% to 1% since April 16, meanwhile, the commercial banks' cash buying-selling spread on U.S. dollar was allowed to be increased to 2% of the central parity from the previous 1%. This was another floating band widening since 2007, in the context of China's BOP position getting improved, RMB exchange rate being close to an adaptable and equilibrium level, and FX market becoming more mature. Consequently, the further widening could be conducive to an enhanced role of market demand and supply in exchange rate formation mechanism.

3.2 "A management interval with positive upper bound and negative lower bound" was applied to banks' synthetic position by settlement and sale of foreign exchange

In order to further promote the development of FX market, the State Administration of Foreign Exchange(SAFE) decided on April 6 to implement "a management interval with positive upper bound and negative lower bound" on banks' synthetic position by settlement and sale of foreign exchange, which reset the lower bound below zero on the back of current upper & lower bound management. This new method was launched in response to the need of RMB exchange rate regime reform and changing BOP position, in a bid to enhance banks' flexibility and initiative in FX trading and risk management and improve price discovery of RMB exchange rate. At the same time, the SAFE decided to remove "the lower bound management" governing banks' position on a cash basis which had been applied since November 2010.

3.3 The JPY/CNY direct trading kicked off

Authorized by the People's Bank of China, the interbank FX market launched JPY/CNY direct trading since June 1 in order to improve the trading mode. There were several differences from the previous trading mode. Firstly, market-making mechanism was introduced in the direct trading, by which the market makers must provide continuous bid-ask quotes to improve market liquidity. Secondly, the JPY/CNY central parity was based on market makers' direct quoting rather than on the cross rate computed from USD/CNY and USD/JPY rates. This was the third directly traded currency pair after RMB against Ringgit and Ruble. The JPY/CNY direct trading was conducive to bilateral trade and financial exchanges and tightening links between these two largest Asian economies. In addition, the new trading mode was in the interests of economic participants by reducing exchange costs, and was beneficial to enhance the role of RMB in the international FX market.

3.4 One-to-one platform was established in the foreign currency pair market

The foreign currency pair market formally launched the one-to-one platform on January 6, in a bid to optimize market structure and trading mechanism. With this platform, every market maker could provide differentiated bid-ask quotes for different member banks considering counterparty's credit risk and specific trading volume. Transactions were centrally cleared in a non-anonymous way. As of end-2012, 18 members were qualified for entering this platform. This trading system performed well amid brisk trade activities.

Box3 Offshore RMB Market Developments and Analysis in 2012

In recent years, RMB has been becoming more and more popular in offshore market thanks to the expanding cross-border RMB trade settlement and investments. The year of 2012 witnessed strong growth momentum of cross-border RMB businesses, with growing foreign countries and regions getting involved and more offshore RMB products and businesses being initiated. Take RMB Global Index (RGI) published by the Standard Chartered Bank, it started from 100 at end-2010, and rose over 6 times to 737 till the end of November 2012. RMB market in Hong Kong SAR advanced steadily, RMB businesses in London and Singapore boomed rapidly, and those in Taiwan province were further pushed forward. Generally, offshore RMB market performed quite well.

1. Hong Kong SAR further improved RMB business-related policies and RMB product diversification, more and more foreign countries and regions started to launch offshore RMB businesses

Hong Kong SAR continued to press ahead with the improvement of RMB business-related policies and financial infrastructure, creating an enabling environment for RMB businesses. Hong Kong SAR boasts safe and efficient settlement system, including Central Money Markets Unit (CMU) and real-time RMB payment and settlement system. On top of these, further efforts were made in 2012 to introduce cross-border bond investment and delivery platform, promote cooperation between Hong Kong Monetary Authority (HKMA) and Euro Clearing Bank & J.P. Morgan Chase on providing cross-border collateral management services via a bilateral agreement. The HKMA further de-regulated RMB market, which led to enhanced flexibility conducive to market participants. For example, HKMA simplified cross-border RMB trade settlement procedures, allowing banks to assess eligible corporate customers in accordance with know your customer (KYC) and due diligence principles, not to verify relevant documents anymore; HKMA further loosen restrictions on unwound net RMB position, and allowed designated banks, in consultation with the HKMA, to set their own upper limits of unwound net RMB position taking account of the nature and scale of their RMB businesses; Banks could borrow RMB from the HKMA for 7 days or shorter; HKMA replaced quota-based risk management with the requirement of no lower than 25% RMB liquidity ratio imposed on banks, and allowed designated banks to provide RMB services to non-Hong Kong individual customers. Starting from January 3, 2012, three currency issuing banks of HSBC, BOC Hong Kong and Standard Chartered Bank quoted their interbank RMB lending rates on the website of Treasury Market Association (TMA). The TMA gradually added more bidding banks thereafter, and included 13 banks till present, which laid the foundation for publishing fixing CNH interbank rate. Furthermore, RMB products on Hong Kong market grew more diversified in 2012. RQFII was officially launched on January 11, 2012, RMB-denominated Gold ETF was initiated by Hong Seng Bank on February 14, the first A-share ETF was issued in Hong Kong by Hua Xia Fund Company on July 17, and the newly-developed deliverable RMB futures was traded on Hong Kong Stock Exchange on September 17.

On April 18, 2012, the City of London Corporation kicked off the program of "Building RMB Business Center", planning to develop London into the "Western Center" of RMB offshore market through closer cooperation with Chinese government and relevant Hong Kong agencies. Currently, Bank of China, Barclays Bank, Deutsche Bank, HSBC, *Standard Chartered Bank, J.P. Morgan Chase, Royal Bank of Scotland, Industrial and Commercial Bank of China, China Construction Bank and Citibank participated in this program, and UK's Treasury Department, Bank of England and Financial Services Authority acted as observers. The City of London Corporation published the report titled* ***London: the Center of RMB Business*** *in April 2012, stating that, as of end-2011, outstanding RMB deposits on London market stood at 35 billion yuan, and average daily RMB-involved FX trading registered $680 million. Entering 2012, RMB businesses developed at a rapid pace. HSBC issued the first ever RMB-denominated bond in London in April. Major banks of Citibank, J.P. Morgan Chase and HSBC reported over 50% year-on-year growth of RMB businesses on London market. Deutsche Bank estimated that outstanding RMB deposits might arrive at 50 billion yuan presently.*

At the same time, Singapore has been making great efforts to promote RMB businesses. According to Singapore Monetary Authority, outstanding RMB deposits on Singapore market amounted to 60 billion yuan as of end-June, 2012. Based on the cooperative agreement between Chinese and Singapore authorities, a Chinese-funded bank holding a whole-bank license in Singapore could be chosen by Chinese regulatory authority as RMB clearing bank on offshore market.

Taiwan province also set to push forward RMB businesses. Monetary authorities on both sides of Taiwan Strait signed MOU on Cross-strait Currency Clearing Cooperation on August 31, 2012. Taiwan monetary authority designated Bank of Taiwan Shanghai Branch as the TWD clearing bank on the mainland on September 17, and the People's Bank of China named Bank of China Taipei Branch as RMB clearing bank in Taiwan province on December 11. Therefore, cross-strait currency clearing mechanism officially came into shape, indicating that RMB businesses in Taiwan are about to be on a fast track.

In addition, with the launch of JPY/CNY direct trading in June, the use of RMB and JPY increased in cross-border trade settlement. Also, Japan, South Korea and Germany all expressed their strong interests in conducting offshore RMB businesses.

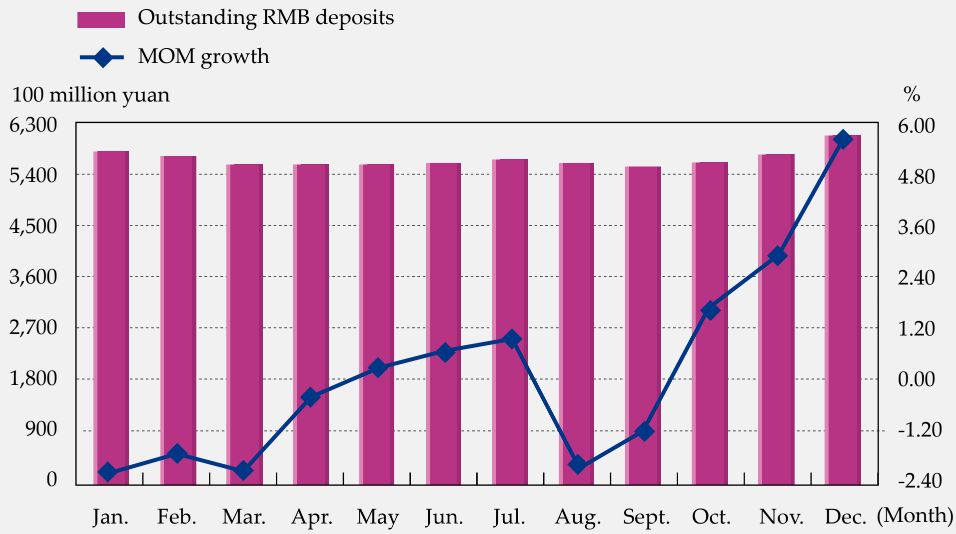
2. Offshore RMB funds expanded by a small margin, and Hong Kong RMB deposit growth decelerated with deposit interest rates moving up

2.1 RMB deposits on Hong Kong market saw weakening growth momentum, while cross-border lending became more active

According to relevant statistics, RMB funds accumulated on Hong Kong, London, Singapore and Taiwan markets totaled 920 billion yuan, up 12% compared with 2011. Data from HKMA showed that outstanding RMB deposits in Hong Kong registered 603 billion yuan as of end-2012, an increase of 14.5 billion yuan, or 2.46% compared with end-2011. Month-on-month growth of RMB deposits in Hong Kong slowed into negative for 6 out of 12 months in 2012, indicating an apparent slowdown in RMB liquidity expansion. The reasons for such slowdown were as follows: China's export growth decelerated, RMB appreciation expectation weakened and even reversed to depreciation expectation in the first half of 2012, and more RMB funds flew back to mainland market driven by availability of new channels of RQFII and cross-border RMB FDI.

At the same time, Cross-border lending between Hong Kong and mainland markets became increasingly brisk. As of end-2012, outstanding RMB loans extended to mainland customers by Hong Kong institutions totaled 79 billion yuan,

Figure 5.11 Change in Outstanding RMB Deposits in Hong Kong in 2012



Source: Hong Kong Monetary Authority.

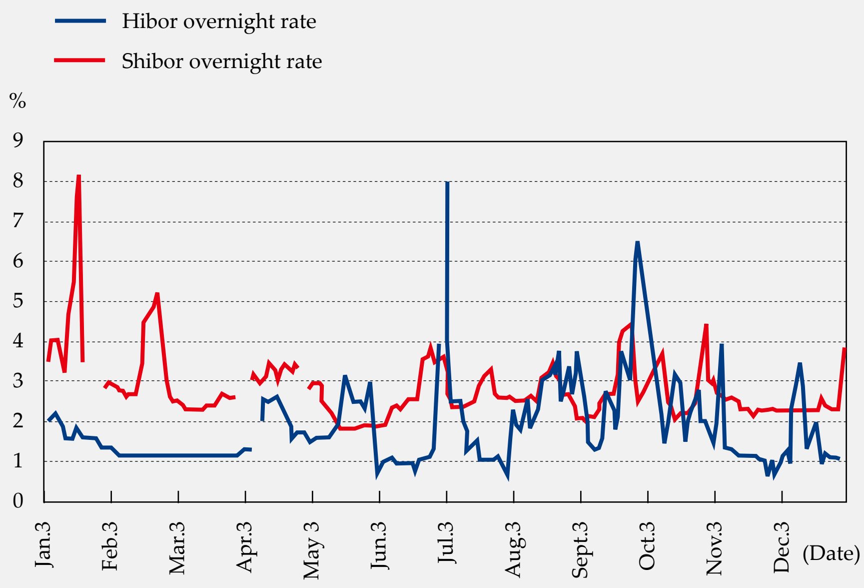
2.56 times that at end-2011 (30.8 billion yuan), showing strengthened financial cooperation between the two markets in support of real economy.

2.2 Fluctuation of Hong Kong interbank offered rate (Hibor) intensified and RMB deposit interest rates went up on Hong Kong market

Since there was no fixing RMB interbank offered rate, we used Hibor, the overnight interbank offered rate, to illustrate how the market rates moved on Hong Kong market (see Figure 5.12). Contrary to historical small fluctuations, Hibor fluctuated sharply during 2012, hitting an all-year high of 8%, and closed at 1% at year-end, 100 bps down from the beginning of the year. Overall, Hibor curve lied below the curve of Shibor, and the two curves moved closer. But there were certain periods when Hibor was markedly higher than Shibor. For example, during the period of end-June and early-July, institutions allocated 17.5 billion yuan back to mainland market for the purchase of treasury bonds, short-term RMB position was therefore under stress and Hibor rose sharply. Market performed likewise during the National Day Holiday of end-September and early-October.

RMB deposit interest rates on Hong Kong market remained much lower than mainland market. 1-year deposit rate for amounts less than 100,000 yuan stood at a lower level of 0.58%. In response to sluggish RMB deposit growth in 2012, banks in Hong Kong stepped up efforts to promote attractively priced RMB CDs etc. As a result, newly issued 1-year RMB deposits featured much higher rates which climbed closer to corresponding mainland rates, with the highest over 3%, much higher than 2% registered in 2011.

Figure 5.12 Comparison of Overnight Rates for Hibor and Shibor in 2011



Source: Reuters.

3. Offshore RMB bond market continued to advance, and the average yield-to-maturity of RMB bonds in Hong Kong went down

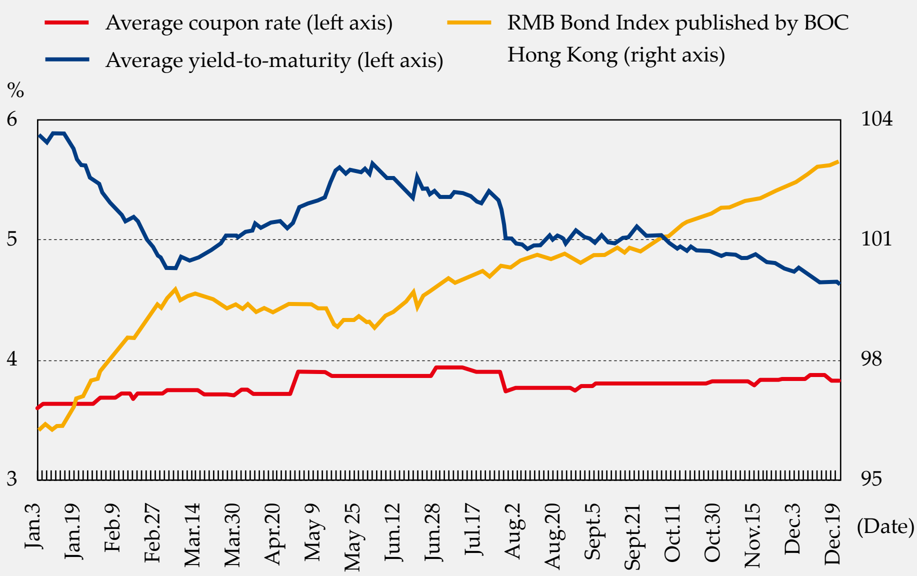
3.1 RMB bond issue on Hong Kong market edged up

The year of 2007 marked the starting point of offshore RMB bond market. Currently, bond issuers come from 25 countries and regions, and have been becoming more diversified evidenced by issuers of China's Ministry of Finance, commercial banks and large enterprises; mainland branches of Hong Kong banks, Hong Kong incorporated companies, multi-nationals and international financial institutions etc. As of end-2012, notional value of outstanding bonds totaled 366 billion yuan, representing cumulative fund-raising of 500 billion yuan since 2007. Offshore RMB bond market maintained growth momentum in 2012. Hong Kong RMB bond market presented steady performance, and London market witnessed issuance of RMB-denominated bonds by HSBC UK, Australia & New Zealand Banking Group Ltd., and China Construction Bank. In 2012, RMB bonds totaling 104.6 billion yuan were issued on Hong Kong market, up 5.54% from 2011.

3.2 Coupon rates of RMB bonds issued in Hong Kong trended up, and the average yield-to-maturity declined.

In 2012, due to factors of decelerated RMB deposit growth, weakened RMB appreciation expectation and greater attention paid to issuers' credit standing by investors, higher yield were required on RMB bonds issued in Hong Kong. Average coupon rate trended up, arriving at 3.83% as of end-2012, up 22 bps compared with 3.61% recorded at the beginning of the year, while still lower than mainland. In the secondary market, average yield-

Figure 5.13 Movements of Hong Kong RMB Bond Yield Curve in 2012



Source: Bloomberg.

to-maturity moved down driven by factors of RMB appreciation expectation on offshore market during the first 2 months of 2012 and benchmark rate cuts on mainland market. The average yield-to-maturity dropped to 4.63% as of end-2012, 123 bps lower compared with the level of 5.86% at the beginning of the year. RMB Bonds traded higher in the secondary market and rate of return was quite pleasant in 2012. Take RMB Bond Index (RBI) published by BOC Hong Kong, it closed at 102.99 as of end-2012, showing an accumulative rate of return of 7.16%.

4. Offshore RMB/FX market enjoyed brisk trading, and RMB valuation was generally expected to decline in the future

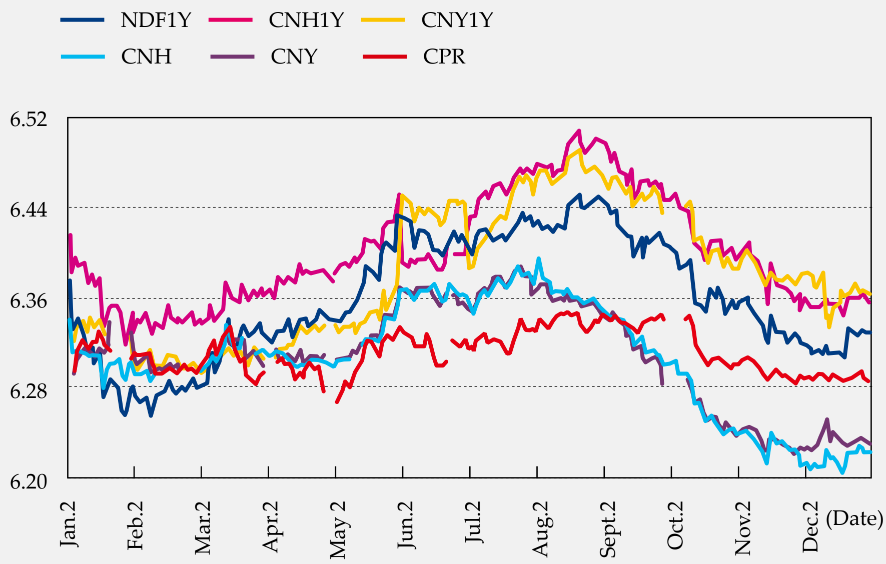
4.1 Offshore RMB/FX market saw more diversified products and brisk trading.

Hong Kong Stock Exchange introduced deliverable USD/CNY futures on September 17, 2012. This product marked the first of its kind and enjoyed brisk trading from its inception. Average turnover of the deliverable USD/CNY futures in December registered $37.24 million, up 71.44% from September. Hong Kong CNH market grew rapidly after its birth in July 2010. According to market estimates, average turnover on CNH market stood at $2.5 billion, increasing by over 60% compared with $1.5 billion at end-2011. Average turnover on CNH forward and swap markets was about $5 billion, more than double that in 2011. NDF transactions in Hong Kong, however, experienced slower growth.

On the Chicago Mercantile Exchange, average daily turnover of RMB futures was only $2.57 million in 2012, shrinking 40% on the previous year.

4.2 Offshore RMB forward market implied RMB depreciation in the future, and correlation between

Figure 5.14 Onshore and Offshore RMB Exchange Rate Movements in 2012



Note: Except CPR, all rates use daily closing prices.
Source: Reuters.

onshore and offshore markets was high with developments in the onshore spot market exerting an influence on the offshore spot market.

In the past, offshore (CNH) spot rate curve was generally under the onshore (CNY) spot rate curve. But it was not the case in 2012. The two curves intersected during 2012, and spread between offshore and onshore rates was 50 bps, narrowing dramatically compared with the 172 bps spread in 2011. During January-February period, CNH and CNY spot rates were lower than the central parity rates (CPR), since market sentiment turned positive due to temporary improvement in EU fundamentals, and China's foreign trade data beat market expectations. CNH and CNY rates then moved higher than CPR till September during which period the interest rate spread between China and the U.S. narrowed and China's economy showed signs of slowdown. After mid-September, the U.S. FED implemented QE3, China's economy bottomed up apparently and companies sold U.S. Dollar holdings previously bought on expectation of RMB depreciation when approaching the year-end. As a result, CNY spot rates moved much higher than CPR, and even continuously touched the upper limits of the floating band. As for forward market movements, forward curve generally stood beyond the spot curve except few transaction days, implying RMB depreciation in the future. Such depreciation expectation remained even when onshore CNY spot rates touched upper limits after mid-September. Therefore, it's fair to say that present RMB exchange rate stands closer to the equilibrium level.

We conducted analysis on links between onshore (CNY) and offshore (CNH) spot rates, as well as onshore (CNY) and offshore (CNH & NDF)

Table 5.1 Correlations between Onshore and Offshore RMB Exchange Rates

	CNY	CNH	CNH1Y	CNY1Y	NDF1Y
CNY	1.000000	0.988005	—	—	—
CNH	0.988005	1.000000	—	—	—
CNH1Y	—	—	1.000000	0.854662	0.915618
CNY1Y	—	—	0.854662	1.000000	0.883638
NDF1Y	—	—	0.915618	0.883638	1.000000

Table 5.2 Granger Causality Analysis Results

Null Hypothesis	Obs	F-Statistic	Probability
CNY1Y does not Granger Cause CNH1Y	231	0.64973	0.52316
CNH1Y does not Granger Cause CNY1Y		7.08875	0.00103
NDF1Y does not Granger Cause CNH1Y	253	2.47125	0.08656
CNH1Y does not Granger Cause NDF1Y		0.35076	0.70450
NDF1Y does not Granger Cause CNY1Y	234	10.7939	3.3E-05
CNY1Y does not Granger Cause NDF1Y		2.30489	0.10208
CNY does not Granger Cause CNH	231	15.2940	5.9E-07
CNH does not Granger Cause CNY		2.98699	0.05243

forward rates, all using 1-year forward rates and daily closing prices. Analysis results showed that, correlation between onshore and offshore spot rates was as high as 0.988, and correlation between corresponding forward rates also presented strong positive relations, indicating close linkage between onshore and offshore markets. As regards forward market, there existed arbitrage channels between CNH and NDF markets, cross market capital flow was relatively smooth, thus inter-market relation was stronger.

According to Granger Causality analysis, onshore (CNY) spot rate Granger-caused offshore (CNH) spot rate using 99% confidence interval, meaning that the developments in the onshore spot market exerted an influence on the offshore spot market. As for 1-year forward rates, CNH rate and NDF rate both Granger-caused onshore CNY rate, while CNH and NDF rates exerting no influence on each other. These were explained by the fact that forward rate reflected market participants' expectation on RMB exchange rate movements in the future, whereas onshore market was less developed in that sense. Onshore market is lack of speculative forces with participants' involvement mainly out of their actual needs. Therefore, the onshore market potential has not been fully exploited.

Part VI Gold Market

In 2012, the international gold price increased slightly amid wide fluctuation. With the trend of gold price moving from big ups and downs in 2011 to volatile fluctuations in 2012, the gold trading volume on Shanghai Gold Exchange (SGE) and Shanghai Futures Exchange (SHFE) declined slightly year-on-year. Domestic demand for physical gold remained strong, and gold business of commercial banks was characterized by diversity. Other proprietary gold business of commercial banks showed positive growth, except personal account gold business. Agent branded gold, gold accumulation and leasing, as well as domestic gold derivatives business increased rapidly. With formal launch of the interbank gold inquiry transactions and the strengthening of banking financial institutions gold market business administration, gold market and product systems were further enriched and improved. Looking ahead, the development of gold market requires further strengthening of institutional infrastructure construction, increased education of gold market investors, as well as strengthening of gold market innovation.

1. Gold market performance

1.1 SGE spot gold market performance

1.1.1 Gold price fluctuated at a high level and the trading scale declined slightly

In 2012, spot gold prices on the SGE rose slightly with fluctuation at a high level. Take spot trade product Au99.99 for example, the price opened at 328.45 yuan per gram earlier 2012, hit the maximum of 363 yuan per gram and the minimum of 312.69 yuan per gram. It closed at 334.5 yuan per gram at the year-end, an annual growth of 4.6% year-on-year. In 2012, the cumulative trading volume of all types of gold products on the SGE reduced by 1088.26 tonnes, decreasing 14.63% year-on-year to 6350.20 tonnes. The cumulative turnover dropped 326.583 billion yuan, decreasing 13.18% year-on-year to 2.150634 trillion yuan. The average daily trading volume declined 14.30% year-on-year to 26.13 tonnes.

1.1.2 Fund clearing and physical delivery operated steadily

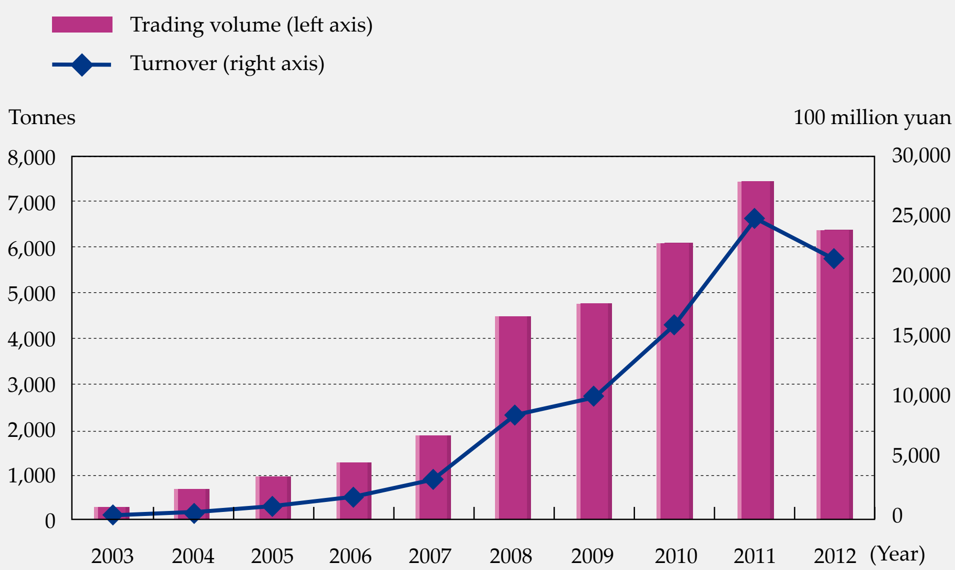
In 2012, the annual clearing on the SGE rose 185.2 billion yuan, increasing 19.65% year-on-year to 1.1279 trillion yuan. In particular, the clearing volume of proprietary and agent businesses was 700.2 billion yuan and 427.7 billion yuan, accounting for 62.08% and 37.91% respectively. The average daily fund clearing and stock value of membership deposit totaled more than 1100 transactions and 4.642 billion yuan.

The vaults of SGE enjoyed smooth performance. 49 vaults in 34 regions had been put into use, and the using rate reached 71.01%.

1.1.3 Member structure remained stable, and market participants continued to grow

In the end of 2012, the members of SGE totaled 166, including 21 Chinese bank members, 8

Figure 6.1 Gold Trading Volume and Turnover on SGE



Source: SGE.

foreign-funded bank members, 4 non-banking financial members, 130 general members and 3 proprietary members. At year-end, the number of corporate clients and individual clients on SGE totaled 9230 and 3.3539 million, increasing 14.6% and 42.8% respectively over 2011.

1.1.4 System construction and risk management were further improved

In 2012, the SGE regarded serving its members and real economy as the aim, further improved system construction, reinforced risk management and guaranteed interests and benefits of market participants. On the one hand, related management systems and business regulations were formulated or improved. For example, *Implement Rules for Overdue Charge System of Shanghai Gold Exchange* was formulated. *Administrative Measures for Emergency Transactions of Shanghai Gold Exchange, Administrative Measures for Membership Invoice Management of Shanghai Gold Exchange, Administrative Measures for Assisted Pledge of Shanghai Gold Exchange* and *Administrative Measures for Physical Lease of Shanghai Gold Exchange* were revised. On the other hand, based on market changes and market risks, risk control measures, such as adjusting overdue charge rate, increasing margin rate and adjusting fluctuation limits, had been adopted many times to reinforce risk management and protect interests of market participants.

1.2 SHFE gold futures market performance

1.2.1 Price of gold futures and spot gold were highly linked

In 2012, dominant contract of gold futures on the SHFE opened at 328.98 yuan per gram on the first trading day. Lowest and highest price of 2012 reached 313.72 yuan per gram and 366.03 yuan per gram respectively. It closed at 340.29 yuan per gram at year-end, with cumulative growth of 3.44%. After calculation, the correlation coefficient of the price of dominant contract of gold futures on SHFE and COMEX dominant contract of gold futures, as well as spot price of Au (T+D) on SGE was 96.72% and 99.09% respectively, which proved close linkage between each other. Among 243 trading days of 2012, 236 trading days saw the price of gold futures exceeding the price of spot gold. Excluding direction, the average spread of gold futures and spot gold reached 2.79 yuan per gram, higher than average spread of 1.56 yuan per gram in 2011.

1.2.2 Trading volume of gold futures underwent year-on-year decline

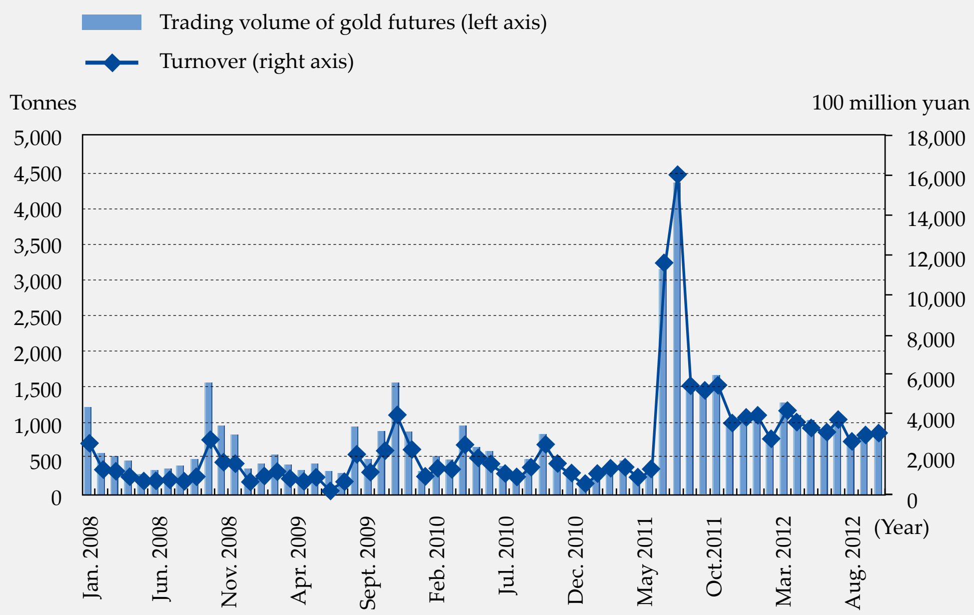
Calculated by bilateral basis, cumulative trading volume of gold futures contract on SHFE in 2012 decreased 18.07% year-on-year to 11.83349 million lots (about 11833.49 tonnes), and the cumulative turnover declined 20.82% year-on-year to 4.036437 trillion yuan, accounting for 4.53% of total turnover of SHFE. Annual average daily trading volume of gold futures reached 48,700 lots (about 48.7 tonnes), and the average daily turnover was 16.611 billion yuan.

1.2.3 Open interest and delivery volume of physical gold grew tremendously

In 2012, the average daily open interest of gold futures dominant contract increased 60.15% year-on-year to 98,856 lots (98.86 tonnes), and the year-end open interest increased 11.33% year-on-year to 109,076 lots (109.08 tonnes). The ratio of average daily open interest to average daily trading volume increased from 1.04 in 2011 to 2.03 in 2012. The increase of open interest indicated the growing inflow of funds into the market.

In 2012, delivery volume of gold futures increased 2.55 times year-on-year to 2,577 kilograms, and average monthly delivery volume reached 214.75 kilograms. The ratio of annual delivery volume to unilateral trading volume rose from 0.01% in 2011 to 0.044% in 2012.

Figure 6.2 Monthly Trading Volume and Turnover of Gold Futures, 2008—2012



Source: SHFE.

1.3 Commercial banks gold business performance

1.3.1 Proprietary and agent gold business declined slightly

In 2012, the total trading volume of commercial banks on SGE reduced by 1,212 tonnes, decreasing 25.25% year-on-year to 3,588.55 tonnes (including proprietary and agent business). The gold trading of commercial banks accounted for 56.51% of total gold trading volume of SGE, decreasing 7.36 percentage points over 2011. In the same period, the trading volume of proprietary business of commercial banks on SHFE totaled 448.3 thousand lots, accounting for 3.79% of the total trading volume of gold futures.

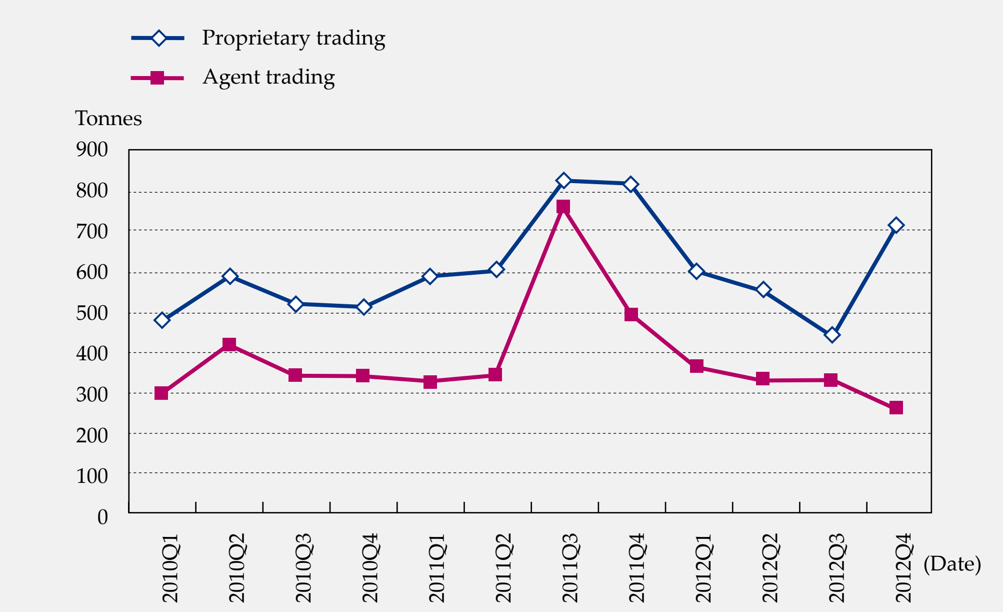
(1) Proprietary business

In 2012, the cumulative trading volume of commercial banks proprietary business on SGE dropped 529.66 tonnes, decreasing 18.69% year-on-year to 2,304.46 tonnes. According to annual transactions, the proprietary gold trading volume of commercial banks continued to decline in the first three quarters, and started to recover in the fourth quarter because of the carry-over effects. It increased by 62% to 711.97 tonnes in one quarter. In terms of gold futures proprietary trading, a total of 9 commercial banks participated in gold futures proprietary trading on SHFE, and the cumulative trading volume rose 47.18% year-on-year to 448.3 thousand lots (about 448.3 tonnes).

(2) Agent business

Since the third quarter of 2011, commercial banks agent business of SGE continued to decline in five quarters. In 2012, the cumulative trading volume dropped 633.03 tonnes, decreasing 34.7% year-on-year to 1284.09 tonnes. In particular, cumulative trading volume of agent of enterprise business declined 15.96% year-on-year to 386.91 tonnes. The cumulative trading volume of agent of personal business decreased 40.43% year-on-year to 897.18 tonnes. Agent of individual business of commercial banks accounted for 69.87% of total agent business volume, decreasing 6 percentage

Figure 6.3 Quarterly Trading Volume of Spot Gold Business of Commercial Banks, 2010—2012



Source: SGE.

points over 2011. In 2012, cumulative trading volume of personal agent business of SGE spot physical gold offered by commercial banks declined 25.82% year-on-year to 80.24 tonnes, 27.93 tonnes less than 2011. The cumulative trading volume of personal agent business of Au (T+D) on SGE decreased 41.56% year-on-year to 816.94 tonnes, 580.94 tonnes less than 2011.

1.3.2 Domestic proprietary gold businesses maintained growth momentum

In 2012, the cumulative trading volume of domestic proprietary gold businesses of commercial banks increased 5.21% year-on-year to 2784.43 tonnes. Most proprietary gold businesses presented growth momentum, except personal account gold business (including U.S.dollar & RMB) decreasing 20.59% year-on-year. In particular, businesses of agent branded gold, gold accumulation, gold leasing and domestic gold derivatives grew fast.

Physical gold business maintained steady growth. In 2012, the cumulative trading volume of physical gold business, including proprietary branded gold, agent branded gold and gold accumulation (automatic gold investment plan), increased 18.44% year-on-year to 196.575 tonnes with the turnover rising 25.09% year-on-year to 69.071 billion yuan. In particular, the trading volume of proprietary branded gold declined 2.5% year-on-year to 126.24 tonnes, accounting for 64% of total physical gold business of commercial banks. The cumulative trading volume of agent branded gold increased 71% year-on-year to 10.54 tonnes and the cumulative trading volume of gold accumulation (automatic investment plan of gold) rose 97% year-on-year to 59.84 tonnes, accounting for 5.36% and 30.44% of total physical gold business respectively.

Gold leasing business continued to grow rapidly. Gold leasing business included two parts: interbank gold lending among commercial banks and gold leasing between commercial banks and enterprise clients. In 2012, the cumulative trading volume of interbank gold lending business increased 71.3% year-on-year to 54.8 tonnes with the turnover rising 78.45% year-on-year to 18.723 billion yuan. In the same period, the cumulative trading volume of gold leasing business of commercial banks totaled 465.01 tonnes with a turnover of 158.374 billion yuan, increasing 54.33% and 63.18% respectively.

Gold pledged business enjoyed fast development. Gold pledged business belonged to financing gold business, which generally granted loans as per 70%-80% value of pledged gold. In 2012, commercial banks accepted 7.42 tonnes of pledged gold cumulatively, increasing 62.66% year-on-year.

Domestic gold derivatives business achieved robust growth. Domestic OTC gold derivative business of commercial banks was mainly U.S. dollar gold forward. It also included U.S. dollar gold option business, U.S. dollar gold swap business and RMB gold forward business. In 2012, cumulative trading volume of various domestic gold derivatives totaled 469.74 tonnes, increasing 2.37 times year-on-year over 2011, of which U.S. dollar gold forward increased 2.27 times year-on-year to 414.14 tonnes.

Personal account gold business declined slightly. In 2012, the cumulative trading volume of personal account gold of commercial banks decreased 20.59% year-on-year to 1590.89 tonnes, 412.607 tonnes less than 2011. In particular, cumulative trading volume of gold through U.S. dollar account declined 5.11% year-on-year to 131.99 tonnes, with the turnover decreased 4.44% year-on-year to 44.4195 billion yuan. The cumulative trading volume of gold through RMB account decreased 21.75% year-on-year to 1,458.89 tonnes, with the turnover dropped 21.12% year-on-year to 494.718 billion yuan.

1.3.3 Derivatives trading in offshore gold business grew rapidly

At present, varieties of offshore gold business engaged by commercial banks mainly include gold spot, gold forward, gold swap, as well as small amount of gold option business. In 2012, the cumulative trading volume of offshore gold business of commercial banks increased 2.72% year-on-year to 4,160.83 tonnes, with the turnover increased 8.37% year-on-year to US$223.5114 billion. Viewed from product structure, the trading volume of gold spot business incurred with purpose of position management decreased significantly. In 2012, the cumulative trading volume of offshore gold spot business decreased 18.15% year-on-year to 2,188.31 tonnes. Offshore gold forward business and offshore gold swap business with main purpose of hedge and arbitrage enjoyed fast growth. In 2012, the cumulative trading volume of offshore gold forward and offshore gold swap business totaled 935.18 tonnes and 1,017.96 tonnes, increasing 15.83% and 83.78% year-on-year respectively. In the same period, the cumulative trading volume of offshore gold option business totaled 1.37 tonnes, increasing 4.5 times year-on-year.

2. Analysis of gold price movement in 2012

2.1 Gold price fluctuated within a wide range

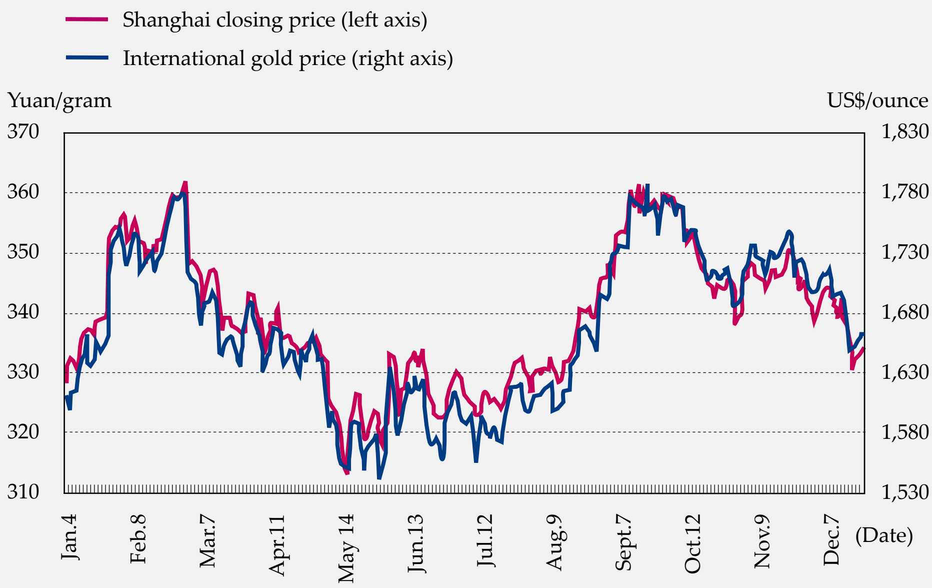
In 2012, international gold price fluctuated within a wide range, but did not break previous high point. The movement of gold price in the year presented the "M" shape and could be roughly divided into three stages: First, from the beginning of 2012 to late-May, international gold price fell fiercely after rising quickly; Second, from the beginning of June to mid-August, gold price remained stable without wide fluctuations; Third, from mid-August to the year-end, gold price climbed and dropped again. In early-January, international gold price opened at US$1,590 per ounce. It hit the high of US$1,781 and US$1,791 per ounce respectively on February 28 and October 4 without exceeding the historical high point of US$1,895 per ounce in 2011. International gold price declined within a wide range after flushing high twice. It went down to the bottom of US$1,540 per ounce on May 30. From June to August, international gold price fluctuated repeatedly between US$1,556 and US$1,635 per ounce. At year-end, international gold price closed at US$1,664 per ounce, increasing 5.68% year-on-year.

In 2012, almost moving in the same way as the international gold market, the domestic gold price fluctuated at a high level. The price of Au99.99, main product of spot trading at the SGE, rose quickly in the first trading day after opening at 328.45 yuan per gram. It climbed to the peak of 363 yuan per gram on February29, dropped violently to the bottom of 312.69 yuan per gram on May 16. From that time on, domestic gold price fluctuated with international gold price for more than two months. In early-September, domestic gold price started to rise again. It climbed to 362.99 yuan per gram on September 18, the high point in the second half of the year, and then declined promptly. The price closed at 334.5 yuan per gram at the year-end, an annual growth of 4.6% year-on-year.

2.2 Main factors influencing gold price movement

First of all, fragile prospect of economic recovery of the U.S. and fluctuation of U.S. dollars index increased uncertainty of gold price movement.

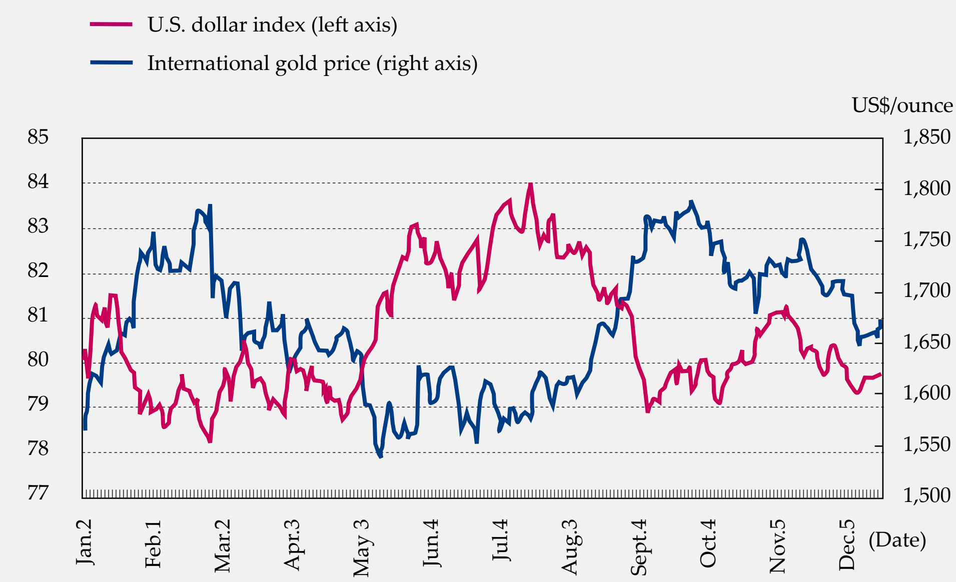
Figure 6.4 International Gold Price Movement in 2012



Note: The data for the international gold price is the London afternoon fix and the data for domestic gold price is the closing price of Au99.99 on the SGE.
Sources: London Bullion Market Association and SGE.

Although American economy experienced certain recovery in 2012, it still faced with problems, such as upper limit of debt and "fiscal cliff", and the prospect of economic recovery was fragile. In addition, fluctuation of dollar index (see Figure 6.5) increased uncertainty of gold price movement on the one hand, and made investors more cautious in gold market transaction on the other hand. Second, continued loose monetary policy of developed economies, such as the U.S., Europe and Japan, as well as emerging market countries, such as Brazil, had become an important factor affecting the gold price movement. In particular, the U.S. policy of quantitative easing in the short term might result in excessive adjustment of gold demand and corresponding price change. The policy in the long term might push up gold price. Third, increase of gold reserve of central banks would support gold price to certain extent. In 2011, total volume of gold purchase of global central banks exceeded 400 tonnes, and the volume in the first three quarters of 2012 reached 343.7 tonnes. Emerging market countries, such as India, Russia and Turkey, had increased gold reserve in recent years, whereas the size of gold sales of western protocol gold-selling countries decreased continuously. Fourth, evolution of European debt crisis increased short-term fluctuation of gold price. At early stage of the crisis, driven by market demand for hedging, gold price rose slightly. Later with deterioration of debt crisis, financial institutions had to sell quality assets in big quantities, such as gold for insufficient liquidity, which further suppressed gold price. On the whole, with improvement of American economy, the upward trend of international gold price weakened. Gold price movement in the future will still be influenced by global economy and U.S. dollar index. Before signs of stable growth of global economy appear, uncertainty of international gold price movement is still quite big.

Figure 6.5 Comparison of International Gold Price with U.S. Dollar Index



Note: The data for the international gold price is the Reuters XAU daily closing price and the data for U.S. dollar index is the daily closing price.
Source: Reuters.

3. Characteristics of gold market development in 2012

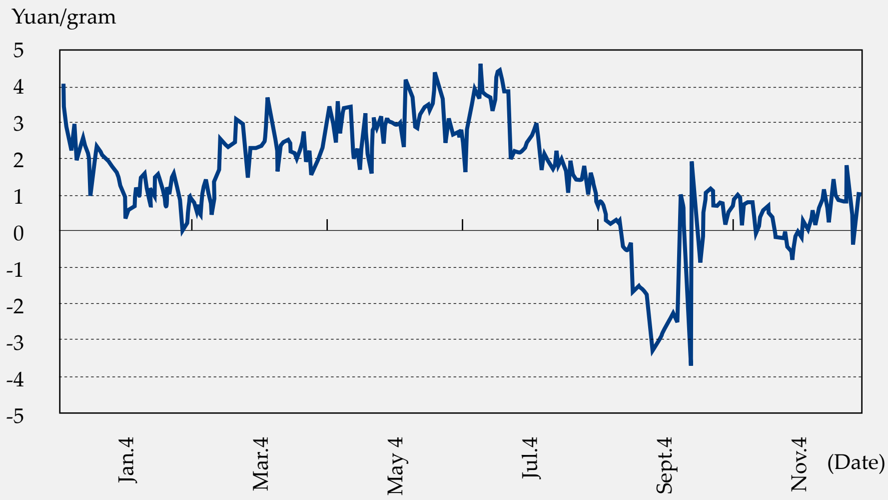
3.1 Gold price fluctuation amplitude narrowed, and the difference between domestic and foreign gold prices widened continuously

In 2012, the maximum of international gold price reached US$1,791.75 per ounce, far less than the historical record of US$1,895 per ounce in September 2011. In the same period, fluctuation amplitude of domestic gold price (price difference between the highest and lowest prices) decreased from 110.5 yuan per gram in 2011 to 50.31 yuan per gram. In terms of difference of domestic and foreign gold price, among 243 trading days in 2012, 218 days saw domestic gold price exceeding international gold price, of which 156 days saw the price difference exceeding 1 yuan per gram, 12 days more than previous year, and maximum price difference even reached 4.56 yuan per gram (July 12). Regardless of the direction of price difference, average difference between domestic and foreign gold prices increased 9% year-on-year to 1.79 yuan per gram in 2012, and had widened for four consecutive years. In terms of price difference fluctuation, when gold price fluctuated within a wide range in a short period, domestic fluctuation of gold price was often less than that of international gold price, which resulted in lower domestic gold price while international gold price rose rapidly and higher domestic gold price while international gold price dropped promptly. This reflected strong domestic demand on physical gold on the one hand and lower price sensitivity of domestic gold market than that of international gold market.

3.2 Demand for gold transactions declined, and demand on physical gold remained strong

Because of repeated fluctuation of gold price,

Figure 6.6 Movement of Domestic-International Gold Spread in 2012



Source: SGE.

obvious trend had not been formed. Increased uncertainty of gold price fluctuation resulted in shrinking short-term gold trading demand aimed at achieving earnings from price difference. In 2012, cumulative trading volume of domestic gold futures decreased 18.07% year-on-year to 11833.49 tonnes. Cumulative trading volume of spot gold deferred products on SGE declined 21.32% year-on-year to 4,225.53 tonnes. Similar changes appeared in over-the-counter (OTC) gold trading. Cumulative trading volume of personal account gold business of commercial banks, dominant OTC gold trading product, dropped 20.59% year-on-year to 1,590.89 tonnes in 2012.

On the other hand, influenced by anticipated inflation, long term gold investment demand aimed for hedging was still vigorous, which was reflected in following aspects: First, gold ex-vault and delivery volume on SGE increased steadily. In 2012, gold ex-vault volume of SGE increased 9.2% year-on-year to 1138.96 tonnes, 95.92 tonnes more than 2011. Gold delivery rate increased 5.81 percentage point year-on-year to 35.87%. Second, total turnover of physical gold of commercial banks grew continuously. In 2012, cumulative trading volume of physical gold business, including proprietary branded gold, agent branded gold and gold accumulation (automatic investment plan of gold), increased 18.44% year-on-year to 196.575 tonnes with the turnover rising 25.09% year-on-year to 69.071 billion yuan. Third, physical gold consumption grew sharply. During the past 10 years, domestic gold consumption increased from 204.5 tonnes in 2002 to 761.05 tonnes in 2011, of which consumption of bullions increased fastest. In 2011, 213.85 tonnes of gold was consumed for bullions, increasing 50.7%[1] year-on-year.

1 Source: China Gold Association, *China Gold Yearbook*.

3.3 Active degree of spot gold transaction on exchange of commercial banks declined slightly

In 2012, trading volume of proprietary business and agent business of commercial banks on SGE decreased 25.25% year-on-year to 3588.52 tonnes with the trading share declining from 64.5% in 2011 to 56.5%. There were several reasons for wide margin decrease of spot gold transaction on exchange of commercial banks: First, Influence of gold price. In 2012, gold price fluctuation tended to weaken with a decreasing fluctuation of price difference between domestic and international price, which reduced the willingness of commercial banks for proprietary business, as well as the motive of individual clients for floor trading accordingly. In 2012, trading volume of proprietary business and agent business of commercial banks on SGE decreased 18.69% and 34.7% year-on-year respectively. Especially in the third and fourth quarters of 2012, trading volume of agent business of commercial banks decreased 56.8% and 46.3% year-on-year respectively. Second, substitution effect of gold futures. Au (T+D) and gold futures, which had certain effect of substitution, had characteristics of leverage trading. Third, trading strategy adjustment. Influenced by changes in market conditions and intensified competition, commercial banks had adjusted trading strategy. Some share-holding banks increased the intensity of gold proprietary trading. For example, proprietary trading of spot gold or gold futures of institutions, such as Bank of Shanghai and Shanghai Pudong Development Bank, increased rapidly. However, trading scale of state-owned commercial banks and foreign-funded banks shrank at a wide range due to decreased fluctuation of gold price difference and increased difficulty of cross-market arbitrage.

4. Construction of gold market systems and infrastructure facilities

4.1 Clear-up of illegal gold exchange was steadily promoted to standardize market order

At the end of 2011, People's Bank of China issued *Notice on Reinforcing Management on Gold Exchanges or Gold Business Trading Platform* (PBC document No.301, 2011) together with related ministries. In 2012, People's Bank of China took effective measures to clear up illegal gold exchange places. Hunan Weicai Precious Metal Exchange and other illegal gold trading places had stopped gold trading. Meanwhile, People's Bank of China issued administrative confirmation on multiple cases of illegal gold trading together with relevant departments, and took concerted action with public security organs to strike illegal gold trading effectively. In addition, People's Bank of China organized market institutions to strengthen propaganda of formal gold investment channels and promote stable and healthy operation of gold market.

4.2 Gold business administration of financial institutions was reinforced to promote healthy market development

In December 2012, People's Bank of China Beijing Headquarters issued *Notice on Related Issues of Reinforcing Gold Market Business Administration of Banking Financial Institutions* (PBC office document No.238, 2012, hereinafter referred to as the *Notice*), which required banking financial institutions that conduct gold market business to report business conditions to People's Bank of China regularly. The *Notice* demanded a record filing management system for gold market business of banking financial institutions and further improvement of statistical and monitoring system over gold market business. Release of the

Notice had important significance in standardizing gold market business of commercial banks and facilitating orderly development of floor and OTC gold markets.

4.3 Interbank gold inquiry transaction was launched to improve market functions

To satisfy the need of large amount interbank gold trading, pushed and supported by People's Bank of China, the SGE and China Foreign Exchange Trade System (CFETS) jointly launched online interbank gold inquiry business on December 3. Market participants could handle gold trading through foreign exchange trading system of CFETS in the form of bilateral inquiry, and handle liquidation and delivery through SGE. Interbank gold inquiry business met the need of diversified investment of gold market investors, enriched market trading patterns, deepened market functions, and was beneficial for formation of multi-level gold market trading system.

The listing varieties of interbank gold inquiry transactions included AUX.CNY and AUY.CNY, corresponding to underlying trading of gold with purity no less than 99.95% and 99.99% respectively. There were 20 Chinese and foreign banks that were first approved to handle interbank gold inquiry business, namely, Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, Construction Bank of China, Shanghai Pudong Development Bank, China Merchants Bank, China CITIC Bank, Ping An Bank, Bank of Communications, Bank of Shanghai, Guangdong Development Bank, Industrial Bank Co., Ltd., Evergrowing Bank Co., Ltd., Xiamen Bank, Bank of Beijing, Shanghai Rural Commercial Bank, HSBC, Standard Chartered Bank, Australia and New Zealand Banking Group Limited and United Overseas Bank. On the first day of trial online operation of interbank gold inquiry business, 13 banks participated in 30 transactions with the trading volume reaching 3.62 tonnes of gold. Up to end-2012, cumulative trading volume of interbank gold inquiry business totaled 14.31 tonnes with the turnover reaching 4.881 billion yuan.

5. Outlook for gold market development

Construction of laws, regulations and systems for gold market should be vigorously promoted to improve gold business management of financial institutions, establish and improve gold business record filing system and market supervision system of financial institutions. Gold trading system management should be reinforced to improve various systems and regulations, ensure safe trading and standardized operation of market earnestly. Disposal mechanism over illegal gold transaction and gold derivatives transaction involved by relevant departments should be established and improved to consolidate results of striking illegal gold transaction. Gold derivative products quoted by RMB should be developed actively and gold leasing market should be further developed. Interbank gold inquiry business should be improved continuously to increase liquidity of gold market. All-round financial services offered by commercial banks to gold enterprises should be encouraged and gold pledge financing and gold forward business should be launched combining with the needs of industrial development and market development. We should adopt various methods to propaganda and interpret knowledge of gold market to make investors understand significance of investment on gold market correctly, and strengthen risk warning to assist investors to evaluate benefits and risks of investment on gold market correctly and rationally, guide investors to invest on gold through compliance channels.

Part VII Futures Market

China's futures market witnessed stable development in 2012. With strengthened legal system building, commodity futures further diversified, stock index futures saw higher degree of maturity, and innovations were put forward in futures companies. Amid rebounding market volume and turnover, the futures market played an increasingly important role in hedging risk and serving the real economy.

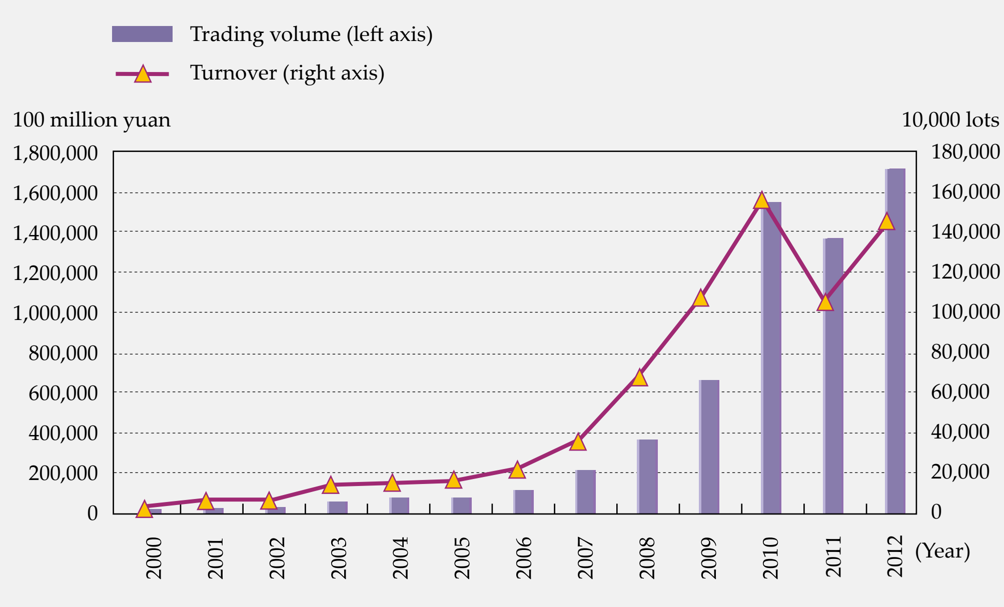
1.Futures market performance

1.1 Futures transaction surged in both volume and turnover

In 2012, trading volume of China's futures market reached 1.445 billion lots amounting to 171.12 trillion yuan, up 37.60% and 24.44% respectively year-on-year. The tick-up of futures market transaction was attributed to introduction of new futures type, enhanced business innovation, lowered trading cost and incremental fund into the market.

By futures exchange, transactions on the Shanghai Futures Exchange totaled 365 million lots to 44.60 trillion yuan, up 18.52% and 2.63% respectively year-on-year, with a proportion of 25.19% and 26.06% of the nationwide value.

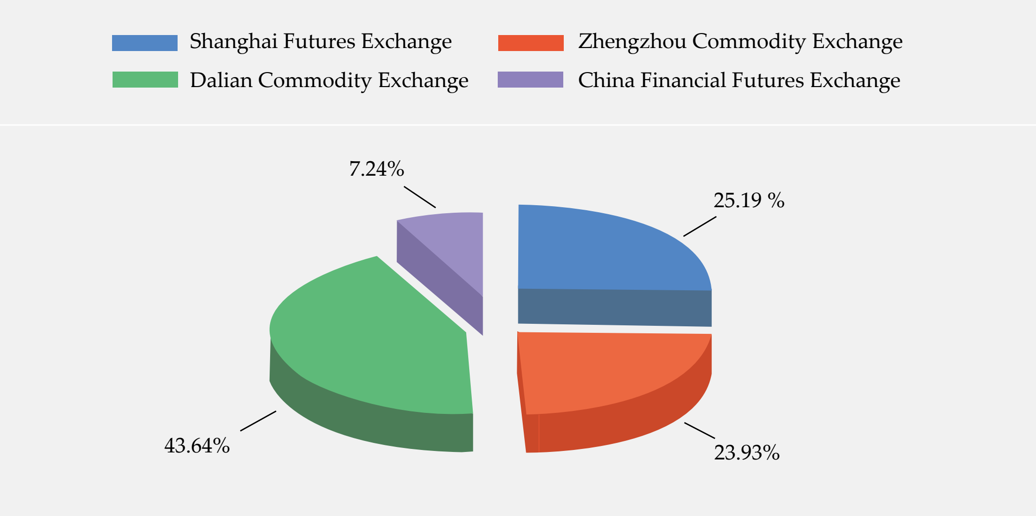
Figure 7.1 Trading Volume and Turnover of Futures Market, 2000—2012



Note: The statistics are single counted.
Source: China Futures Association.

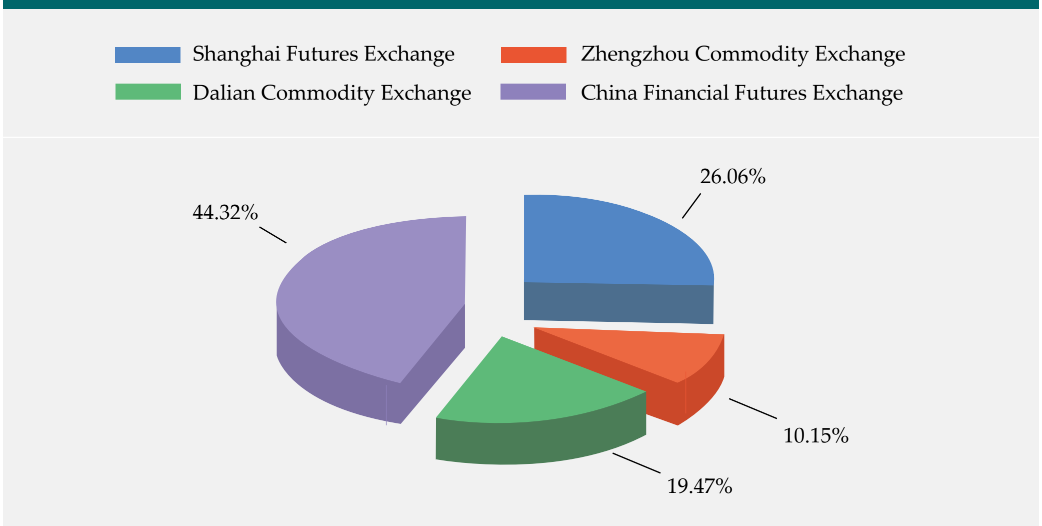
Transactions on the Zhengzhou Commodity Exchange reached 347 million lots with a turnover of 17.37 trillion yuan, down 14.61% and 48.04% respectively year-on-year, amounting to 23.93% and 10.15% of the nation. Transactions on the Dalian Commodity Exchange registered 633 million lots, realizing 33.32 trillion yuan, soaring 119.01% and 97.45% respectively year-on-year, proportioned 43.64% and 19.47% of the nation. Transactions on the China Financial Futures Exchange recorded 105 million lots with a turnover of 75.84 trillion yuan, surging 108.41% and 73.29% respectively, accounting for 7.24% and 44.32% of the nation market.

Figure 7.2 Breakdown of Trading Volume by Futures Exchanges in 2012



Source: China Futures Association.

Figure 7.3 Breakdown of Turnover by Futures Exchanges in 2012



Source: China Futures Association.

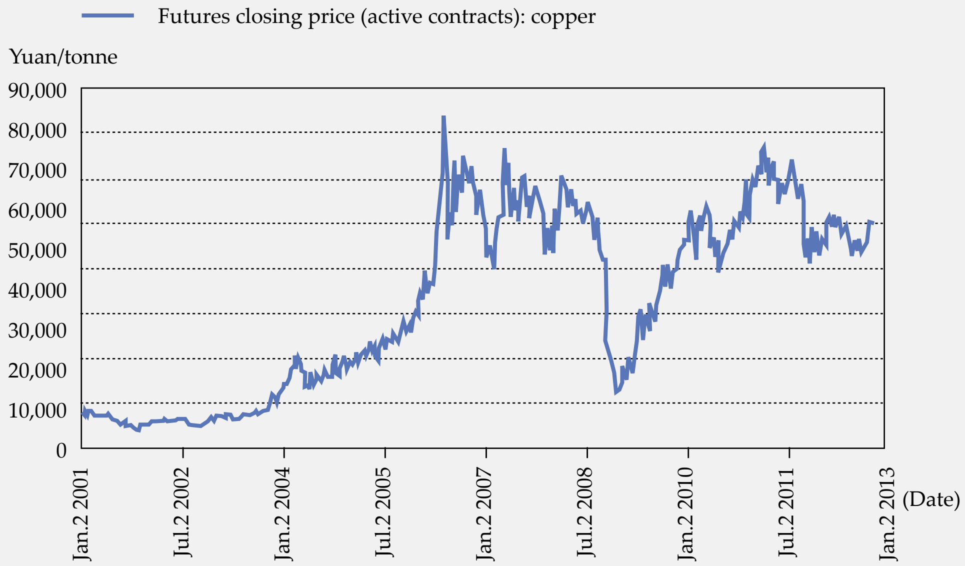
1.2 Commodity Futures rebounded following decline with significant divergence in transaction

Affected by the ongoing influence of the debt crisis in euro area, commodity prices appeared subdued in the first half of 2012, while due to a new round of quantitative easing policies in the U.S., Japan and euro area, market sentiment restored, which set the basis for commodity prices pick-up.

Figure 7.4 Price Movement of Natural Rubber

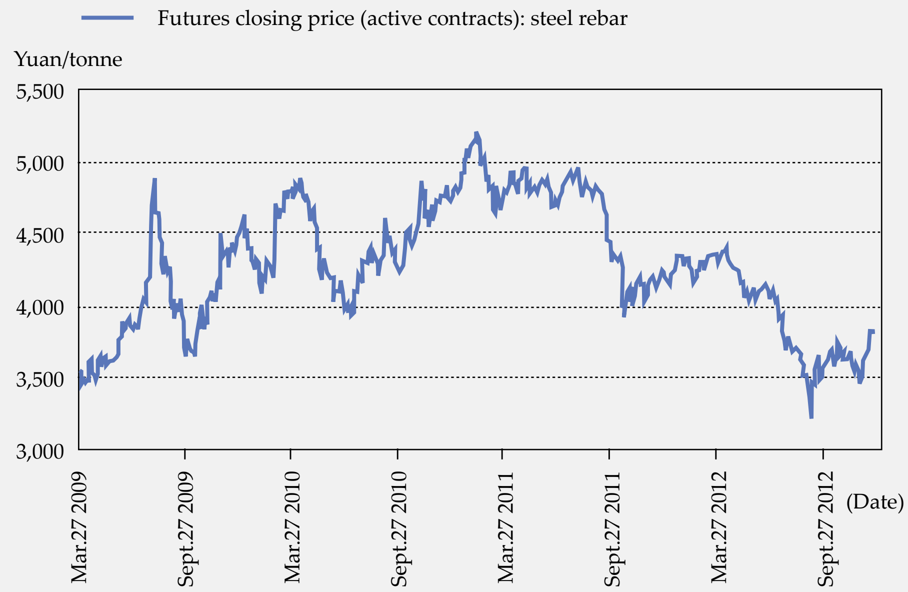
Source: Wind Info.

Figure 7.5 Price Movement of Copper



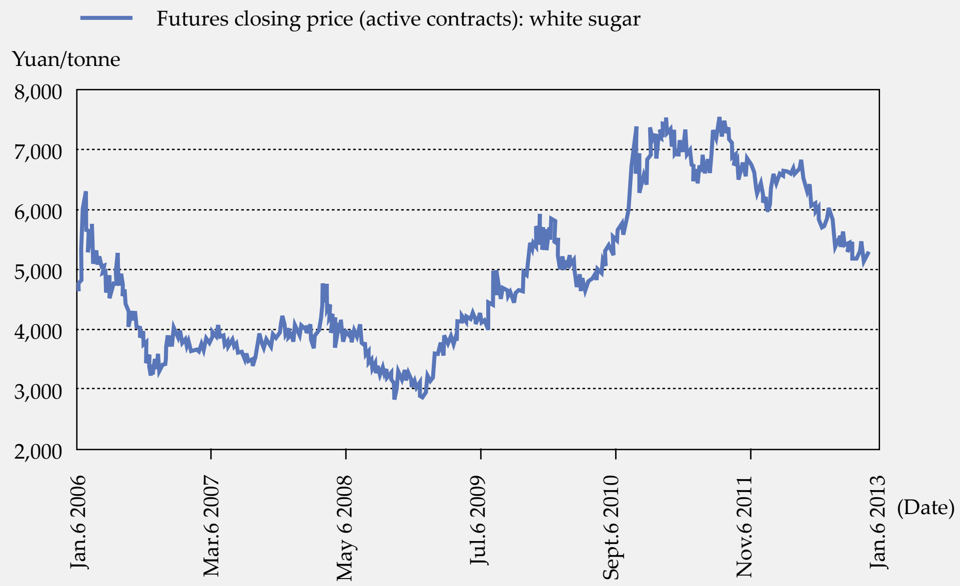
Source: Wind Info.

Figure 7.6 Price Movement of Steel Rebar



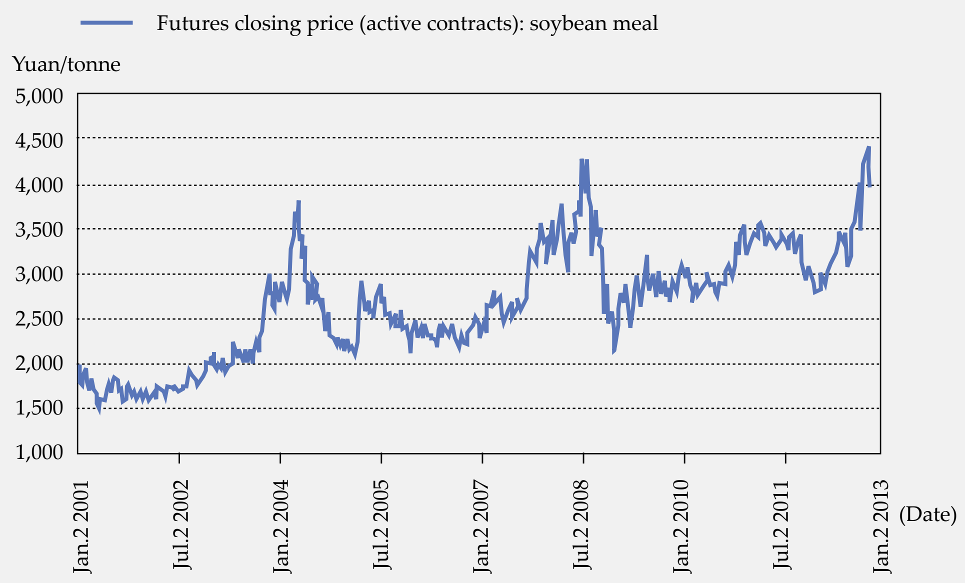
Source: Wind Info.

Figure 7.7 Price Movement of White Sugar



Source: Wind Info.

Figure 7.8 Price Movement of Soybean Meal

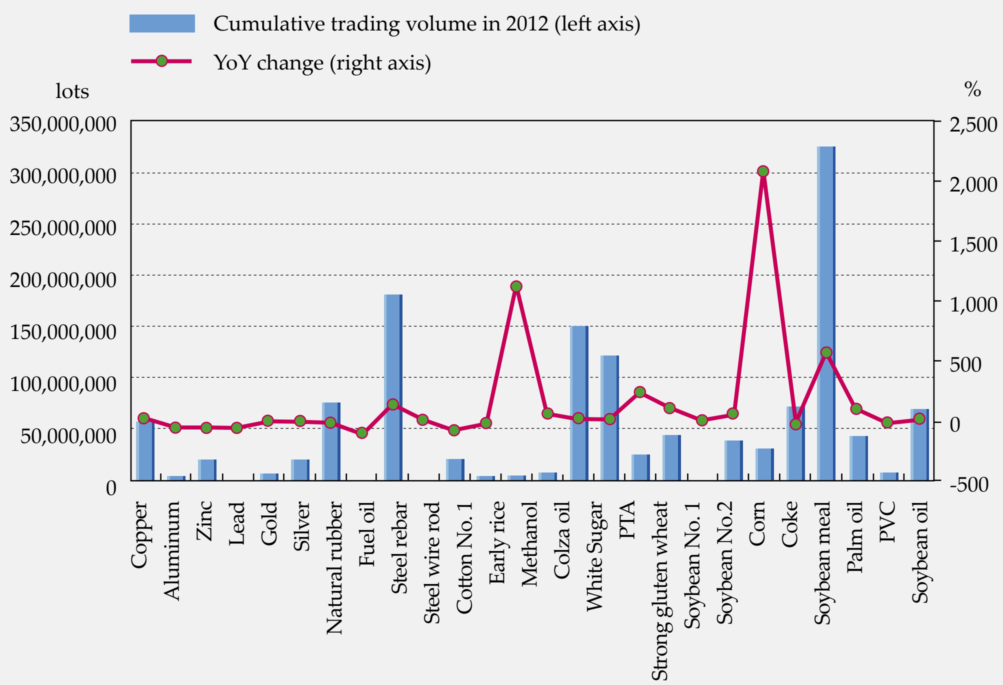


Source: Wind Info.

Regarding trading activity, soybean meal, steel rebar, white sugar, PTA, natural rubber, LLDPE, soybean oil, copper, soybean No. 1, and palm oil were rated top 10 in terms of trading volume among all 30 commodity futures products. Their trading volume reached 1.138 billion lots, accounting for 84.58% of the volume of all products. In terms of turnover, the top ten products registered copper, natural rubber, soybean meal, white sugar, steel rebar, soybean oil, coke, PTA, LLDPE and palm oil. Their total turnover recorded 81.80 trillion yuan with a proportion of 85.85% of all products.

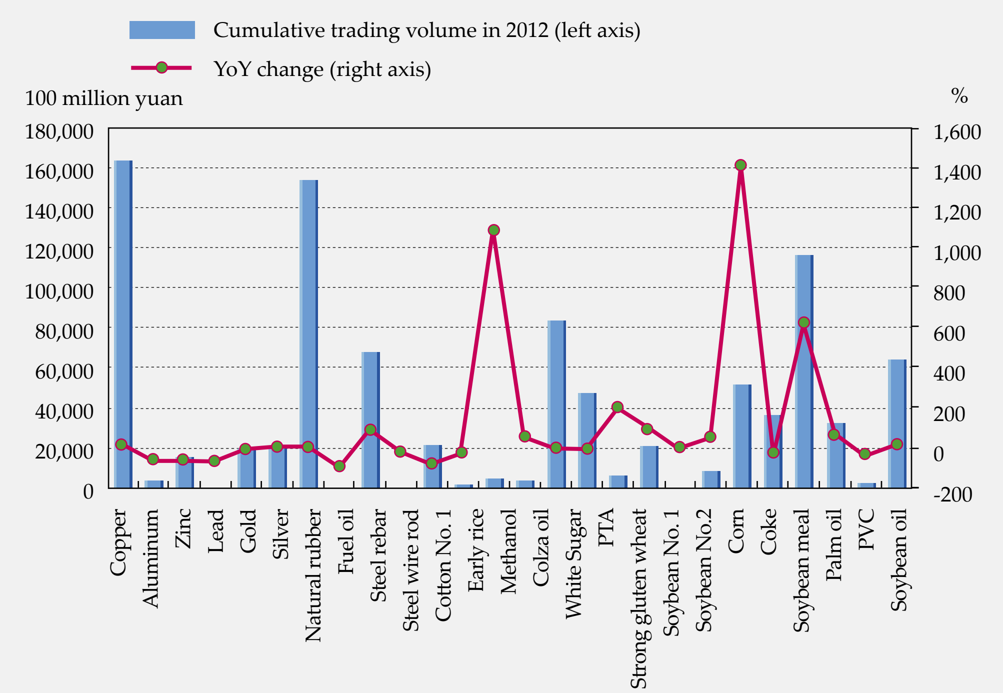
Regarding industries, among mental and industrial products, the copper's volume and turnover both recorded higher than the previous year, with its turnover amounting to 16.37 trillion yuan in 2012, up 9.41% year-on-year, accounting for 17.19% of all commodity futures products. Affected by cyclical market fluctuations, steel industry sped up the process of de-stocking in the second half of the year, which followed by inventory refilling. Transactions of steel rebar soared and realized 181 million lots in volume and 6.74 trillion yuan in turnover, up 120.51% and 81.25% respectively year-on-year. Most of other metal and industrial products recorded lower transactions to various degrees. Among agricultural products, due to droughts in foreign countries and other factors, most products saw active transactions. The trading volume of soybean meal reached 326 million lots, rocketing 549.54% year-on-year, accounting for 24.22% of all futures products, with 11.59 trillion yuan in turnover, soaring 612.24% year-on-year. Besides, palm oil, colza oil, soybean No. 1 and corn also registered surge in trading volume and turnover.

Figure 7.9 Trading Volume of Commodity Futures and YoY Change in 2012



Source: China Futures Association.

Figure 7.10 Turnover of Commodity Futures and YoY Change in 2012



Source: China Futures Association.

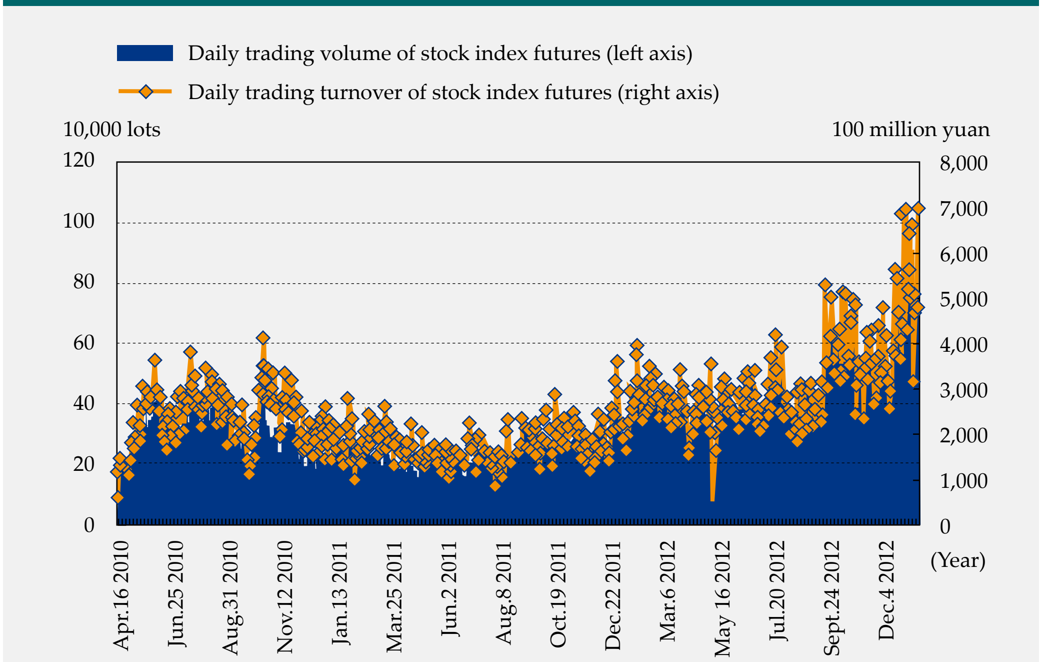
1.3 Stock index futures saw active transaction with a sharp increase of open position

Amid active transaction on CSI 300 index futures in 2012, both daily trading volume and turnover witnessed a big surge. Trading volume throughout the year reached 105 million lots with daily average of 432.4 thousand lots, soaring 109.3% year-on-year. Yearly turnover reported 75.84 trillion yuan, with daily average of 312.102 billion yuan, up 74% year-on-year. In particular, near month contracts, as rated the most active trading contracts, were dominant contracts, whose volume and turnover accounted for over 90% of the market. As a result, the overall market liquidity was further enhanced.

Futures and spot prices had a high correlation with the coefficient between dominant contracts and CSI 300 index reached 99.84%. The future-spot spread rate stood at relatively low level, within a volatility range between ±1%, dominated by positive spread, which reflected futures prices surplus spot prices, accounting for over 70% of trading days.

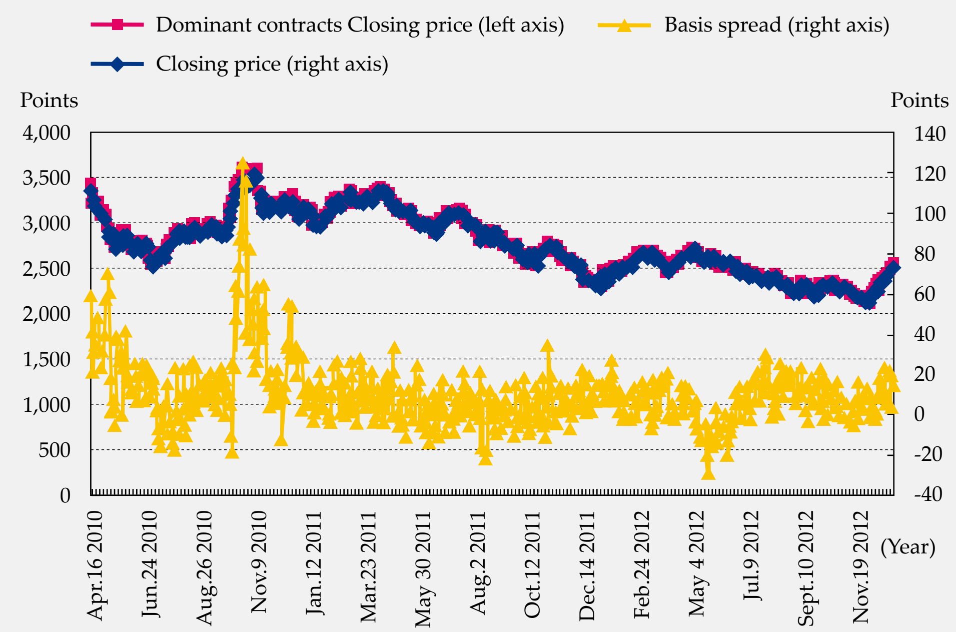
Accounts opening maintained steady and balanced rise, which was attributed to continued expansion of market participants. By the end of 2012, accounts opening totaled 127 thousand, among which 114 thousand had participated in transactions. Open position recorded a steady surge from 50 thousand lots at the year-beginning to 110 thousand lots at the year-end. Daily open position soared 94.5% year-on-year to 76.6 thousand lots. Average yearly ratio between trading volume and holding volume declined substantially to 5.69. Enlarged market participants with open positions and optimized position structure contributed to hedging risk against spot stock transactions and enhanced functions of futures market.

Figure 7.11 Daily Trading Volume and Turnover of Stock Index Futures since its Introduction



Source: China Financial Futures Exchange.

Figure 7.12 Futures and Spot Correlation and Basis Spread Movement since the Introduction of Stock Index Futures



Source: China Financial Futures Exchange.

Delivery volume remained low, reported 23,404 lots throughout the year with 1,950 lots on average and 0.02% of average delivery rate. In terms of the convergence of futures and spot prices, contract prices maintained steady movement, with slight flux around final settlement prices, which showed good convergence, without occurrence of "expiration effect" or excessive trading on contracts near expiration.

2.Features of futures market performance

2.1Futures market kept innovating

In 2012, futures market sped up progress and breakthrough in innovation of product type and business with gradual promotion in institutional building. With regard to the innovation of product type, silver futures were launched on Shanghai Futures Exchange in May 2012, which lengthened precious metals futures series, with a trading volume recorded 21.265 million lots and a turnover of 2.07 trillion yuan at the end of the year. New product types were added into industrial futures after glass futures contracts were approved to be trade on Zhengzhou Commodities Exchange in November 2012, which contributed to implementing the national development policy of promoting glass industry through market approach. The glass futures realized trading volume and turnover of 16.1369 million lots and 429.548 billion yuan respectively since its introduction in early December. Product line of agricultural futures was further enriched when China Securities Regulatory Commission (CSRC) made the approval of trading rapeseed and rapeseed meal futures contracts on Zhengzhou Commodities Exchange in December 2012. Combined with existing colza oil futures, the new progress helped to form complete futures types along rapeseed production chain, and to improve price formation mechanism. Thus, including these new futures, product types totaled 31 in China. On business innovation, futures companies launched pilot asset management business in September 2012, followed by the first 18 futures companies with approval in November. Futures bonded warehouse pledge was introduced in Yangshan Free Trade Port Area in April, which made a milestone in warehouse receipt financing. Shanghai Futures Exchange publicized SHFE-IMCI in December 2012, which provided a basic tool for commodity index investment and other index derivatives innovation in the future. On institutional innovation, the new *Administrative Regulations on Futures Trading* was revised and implemented. Risk hedging and arbitrage mechanism was further optimized, with transaction fees lowered twice, which remarkably reduced market operation cost. All these measures created sound conditions for futures market to better serve the real economy.

2.2 Stock index futures witnessed higher degree of maturity

Since its introduction in 2010, the margin standard of stock index futures trading has maintained at a relatively high level, with near month contracts and far month contracts at 15% and 18% respectively. However, all margin requirements on stock index futures were lowered to 12% on June 29, 2012, with trading fee adjusted downwards to 0.025‰, which remarkably reduced trading cost and encouraged transactions. Amid strengthened market liquidity, futures and spot prices showed a high correlation with steadily lowered ratio between trading volume and holding volume and enhanced market depth. Taking advantage of arbitrage and hedging business, a large number of securities companies, which engaged in proprietary trading and assets management, public offering funds, fund account and trust fund opened accounts and played an active role in futures market trading. Confronted with continued decline amid fluctuation of CSI 300, some special legal entities, mostly securities companies, managed risks by stock index futures to effectively hedge market risk and achieved sound return, which virtually reflects the risk management function of futures market. In addition, market innovation was sped up with enhanced trading layers and contents. 2012 witnessed much more stock index futures related product innovation, such as synthetic index fund, enhanced index fund, structured guaranteed products, absolute return products, portable Alpha products and so on. The stock index market was characterized by diversified trading strategies and individualized product innovation. Institutional investors shifted from traditionally high risk and directional investment to diversified low risk and steady return business pattern based on a neutral market strategy.

2.3 Futures companies strengthened competitiveness by acquisition and capital injection

In 2012, with enlarged business scope, futures companies launched pilot business on asset management, and obtained approval to establish subsidiaries, which provide risk management service. Amid a series of introduction of new business and fierce peer competition, merger and acquisition became a desirable means to expand business by futures companies, which helped to strengthen general counter-risk abilities, promote specialization of customer service and enhance core competitiveness. After merging Zhujiang Futures Company, Ltd. in 2011, China International Futures Company got approval to acquire Huayuan Futures by both shareholders conferences in September 2012, followed by the endorsement from SCRC in November. Besides, Green Futures has been undergoing its acquisition of Dahua Futures, its 100% capital subsidiary. At the same time, in order to meet capital regulatory requirements on new business and alleviate margin burden, many futures companies responded by increasing capital and by issuing new shares. 2012 witnessed a wave of capital injection, such as Hongyuan Futures, Citic Securities Futures, China International Futures, Everbright Futures, China Merchants Futures, and Wanda Futures raised registered capital by 600 million yuan, 700 million yuan, 700 million yuan, 250 million yuan, 100 million yuan and 266 million yuan respectively. Strengthening capital base supported futures companies to compete in the market and to better serve the real economy.

3. Institution and infrastructure building on the futures market

3.1 "*The Administrative Regulations on Futures Trading*" was revised and took effect

The State Council unveiled *the Decision on the Revisions to the Administrative Regulations on Futures Trading* on November 5, 2012. The revised Administrative Regulations on Futures Trading (hereinafter referred to as the *Regulation*) took effect from December 1, 2012. The Regulation specified the definition of "futures trading", deleted provisions on futures trading in disguised form, clarified the mandate of local government to investigate and crack down illegal futures trading activities, and provide a clear legal basis for futures supervision and the rectification of illegal trading activities. By modifying and fulfilling relevant provisions, the *Regulation* created new room for innovation on futures market. It included clauses to allow qualified overseas institutions to conduct futures trading of certain products in futures exchanges, adding that concrete measures would be made by futures management authorities under the State Council. Prohibition on non-settlement participants of futures companies from engaging in futures trading and relevant penalties on violations were both deleted. At the same time, in line with the principles of the reform of administrative license system, the regulation lifted a number of qualification requirements that needed to be approved by supervisory authorities under the State Council, including settlement qualifications of settlement members of a future exchange, changes of a company's format, change of business address or person-in-charge of a futures company branch in China, qualification to provide intermediary services to futures companies, and the business qualifications for financial institutions in the banking industry to engage in the safe keep of futures trading margins and futures trading settlement. Clauses on changes of registered capital and 5% or more of the shareholding were modified. In addition, with the aim of improving futures trading system, the *Regulation* clarified a futures exchange's function as a Central Counter Party, and adjusted its previous function of ensuring fulfilling contracts to new function to fulfill the duty of performance guarantee for the Futures Exchange.

3.2 Futures companies launched pilot asset management service

In order To methodically carry out the pilot program on the asset management service of futures companies, regulate the provision of the asset management service during the period of the pilot program, and protect the lawful rights and interests of investors, CSRC released the *Measures for the Pilot Program on the Asset Management Service of Futures Companies* (hereinafter referred to as the *Measures*) in July 2012, which took effect since September 1 2012. The *Measures* define that the asset management service means that a futures company, after accepting a written authorization from a single client or several specific clients, makes investments with assets entrusted to it by the client or clients, in accordance with these Measures and contracts, and collect charges or remuneration as agreed on under contracts. The Measures regulated pilot asset management service of futures companies in a comprehensive manner with aspects of qualification for participation in the pilot program, business rules, rules for business management and risk Control, account monitoring and control, supervision, administration and legal liability. In particular, besides futures, options and other financial derivatives, the scope of investment for the asset management service also include stocks, bonds, securities investment funds, collective asset management plans, central bank bills, short-term financing bills, asset-backed securities and other investment products recognized by the CSRC, which thus substantially enlarged business spectrum of futures companies. With the aim of accommodating the introduction of asset management service of futures companies, China Futures Association formulated the *Directives on Asset Management Contracts of Futures Companies*, and jointly released the *Procedures on Suitability Assessment of Investors Participating in Asset Management business of Futures Companies (Trial)* with China Futures Margin Monitoring Center. The *Directives on Asset Management Contracts of Futures Companies* set general standard for basic contents of risk disclosure statements, customer commitment statements and contracts. The *Procedures on Suitability Assessment* listed assessment procedures and items in detail annexed with comprehensive assessment table and questionnaire, which helped futures companies to understand investors' risk acknowledge and risk tolerance.

3.3 The Administrative Measures on hedging and arbitrage of Stock Index Futures was revised

China Financial Futures Exchange unveiled the revised *Measures on Hedging and Arbitrage Trading* (Hereinafter referred to as the *Measures*) in February 2012. The Measures define hedging with two trading patterns and arbitrage with three trading patterns. The former includes long hedge and short hedge, and the later includes cash-futures arbitrage, calendar spread arbitrage and cross-product arbitrage. The Measures regulate that the Exchange will examine and approve the application for hedging and arbitrage quotas based on market conditions and the applicant's application documents and credit status. The Exchange may supervise and investigate the applicant's business performance and credit information as well as its trading activities in the futures and securities markets. The Exchange may supervise and administrate the applicant's use of the hedging and arbitrage quotas and adjust the quotas depending on market conditions. A member or client shall conduct long or short hedge as per its hedging plan. In cash-futures arbitrage, a client shall simultaneously or near simultaneously buy (sell) futures market contracts and sell (buy) stocks, funds and other marketable securities of comparable value. In calendar spread arbitrage, a client shall execute transactions of comparable value but in opposite directions simultaneously or near simultaneously. In cross-product arbitrage, a client shall simultaneously or near simultaneously execute transactions of comparable value but in opposite directions between contracts of different futures products. The net arbitrage positions in the contracts held by a client shall be comparable in value with that of underlying securities assets but in opposite directions. The Measures strengthened administration on hedging and arbitrage, streamlined operational procedures, and introduced arbitrage, which played an important role in maintaining reasonable futures-spot spread, enhancing quality of market operation, avoid excessive short-term price fluctuations and prevent risk of market maneuvers.

3.4 Insurance fund was allowed to participate in stock index futures transactions

The Provisions on the Participation of Insurance Funds in the Stock Index Futures Trading (hereinafter referred to as the *Provisions*) was released in October 2012. The *Provisions* allow insurance institutions, including insurance group (holding) companies, insurance companies, and insurance asset management companies that are legally established within the territory of China, to participate in financial futures contracts with stock price indexes as the subject matter as listed and traded on the China Financial Futures Exchange. Subject to the requirement of asset allocation and risk management, an insurance institution participating in stock index futures trading shall develop proper trading strategies. At all trading day ends, the value of short stock index futures contracts of an asset portfolio shall not exceed regulated ceiling of investment ratio. Besides, minus due trading margins for stock index futures contracts, a portfolio should hold cash, central bank bills, money market fund, government or policy banks bonds with maturity within one year, in total no less than the amount of its trading margins so as to effectively prevent mandatory closing risk. Allowing insurance fund investing on stock index futures market contributes to improving investor structure and enhancing market functions.

4. Outlook for futures market development

It is evidenced that innovation is the original driver for futures market development. Only with determination and encouragement to innovate can the futures industry be led to sound development. At the same time, it is innovation that generates high quality and scale development of futures market, and helps to better serve the real economy. Looking forward in 2013, with regards to institutional innovation, after the adoption of revised *Administrative Regulation on Futures Trading*, a series of accommodative arrangements and detailed explanation will be released, followed by new institutional investors participating in transactions of new futures products. It is expected that more items for administrative approval will be streamlines or modified, which injects new vitality into regulation and innovation of futures market. In product innovation, listings of crude oil futures and Treasury bond futures will be promoted, while other new futures types of agricultural products, metals, energy, chemical and industrial products, will enrich futures product spectrum. In business innovation, with further enhancing brokerage service, the business scope of futures companies will be expanded by domestic and overseas futures agency service, investment consultancy, asset management, merger and restructuring, training and IT innovation services and so on.

Part VIII Financial Derivatives Market

In 2012, China's financial derivatives market grew steadily and trading became more brisk. Players in interest rate swap market were more active, the role of Shibor as benchmark was further enhanced, exchange rate derivatives market kept growing rapidly, and the market for Credit Risk Mitigation (CRM) instruments maintained a stable performance. Meanwhile, the construction of market institution and infrastructure was sped up, and a new version of definitive document for financial derivatives transactions was published. Insurance companies and securities companies were allowed to expand their scope of trading. The access to foreign exchange derivatives market was simplified. Non-deliverable currency swap was introduced into market. The complementary polices for CRM instruments were issued. The construction of trading benchmark was further improved. Interest rate swap payment management along with electronic trading confirmation and sterilization was launched.

1. Performance and features of RMB interest rate derivatives market

1.1 Market performance

In 2012, the trading of interbank RMB interest rate derivatives amounted to 2.92 trillion yuan, up 5.03% year-on-year. In particular, the trading value of interest rate swaps (IRS), bond forwards and forward rate agreements (FRAs) stood at 2.90 trillion yuan, 16.612 billion yuan and 200 million yuan respectively.

1.1.1 IRS market expanded steadily

The trading volume in IRS market increased steadily. After a leapfrog growth in 2011, the trading volume of IRS switched to a steady growth track in 2012. Throughout the year, 20,945 IRS transactions were concluded with the notional principal totaling 2.90 trillion yuan, a year-on-year increase of 8.45%. In particular, the trading value in November hit a record high of 440.204 billion yuan in a single month.

Short-term swaps dominated the maturity structure. The notional principal of swaps with a maturity of or less than one year reached 2.25 trillion yuan, accounting for 77.52% of the total, up 2.81 percentage points compared with the previous year. Entering the third quarter, swaps with a maturity of five to ten years became active, all accounting for over 10% of the total, and trading for swaps with a maturity of or less than one year came down.

Reference interest rates were diverse. Although the main reference interest rates were still 7-day fixed repo rate (FR007) and Shibor, there were two major changes this year. For one, the share of swaps using Shibor as reference rate exceeded those using FR007 for the first time. The notional principal of swaps using Shibor and FR007 as reference rate was 1.45 trillion and 1.32 trillion yuan respectively, accounting for 50.01% and 45.33% of the total turnover. For the other, the types of reference interest rates other than FR007 and Shibor increased and their market share went up. In 2012, another two types of reference rates were introduced to the market. Besides 1-year deposit rate, lending rates with a maturity of six months, one year, three years, five years and more than five years also served as reference rates. The share of trade using these reference rates gained 1.74 percentage points over 2011 to 4.67%.

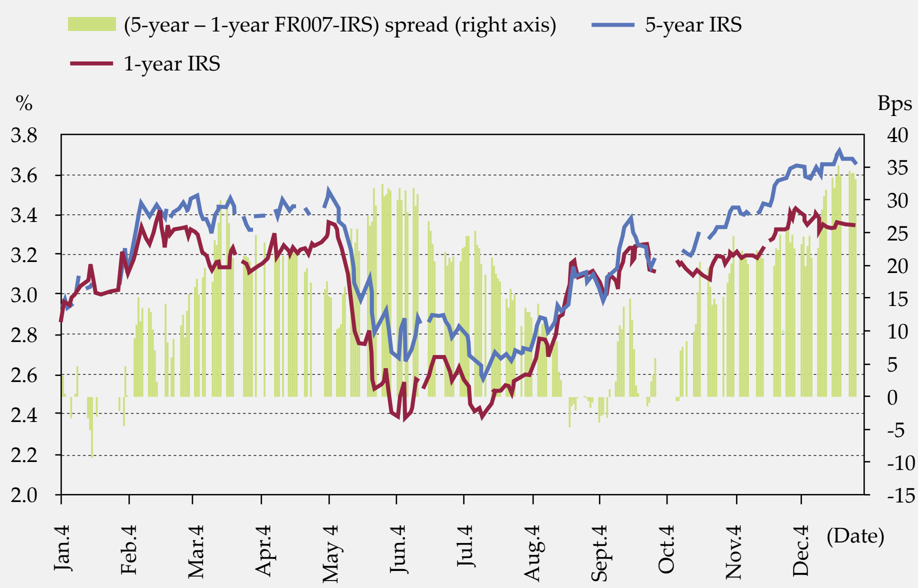
The IRS tracked money market closely on the whole. From January to April 2012, due to the continuously declining funds outstanding for foreign exchange, calendar effect and commercial banks paying overdue reserve requirements, the market was tight with liquidity and the IRS market equilibrated at high rates. Take FR007-IRS for example, the middle area of 5-year swap rate was maintained around 3.2%, and the spread between 5-year and 1-year swap rates was relatively small. From May to July, as market expectation of macroeconomic outlook turned pessimistic, money market rates went down. The FR007-IRS rate followed suit. The short end declined 52 basis points on average and the middle area of price came down to around 2.7%. The long end declined slightly less than the short end, declining 43 basis points on average, and the middle area of price was around 2.9%. As a result, the spread between 5-year and 1-year swap rates narrowed. From August on, as macroeconomic data improved, 5-year FR007-IRS rate went up continuously. Then, as the People's Bank of China (PBC) adjusted market liquidity through open market operation, the short end of FR007-IRS increased steadily. But the increase was less than the long end, so the spread between 5-year and 1-year swap rates widened in the fourth quarter.

1.1.2 The trade of bond forwards shrank

In 2012, 56 transactions were concluded in bond forwards, with turnover declining 83.87% year-on-year to 16.612 billion yuan. Among interest rate derivatives, bond forwards accounted for 0.57% in terms of trading volume, lower than 2011's 3.71%, indicating a much less brisk market.

As for the maturity structure, 7-day bond

Figure 8.1 Movement and Interest Rate Spread of 5-year and 1-year FR007-IRS in 2012



Source: China Foreign Exchange Trade System.

forwards was most active, accounting for 63.29% of total trading volume, increasing 1.19 percentage points compared with 2011; 14-day bond forwards accounted for 27.33% of the total, increasing 7.03 percentage points over 2011; 30-day bond forwards accounted for 3.12% of the total, a remarkable decline from 2011's 14.94%. In terms of the type of underlying bond instruments, bond forwards with policy financial bonds, short-term financing bills and corporate bonds as underlying bonds were the major types, accounting for 73.89%, 17.93% and 5.09% of the market respectively.

1.1.3 FRAs trade was light

In 2012, FRAs continued the slack trade of 2011. Only three transactions were concluded with a total notional principal of 200 million yuan. There were four major reasons for the lukewarm trading activities. Firstly, FRAs could be replaced by IRS. Secondly, market participants had the same risk aversion demand. Thirdly, FRAs were subject to independent market access and regulation. Internal operation procedure and risk management system needed to be submitted when applying market access for FRAs, which cannot substitute with that preparatory process of IRS. Financial institutions that had acquired the qualification for IRS transaction tended to continue IRS trade instead of switching to FRAs. Fourthly, the choice of reference rates was limited for FRAs. All FRAs in the market had a maturity of three months. As a result, FRAs can only use 3-month Shibor as reference rate and cannot use short-term Shibor or FR007 which was more market- based and more suitable for trading.

1.2 Performance and features of RMB interest rate derivatives

1.2.1 The trading volume and market share of IRS continued to increase

In 2012, IRS reported a trading value of 2.90 trillion yuan, increasing 8.45% year-on-year. The share of IRS in total RMB interest rate derivatives increased continuously to more than 99%. Market participants grew steadily. By the end of 2012, there were 93 institutions registered for IRS trade, adding 10 compared with the end of 2011.

1.2.2 The role of Shibor as benchmark was further enhanced

In 2012, the notional principal of IRS using Shibor as reference rate reached 1.3 trillion yuan, accounting for 49% of the total market turnover, up 6 percentage points compared with 2011. Meanwhile, the management of Shibor quoting, data selection, monitoring of abnormal data, and internal management of market participants improved continuously. Shibor played a more important role as benchmark.

1.2.3 The IRS curve significantly improved compared with 2011

From the second half of 2011, the IRS curve flattened out and even became inverted. This situation greatly improved in 2012. In general, the short-end IRS was susceptible to the fund flow in money market while the medium and long-end IRS was closely related with economic performance. As the economy stabilized and improved in 2012, the PBC actively used reverse repo to steer short-term interest rate. As a result, the extreme cases of behavior for short-term interest rate declined dramatically. Throughout 2012, the IRS curve was only inverted on rare occasions at the beginning of January and in the last part of August.

1.2.4 The reference rates for the floating leg of IRS were diverse

In the third quarter of 2012, the IRS trade using lending rates rather than Shibor and FR007 as reference rate for the floating leg increased gradually. Due to the sluggish global economy and the slowing domestic economy, market expectation and demand changed. For one, market participants disagreed over the future shape of IRS curve so that spread trade thrived. For the other, the PBC lowered policy rate for two times in 2012, and enterprises had a rising demand to lock up their financing cost.

2. Performance and features of the RMB exchange rate derivatives market

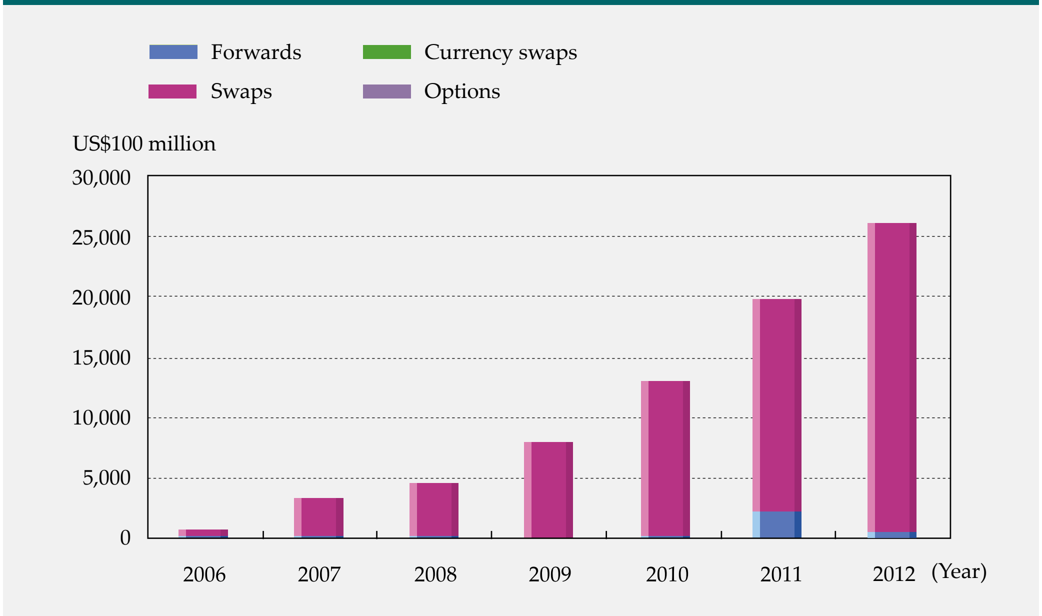
2.1 Market performance

In 2012, the interbank RMB exchange rate derivatives market continued to grow rapidly, and total turnover amounted to US$2.61 trillion, up 31.6% year-on-year. In particular, RMB/FX forwards recorded a turnover of US$86.6 billion, down 59.6% year-on-year; RMB/FX swaps registered a turnover of US$2.52 trillion, up 42.2% year-on-year; RMB/FX currency swaps and options reported a turnover of US$6.53 billion and US$3.34 billion respectively. The share of RMB exchange rate derivatives in RMB/FX market increased further to 43.8% from 2011's 35.9%, up 36 percentage points compared with 2006.

The RMB exchange rate derivatives market was at premium continuously. In 2012, the 1-year RMB/USD swap was at premium, and the price trended upward on the whole. The 1-year swap quoted 490 points at the beginning of the year and 1,340 points at the end of the year. In particular, in the third quarter, the 1-year swap rose from 400 points at the beginning of July to over 1500 points at the end of September.

The membership in the RMB exchange rate derivatives market kept increasing. By the end of 2012, there were 80 members in the RMB/FX forward market, 79 members in the RMB/FX swap market, 77 members in the RMB/FX currency swap market, 29 members in the RMB/

Figure 8.2 RMB/FX Derivatives Market



Source: China Foreign Exchange Trade System.

FX option market, adding 7, 8, 41 and 5 members respectively compared with the end of the previous year.

2.2 Features of market performance

2.2.1 The RMB/FX forward and swap market readjusted trade pattern

On April 16, 2012, the State Administration of Foreign Exchange (SAFE) cancelled lower limit management that had been applied to commercial banks' balance of position under the cash basis accounting since November 2010. As a result, the turnover and outstanding amount in RMB/FX forward market declined continuously. In the second half of 2012, RMB/FX forward market only registered a turnover of US$22.1 billion, declining 65.7% compared with the first half of 2012 and 77.6% compared with the same period in 2011; RMB/FX swap reported a turnover of US$1.38 trillion, increasing 21.6% compared with the first half of 2012 and 41.2% compared with the same period in 2011. The forward curve and the swap curve nearly merged into one. The forward and swap market gradually returned to the trade pattern before the enforcement of lower limit management.

2.2.2 The transaction function of short-term swaps was further strengthened

Short-term products had always been active in interbank RMB/FX derivatives market. This characteristic was particularly obvious in swap. In 2012, swaps with a maturity of one month or shorter accounted for 78.7% of the total trade in interbank swap market, up further from 2011's 73.4%. In particular, overnight swaps dominated the market with its market share increasing quarter by quarter, from 54.8% in the first quarter to 64.6% in the fourth quarter. This demonstrated that the transaction function of short-term swaps was strengthened continuously and the money market function of swap trade was further enhanced.

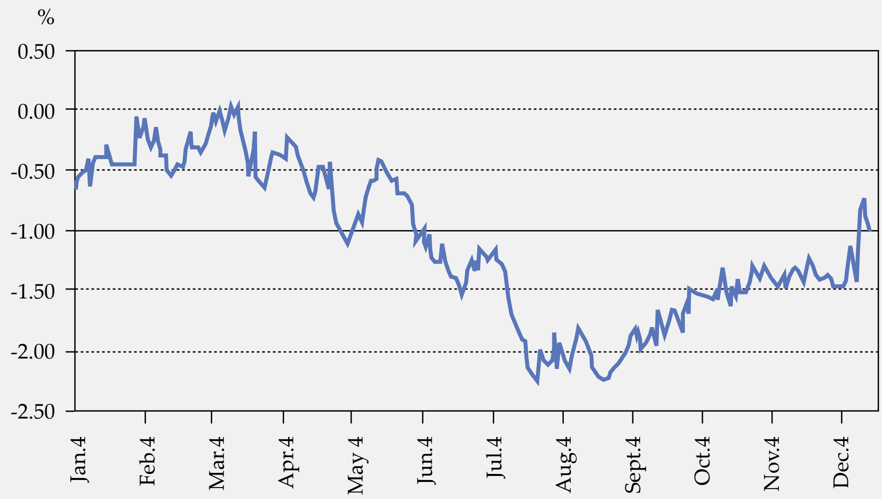
2.2.3 The implied depreciation expectation of derivatives first widened then narrowed

In general, the implied depreciation expectation of RMB/USD derivatives first widened and then narrowed in 2012, mimicking the RMB/USD middle rate and exchange rate. Measured against the middle rate, the implied depreciation expectation of 1-year swap in interbank market maintained within 0.5% from the beginning of the year to April. Entering May, as the European debt crisis deteriorated continuously, the market became more risk averse. The dollar index surged. The RMB/USD middle rate weakened. The RMB depreciation expectation heated up rapidly and the implied depreciation expectation of 1-year swap rose to as high as 2.3%. From August on, as advanced economies such as the U.S., Europe and Japan launched another round of quantitative easing, the dollar index dropped sharply. While at home, with the economy stabilizing and export growth picking up, market sentiment turned positive. As a result, the RMB/USD middle rate rose back, and the depreciation expectation tempered consequently. By the end of December, the implied depreciation expectation of 1-year swap narrowed to 1.2%.

2.2.4 RMB/FX options and currency swaps traded actively

RMB/FX options and currency swaps trade actively in 2012, registering a turnover of US$3.34 billion and US$6.53 billion respectively, increasing 2.3 times and 83.8 times year-on-year. In RMB/FX option market, RMB/USD option dominated the trade. The maturity distribution was balanced. The market share of 1-year and 1-month options was 33.3% and 17.6% respectively, and the market share of 1-week, 3-month and 6-month options was all around 10%. Implied volatility dropped

Figure 8.3 RMB Appreciation (Depreciation) Expectations as Indicated by Onshore 1-Year Derivatives in 2012



Note: The appreciation (depreciation) expectation was measured by onshore 1-year derivatives' price against the middle rate of RMB/USD exchange rate.
Source: China Foreign Exchange Trade System.

significantly. At the end of 2012, the implied volatility of 1-year and 1-month options was 2.48% and 1.99% respectively, down 206 and 95 basis points compared with the end of 2011. The bearish sentiment in market was tempered with the share of put options dropping to 45% from 2011's 76%. Since the middle part of June when the SAFE simplified the access to currency swap market and introduced non-delivery currency option, the trade of currency options had been growing rapidly, with turnover reaching US$5.21 billion in the second half of 2012, growing 2.9 times compared with the first half of the year.

3. Performance of the foreign currency derivatives market

3.1 Trade of foreign currency derivatives continued to grow rapidly

In 2012, the trade of interbank foreign currency derivatives continued to grow rapidly, with turnover reaching US$23.5 billion, up 1.6 times year-on-year. In particular, foreign currency forwards registered a turnover of US$2.7 billion, increasing 22.4% year-on-year; foreign currency swaps reported a turnover of US$20.8 billion, increasing 2.1 times year-on-year.

3.2 The dominant position of foreign currency swaps was further consolidated

In 2012, foreign currency swaps accounted for 88.6% of total turnover in foreign currency derivatives market, up 13 percentage points over 2011. The dominant position of foreign currency swaps was further consolidated.

3.3 The trend of currency composition change continued

In 2012, the currency composition of foreign currency derivatives market continued to change as in 2011. The market share of three major currency pairs – USD/HKD, EUR/USD and USD/JPY kept declining. Their shares in total turnover of foreign currency derivatives added up to 84.9%, down 8.6 percentage points compared with 2011. At the same time, the turnover of AUD/USD, USD/CAD and GBP/USD increased sharply, up 10.1, 17.4 and 15.9 times respectively over the previous year.

4. Performance of the RMB credit derivatives market

4.1 The number of institutions qualified to trade CRM instruments grew steadily

In 2012, market members that were awarded with CRM traders, CRM core traders or issuers of Credit Risk Mitigation Warrant (CRMW) grew steadily. At the end of 2012, 45 market members were CRM traders (including 33 foreign and domestic commercial banks, 10 securities companies, one financial asset management company and one institution of other types), adding two compared with the end of 2011; 26 market members were CRM core traders (including 24 foreign and domestic commercial banks and two securities companies), increasing one compared with the end of 2011; 29 market members were CRMW issuers (including 22 foreign and domestic commercial banks, six securities companies and one institution of other types), one more compared with the end of 2011.

4.2 The CRM market was stable

In 2012, the CRM market was stable with some Credit Risk Mitigation Agreement (CRMA) and CRMW coming due smoothly.

In 2012, eight institutions concluded 13 CRMA transactions, totaling 1.34 billion yuan in notional principal. The underlying debt instruments included short-term financing bills, medium-term notes and notes issued collectively by a group of small and medium-sized enterprises (SMEs). By the end of 2012, 16 institutions had concluded CRMA transactions with a notional principal of 3.94 billion yuan. The underlying debt instruments included short-term financing bills, medium-term notes, notes issued collectively by a group of SMEs, and bank loans. The maturity of CRMA ranged from 32 days to 2.21 years. The settlement methods in case of credit events[1] included settlement in kind and in cash. At the end of 2012, two CRMA transactions were still in existence period, three fewer compared with the end of 2011; the notional principal was 350 million yuan, declining 300 million yuan compared with the end of 2011; three traders were involved, the same as the end of 2011.

In 2012, there was neither new CRMW issuance in the primary market nor new CRMW transaction in the secondary market. By the end of 2012, six CRMW issuers had registered and issued nine CRMWs with a total notional principal of 740 million yuan. The underlying debt instruments included short-term financing bills and medium-term notes with a maturity of about one year. Market participants had concluded six CRMW transactions through trading system with a notional principal of 240 million yuan.

1 Credit events refer to events due to which the obligations might not be honored when due. Counterparties need to define credit events in transaction which include bankruptcy, failure to pay, obligation acceleration, obligation default, repudiation or moratorium, restructuring, etc..

5. Institution building in the financial derivatives market

5.1 The *Definitive Document for the Transaction of Financial Derivatives in China's Interbank Market (2012)* was issued and put into effect

On August 21, 2012, the National Association of Financial Market Institutional Investors (NAFMII) issued the *Definitive Document for the Transaction of Financial Derivatives in China's Interbank Market (2012)* (hereinafter referred to as the *Definitive Document*). The *Definitive Document* was upgraded on 2009's definitive document with proper revision and on the basis of opinions from market members. The new definitive document was more complete in definition, more applicable in the market, more precise in terms of language and better in line with the development of China's derivatives market. The *Definitive Document* can be divided into different subdocuments for different products, i.e. interest rate derivatives, bond derivatives, exchange rate derivatives and credit derivatives.

With respect to interest rate derivatives, the new definitive document revised provisions that were not in line with real transaction conventions, modified in detail provisions on reset date, reset period, interest period, computing institution and interest rate set date, with an aim to satisfy the real demand of market development. Meanwhile, the new definitive document formulated a transaction verification form so as to reduce the coordination and transaction cost for trading parties. Furthermore, in line with market demand, the new definitive document added information backup system, early termination mechanism and interest rate swap option so as to make the document more complete, more flexible and more forward-looking.

Regarding exchange rate derivatives, the new definitive document modified the current contents of definition, upgraded the definition of pricing date, foreign exchange, spot exchange rate, forward exchange rate and cut-off time, and added the definition of currency swap, making the contents of definition better in line with market conventions and transaction demand. In addition, the new definitive document introduced provisions related to currency swap transaction including definition related with date and interest, in order to satisfy the real demand of market participants.

With regard to bond derivatives, the new definitive document enriched the contents of the old document with more detailed provisions, making the structure and contents of the definitive document more reasonable. Besides, in order to fully reflect market conventions, the new definitive document added some new definitions, such as Payment after Delivery (PAD), Delivery after Payment (DAP) and Delivery versus Payment (DVP) which were common in physical settlement. Also, the new definitive document introduced a new backup and resolution system. In case any party disagreed over any computation, setting or adjustment made by computing institutions, it can decide on a review institution in time according to rules. In addition, when one party failed to deliver bonds as contracted, the other party can start the backup system in time for bond covering.

The new definitive document made a large revision on credit derivatives given the fact that the 2009 definitive document was formulated and released before the practice of China's credit derivatives. On the basis of current market practice, the new definitive document modified current definitions, improved and revised definitions that were not concrete or not in line with transaction conventions. Meanwhile, the new definitive document added new definitions so as to enhance its integrity and applicability. For example, the new document introduced cash settlement system which was in line with market practice. Also, new mechanisms such as bond covering and loan delivery backup were brought in so as to adapt to the demand of market development. The new definitive document attempted to establish definitions and mechanisms with the Chinese market characteristic, paving the way for the construction of central clearing, auction settlement and decision making committee in the future. Besides, the new definitive document formulated transaction verification forms for different types of derivatives and improved the transaction efficiency in financial derivatives market.

The *Definitive Document* fully incorporated the practice of China's OTC financial derivatives market in recent years and established standards and rules for market operation. This would reduce the market transaction cost effectively, improve transaction efficiency, and lay a solid legal basis for further development of China's OTC financial derivatives market.

5.2 Insurance and securities institutions were allowed to expand the scope of derivatives transaction

On October 23, 2012, the China Insurance Regulatory Commission (CIRC) issued the *Interim Measures for Insurance Funds to Participate in Financial Derivatives Trade* (hereinafter referred to as the Interim Measures), allowing insurance institutions to participate in forward, futures, option and swap trade. Thus, insurance institutions can conduct all domestic financial derivatives trade. According to the *Interim Measures*, insurance group (holding) companies and insurance companies can either participate in financial derivatives trade on their own or designate insurance asset management companies to conduct derivatives trade for them. However, in either case, insurance companies can only use derivatives trade for hedging against and mitigating risk, and cannot use it for speculation. The expansion of derivatives transaction scope for insurance companies can help diversify the investors of derivatives market, promote trading and improve the balance between supply and demand.

On April 29, 2011, the China Securities Regulatory Commission (CSRC) issued the *Provisions on the Investment Scope of the Proprietary Trading Business of Securities Companies and Related Issues* (hereinafter referred to as the *Provisions*). The *Provisions* had great implications for expanding the scope of the proprietary investment of securities companies and preventing risks associated with proprietary business and alternative investment. However, with the innovation and development of securities companies, the *Provisions* cannot satisfy the demand of market development any more. Therefore, on November 1, 2012, the CSRC released the consultative document on the revision of the *Provisions* to solicit public opinions and suggestions and thus better meet the demand of market innovation and development. The new provisions clearly stipulated the qualification of securities companies for conducting derivatives trade. Considering the high complexity and risk of derivatives trading, securities companies must be qualified in investment decision making and risk management. Except for hedging, only securities companies qualified for proprietary trading were allowed to directly engage in derivatives trading for the purpose of speculation and arbitrage. The expansion of proprietary business scope for securities companies can help diversify market participants and promote the reasonable distribution of market risk among different types of investors.

5.3 Market access to foreign exchange derivatives market was simplified and non-deliverable currency swap was introduced to market

In order to enhance the role of finance in serving real economy and promote the development of foreign exchange market, the SAFE issued in April 2012 the *Notice on Adjusting the Administration of Some Businesses in Interbank Foreign Exchange Market* (hereinafter referred to as the *Notice*), deciding to simplify the market access administration for foreign exchange swap and currency swap as of June 11, and adopt one-time registration administration for RMB/FX forward, foreign exchange swap and currency swap. Eligible institutions can apply to the SAFE for the qualification of those three businesses simultaneously via the China Foreign Exchange Trade System (CFETS). Domestic institutions that had got the qualification for forward trade would automatically get the qualification for swap and currency swap trade. The *Notice* also introduced a new form of principal exchange for currency swap, stipulating that except for current provisions, domestic institutions did not have to exchange RMB and foreign currencies on the effective date and expiration date of the agreement when conducting RMB currency swap business in interbank foreign exchange market.

5.4 Supporting polices and regulations were issued for CRM instruments

Above all, the *No.5 Interpretation of Corporate Accounting Standards* (hereinafter referred to as the *Interpretation*) was released, stipulating accounting treatment for CRM instruments. In November 2012, the Ministry of Finance issued the *Notice on Printing the No.5 Interpretation of Corporate Accounting Standards* (Ministry of Finance Document No. 19, 2012), announcing that the *Interpretation* would come into effect as of January 1, 2013. In accordance with relevant provisions in the *Guidelines for the Pilot Operation of CRM Instruments in Interbank Market*, the *Interpretation* clarified definitions related to CRM instruments in the second clause; made clear that according to the principle of substance over form, CRM instruments can be identified as derivatives or financial guarantee contracts; and stipulated the accounting treatment and reporting methods under different identifications. The second clause of the *Interpretation* provided guidelines for market members on how to treat CRM instruments in accounting, which improved the institutional framework for the operation of CRM instrument market, and facilitated the healthy and sustainable development of CRM instrument market.

Secondly, the *Administrative Measures on Commercial Banks' Capital (Trial)* (hereinafter referred to as the *Capital Measures*) would be effective as of January 1, 2013. On June 7, 2012, the China Banking Regulatory Commission (CBRC) issued the *Capital Measures*, effective from January 1, 2013. The Capital Measures introduced the principles and contents of new Basel agreement, strengthened regulation on banking institutions in conducting derivatives business, reinforced risk management requirement, emphasized the protection of institutional clients, and further regulated the derivatives business of banking institutions. Besides, the *Capital Measures* clarified the capital buffer role of eligible credit derivatives in internal rating, clearly stipulated the types, qualification and econometric methods of eligible credit derivatives in internal rating, and made clear the requirement to weight capital according to the risks of credit derivatives counterparties. The implementation of the *Capital Measures* can help tap the role of CRM instruments as capital buffer, improve the sharing mechanism of market credit risk and enhance the efficiency of capital operation in commercial banks.

6. Infrastructure building of financial derivatives market

6.1 The construction of benchmark for interest rate and exchange rate derivatives was improved

In order to further tap the role of Shibor as benchmark interest rate and improve the pricing of IRS using Shibor benchmark, the CFETS, on pilot basis, started to officially publish the fixing and closing curves for IRS using Shibor as benchmark from May 21, 2012. These curves included five categories - Shibor_3M, Shibor_O/N, Shibor_1W, FR007 and 1-year deposit rate (annual). The CFETS published bid, offer and average curves for each category. At present, these curves not only provided the basis for unwinding IRS trade, and were also used by some market members in IRS valuation, mid-office and back-office processing.

With a view to meet the demand of market members for derivatives valuation and risk management, the CFETS began to publish foreign exchange forward curve in February 2012, which, together with the existing foreign exchange swap curve, USD implied interest rate curve and implied volatility curve of foreign exchange option, formed the basic spectrum of benchmark curves for exchange rate derivatives.

6.2 The electronic confirmation and unwinding of IRS trade were launched officially

In the first half of 2012, the PBC officially approved the CFETS to launch electronic confirmation and unwinding of IRS trade in interbank market. In recent years, electronic confirmation had become an important trend in post-trade processing in international derivatives market. Starting from March 2011, the CFETS attempted to launch the electronic confirmation of IRS trade. It provided platform for electronic confirmation through local currency trading system and provided a uniform confirmation letter, allowing each party to confirm their transactions quickly. By the end of 2012, 63 institutions had signed commitment letter, committing to using the IRS electronic confirmation; over 93% of IRS trade in interbank market was confirmed electronically. As a result, the trade confirmation efficiency improved significantly, and the problem of lagging confirmation in OTC derivatives trade was resolved. The unwinding business of IRS trade started trial operation in June 2011. In 2012, 30 institutions signed commitment letter, committing to conducting IRS unwinding business. Throughout the year, there were five rounds of IRS unwinding, terminating 8,437 IRS transactions in advance with a total notional principal of 476.96 billion yuan.

The electronic confirmation and unwinding of IRS trade can help mitigate operational risk, credit risk and legal risk involved in market trade for financial institutions. Therefore, they were important steps and measures in the infrastructure building of interest rate derivatives market.

6.3 The IRS payment management started trial operation

Compared with traditional securities trade, the interbank OTC derivatives contracts were complicated in clauses and not that standard. Also, it was difficult to calculate the regular cash payment precisely. As market expanded, disagreement over the calculation of cash payment led to more and more disputes, which had a negative impact on the operation efficiency of interbank OTC derivatives market.

Payment management referred to the service to calculate, determine and adjust payment amount throughout OTC derivatives trade according to the authorization of trading parties on the basis that the trading position of market members was recorded accurately. Drawing on international experience, the CFETS initiated payment management service provided by the third party in China. In this service, the third party acted as the computing institution according to the trading parties' agreement in confirmation letter or according to the authorization of trading parties, calculated the payment obligations of eligible derivatives trade in the normal execution of transaction through the CFETS's local currency trading system, and informed the trading parties of calculation results.

On July 16, 2012, the CFETS began to provide electronic calculation service for interest payment in IRS. By the end of 2012, 37 major market participants had applied for this service. The CFETS had calculated interest for over 12,000 outstanding and new derivative transactions and sent payment notices, which replaced the traditional methods of checking payment amount with email, phone and fax and significantly improved the execution efficiency of OTC derivatives contracts.

6.4 The RMB/FX option trade was further improved

Since the RMB/FX option was launched in April 2011, trading had been lukewarm due to the discontinuity of spot market price. In order to resolve this issue, the CFETS further enhanced the function of Delta exchange, introduced more option pricing instruments and disseminated the volatility of option trade to the entire market, which improved market acknowledgement, quoting efficiency and liquidity significantly.

7. Outlook for financial derivatives market development

7.1 Continuous innovation will enrich the product spectrum of derivatives

Right now, China's interbank interest rate derivatives market has launched bond forward, IRS, FRA and other basic derivatives products. The exchange rate derivatives market also boasts a relatively complete spectrum of tradable products including foreign exchange forward, foreign exchange swap, currency swap and RMB exchange rate option. Meanwhile, the launching of CRM instruments marks the start of interbank credit derivatives market.

However, the risk management and business development of market participants raised higher requirement for derivatives. Above all, as the reform of exchange rate formation mechanism and the liberalization of RMB interest rate move forward steadily, exchange rate and interest rate risks are increasingly becoming issues of concern. In order to satisfy the demand for market risk management, the derivatives market needs to further enrich the series of tradable products which might include exchange rate futures, interest rate futures and interest rate option, and needs to enhance its function of price discovery. Besides, the expansion of China's corporate credit bond market and the development of trading platform for loans provide enormous spot assets for credit derivatives, and guarantee the volume, efficiency and liquidity of credit derivatives market. Therefore, the credit derivatives market is expected to expand further. In addition, the research on derivatives such as commodities, carbon emission trade and precious metal can be brought onto schedule so as to lay the foundation for the further development of derivatives market.

7.2 The CRM instrument market will be deepened further

On the occasion of the release and implementation of the *Capital Measures*, the capital buffer function of CRM should be further clarified, providing great support for commercial banks in managing their own credit risk and improving capital efficiency. In addition, there should be more types of CRM products so as to satisfy different hedging and transaction demand and enhance the function of CRM in managing credit risk. Besides, insurance, securities, funds and asset management companies should be introduced into CRM instrument market so as to diversify market participants, improve the allocation of credit risk among different participants, and tap the role of CRM in credit risk transferring and sharing to the utmost. Furthermore, research on the pricing mechanism of CRM products and the applicability of some models should be strengthened. Sophisticated valuation and pricing methods should be widely applied and database construction should be enhanced.

7.3 The participants of derivatives market should be diversified so as to improve the allocation of market risk

Considering the high risk associated with financial derivatives trade, investors with different risk appetites can facilitate the reasonable allocation of market risk and ensure the stable, healthy and sustainable development of market. Therefore, it is necessary to loosen regulation, improve market participants' capacity of risk management and promote the diversification of investors. Above all, regulation needs to be loosened further. Right now, the OTC derivatives market is dominated by commercial banks. It is conducive to introduce securities, insurance and fund companies with different risk appetites into market and increase the number and types of investors. Secondly, market participants need to improve their risk management capacity continuously. The high risk of derivatives trade requires market participants to enhance corporate governance, improve risk management technique, comply with operation procedures and risk management procedures, and ward off derivatives trade risk at the root. Thirdly, non-financial institutions should be encouraged to participate in derivatives trade. It is necessary to develop corporate clients and improve their channels and capacity of risk management, promoting the role of derivatives market in serving real economy.

7.4 The market regulation and self-discipline system should improve further

With the diversification of financial market participants and the trend of mixed operation for financial institutions, it is imperative to establish a regulation system for OTC derivatives market which combines administrative regulation, self discipline and front-desk monitoring, bringing the role of government, self-discipline organizations and intermediary platforms to full play. On one hand, the market should be self-disciplined. Familiar with product and business innovation and being close to market, self-discipline organizations can play an important role in enhancing market participants' self restraint, internal control and monitoring, and industry discipline. On the other hand, administrative regulation and self-discipline management should be combined. The government should strengthen the vertical communication and coordination with self-discipline organizations, front-desk monitoring platforms and market participants, ensure the smooth transmission of market monitoring information through real-time and regular reporting mechanism, and improve risk prevention and resolution capacity.

7.5 Legal system construction should be enhanced so as to create a favorable environment

In order to maintain the sustainable and sound development of market, prevent legal risk in derivatives trade and create a favorable market environment for participants, the construction of legal system for OTC derivatives market needs to be strengthened continuously. Above all, there needs to be legislation for close-out netting and performance guarantee, which are basic mechanisms common in OTC derivatives market. In order to promote the application of these mechanisms in China, China needs to push for the legislation for these mechanisms in time and make clear their legitimacy and feasibility within China's legal framework. Secondly, the document of the *Master Agreement for Financial Derivatives Trade in China's Interbank Market* (hereinafter referred to as the *NAFMII Master Agreement*) should be improved continuously. In accordance with market development, a long-term mechanism should be established to update the definitive document of the *NAFMII Master Agreement*. Meanwhile, derivatives such as commodities and carbon emission trade should be included into the master agreement, and the application scope of the *NAFMII Master Agreement* should be expanded further. Thirdly, a fast resolution mechanism for derivatives disputes should be set up, allowing trading parties to resolve their disputes quickly before arbitration or litigation. This will help improve risk control capacity and reduce risk control cost.

7.6 Infrastructure construction should be enhanced to ensure the efficiency and safety of market operation

In order to ensure the efficiency and safety of derivatives market operation, mitigate market risk and improve market efficiency, the construction of OTC market infrastructure needs to be enhanced continuously. Above all, a central clearing mechanism for OTC derivatives market should be established. The net settlement for spot trade needs to be consolidated further, expanding the product scope of spot net clearing. The central clearing for OTC derivatives market needs to be pushed forward continuously so as to improve clearing efficiency and prevent clearing risk. Secondly, the transaction service should be further standardized. The electronic confirmation of derivatives transactions needed to be promoted continuously so as to improve market efficiency and reduce operation risk. Efforts should be made to enhance transaction registration and reporting, transaction matching and confirmation, agreement update and transfer, contract compression and termination, and the establishment and cancellation of performance guarantee, gradually improving the construction of OTC derivatives market infrastructure. Thirdly, the construction of OTC derivatives Trade Repository should be accelerated. After the international financial crisis, the construction of electronic database - OTC derivatives Trade Repository that can collect, keep and disclose OTC derivatives trade records is receiving more and more attention from global regulatory authorities. At the Pittsburgh summit in September 2009, the leaders of G20 agreed that all OTC derivatives contracts should be reported to the Trade Repository by the end of 2012. Since China uses electronic trading platform in interbank market and has local and foreign currency trading system, reporting system and post-trade processing platform, China has an inherent advantage in establishing the Trade Repository in interbank market. As the next step, China needs to further improve the soft and hard infrastructure such as organization and structure, personnel, management and system construction, and complete the construction of OTC derivatives Trade Repository as soon as possible, allowing regulatory bodies and financial institutions to know market dynamics in time, facilitating market standardization and information transparency, improving the risk prevention capacity of the whole market.

Box4 The Latest Development of Credit Asset Securitization in China

The pilot of credit asset securitization was approved by the State Council and launched officially in China in March 2005. Under the correct leadership of the State Council, the PBC, together with joint efforts of member institutions of the coordinating team for the pilot, has pushed forward credit asset securitization continuously. From 2005 till the end of 2008, 11 domestic financial institutions successfully issued securities backed by credit assets in interbank bond market with an amount of 66.783 billion yuan. The preliminary pilot generally reached the expectation.

Due to the impact of the U.S. sub-prime debt crisis, the pilot of credit asset securitization has stagnated in China since 2009. In 2011, based on the development of international asset securitization market since the U.S. sub-prime crisis and domestic macroeconomic regulation, the coordinating team for the pilot conducted in-depth analysis on how to push forward credit asset securitization in China steadily. According to member institutions of the coordinating team, the pilot of credit asset securitization in China is different in essence from the synthetic asset securitization that caused the U.S. sub-prime debt crisis. At the initial stage of credit asset securitization market development, China can avoid and effectively prevent the risks and regulation gap that were exposed in the asset securitization products of the U.S. sub-prime debt crisis. As long as China emphasizes institution construction, pays attention to risk prevention, learns by heart lessons from international financial crisis, reviews carefully the experience of credit asset securitization pilot and pushes forward credit asset securitization in China in a gradual and prudent manner, risks associated with credit asset securitization are controllable. Besides, asset securitization can play an active role in supporting the strategic adjustment of economic structure and accelerating the transformation of economic development pattern, and can promote financial innovation and the healthy development of China's financial market.

1. Credit asset securitization has important implications for improving the imbalance of China's financing structure

There has been an evident imbalance of direct and indirect financing in China's social financing structure for a long time, which implies great financial risks. In 2009, in order to deal with the international financial crisis, the money supply of China grew rapidly, the loans of financial institutions increased significantly, and the ratio of indirect and direct financing was as high as 4.13. The excess reliance of enterprises on indirect financing makes social financing risk concentrate on the banking system, and will do harm to the stable and healthy development of financial industry in the long run.

The imbalance of social financing structure can change either through expanding the issuance of direct financing instruments such as stocks and bonds or through asset securitization where the traditional unit financing products are transformed into direct financing products in an orderly manner. Among the direct financing products of advanced market economies, asset backed securities *occupy a large share. For example, at the end of 2009, the outstanding amount in the U.S. bond market totaled US$34.75 trillion, of which asset backed securities (including securities backed by mortgages and other assets) reached US$11.62 trillion, overtaking corporate bonds and treasury bonds (US$6.9 trillion and US$7.6 trillion respectively) and accounting for 33.4% of the total.*

Securities backed by sub-prime mortgages that went wrong in the international financial crisis accounted for only a small share of the whole asset securitization market in the U.S. And the main problem lay in opaque information disclosure, excessively virtual design of product and inadequate financial regulation instead of the asset backed securities itself. In January 2010, the Financial Stability Board (FSB) agreed that it was significant to reopen securitization market in a prudent manner. However, without the support of relevant policies, especially the great support of government, it is hard for the asset securitization market in major market economies to satisfy the demand of real economy, which might affect the recovery of economy.

China's asset securitization is still at an early stage of development. By the end of 2008, the pilot issuance of asset backed securities was less than 70 billion yuan. In contrast, the issuance in interbank bond market reached 8.7 trillion yuan in the first 11 months of 2010, and the newly-added RMB loans by financial institutions reached 7.5 trillion yuan. Whether compared with bond market or credit market, the issuance of asset backed securities was trivial, accounting for a minimal share of the whole financial market. Through the pilot of credit asset securitization, China has felt for a path of asset securitization development with Chinese characteristic. However, whether credit asset securitization can play its role to the utmost depends on the gradual expansion of market. Meanwhile, China's credit asset securitization is also different from the sub-prime mortgage securitization that caused international financial crisis. The underlying assets of China's credit securitization are mainly credit assets of high quality, and the securitization products are featured with simple structure, standard operation, strict regulation and controllable risks. Thanks to the asset securitization technique, there is large room for increasing the ratio of direct financing, which is in line with the need of developing multi-level capital market and the need of financial reform.

2. The preliminary pilot of credit asset securitization in China has made some achievement but also encountered some problems

2.1 The credit asset securitization products issued in the preliminary pilot has maintained good performance, with underlying assets, issuing institutions and investor base expanding steadily

Above all, the market of product issuance and transaction has maintained sound performance. None of the 17 asset backed securities issued in the preliminary pilot has encountered the problem of default or cash flow discontinuity. Secondly, the underlying asset pool keeps expanding steadily. The asset pool in the preliminary pilot has included ordinary medium and long-term loans, personal mortgages, auto mortgage, SMEs loans and non-performing loans. Thirdly, the scope of issuing institutions has expanded gradually from policy banks and state controlled commercial banks at the beginning to share-holding commercial banks, auto financing companies and asset management companies. Fourthly, the types of qualified institutional investors also increase steadily. With the expansion of asset securitization market, *investor scope has expanded gradually from large commercial banks to share-holding commercial banks, city commercial banks, credit cooperatives, financing companies, securities companies, foreign banks, securities investment funds, social insurance funds, etc..*

2.2 The institutional framework of credit asset securitization improves gradually through the preliminary pilot and the risk management capacity keeps strengthening

In accordance with the development strategy of pushing pilot and legislation forward together, the institutional framework of China's credit asset securitization pilot improves continuously. At the initial stage of the pilot, the PBC, the CBRC, the Ministry of Housing and Urban-rural Development, the Ministry of Finance and the State Administration of Taxation issued nearly 10 regulations in their responsibilities regarding the supervision and administration of credit asset securitization pilot, market operation rules, measures on the transfer of house mortgage right, accounting treatment principles, taxation administration, etc., establishing the preliminary institutional framework for credit asset securitization that suited China. Then, in light of the severe issues exposed in the asset securitization market since the international financial crisis, the coordinating team adhered to the important instruction of Premier Wen Jiabao in ***Paying Attention to Institutional Construction and Risk Prevention****, and did a lot of work in improving institution and preventing risk. In 2007, the PBC issued two announcements, stipulating the information disclosure requirement for the underlying asset pool of securities backed by credit assets and allowing collateralized repo for asset backed securities. In 2008, the CBRC issued the* ***Notice on the Management of Credit Asset Securitization Business****, requiring pilot banks of credit asset securitization to be strict on the selection of underlying assets and to ward off default risk and credit risk. In 2009, the CBRC issued the* ***Guidelines for the Measurement of Regulatory Capital for Asset Securitization Exposures of Commercial Banks****, stipulating provisions on regulatory capital for asset securitization exposures of commercial banks, which helped strengthen the prudential regulation of risks and promote the healthy development of asset securitization.*

2.3 Credit asset securitization has begun to play a role in promoting financial reform and innovation

Above all, the pilot of credit asset securitization increases product types in bond market and facilitates the development of multi-level capital market. The unique risk-return characteristic and term structure make asset backed securities another asset choice for institutional investors in asset allocation apart from stocks, funds, treasury bonds, financial bonds and corporate bond. Secondly, the pilot enriches the tools for credit policy regulation and enhances the coordination of credit policy and industrial policy. Thirdly, the pilot enriches the means of asset and liability management for financial institutions, revitalizes the medium and long-term credit assets of financial institutions, transforms the practice of holding credit assets to maturity into adjusting and managing credit risk according to the risk profile of credit assets, and blazes a new path of strengthening asset and liability management for financial institutions. Fourthly, the pilot facilitates the transformation of profiting pattern for financial institutions. Through credit asset securitization, the initiating financial institutions give away the traditional loan interest, but gain commission and also promote the development of banking intermediary business.

2.4 The issues exposed lately in the pilot of credit asset securitization shall be resolved in the phased development of market

Firstly, the scale of credit asset securitization is small on the whole, and the role of asset securitization in improving the imbalance of China's financing structure and enhancing financial market efficiency is not yet evident. Therefore, it is necessary to accelerate the development of a healthy and sound market for credit asset securitization and gradually expand the market scale. Secondly, as pilot and legislation go hand in hand in China's credit asset securitization, it is imperative to continuously improve institutional construction in the process of business development. The legislation of current institutions for asset securitization is neither strict nor perfect. So it is necessary to upgrade the regulations of some ministries into national legislation on the basis of practice. By expanding the pilot continuously, China can accelerate the draft of the Regulation on Asset Securitization, bringing China to the road of asset securitization legalization. Thirdly, since the investors of asset backed securities are mainly banking financial institutions and other types of investors account for only a small share, risks are still concentrated in the banking system. Therefore, it is a must to improve product design and develop securities investment funds, insurance funds, corporate annuity, social insurance funds and other institutional investors so as to promote the diversification and transfer of credit risk. Fourthly, the market intermediary service is not perfect, in particular, the professionalism and fairness of rating agencies remain to be improved, which might affect the risk identification capacity of investors. Thus, it is essential to strengthen the training and management of market intermediaries, regulate market environment, enhance credit rating and information disclosure management, urge intermediaries to improve their technique and service quality, and protect the legitimate right of investors.

3. There is an urgent need to push forward credit asset securitization in China steadily

3.1 Credit asset securitization can raise the ratio of direct financing, promote financial reform and innovation, and accelerate the development of financial market

Right now, China is at the important stage of financial innovation and financial market development. Financial innovation is not too fast. On the contrary, it cannot keep up with the real demand of rapid economic and financial development. Asset securitization turns less liquid credit assets into more liquid securities backed by credit assets, and builds a bridge between credit market and capital market, which can improve the allocation of credit funds, raise the ratio of direct financing, ameliorate China's social financing structure currently dominated by indirect financing, and promote the coordinative development of direct and indirect financing. In addition, asset securitization provides a new financial product-asset-backed securities to financial market, enriching the types of investment in financial market. As a fixed-income product, the risk of asset backed securities lies between stocks and bonds. Asset backed securities can satisfy different demands of investors, attract more funds into financial market, and promote the development of multi-level capital market. Also, the financing function of asset securitization provide fundraisers with more choices of financing instruments, satisfy their different financing demands and improve the efficiency of financial resource allocation. Furthermore, asset securitization can enhance the institutional construction of financial market, facilitate financial institutions to improve *information disclosure, credit rating, issuance and transaction, clearing arrangement and the construction of other basic institutions, and consolidate the basis of market development.*

3.2 Credit asset securitization can enhance risk management of financial institutions and promote financial stability

In dealing with the international financial crisis, China's financial institutions have witnessed a rapid growth of credit, especially medium and long-term credit since 2009. While driving China's economy to the road of recovery, the rapid credit growth has also brought other issues, such as the increase of credit risk associated with loans, the decrease of banks' capital adequacy ratio, and the maturity mismatch of banks' assets and liabilities. In 2009, the new RMB loans in China totaled 9.59 trillion yuan, an increase of 4.69 trillion yuan compared with the previous year. In particular, new medium- and long-term loans increased 4.18 trillion yuan year-on-year. In the first 11 months of 2010, financial institutions registered new RMB loans of 7.46 trillion yuan, of which medium and long-term loans accounted for 79%. The rapid growth of credit asset and the excessively high ratio of medium- and long-term loans have augmented latent credit risk, further exposing the issue of long-term, large and concentrated lending. Through the technique of asset securitization, eligible medium and long-term credit assets are packaged and sold to investors with different appetites, which can not only help resolve the mismatch in term structure of financial institutions' assets and liabilities, but also help raise banks' capital adequacy ratio and urge financial institution to strengthen the comprehensive management of assets and liabilities. Therefore, asset securitization is an effective means to ward off credit risk and promote financial stability. In addition, in order to manage the credit risk associated with loans to local financing platforms, when conditions allow, China can study and explore issuing credit assets backed securities using eligible loans to local financing platforms as underlying assets. This will reduce the latent risk of loans to local financing platform through market means, provide a new way of resolving the risks of loans to local financing platform, increase the transparency of local government debt and enhance risk management capacity.

3.3 Credit asset securitization can enrich macro-financial regulation tools and promote economic restructuring and the transformation of economic development pattern

Asset securitization integrates the merits of direct and indirect financing and can promote effectively the adjustment of credit structure in market environment. By adjusting the scope and structure of underlying assets in the asset securitization pool, China can realize its macro policy goals, such as adjusting the industrial and geographical structure of credit. For example, commercial banks securitize loans to agriculture, farmers and rural areas and SMEs loans and then sell them to other investors in the market, which not only diversifies credit risk, but also expands the financing channels for agriculture, farmers and rural areas and SMEs, and attracts more funds to real economy, especially agriculture, farmers and rural areas and SMEs. This is in line with the direction of national macro regulation.

3.4 Credit asset securitization can facilitate the transfer of policy bank and further reform of banking industry

The China Development Bank (CDB) is now steadily pushing forward its commercialization reform. The CDB undertakes the function of providing medium and long-term credit to national infrastructure, basic industries and pillar industries. As the construction cycle of infrastructure projects is long, loans to these projects are less liquid and the expected cash flow is very stable, which is quite suitable for securitization. By securitizing loans to infrastructure projects, credit assets associated with infrastructure projects that are less liquid but expected to generate cash revenue can be restructured into securities and then sold in financial market. This can revitalize the stock assets of policy banks, accelerate the CDB's commercialization, and help the CDB realize the commercial and sustainable development while meeting capital constraint.

3.5 Credit asset securitization can create new channels for credit asset transfer and enhance the competitiveness of financial institutions

As the pilot of credit asset securitization in China came to a stand-off after 2009, many commercial banks have begun to conduct credit asset transfer and credit risk transfer through the cooperation between banks and trusts, which is similar to quasi credit asset securitization. These trust products for wealth management are large in value, but not reflected in banks' balance sheet, which might cause risks and affect macro-financial regulation. Since 2010, the CBRC has strengthened the regulation on the cooperation between banks and trusts. However, in the long run, it is imperative to establish a standard market for credit asset securitization, create normal securitization channels, lead banks to transfer credit assets through credit asset securitization that is characterized by standard operation, clear structure and transparent information, help banks adjust their asset and liability structure, and enhance their risk prevention capacity. Meanwhile, intermediary institutions like trust companies can improve their management capacity and core competiveness by participating in credit asset securitization.

4. The pilot of credit asset securitization will continue to expand

According to the instruction of the State Council and based on the experience of the credit asset securitization pilot, the PBC, together with the coordinating team of the pilot, analyzed the changing trend of international regulation on asset securitization after the international financial crisis, learned carefully the lessons from the international financial crisis, and improved further the management system of securitization. In May 2012, the PBC, jointly with the CBRC and the Ministry of Finance, issued the ***Notice on Issues Related with Further Expanding Credit Asset Securitization Pilot*** *(PBC Document No.127, 2012, hereinafter referred to as the* ***Notice****), strengthening financial risk prevention and control from the perspective of underlying assets, product structure, risk retention, rating and information disclosure.*

With respect to underlying assets, the ***Notice*** *stipulates that financial institutions shall consider both return and orientation in the selection of underlying assets. Namely, the underlying assets shall not only generate stable cash flow as expected, but also comply with the national industrial policies. The* ***Notice*** *encourages financial institutions to choose eligible loans to large national infrastructure projects, loans to agriculture, farmers and rural areas, loans to SMEs, loans to the financing platforms of local government, loans for energy saving and emission reduction, loans to new strategic industries, loans to cultural* *and creative industry, loans to social security housing projects and auto loans as underlying assets in securitization. The structure of credit asset securitization products shall be simple and clear. At the stage of pilot enlargement, pilots of re-securitization and synthetic securitization are prohibited.*

With respect to risk retention, the ***Notice*** *stipulates that at the stage of pilot enlargement, each initiating institution shall hold a certain proportion of asset-backed securities of the lowest grade in each tranche of asset securitization it initiates. The proportion shall not be lower than 5% of total asset-backed securities in principle, and the holding period shall not be shorter than the maturity of asset back securities of the lowest grade.*

With respect to credit rating, the ***Notice*** *stipulates that financial institutions shall hire two credit rating agencies to award initial issuance and trading rating and to conduct continuous rating for asset backed securities in national interbank bond market, and shall submit the rating reports of these two credit rating agencies to financial regulators in accordance with relevant policies when applying to issue asset backed securities. The* ***Notice*** *encourages financial institutions to explore and adopt diverse credit rating methods, and supports using the investor-pay model of credit rating.*

With respect to requirements on investors, the ***Notice*** *stipulates that the scope of institutional investors for asset- backed securities shall be expanded gradually, encouraging insurance companies, securities investment funds, corporate annuity, the national social security insurance fund and other compliant non-banking institutional investors to invest asset backed securities. The proportion of asset backed securities bought by an individual banking financial institution shall not exceed 40% of the total volume of the tranche in principle.*

At present, the credit asset securitization pilot is enlarged steadily. Five financial institutions – the CDB, the Bank of Communications, the GMAC-SAIC Automotive Finance, the SAIC Finance and the Bank of China have issued five tranches of credit asset- backed securities in national interbank market with a total amount of 19.2 billion yuan.

Appendix I Highlights of Financial Market Development in 2012

On January 17, the People's Bank of China (PBC) and the Central Bank of the United Arab Emirates signed a bilateral local currency swap agreement worth 35 billion yuan/20 billion dirham. The agreement will expire in three years and can be extended upon mutual consent.

On February 6, the PBC, jointly with the Ministry of Finance, Ministry of Commerce, General Administration of Customs, State Administration of Taxation and China Banking Regulatory Commission, issued the *Notice on Issues Concerning Administration over Enterprises Engaging in RMB Settlement of Export of Goods* (PBC Document [2012] No.23). The *Notice* sets down that participants in RMB settlement of export of goods are expanded from pilot enterprises to all those with import and export business qualifications.

On February 8, the PBC renewed the bilateral local currency swap arrangement with the Bank Negara Malaysia, and increased its size from 80 billion yuan/40 billion ringgit to 180 billion yuan/90 billion ringgit. The renewed currency swap agreement has a three-year term and can be extended upon mutual consent.

On February 16, the PBC's General Administration Department issued the *Notice on Applying Differentiated Reserve Requirement Ratio to Pilot Country Area Banking Divisions of the Agricultural Bank of China* (PBC General Administration Department Document [2012] No.24). The Notice expands the coverage of the differentiated treatment to another 379 county-level sub-branches in Heilongjiang, Henan, Hebei, and Anhui provinces from the current 563 pilot county-level sub-branches in Sichuan, Chongqing, Hubei, Guangxi, Gansu, Jilin, Fujian and Shandong. Those sub-branches who extend large amounts of agro-linked loans will enjoy a preferential reserve requirement ratio 2 percentage points lower than that applied to the Agricultural Bank of China.

On February 18, the PBC decided to cut the RMB reserve requirement ratio for depository financial institutions by 0.5 percentage point, effective from February 24, 2012.

On February 20, the PBC, jointly with the National Development and Reform Commission, China National Tourism Administration, China Banking Regulatory Commission (CBRC), China Securities Regulatory Commission (CSRC), China Insurance Regulatory Commission (CIRC) and State Administration of Foreign Exchange (SAFE), issued the *Opinions on Stepping up Financial Support to Facilitate the Rapid Development of the Tourism Industry* (PBC Document [2012] No.32). According to the *Opinions*, financial institutions should follow differentiated principles in credit extension, enhance credit management and financial services for the tourism industry, actively promote innovative direct financing instruments, support tourism businesses' efforts to develop diversified financing channels and patterns, improve payment and settlement services for the tourism industry, and foster the development of tourism consumer credit.

On February 21, the PBC and the Central Bank of the Republic of Turkey signed a bilateral local currency swap agreement worth 10 billion yuan/3 billion Turkish lira. The tenure of the agreement is three years and can be extended upon mutual consent.

On March 1, the PBC, jointly with the National Development and Reform Commission, Ministry of Finance, Ministry of Water Resources, CBRC, CSRC and CIRC, issued the *Opinions on Improving Financial Services to Facilitate the Development and Reform of Water Resources Projects* (PBC Document [2012] No.51). According to the Opinions, financial institutions should vigorously innovate financial products and services to cater to the needs of water resources projects, take active steps to diversify financing entities, create new vehicles for project financing, broaden financing channels, further step up financial support for water resources projects, and try setting up a risk diversification and policy support mechanism for rendering financial support to water conservancy reform and development.

On March 6, the PBC issued the *Notice on Beefing up Credit Support for Agriculture, Rural Areas and Farmers via Agro-linked Central Bank Loans* (PBC Document [2012] No.58). Accordingly, the PBC increased agro-linked central bank loans by 10 billion yuan to assist spring farming activities, and urged its branches to follow the principle of "finance supporting the real economy", properly manage agro-linked central bank loans and facilitate agro-linked credit expansion.

On March 8, at the 22nd regular meeting of the PBC review committee for the issuance and redemption of earmarked central bank notes under the pilot program of rural credit cooperative (RCC) reform, it was decided that earmarked central bank notes be redeemed for RCCs in three counties (or county-level cities) in two provinces (including Ledong County in Hainan Province), with a quota of 213 million yuan.

On March 20, the PBC and the Bank of Mongolia signed a bilateral local currency swap supplementary agreement, which boosted the swap size from the original 5 billion yuan/1 trillion togrog to 10 billion yuan/2 trillion togrog.

On March 22, the PBC and the Reserve Bank of Australia signed a bilateral local currency swap agreement worth 200 billion yuan/A$30 billion. The currency swap agreement will expire in three years and can be extended upon mutual consent.

On March 31, the PBC issued the *Notice on Conscientiously Implementing the Incentive and Restrictive Measures in Support of the Two Policies Introduced in 2011, i.e. Inspection of County-Level Incorporated Financial Institutions' Use of A Portion of Their New Deposits for Local Lending, and Monitoring and Inspection to Follow the Redemption of Earmarked Central Bank Notes for Rural Credit Cooperatives* (PBC Document [2012] No.86). According to the *Notice*, from April 1, 2012 to March 31, 2013, county-level incorporated financial institutions that prove to have used as required a portion of their new deposits for local lending shall enjoy a reserve requirement ratio 1 percentage point lower than that applied to peer financial institutions. Moreover, an extra 30 billion yuan quota of agro-linked central bank credit shall be extended to 536 RCCs at the county level and 78 village and township banks that have met both the requirement to use some portion of their incremental deposits for local lending and the standards for post-redemption monitoring and inspection.

On April 3, with the approval of the State Council, the CSRC, PBC and SAFE decided to raise the total investment quota for Qualified Foreign Institutional Investors (QFIIs) by US$50 billion to US$80 billion. It was also decided that the investment quota for RMB Qualified Foreign Institutional Investors (RQFIIs) be increased by 50 billion yuan, with pilot institutions allowed to issue with the money RMB-denominated A-share ETFs tracking A-share indices and list them on the Hong Kong Stock Exchange.

On April 14, in view of the development of China's foreign exchange market and in a bid to enhance the flexibility of the two-way movement of the RMB exchange rate, the PBC released the *Announcement* ([2012] No.4). Accordingly, the floating band of the RMB trading price against the U.S. dollar on the interbank spot market would be widened from 0.5% to 1%, effective from April 16, 2012.

On April 18, HSBC issued in London the first RMB-denominated bond, which mainly targeted investors in the U.K. and continental Europe. The total size of the issue was expected to reach 1 billion yuan.

On April 23, the PBC signed with the World Bank the *Agency Agreement for the PBC to Act on Behalf of the International Bank for Reconstruction and Development (IBRD) to Invest in China's Interbank Bond Market and the Agency Agreement for the PBC to Act on Behalf of the International Development Association (IDA) to Invest in China's Interbank Bond Market*.

On May 10, trading of silver futures contracts was launched on the Shanghai Futures Exchange.

On May 12, the PBC decided to cut the RMB reserve requirement ratio for depository financial institutions by 0.5 percentage point, effective from May 18, 2012.

On May 17, the PBC and the government of Zhejiang Province jointly issued the *Notice on Launching the Pilot Program of Rural Financial Reform in Lishui City of Zhejiang Province* (PBC Document [2012] No.82). It was decided that pilot rural financial reform be carried out in Lishui, and the *Overall Scheme for the Pilot Program of Rural Financial Reform in Lishui* was approved.

On May 29, with the authorization of the PBC, the China Foreign Exchange Trade System announced to improve the trading mode between the RMB and the Japanese yen and launch direct trading between the two currencies on the interbank foreign exchange market, effective from June 1, 2012.

On May 31, securities companies resumed the issuance of short-term financing bills.

On June 5, the PBC, jointly with the Ministry of Finance, Ministry of Commerce, General Administration of Customs, State Administration of Taxation and CBRC, issued the *Circular on the Enhanced Supervision List of Enterprises Engaging in RMB Settlement of Export Trade in Goods* (PBC General Administration Department Document [2012] No.381). All domestic enterprises with import and export business qualifications can hereby carry out RMB settlement of goods exports according to law.

On June 7, the PBC decided to cut RMB benchmark deposit and loan rates for financial institutions as of June 8, 2012. Specifically, the one-year RMB benchmark deposit rate would be lowered by 0.25 percentage point from 3.5% to 3.25%; the one-year RMB benchmark loan rate would be lowered also by 0.25 percentage point from 6.56% to 6.31%; adjustments would be made correspondingly to benchmark rates on deposits and loans of other maturities and to deposit and loan rates on personal housing provident fund. As of the same day, the floating range for deposit and loan rates would be adjusted. Specifically, the upper limit of the floating range for deposit rates would be 1.1 times the benchmark rate and the lower limit of the floating range for loan rates 0.8 time the benchmark rate.

On June 7, the Asset Management Association of China held in Beijing its founding ceremony and first annual meeting.

On June 26, the PBC signed a bilateral local currency swap agreement with the National Bank of Ukraine. The size of the swap facility is 15 billion yuan/19 billion hryvnia. The tenure of the arrangement is three years and can be extended upon mutual consent.

On July 5, the PBC decided to cut RMB benchmark deposit and loan rates for financial institutions as of July 6, 2012. Specifically, the one-year RMB benchmark deposit rate would be lowered by 0.25 percentage point from 3.25% to 3%; the one-year RMB benchmark loan rate would be lowered by 0.31 percentage point from 6.31% to 6%;

adjustments would be made correspondingly to benchmark rates on deposits and loans of other maturities and to deposit and loan rates on personal housing provident fund. As of the same day, the lower limit of the floating range for loan rates would be tuned to 0.7 time the benchmark rate.

On July 19, the CIRC released the *Provisional Rules for Bond Investment with Insurance Funds* in an effort to strengthen the regulation of insurers' bond investments and promote stable growth of the insurance market.

On July 23, the CIRC released the *Provisional Rules for Entrusted Investment Management of Insurance Funds*. According to the Rules, securities companies and fund companies can be entrusted to manage the investment of insurance funds. The move aimed to regulate investment management of insurance funds and protect the legitimate rights and interests of parties concerned.

On July 31, in order to strengthen the management of RMB bank accounts of overseas institutions and facilitate international trade and investment, the PBC issued the *Notice on Issues Concerning the Opening and Use of RMB Bank Accounts by Overseas Institutions* (PBC Document [2012] No.183).

On August 23, in response to the requirement for the financial sector to play a supporting role for the real economy and in an effort to promote agricultural lending by financial institutions, the PBC issued the *Notice on Launching the Pilot Program of Expanded Application of Agro-linked Central Bank Loans* (PBC Document [2012] No.207). According to the Notice, a pilot program shall be carried out in Heilongjiang Province and Shaanxi Province to expand the recipients of agro-linked central bank loans, at the time including rural commercial banks, rural cooperative banks, rural credit cooperatives and village and township banks at the county or village level. With the expansion, the aforementioned four kinds of financial institutions in urban areas whose agro-linked loans account for no less than 70% of their total loans shall also be included.

On August 31, monetary authorities on both sides of the Taiwan Straits signed the Memorandum on *Cross-Straits Currency Clearing Cooperation*. Both agreed to set up a cross-Straits currency clearing mechanism based on the principles and cooperation framework as specified in the *Memorandum*.

On August 31, the CSRC issued the *Guiding Opinions on Regulating Securities Companies' Participation in Regional Equity Trading Markets (for Trial Implementation)*.

On September 17, with the approval of the State Council, the *Twelfth Five-Year Plan for Financial Sector Development and Reform*, jointly formulated by the PBC, CBRC, CSRC, CIRC and SAFE, was released to the public.

On September 24, the PBC and the Bank of China Macau Branch renewed the *Clearing Agreement on RMB Business*.

On September 27, in order to regulate payment institutions' conduct of prepaid card business, safeguard prepaid card market order and prevent payment risks, the PBC issued the *Announcement* No.12 to implement the *Administrative Measures for Prepaid Card Business of Payment Institutions*.

On October 16, the PBC and the Inter-American Development Bank (IDB) signed in Beijing a Memorandum of Understanding on co-financing, in an effort to further promote collaboration between China and the IDB and support the economic and social development in Latin America and the Caribbean.

On October 22, the PBC and the State Bank of Pakistan signed the *Agency Agreement for the PBC to Act on Behalf of the State Bank of Pakistan to Invest in China's Interbank Bond Market*.

On November 7, in an effort to speed up the construction of the Kashgar and Korgas economic development zones and further scale up financial support for Xinjiang's leap-forward development, the PBC, CBRC, CSRC and CIRC jointly issued the *Opinions on Financial Support for the Construction of the Kashgar and Korgas Economic Development Zones*.

On November 29, the PBC released the *System of Standards for the Banking Sector* in a bid to push ahead with banking standardization in a comprehensive way and promote internationalization and informatization in the banking sector.

On December 3, in order to protect the legitimate rights and interests of market participants and promote regulated and sound development of China's bond repurchase market, the PBC issued the Announcement No.17, giving approval to the publication of the *Master Agreement for Bond Repurchase Transactions in China's Interbank Market* by the National Association of Financial Market Institutional Investors.

On December 3, glass futures trading was launched on the Zhengzhou Commodity Exchange.

On December 11, based on the *Memorandum on Cross-Straits Currency Clearing Cooperation*, the PBC, in its *Announcement* No.18, authorized the Bank of China Taipei Branch to serve as the clearing bank for RMB business in Taiwan.

On December 14, in order to provide guidance and set norms for the development of China's financial mobile payment business and to achieve resource sharing and efficient resource allocation, the PBC issued technical standards series for financial mobile payment in China. The standards fall into 35 items under five categories, including application basics, security control, equipment, payment practice and networking. Systematic technical requirements are clearly set down in terms of product form, business model, networking, security control, etc.. The standards cover basic elements, security requirements and implementation schemes for every link of financial mobile payment so that the framework for a technical system is set up aimed at networking, safety and credibility.

On December 28, futures contracts in rapeseed and rapeseed meal were launched on the Zhengzhou Commodity Exchange.

Appendix II China Financial Market Statistics

Table 1 Major Macroeconomic and Financial Indicators, 1998—2012 (Year-End Balance)

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

Note: Past data have been adjusted according to latest statistical releases.
Sources: National Bureau of Statistics of China, People's Bank of China and Ministry of Finance of the People's Republic of China.

Units: 100 million yuan, %

2004	2005	2006	2007	2008	2009	2010	2011	2012
159,878	184,937	216,314	265,810	314,045	340,903	401,513	473,104	519,322
10.1	10.4	12.7	14.2	9.6	9.2	10.4	9.3	7.8
11,547	14,221	17,607	21,738	25,616	22,073	29,728	36,421	38,668
35.7	23.2	23.8	23.5	17.8	-13.9	34.7	22.5	6.2
5,934	7,620	9,690	12,205	14,307	12,016	15,778	18,986	20,489
5,614	6,601	7,915	9,561	11,326	10,059	13,962	17,435	18,178
6,099	8,189	10,663	15,282	19,460	23,992	28,473	31,811	33,116
606	603	694.7	747.7	924	900	1,057	1,160	1,117
26,355.9	31,628	38,760.2	51,304	61,330	68,518	83,102	103,874	117,210
28,360.8	33,708.1	40,222.7	49,565.4	62,593	76,300	89,874	109,248	125,712
-2,004.9	-2,080.1	-1,462.5	1,738.6	-1,263	-7,782	-6,772	-5,374	-8,502
254,107	296,040.1	345,577.9	403,401.3	475,166.6	606,223.6	725,851.79	851,590.9	974,148.8
14.9	16.5	16.7	16.7	17.8	27.6	19.7	13.5	14.4
95969.7	107,279.9	126,028.1	152,519.2	166,217.1	220,004.5	266,621.54	289,847.7	308,664.2
14.1	11.8	17.5	21.0	9.0	32.4	21.2	7.9	6.5
21,468.3	24,032.8	27,072.6	30,334.3	34,218.96	38,245.97	44,628.17	50,748.46	54,659.77
8.7	11.9	12.6	12	12.8	11.8	16.7	13.8	7.7
9,422	10,493	11,759	13,786	15,781	17,175	19,109	21,810	24,565
7.7	9.6	10.4	12.2	8.4	9.8	7.8	8.4	12.6
2,936	3,255	3,587	4,140	4,761	5,153	5,919	6,977	7,917
6.8	6.2	7.4	9.5	8	8.5	10.9	11.4	13.5
241,424.3	300,208.6	348,015.6	401,051.4	478,444.2	612,005.1	733,382.03	826,701.35	943,102.27
16.0	24.3	15.9	15.2	19.3	27.9	19.8	12.7	14.1
178,197.8	206,838.5	238,279.8	277,746.5	320,048.7	425,622.6	509,225.95	581,892.5	672,874.61
12.1	16.1	15.2	16.6	15.2	33.0	19.6	14.3	15.6
3.9	1.8	1.5	4.8	5.9	-0.7	3.3	5.4	2.6

Table 2 Composition and Growth of RMB and Foreign Currency Deposits and Loans, 1998—2012 (Year-End Balance)

Item	1998	1999	2000	2001	2002	2003
Total deposits with financial institutions	95,697.9	108,778.9	123,804	143,617.2	170,917.4	208,055.6
YoY growth	16.1	13.7	13.8	16.0	19.0	21.7
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
YoY growth	17.1	11.6	7.9	14.7	17.8	19.2
Corporate deposits	32,486.6	37,182.4	44,093.7	51,546.6	60,028.6	72,487.1
YoY growth	13.4	14.5	18.6	16.9	16.5	20.8
Total loans by financial institutions	86,524.1	93,734.3	99,371.1	112,314.7	131,293.9	158,996.2
YoY growth	15.5	8.3	6.0	13.0	16.9	21.1
Of which: Short-term loans	60,613.2	63,887.6	65,748.1	67,327.2	76,822.4	87,397.9
YoY growth	9.4	5.4	2.9	2.4	14.1	13.8
Medium- and long-term loans	20,717.8	23,968.3	27,931.2	39,238.1	51,731.6	67,251.7
YoY growth	33.9	15.7	16.5	40.5	31.8	30.0

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

Table 3 Outstanding Loans, Outstanding Bonds, and Stock Market Capitalization as Percentage of GDP, 1997—2012

Units: 100 million yuan, %

Year	GDP	Outstanding loans	Outstanding loans /GDP	Outstanding bonds	Outstanding bonds /GDP	Stock market capitalization	Stock market capitalization /GDP
1997	78,793	74,914	95.1	4,121	5.2	17,529	22.2
1998	84,402	86,524	102.5	9,884	11.7	19,506	23.1
1999	89,677	93,734	104.5	13,189	14.7	26,471	29.5
2000	99,215	99,371	100.2	16,746	16.9	48,091	48.5
2001	109,655	112,315	102.4	19,728	18.0	43,502	39.7
2002	120,333	131,294	109.1	25,584	21.3	38,329	31.9
2003	135,823	158,996	117.1	37,625	27.7	42,458	31.3
2004	159,878	178,198	111.5	51,444	32.2	37,056	23.2
2005	184,937	206,839	111.8	72,323	39.1	32,430	17.5
2006	216,314	238,280	110.2	92,172.3	42.6	89,404	41.3
2007	265,810	277,747	104.5	123,354	46.4	327,140.9	123.1
2008	314,045	320,049	101.9	151,633	48.3	121,366.4	38.6
2009	340,903	425,623	124.9	176,005	51.6	243,939.12	71.6
2010	397,983	509,226	128	203,581	51.2	265,422.59	66.7
2011	471,564	581,893	123	214,798	45.6	214,758.1	45.5
2012	519,322	672,875	130	254,352	49.0	230,357.6	44.4

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: People's Bank of China, China Central Depository & Clearing Co., Ltd., China Securities Depository & Clearing Corp., Ltd. and China Securities Regulatory Commission.

Units: 100 million yuan, %

2004	2005	2006	2007	2008	2009	2010	2011	2012
241,424.3	300,208.6	348,015.6	401,051.4	478,444.21	612,005.1	733,382.03	826,701.35	943,102.27
16.0	24.3	15.9	15.2	19.3	27.9	19.8	12.7	14.1
119,555.4	147,053.7	166,616.2	176,213.3	221,503.47	264,756.9	307,166.39	357,901.58	415,549.87
15.4	23.0	13.3	5.8	25.7	19.5	16.0	16.5	16.1
84,669.5	101,750.6	118,851.7	144,814.1	164,385.79	224,360	252,960.27	423,086.61	478,730.2
16.8	20.2	16.8	21.8	13.5	36.5	12.7	67.3	13.2
178,197.8	206,838.5	238,279.8	277,746.5	320,048.68	425,622.6	509,225.95	581,892.5	672,874.61
12.1	16.1	15.2	16.6	15.2	33.0	19.6	14.3	15.6
90,808.3	91,157.5	101,698.2	118,898	128,571.47	151,390.7	171,236.64	217,480.1	268,152.19
3.9	0.4	11.6	16.9	8.1	17.7	13.11	27	23.3
81,010.1	92,940.5	113,009.8	138,581	164,160.42	235,591.3	305,127.55	333,746.51	363,894.22
20.5	14.7	21.6	22.6	18.5	43.5	29.5	9.4	9

Table 4 Composition of All-System Financing, 2010—2012

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	0

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: People's Bank of China.

Table 5 Interbank Funding and Bond Repo Trading, 1997—2012

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

Source: China Foreign Exchange Trade System.

Table 6 Change in Interbank Funding Market Participants, 1997—2012

Year	Banks	Securities companies	Insurance companies	Trust companies	Finance companies	Leasing companies	Rural credit unions	Urban credit cooperatives	Others	Total
1997	59	0	0	0	0	0	0	0	37	96
1998	165	0	0	0	0	0	0	0	2	167
1999	187	7	0	0	0	0	99	0	3	296
2000	232	14	0	0	20	0	148	0	3	417
2001	246	18	0	0	25	0	198	0	3	490
2002	261	41	0	0	25	0	202	4	3	536
2003	289	56	0	0	32	0	229	10	1	617
2004	309	64	0	0	35	0	236	11	1	656
2005	323	66	0	0	38	0	239	12	1	679
2006	339	53	0	0	46	0	250	15	0	703
2007	326	56	0	3	49	0	267	16	0	717
2008	340	58	0	16	55	4	298	13	4	788
2009	348	65	6	26	68	6	320	9	6	854
2010	347	68	6	30	72	11	338	8	7	887
2011	347	70	7	38	77	11	369	7	11	937
2012	359	77	7	39	81	16	422	7	14	

Note: *Others* includes auto finance companies and asset management companies.
Source: National Interbank Funding Center.

Table 7 Bill Market, 1998—2012

Unit: 1 trillion yuan

Year	Cumulative issuance of commercial bills	Cumulative value of discounted bills
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

Source: People's Bank of China.

Table 8 Bond Market Trading, 1997—2012

Units: 100 million yuan, %

Year	Inter-bank bond market				Stock exchange treasury bond market				OTC market
	Spot trading	YoY change	Repo trading	YoY change	Treasury bond spot trading	YoY change	Treasury bond repo trading	YoY change	
1997	8.90	—	309.87	—	3,561.66	—	12,876.77	—	0
1998	76.39	758.31	1,021.48	229.65	6,059.9	70.1	15,540.86	20.69	0
1999	150.50	97.03	3,956.93	287.37	5,300.9	-12.5	12,890.44	-17.05	0
2000	647.66	330.33	15,784.94	298.92	4,157.5	-21.6	14,733.66	14.3	0
2001	844.34	30.37	40,133.30	154.25	4,815.6	15.8	15,487.63	5.12	0
2002	4,343.50	414.43	101,885.21	153.87	8,708.69	80.8	24,419.66	57.67	14.4
2003	31,609.70	627.75	117,203.41	15.03	5,756.16	-33.9	52,999.86	117.04	24.5
2004	28,196.45	-10.80	94,367.54	-19.48	2,966.5	-48.5	44,086.63	-16.82	62.2
2005	63,378.92	124.78	159,007.15	68.50	2,779.05	-6.3	23,261.2	-47.24	65.7
2006	109,326.62	72.50	265,912.71	67.23	1,540.7	-44.6	15,413.3	-33.74	42.8
2007	165,915.94	51.76	447,924.95	68.45	1,267.32	-17.7	18,345.09	19.02	35.7
2008	408,269.74	146.07	581,205.24	29.76	2,122.52	67.5	24,268.65	32.29	30.4
2009	488,682.15	19.7	702,898.60	20.94	2,085.11	-1.76	35,475.87	46.18	62.8
2010	676,872.18	38.5	875,935.55	24.62	1,661.64	-20.31	65,877.79	85.7	41.7
2011	677,585.53	0.11	994,534.79	13.54	1,252.92	-24.60	199,588.41	202.97	27.89
2012	708,413.22	4.54	1,417,140.3	42.49	881.43	-29.65	346,360.74	73.54	14.99

Note: *Repo trading includes pledged repo trading and outright repo trading.*
Sources: China Central Depository & Clearing Co., Ltd., People's Bank of China and China Foreign Exchange Trade System.

Table 9 Bond Market in 2012

Units: 100 million yuan, %

Month	Interbank bond market			Stock exchange treasury bond market			
	Spot trading	YoY change	Interbank aggregate bond index	Treasury bond spot trading	YoY change	Stock exchange treasury bond index	OTC market
Jan.	32,014.44	-24.44	116.8130	62.12	-11.23	131.78	0.41
Feb.	50,679.96	77.96	116.1506	79.03	45.12	132.03	1.28
Mar.	66,448.69	1.85	116.1842	89.24	-39.61	132.46	1.47
Apr.	51,891.71	-14.44	116.0280	62.4	-29.89	132.81	0.66
May	63,179.88	-2.14	117.4422	113.11	4.31	133.3	1.55
Jun.	58,908.95	-15.35	117.4454	72	-48.64	133.71	0.98
Jul.	63,143.24	-4.86	117.4153	89.84	-10.46	134.12	1.97
Aug.	69,088.25	4.80	116.5177	74.72	-30.45	134.51	1.48
Sept.	63,722.05	26.28	116.0679	49.01	-71.28	134.8	0.9
Oct.	5,2842.3	27.91	115.8591	61.48	-38.20	135.19	1.0
Nov.	67,250.55	23.07	115.8236	73.98	-27.35	135.48	1.93
Dec.	69,243.21	1.86	115.6976	54.5	-14.00	135.79	1.35
Total	70,8413.2	4.55	—	811.43	-29.65	—	14.99

Note: *Interbank aggregate bond index* refers to the net price index.
Sources: People's Bank of China, China Central Depository & Clearing Co., Ltd., Shanghai Stock Exchange and China Foreign Exchange Trade System.

Table 10 Issuance and Redemption of Treasury Bonds, 1998—2012

Unit: 100 million yuan

Year	Issuance	Redemption	End-period outstanding
1998	4,274	0	4,567
1999	2,446	0	6,751
2000	2,720	163	9,156
2001	3,084	360	10,973
2002	4,461	892	13,578
2003	5,442	735	21,014
2004	4,809	1,551	23,677
2005	5,042	2,121	26,587
2006	6,933	4,163	28,539
2007	21,883	4,090	46,113
2008	7,246	4,930	47,806
2009	14,214	7,570	54,057
2010	15,878	8,605	60,915
2011	13,998	8,578	64,486
2012	13,562	6,340	70,638

Notes: 1. Treasury bonds covered in the table exclude certificate savings bonds.
2. *Redemption* includes redemption before maturity and at maturity.
3. *End-period outstanding* refers to the outstanding value of all treasury bonds in custody in the interbank market and on the stock exchange, excluding those in OTC custody.

Sources: People's Bank of China and China Central Depository & Clearing Co., Ltd..

Table 11 Number of Interbank Bond Market Participants, 2000—2012

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

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 12 Interbank Bond Market Settlement Agents in 2012

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

Source: National Association of Financial Market Institutional Investors.

Table 13 Interbank Bond Market Makers

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

Source: National Association of Financial Market Institutional Investors.

Table 14 Participating Banks in Pilot OTC Bond Trading

Industrial and Commercial Bank of China	China Merchants Bank
Agricultural Bank of China	China Minsheng Banking Corp., Ltd.
Bank of China	Bank of Beijing
China Construction Bank	Bank of Nanjing

Source: People's Bank of China.

Table 15 OTC Trading of Book-Entry Treasury Bonds in 2012

Unit: 10,000 yuan

Bond code	Total face value traded	Bond code	Total face value traded	Bond code	Total face value traded
050005	3,213.11	081703	0.00	100005	598.75
050009	910.27	090001	1,750.23	100006	9,101.16
050013	2,324.71	090003	1,411.71	100007	647.25
060001	5,581.55	090004	669.52	100008	114.52
060006	353.68	090006	696.20	100010	3,264.44
060013	189.60	090007	813.70	100012	772.26
060020	607.99	090009	1,429.62	100013	1,194.29
061701	0.00	090010	308.40	100015	898.79
061702	0.00	090012	1,997.97	100016	132.44
0700002	1,146.98	090013	158.74	100017	1,301.66
0700003	1,947.81	090015	1,233.98	100019	1,064.12
0700004	1,691.71	090016	432.76	100020	260.15
0700005	273.58	090017	323.07	100022	939.56
0700006	1,860.80	090018	62.28	100024	325.17
0700008	207.22	090019	256.99	100025	418.20
070001	792.39	090022	2,502.95	100027	436.74
070003	956.89	090023	232.09	100028	1,414.46
070007	2,917.34	090024	253.80	100031	1,747.07
070010	628.13	090026	50.37	100032	1,164.09
070014	215.97	090027	151.84	100033	507.09
070018	2,756.21	090029	3,770.52	100034	576.61
071701	0.00	090031	249.93	100035	966.32
080001	913.78	090032	1,089.83	100038	265.07
080003	198.22	091701	2,623.91	100039	344.57
080007	650.30	091702	32,489.34	100041	845.96
080010	1,027.22	091703	3,276.52	101701	0.00
080014	1,065.04	091704	8,161.22	101702	14,621.96
080018	551.36	091705	0.00	101703	0.00
080022	1,247.09	091706	5,409.23	101704	7,808.46
080025	3,575.83	091707	0.00	101705	0.00
081701	0.00	091708	6,331.36	101706	10,681.37
081702	0.00	100002	507.50	101707	0.00

Table 15 OTC Trading of Book-Entry Treasury Bonds in 2012

Unit: 10,000 yuan

Bond code	Total face value traded	Bond code	Total face value traded	Bond code	Total face value traded
101708	7,182.05	110025	298.42	120010	956.23
101709	0.00	111701	1,055.85	120011	1,747.96
101710	11,809.56	111702	27,116.30	120014	110.72
101711	3,440.24	111703	15,286.51	120015	3,197.21
110001	105.66	111704	1,210.92	120016	681.29
110002	466.20	111705	18,774.33	120017	272.89
110003	393.15	111706	9,579.94	120019	3,475.69
110004	82.59	111710	1,755.25	120021	64.39
110006	249.71	111711	10,480.75	121701	43,975.27
110007	361.89	111712	4,458.16	121702	9,438.56
110008	416.99	111713	3,225.36	121703	20,193.44
110009	3,032.14	111714	15,441.79	121704	3,814.77
110011	4,184.75	111715	6,171.74	121705	0.00
110013	531.95	111716	2,229.90	121706	0.00
110014	92.84	111717	14,868.52	121707	0.00
110015	922.90	111718	7,693.46	121708	0.00
110017	142.08	120001	22,091.48	121709	25,433.94
110018	1,602.03	120002	5,924.09	121710	11,093.06
110019	619.50	120003	655.03	121711	10,742.97
110020	5,944.70	120004	756.34	121712	7,389.63
110021	365.67	120005	308.78	121713	5,302.84
110022	130.78	120007	460.27	121714	3,271.89
110024	509.74	120009	1,256.27		

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

Table 16 Primary Dealers for Open Market Operations in 2012

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

Source: People's Bank of China.

Table 17 Stock Market Statistics, 1997—2012

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	38,395.0	230,357.62	181,658.26	3,127.54	314,667.41	—	—	12.3	22.01	14,045.91

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.
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 18 Change in Stock Market Turnover and Indices, 1997—2012

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	1515	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	1,510.61	2,212.00	2,460.69	1,959.77	2,269.13	871.93	1,020.29	724.97	881.17

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

Table 19 Twenty-Six Market Makers for RMB Trading on 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	Guangdong Development Bank
Shenzhen Development Bank	Industrial Bank
China Minsheng Banking Corp., Ltd.	China Development Bank
Bank of Ningbo	BNP Paribas (China) Ltd.
Shanghai Pudong Development Bank	HSBC Bank (China) Co., Ltd.
Bank of Montreal (China) Co., Ltd.	Citibank (China) Co., Ltd.
Standard Chartered Bank (China) Ltd.	Royal Bank of Scotland (China) Co., Ltd.
Calyon (China) Ltd.	Sumitomo Mitsui Banking Corp. (China) Ltd.
Deutsche Bank (China) Co., Ltd.	Bank of Tokyo-Mitsubishi UFJ (China), Ltd.

Source: China Foreign Exchange Trade System.

Table 20 Foreign Exchange Market and Foreign Exchange Reserves, 1994—2012

Units: US$100 million, yuan

Year	Foreign exchange reserves	Foreign exchange market trading	USD100/CNY	EUR100/CNY	JPY/CNY	HKD100/CNY	GBP100/CNY	MYR/CNY100 (ringgit)	RUB/CNY100 (ruble)	AUD100/CNY	CAD100/CNY
1994	516.20	400.59	844.91	—	7.7800	112.660	—	—	—	—	—
1995	735.97	646.73	831.79	—	8.0703	107.600	—	—	—	—	—
1996	1,050.49	627.75	829.92	—	7.1613	107.190	—	—	—	—	—
1997	1,398.90	697.15	827.98	—	6.3627	106.810	—	—	—	—	—
1998	1,449.59	520.11	827.87	—	7.1719	106.780	—	—	—	—	—
1999	1,546.75	314.64	827.93	—	8.0933	106.510	—	—	—	—	—
2000	1,655.74	421.97	827.81	—	7.2422	106.060	—	—	—	—	—
2001	2,121.65	750.33	827.66	—	6.3005	106.060	—	—	—	—	—
2002	2,864.07	971.90	827.73	863.60	6.9035	106.110	—	—	—	—	—
2003	4,032.51	1,511.31	827.69	1,033.83	7.7263	106.570	—	—	—	—	—
2004	6,099.32	2,090.41	827.65	1,126.27	7.9701	106.370	—	—	—	—	—
2005	8,188.72	—	807.02	957.97	6.8716	104.030	—	—	—	—	—
2006	10,663.44	—	780.87	1,026.65	6.5630	100.467	1,532.32	—	—	—	—
2007	15,282.49	—	730.46	1,066.69	6.4064	93.638	1,458.07	—	—	—	—
2008	19,460.30	—	683.46	965.90	7.5650	88.189	987.98	—	—	—	—
2009	23,992.00	—	682.82	979.71	7.3782	88.048	1,097.80	—	—	—	—
2010	28,473.38	—	662.27	880.65	8.1260	85.093	1,021.82	46.649	462.05	—	—
2011	31,811.00	—	630.09	816.25	8.1103	81.070	971.16	50.279	508.60	640.93	617.77
2012	33,116.00	—	628.55	831.76	7.3049	81.085	1,016.11	48.865	485.28	653.63	631.84

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

Table 21 Futures Market Trading, 1993—2012

Units: 100 million yuan, 10,000 lots

Year	Commodity futures market		Stock index futures market	
	Turnover	Trading volume	Turnover	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

Notes: Futures trading volumes are single counted as of 2011. Data in the table exclude Exchange for Physical transactions.
Source: China Securities Regulatory Commission.

Table 22 Gold Market Trading, 2003—2012

Units: 100 million yuan, tonnes

Year	Turnover	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

Source: Shanghai Gold Exchange.

Table 23 OTC Gold Businesses of Commercial Banks, 2007—2012

Business type		Account gold		Brand gold		Others							
Product (Units)		USD-denominated gold (10,000 oz, US$100 million)	RMB-denominated gold (tonne, 100 million yuan)	Proprietary (tonne, 100 million yuan)	Agent (tonne, 100 million yuan)	Gold lease (tonne, 100 million yuan)	Gold loan (tonne, 100 million yuan)	Gold accumulation (tonne, 100 million yuan)	Onshore USD gold forwards (10,000 oz, US$100 million)	Onshore USD gold options (10,000 oz, US$100 million)	Onshore USD gold swaps (10,000 oz, US$100 million)	Onshore RMB gold forwards (tonne, 100 million yuan)	Gold pledge (tonne, 100 million yuan)
2007	Trading volume	157.68	352.71	6.09	3.96	33.11	1.2	—	204.93	8.48	—	—	—
	Turnover	11.08	607.05	11.2	7.16	56.4	2.31	—	11.84	0.598	—	—	—
2008	Trading volume	293.09	1,332.55	33.12	4.13	73.99	11.4	—	574.85	6.28	—	—	—
	Turnover	25.37	2,546.3	66.68	8.18	141.5	20.16	—	54.44	0.579	—	—	—
2009	Trading volume	579.96	1,381.16	40.73	3.43	91.29	7.56	0.542	162.06	2.29	—	—	—
	Turnover	57.34	2,923.48	89.9	7.64	191.98	15.09	1.3	15.98	0.223	—	—	—
2010	Trading volume	418.67	1,205.15	80.4	3.06	155.8	10.63	12.27	257.82	1.74	—	3.09	0.27
	Turnover	51.47	3,227.49	222.9	8.53	413.25	28.85	35.29	32.75	0.21	—	8.78	—
2011	Trading volume	447.2	1,864.4	129.5	6.16	301.3	31.99	30.3	407.04	6.06	17.99	5.09	4.56
	Turnover	72.21	6,271.71	428.5	21.49	970.55	104.92	102.18	64.69	0.9	2.74	17.59	—
2012	Trading volume	424.35	1,458.89	126.2	10.55	465.01	54.8	59.85	1331.5	61.46	49.93	20.95	7.426
	Turnover	70.71	4,947.18	443.7	41.2	1,583.7	187.23	205.82	222.01	10.17	8.35	70.91	—

Source: People s Bank of China Shanghai Head Office.

Table 24 Interest Rate Derivatives Trading, 2006—2012

Unit: 100 million yuan

Year	Interest rate swaps		Bond forwards		Forward rate agreements	
	Number of transactions	Notional principal amount	Number of transactions	Notional principal amount	Number of transactions	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

Source: China Foreign Exchange Trade System.

Table 25 Bond Market Issuance, 1998—2012

Unit: 100 million yuan

Year	Treasury bonds	Local government bond	Policy bank bonds	Central Bank bills	Non-policy financial bonds	Short-term financing bills	Super Short-term financing bills	Private debt financing instruments	Asset-backed securities	Others	Bonds of enterprises	Medium-term notes	Collective notes	Corporate bonds	Convertible bonds	Detachable convertible bonds	SME private placement bonds	Total
1998	4,274	0	1,930	0	0	0	0	0	0	0	0	0	0	0	0	0	—	6,204
1999	2,446	0	1,851	0	0	0	0	0	0	0	73	0	0	0	0	0	—	4,370
2000	2,720	0	1,645	0	0	0	0	0	0	0	50	0	0	0	0	0	—	4,415
2001	3,084	0	2,590	0	35	0	0	0	0	0	140	0	0	0	0	0	—	5,849
2002	4,461	0	3,175	1,938	45	0	0	0	0	0	325	0	0	0	0	0	—	9,944
2003	5,442	0	4,520	7,227	100	0	0	0	0	0	358	0	0	0	182	0	—	17,829
2004	4,809	0	4,348	17,037	775	0	0	0	0	0	326	0	0	0	213	0	—	27,508
2005	5,042	0	6,032	27,882	1,065	1,424	0	0	42	21	654	0	0	0	0	0	—	42,162
2006	6,933	0	8,980	36,574	570	2,920	0	0	116	9	995	0	0	0	111	0	—	57,208
2007	21,883	0	10,932	40,721	973	3,349	0	0	178	0	1,720	0	0	52	106	0	—	79,914
2008	7,246	0	10,809	42,960	974	4,332	0	0	302	0	2,367	1,737	0	381	77	633	—	71,818
2009	14,214	2,000	11,678	39,740	3,071	4,612	0	0	0	10	4,252	6,885	13	638	47	30	—	87,190
2010	15,878	2,000	13,193	46,608	980	6,742	150	0	0	1,090	3,627	4,924	47	603	717	0	—	96,559
2011	13,998	2,000	19,973	14,140	3,529	8,028	2,090	899	0	1,000	2,485	7,270	66	1,262	413	32	—	77,185
2012	13,562	2,500	21,777	0	5,016	8,359	5,822	3,813	250	1,500	6,474	8,423	100	2,472	157	0	94	80,319
Total																		588,104

Notes: 1. *Treasury bonds* excludes certificate savings bonds.
2. *Non-policy financial bonds* includes bonds of commercial banks, bonds of non-banking financial institutions etc..
3. *Asset-backed securities* includes credit asset-backed securities and asset-backed notes of non-financial enterprises.
4. *Collective notes* includes those issued by promising regional SMEs.
5. *Others* includes government-sponsored agency bonds, government-backed bonds, bonds of international institutions etc..

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

Table 26 Bond Custody, 1997—2012

Unit: 100 million yuan

Year	Interbank bond custody													Exchange-traded bond custody							
	Treasury bonds	Local government bonds	Central bank bonds	Financial bonds	Bonds of enterprises	Short-term financing bills	Super Short-term financing bills	Private debt financing instruments	Asset-backed securities	Medium-term Notes	Collective Notes	Others	Total	Treasury bonds	Local government bonds	Bonds of enterprises	Corporate bonds	Convertible bonds	Detachable convertible bonds	SME private placement bonds	Total
1997	573	0	119	3,429	0	0	0	0	0	0	0	0	4,121	—	—	—	—	—	—	—	—
1998	4,567	0	119	5,107	91	0	0	0	0	0	0	0	9,884	—	—	—	—	—	—	—	—
1999	6,751	0	119	6,089	230	0	0	0	0	0	0	0	13,189	—	—	—	—	—	—	—	—
2000	9,156	0	0	7,301	289	0	0	0	0	0	0	0	16,746	—	—	—	—	—	—	—	—
2001	10,973	0	0	8,419	336	0	0	0	0	0	0	0	19,728	—	—	—	—	—	—	—	—
2002	13,578	0	1,488	9,875	643	0	0	0	0	0	0	0	25,584	—	—	—	—	—	—	—	—
2003	17,470	0	3,377	11,790	875	0	0	0	0	0	0	0	33,512	3,544	0	364	0	205	0	—	4,113
2004	19,710	0	11,708	14,508	819	0	0	0	0	0	0	0	46,745	3,967	0	397	0	335	0	—	4,699
2005	23,103	0	22,628	19,686	1,398	1,380	0	0	0	0	0	0	68,195	3,484	0	395	0	249	0	—	4,128
2006	25,407	0	32,300	25,388	2,416	2,667	0	0	188	0	0	21.3	88,387.3	3,132	0	532	0	121	0	—	3,785
2007	43,256	0	36,587	32,270	4,038	3,203	0	0	324	0	0	30	119,708	2,857	0	690	0	99	0	—	3,646
2008	45,232	0	48,121	40,968	6,365	4,203	0	0	551	1,672	0	30	147,142	2,574	0	420	437	139	921	—	4,491
2009	51,944	2,000	42,326	50,952	10,261	4,561	0	0	339	8,622	13	40	171,058	2,113	0	467	1,296	120	951	—	4,947
2010	58,938	4,000	40,909	58,266	13,606	6,530	150	0	182	13,536	55	1,130	197,302	1,977	0.02	447	2,117	787	951	—	6,279
2011	62,497	5,997	19,490	72,488	14,617	7,861	450	899	90	19,743	108	2,130	206,370	1,989	3.32	1,546	2,856	1,163	871	—	8,428.32
2012	68,856	6,497	11,640	89,928	19,550	8,327	3,531	4,502	325	24,922	188	3,630	241,896	1,782	3.3	3,230	5,340	1,255	752	94	12,456.3

Notes: 1. Data on interbank bond custody come from the China Central Depository & Clearing Co., Ltd. and the Shanghai Clearing House. Data on stock exchange bond custody come from the China Securities Depository and Clearing Corp., Ltd..

2. Interbank bond custody data exclude OTC custody data.

3. *Financial bonds* includes bonds issued by policy banks, commercial banks and non-banking financial institutions as well as short-term financing bills issued by financial enterprises.

4. *Asset-backed securities* includes credit asset-backed securities and asset-backed notes of non-financial enterprises.

5. *Collective* notes includes those issued by promising regional SMEs.

6. *Others* includes government-sponsored agency bonds, government-backed bonds, foreign bonds etc..

7. All custody data are based on face value of bonds.

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