FINANCIAL MARKET

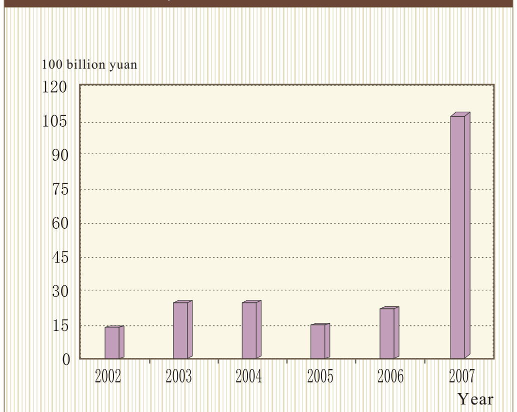
In 2007, the overall performance of China's financial markets was sound and steady. Affected by factors such as the widening trade surplus and increase of the RMB equivalent of foreign exchange reserves, market liquidity was relatively abundant. Trading volume in the inter-bank borrowing market increased rapidly with a higher volatility of the interest rate. The size of the bond market continued to expand, with an increasing variety of products. Trading volume in the stock market soared with the stock indices climbing up rapidly. Fund management sector developed fast with its return rising sharply. There were a wide variety of instruments in the foreign exchange market, and the central parity rate of the RMB against the US dollar edged down amidst two-way fluctuations, with its flexibility continuously enhanced. The PBC continued to promote product innovation, introduce benchmark interest rate, expand participants and products in the inter-bank bond market, and speed up the opening of China's financial market to the outside world, so as to advance sustainable development of various financial markets.

Inter-bank Borrowing Market Performance

Market transaction In 2007, trading volume in the inter-bank borrowing market rose remarkably and the turnover of the electronic transaction system of the inter-bank market registered 10.65 trillion yuan. The turnover of the borrowings filed with the PBC branches registered 19 million yuan. The total of these two types of transactions increased by fourfold from the previous year (Figure 6).

The huge increase in trading volume mainly resulted from a trend of shortening maturities in fund demand and an unbalanced allocation of funds.

Figure 6 Transaction Volume in the Inter-bank Borrowing Market, 2002 ~ 2007



Source: www.chinamoney.com.cn

First, transactions mainly focused on overnight and 7-day products. The turnover of overnight products registered 8.030468 trillion yuan, accounting for 75.4 percent of the total trading volume. In contrast, the turnover of overnight products in 2006 only registered 635.211 billion yuan, accounting for 29.54 percent of the total. The turnover of overnight and 7-day products amounted to 10.20848 trillion yuan, accounting for 95.9 percent of the total trading volume, increasing by more than 4 times over the previous year.

Second, there was a large disparity in the growth of transaction volume of different institutions. Borrowing and lending volume of state owned commercial banks, other commercial banks[1] and foreign financial institutions[2] increased rapidly, while the borrowing and lending volume of other financial institutions[3] increased moderately. The borrowing volume of securities firms[4] increased, while their lending volume decreased. State-owned commercial banks transformed from net fund providers to the largest net borrowers with outstanding 1.10 trillion yuan of net borrowing; other commercial banks were net fund providers; other financial institutions, securities and fund companies,

Notes: 1. Other commercial banks included joint-stock commercial banksand city commercial banks.
2. Foreign financial institutions included foreign banks, foreign insurancecompanies, foreign finance companies, foreign securities companies, foreign fundcompanies and other foreign financial Companies.
3. Other financial institutions included policy banks, ruralcommer cial banks, rural cooperative banks, associations ofrural credit cooperatives, finance companies, trust and investment companies, financial leasing companies, asset managementcompanies, postal saving banks, and social security funds.
4. Securities firms included securities investment funds.

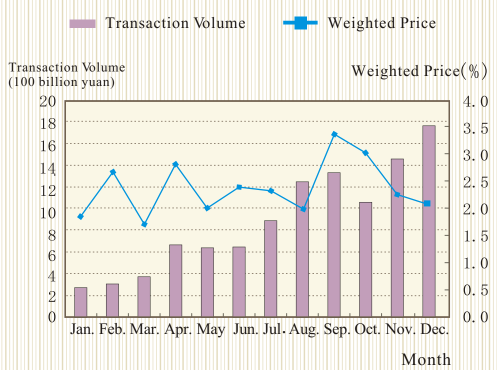
and foreign financial institutions were net borrowers.

There were two main reasons behind the hike in trading volume. One was the policy factor. Since 2007,the central bank has used several monetary policy instruments to mop up market liquidity, and the excess reserves of all financial institutions has decreased rapidly. During the festival periods and when the financial institutions submitted special deposits to the central bank, fund demand in the market rose significantly, resulting in a surge of trading volume. Furthermore, the State Administration of Foreign Exchange (SAFE) has cut yearly short-term foreign debt quotas for financial institutions gradually and urged them to obtain funding from the domestic money market via borrowing and swap, which has also increased the trading volume of the inter-bank borrowing transactions. Secondly, market building was strengthened. *The Rules on the Administration of Inter-bank Lending/Borrowing* was revised in July, which comprehensively adjusted some articles such as those on market entry, maturity management, quota management, filing management, transparency management, supervision and administration, etc. The coverage of inter-bank market participants was enlarged by the new rules, and fund borrowers and suppliers were further diversified. In January, Shibor was introduced. Shibor quoters participated in the transactions actively while other market participants, especially some small rural credit cooperatives referred to Shibor quotation to conduct OTC transactions, making the whole market more active. Third, foreign financial institutions showed more interest in the inter-bank market. The borrowings by foreign financial institutions accounted for 13.6 percent of the total volume, and their net borrowing amounted to 608 752 billion yuan, only less than state-owned commercial banks and securities firms.

Market interest rate While the turnover of inter-bank borrowing market increased markedly, the interest rate volatility was relatively high (Figure 7). In 2007, the highest monthly weighted interest rate averaged 3.3589 percent, and the lowest averaged 1.7359 percent, with the range being 162 bps. Among this, the lowest overnight borrowing rate was 1.2329 percent and the highest was 15.0000 percent, with the range being 1377 bps.

The high volatility of the interest rate in the inter-bank market was mainly influenced by the rapid development of the capital market. Funds flowed to the booming stock market to earn higher yield. Affected by factors such as inter-bank fund depositing and pre-IPO capital verification, funds allocation of financial institutions witnessed some big changes, and there was sometimes short-term structural scarcity of funds. Financing requirement via inter-bank borrowing increased. Inter-bank borrowing interest rates, especially short-term rates fluctuated notably, usually starting to climb before the subscription of big-cap IPO and falling back to normal level after the IPO was completed. For example, in mid-April when China CITIC Bank and Bank of Communications issued A-shares for the first time, the 7-day inter-bank weighted average interest rate climbed to 4.83 percent on April 24. In mid-June, with the IPO of COSCO Company, 7-day inter-bank weighted borrowing rate increased by 236 bps to 4.40 percent. In September, the IPOs of

Figure 7 Transaction Volume and Weighted Price in the Inter-bank Borrowing Market in 2007



Source: www.chinamoney.com.cn

some big-cap stocks such as Bank of Beijing, China Construction Bank, Shenhua Group Corporation left an unusually tight situation in the money market, and the 7-day inter-bank average weighted borrowing rate increased from less than 3 percent in early September to 7.27 percent on September 25. In later October, during the IPO of A-shares by PetroChina Corporation, the 7-day inter-bank average weighted borrowing rate quickly increased by 632 bps in four working days to 9.71 percent, the highest of the whole year.

Investors in the inter-bank borrowing market The newly revised *Rules on the Administration of Inter-bank Lending/Borrowing* enabled trust companies, financial asset management companies, financial leasing companies, automobile financing companies, insurance companies and insurance asset management companies to participate in the inter-bank borrowing market. At end-2007, the number of participants in the inter-bank borrowing market including banks, securities firms, finance companies, rural credit cooperative associations, urban credit cooperatives and trust companies increased by 14 to 717 from end-2006. Among new market participants, 5 were trust companies.

Bond Market Performance

Bond issuance Innovative products in the bond market have been developed steadily, with the bond issuance gradually expanding. The proportion of direct financing has been increasing, which has shattered the dominance of indirect financing for a long time, and the financing channels of enterprises has been broadened. The issuance of RMB bonds in the inter-bank bond market amounted to 3.74313 trillion yuan, representing a growth of 95.85 percent year on year, among which, the issuance of book-entry government bonds by the Ministry of Finance registered 2.18495 trillion yuan, representing a growth of 234.43 percent year on year. In particular, the issuance of special government bonds was 1.55023 trillion yuan, greatly contributing to the issuance of book-entry government bonds. Policy banks issued 1.09319 trillion yuan of financial bonds, representing a growth of 21.74 percent year on year. At end-2007, the outstanding custody bonds in the bond market posted 12.33 trillion yuan, among which, the custody bonds in the inter-bank market amounted to 12.01 trillion yuan, representing a growth of 35.86 percent year on year (Figure 8). The custody bonds in the stock exchanges amounted to 32 million yuan, representing a decrease of 9.43 percent year on year.

Bond products were more diversified both in variety and credit layers. With the steady progress of issuance of ordinary financial bonds, subordinate bonds and hybrid capital bonds by commercial banks, qualified finance companies were also allowed to issue ordinary financial bonds to raise funds via the inter-bank market directly. In 2007, ordinary financial bonds, subordinate bonds, hybrid capital bonds issued by commercial banks registered 44.62 billion yuan, 33.65 billion yuan, 4 billion yuan respectively, while ordinary financial bonds issued by finance companies registered 15 billion yuan. Railway bonds were introduced into the inter-bank market, and the Ministry of Railway issued 15 billion yuan of railway bonds via the bond issuance system of the PBC. which positively expanded the variety of quality bond products in the inter-bank market and broadened the market capacity. The pilot asset securitization program made progress, with four commercial banks issuing a total of 17.808 billion yuan of asset-backed securities. Short-term financing bill market developed in a steady pace. In 2007, 264 short-term financing bills were issued in the inter-bank market, with face value registering 335.61 billion yuan, of which 233 bills were redeemed with a face value of 282.01 billion yuan. At end-2007, there were 257 bills outstanding, totaling 320.31 billion yuan, a growth of 20 percent from the previous year. The issuance of corporate bonds was initiated, and 11.2 billion yuan of corporate bonds was issued on the Shanghai Stock Exchange and the Shenzhen Stock Exchange. Bond issuers include various market participants such as the Ministry of Finance, the Ministry of Railway, policy banks, commercial banks, non-banking financial institutions, international development institutions and enterprises. Bond products with different credit layers have increasingly diversified.

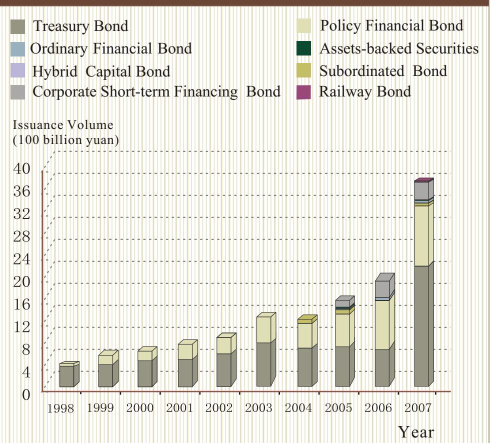
In terms of maturity structure, the proportion of long-term bonds rose rapidly. The reason was that the maturities of the 1.5 trillion yuan of special government bonds were either ten years or fifteen years. In addition, the issuance of railway bonds, subordinate bonds, and hybrid capital bonds also increased the proportion of long-term bonds to some extent. In 2006, bonds with a maturity less than five years accounted for 29.1 percent in bond issuance, down 26.1 percent from the previous year. Bonds with a maturity of 5-10 years (including five years) accounted for 17.0 percent, down 9 percent from the previous year. Bonds with a maturity of more than ten years (including ten years) accounted for 53.9 percent, representing a whopping growth of 35.1 percent over the previous year (Figure 9).

Market transaction performance Market liquidity was abundant in 2007. Since the beginning of the year, the PBC has used a mix of several monetary policy instruments, such as issuing central bank bills and raising the reserve requirement ratio, to mop up liquidity. The effect of macroeconomic management gradually unfolded. Since April, both the inter-bank market bond index and the stock exchange bond index trended down (Figure 10). The inter-bank market bond index decreased by 1.74 percent, or down 2.03 points to 114.76 points from 116.79 points at the beginning of 2007. Treasury bond index in the stock exchange declined by 0.47 percent, or down 0.52 points to 110.87 points from 111.39 points at the beginning of 2007.

Secondary market performance in 2007 had the following features:

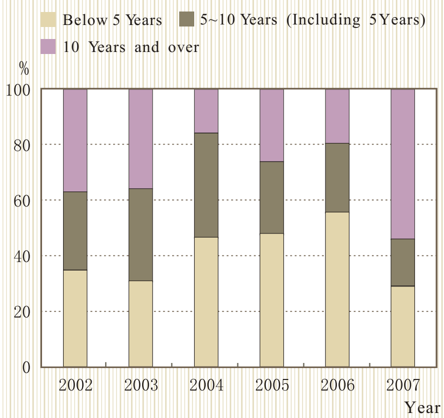
First, the trading volume grew by a large margin. In 2007, the turnover in the inter-bank market reached 60.4 trillion yuan and the daily transaction volume averaged 242.56 billion yuan, up 82.15 percent from a year earlier (Figure 11). In particular, the turnover of outright bond purchase reached 15.6 trillion yuan, with daily averaged transaction volume increasing by 52.14 percent. The main factors behind this hike included abundant market liquidity, increasingly diversified bond products in the inter-bank market and the steadily expanding size of issuance. The turnover of repo

Figure 8 Volume of Bond Issuance, 1998~2007



Source: China Government Securities Depositary Trust & Clearing Co., Ltd.
Note: All annual data did not include central bank bills.

Figure 9 Maturity Structure of New Issues in the Inter-bank Bond Market, 2002 ~ 2007



Source: China Government Securities Depository Trust & Clearing Co., Ltd.

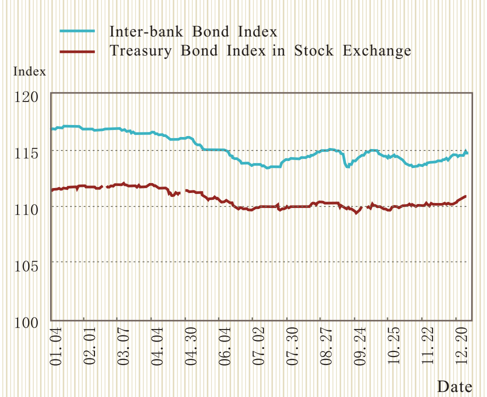
increased by 18.2 trillion yuan from a year earlier and the daily averaged transaction volume increased by 68.45 percent. Affected by factors such as IPOs of big-cap stocks which freezed huge amount of funds, brisk stock market, and the market expectation for the unveiling of new monetary polices, institutions have showed different demand for short-term capital in certain periods, and transactions in the repo market was active with the turnover increasing rapidly.

Second, short-term transactions accounted for a large proportion. The turnover of repos within 7 days amounted to 39.39 trillion yuan, accounting for 87.93 percent of the total. The maturity structure was mainly focused on short-term, and the role of the market in adjusting liquidity among different institutions became more significant.

Market interest rate Since 2007, due to the gradually moving up of CPI, widening trade surplus and abundant market liquidity, the PBC has introduced a series of monetary policy measures to mop up liquidity. As the effect of monetary policy unfolded gradually, the interest rates in the repo market moved up. The stock market also had an increasing impact on the interest rate in the repo market. Expectations for the macroeconomic management measures and the huge fund demands before the IPOs caused the repo market interest rates to fluctuate significantly during certain periods. In December, the weighted average interest rate of 7-day bond pledged repos rose by 180 bps from January to 3.49 percent. Huge freeze of funds before the IPOs of big-cap stocks went in parallel with interest rate fluctuations in different periods (Figure 12).

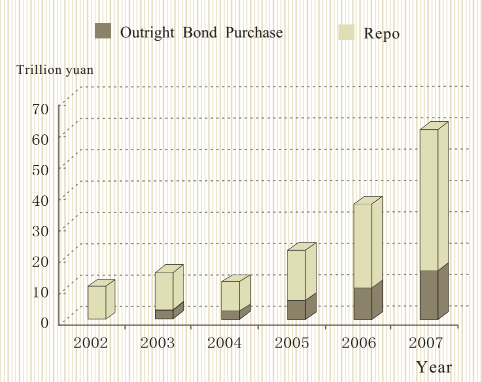
Driven by policy factors such as interest rate hike, the yields of government bonds in the inter-bank market rose substantially. In particular, from January to July, bond prices in the inter-bank market gradually declined and bond yields saw an overall upward trend while the treasury bond yield curve in the inter-bank bond market moved up steeply. From mid-July to end-August as the market expectations changed, the yield curve of treasury bonds changed direction. The yield of short-term treasury bonds increased slightly while the yields of medium- and long-term treasury bonds fell sharply. The treasury bond yield curve in the inter-bank bond market displayed an overall flattening trend. Thereafter, the yield curve displayed an overall upward trend. At end-2007, the yields of long-term treasury bond broadly recovered to the level in late July and the yields of medium- and short-term treasury bond rebounded more quickly, with the treasury bond yield

Figure 10 The Inter-bank Bond Index and Treasury Bond Index in the Stock Exchange in 2007



Source: China Government Securities Depository Trust & Clearing Co. Ltd and the Shanghai Stock Exchange

Figure 11 Transaction Volume in the Inter-bank Bond Market, 2002~2007



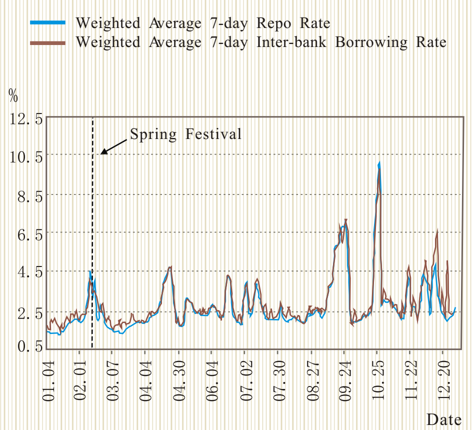
Source: National Inter-bank Funding Center curve further flattening (Figure 13).

Investors in the inter-bank bond market At end-2007, the number of participants including banks, securities companies, fund management companies, insurance companies, non-bank financial institutions, credit cooperatives and enterprises in the inter-bank bond market was 7 095 656 more than a year earlier. The number of inter-bank bond market participants continued the momentum of rapid expansion over the past years. Investors were further diversified, with the number of non-financial institutions and institutions offering collective investment schemes increasing rapidly. Among the new market participants, there were 490 enterprises, 75 fund companies, 47 credit cooperatives, 19 banks, 9 insurance companies, and 5 securities companies.

Financing situation The direction of funds flow was broadly stable. Large commercial banks, joint-stock commercial banks, city commercial banks, associations of rural credit cooperatives, foreign financial institutions, other financial institutions[5], fund companies and insurance companies actively participated in the market. Large commercial banks and joint-stock commercial banks were still the main net funds providers due to their large assets size, numerous outlets, strong capability to absorb deposits, higher excess reserve ratios, abundant funds and stable position. Regional financial institutions with relatively low deposit/loan ratio and excess reserve ratio and large fluctuations in fund positions, such as city commercial banks and associations of rural credit cooperatives were the main net borrowers, who frequently used the money market for funding. Securities companies were also the main borrowers in the money market as stock indices hiked, transactions grew and continuous stock IPOs brought about considerable revenues.

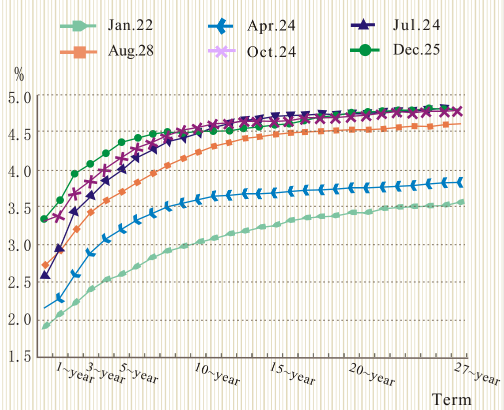
OTC transactions The OTC transactions of commercial banks proceeded stably with the following features: first, the pilot OTC transaction of book-entry government bonds by commercial banks expanded. There were four new participants in the business, including China Merchants Bank, China Minsheng Banking Corporation, Beijing Bank, and Nanjing Bank. Second, there were more trading products of book-entry government bonds integrated in the OTC transactions by commercial banks including those bonds covering major maturity types, and 6 batches of special government bonds were issued via OTC. Third, the turnover declined slightly although the number of

Figure 12 Money Market Interest Rates in 2007



Source: National Inter-bank Funding Center

Figure 13 Treasury Bond Yield Curve in the Inter-bank Market in 2007



Source: China Government Securities Depository Trust & Clearing Co. Ltd.

Note: 5. Other financial institutions mainly included postal saving banks, finance companies and urban credit cooperatives.

newly opened accounts continued to increase. Thanks to the continuous rally of stock market, which attracted many individual investors and idle funds, the turnover of government bonds OTC transactions declined to 4.705 billion yuan, down 44.3 percent from a year earlier (Figure 14). The number of newly opened accounts continued to rise to 381 600. With the increased number of commercial bank outlets, the impact of OTC market emerged gradually.

Stock Market Performance

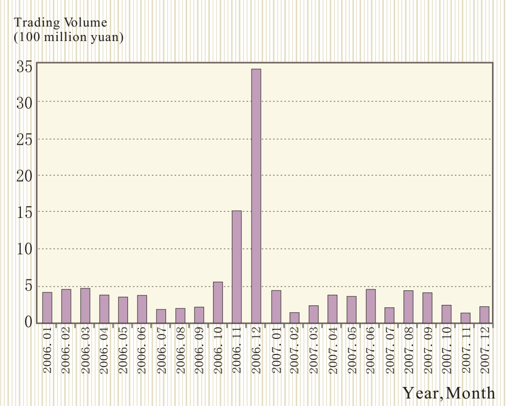
Market Scale The financing function of the stock market continued to improve. In 2007, the total fund raising in the A share market amounted to 781.681 billion yuan, more than three times of the previous year, among which, there were 121 IPOs, raising 446.996 billion yuan. Additional issuance raised 311.917 billion yuan. Rights issuance raised 22.768 billion yuan (Figure 15). Several new big-cap stocks had their IPOs in the A share market, such as Bank of Communications, China Construction Bank, COSCO Ltd. and China Petroleum, etc.

In 2007, there was a total of 1 616 stocks (including both A shares and B shares) of 1 530 listed companies issued on the Shanghai Stock Exchange and the Shenzhen Stock Exchange. Among this, 904 stocks were issued by 860 companies listed on the Shanghai Stock Exchange and 712 stocks were issued by 671 companies listed on the Shenzhen Stock Exchange. The growth of market capitalization was far larger than that of stock index. The total capitalization on both exchanges swelled to 32.714 trillion yuan and the value in circulation was 9.3064 trillion yuan, up by 266 percent and 300 percent year on year respectively.

Market index In 2007, the A-share market continued to rally with the stock indices rising rapidly. At the beginning of 2007, the Shanghai Composite Index opened at 2 715.72 and then climbed up slowly. On May 30, because the rate of stamp duty was increased from 0.1 percent to 0.3 percent, the market indices declined considerably in the following trading days. Thereafter, the indices recovered slowly and climbed to the highest point of the year to 6 036.28 on October 17 before trending down to close at 5 261.56 at end-2007. The Shengzhen component index opened at 6 705.34 at the beginning of 2007, the lowest point of the year, and reached its highest point–19 144. 62 before trending down to close at 17 700.62 at end-2007.

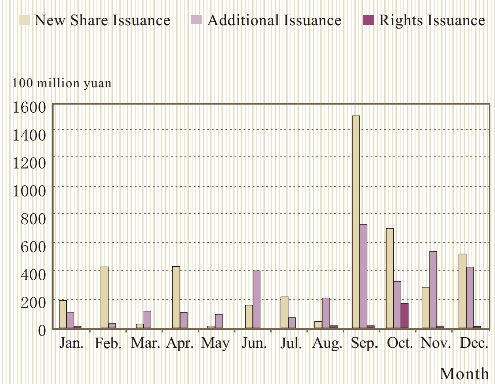
Market transaction With the rally of A-share indices, the trading volume increased remarkably. Trading volumes on both exchanges reached historical

Figure14 Monthly Trading Volume of Government Bonds OTC Transactions Since 2006



Source: China Government Securities Depository Trust & Clearing Co. Ltd.

Figure 15 Fund-raising in A-share Market in 2007



Source: Wind Info.

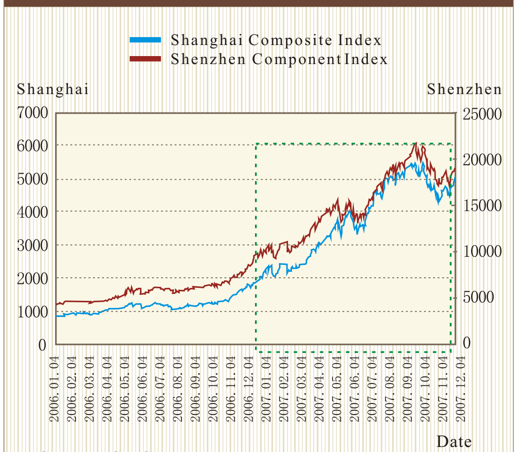
highs. The total accumulative trading volume registered 46.06 trillion yuan for the whole year, 5 times of 2006.

Fund Market Performance

Market size Affected by many factors such as enhanced regulation of the fund market, the favorable development of the stock market, and the increase of market demand, the size of fund sector increased considerably. At end-2007, the number of fund investors exceeded 100 million, eight-fold over the previous year, and there were 368 funds in the market with net assets of 3.3 trillion yuan, up 11.9 percent and 282.8 percent year on year respectively.

Types of funds Since 2007, fueled by the favorable development of the stock market, the equity funds and mixed-asset funds developed rapidly. At end-2007, there were 171 equity funds and 107 mixed-asset funds outstanding , accounted for 62.07 percent and 32.05 percent, in terms of asset value, of the total value of fund market respectively. The aggregate number of bond funds, money market funds and principal-guaranteed funds was 90, the asset values of which accounted for 6 percent of the total market.

Figure 16 Shanghai Composite Index and Shenzhen Component Index, 2006～2007



Source: CEIC

Fund return Thanks to the rally of the A-share market, the net assets value of funds rose sharply and the return of funds increased rapidly. According to the figures of Wind Info., the average return of equity funds (more than one year) in 2007 was 128 percent, and the returns of aggressive funds, close-ended funds and money market funds were 104.5 percent, 99.9 percent, and 3.21 percent respectively.

Foreign Exchange Market Performance

Spot trade of RMB vs. foreign exchanges The daily average transaction volume of the RMB vs. foreign exchanges in the inter-bank spot market increased by about 100 percent over the previous year. The transaction volume of the OTC spot market accounted for 99 percent of the total transactions. Among this, the transactions of RMB vs. US dollar accounted for the lion's share. At end-2007, the spot price of RMB vs. US dollar was 7.3046, down 5 041 bps from a year earlier, representing 6.90 percent of appreciation over the previous year, which was much higher than 3.36 percent in 2006. The daily floating band of RMB vs. US dollar averaged 94 bps, much wider than the 72 bps in 2006, and the flexibility of RMB spot price improved gradually.

RMB forward and swap transactions In 2007, there were 2 952 lots of transactions in the RMB forward market, totaling US$22.387 billion with a daily average of US$93 million, up 60.34 percent year on year. The transactions in the RMB swap market amounted to 15 948 lots, totaling US$315.467 billion, with a daily average of US$1.304 billion, representing a whopping increase of 333.19 percent year on year. Among this, the transactions of RMB vs. US dollar accounted for the lion's share, more than 99 percent of the total.

Foreign currency pairs transactions In 2007, the transactions of foreign currency pairs in the inter-bank market amounted to 27 913 lots, totaling

US$89.816 billion, with a daily average of US$ 371 million, up 19.16 percent year on year. Among 8 foreign currency pairs, the US dollar against the Hong Kong dollar, the Euro against the US dollar, and the US dollar against the Yen were the most actively traded currency pairs, the turnovers of which accounted for 31.37 percent, 28.85 percent and 25.87 percent of the total respectively.

Foreign exchange funding market The total number of transactions in the foreign exchange funding market amounted to 138, with a total turnover of US$1.624 billion and a daily average turnover of US$7 million, down 45.91 percent year on year. Most of the borrowing maturities were less than two months.

Gold Market Performance

Market functioned well Transactions in the gold market were very active and the turnover rose remarkably. In 2007, the gold transaction volume totaled 1 828.13 ton, up 578.53 ton or 46.30 percent year on year. The transactions valued at 316.49 billion yuan, up 121.739 billion yuan or 62.51 percent year on year. Daily transaction averaged 7 554.26 kg, up 46.9 percent year on year. The domestic gold price reached a peak of 200.70 yuan/gram, with the largest daily transaction volume 24 767 kg, both at an all-time high since the establishment of the Shanghai Gold Exchange (Figure17).

Gold price volatility intensified Gold price in the international market fluctuated at a high level. At the beginning of 2007, gold price was US$639.75 per ounce. January through August of 2007, gold price fluctuated between US$600 and US$700. Since September, gold price surged rapidly, and the London gold fixing price hit a 27-year high of US$841.1 per ounce, crossing over the threshold of US$840 per ounce. Thereafter, gold price fluctuated around US$800 per ounce and closed at US$829 per ounce at end-2007, increasing by 29.58 percent year on year.

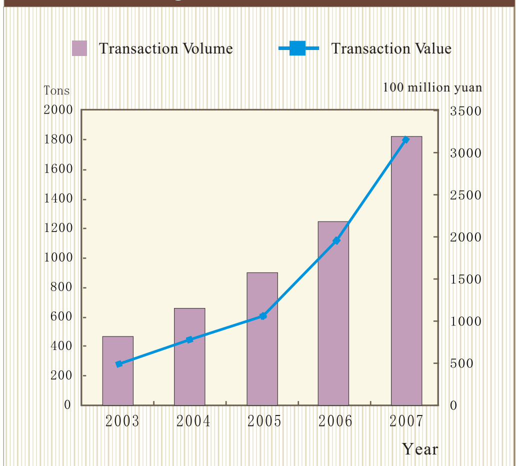
Domestic price was closely linked to that in the international market and demonstrated a similar trend. Gold price in domestic market surged from 158.99 yuan per gram in the beginning of 2007 to 194.22 yuan per gram at end-2007, increasing by 22.16 percent year on year. In 2007, the peak gold price was 200.70 yuan per ounce, while the bottom was 152.80 yuan per ounce, resulting in a weighted average of 170.12 yuan per ounce, 15.01 yuan higher than that of 2006.

Main Policy Measures in the Financial Market

Product innovation was further advanced Efforts were made to continuously advance the pilot asset-backed securitization program. In 2007, 4 financial institutions issued a total of 17.81 billion yuan of asset-backed securities, up 53.8 percent from a year earlier. Meanwhile, finance companies made a breakthrough in the issuance of financial bonds with a total of 15 billion yuan of financial bonds being issued by 6 finance companies affiliated with enterprise groups. The PBC successively promulgated *the Administrative Rules on Forward Interest Rate Agreement and the Public Announcement on Conducting RMB Foreign Currency Swap Business in the Inter-bank Foreign Exchange Market,* which launched the forward interest rate agreement and RMB foreign exchange swap products, introducing more risk management instruments to the financial market. The PBC also gave approval to the Shanghai Gold Exchange to conduct personal gold investment business and gold medium-term and forward transactions, further enriching the gold market products. Innovative close-ended fund was formally launched in the fund market, which avoided the shortcomings of traditional close-end fund and open-end fund such as lack of transparency and high pressure of redemption.

Money market benchmark interest rate was launched The benchmark interest rate of the China's money market–Shibor was formally launched on January 4, 2007 and its impact on the market increased day by day. Shibor is calculated and published based on the technical platform of the National Inter-bank Funding Center, which is located in Shanghai. It is the arithmetic average of inter-bank lending rates offered by 16 quoting banks with high credit ratings. Shibor is a single, non-guaranteed and wholesale interest rate. At present, 8 products of Shibor include overnight, 1-week, 2-week, 1-month, 3-month, 6-month, 9-month, and 1-year have been released to the public at the website of Shibor at 11:30 every trading day. It has proved in practice that the operation of Shibor has made remarkable progress. The benchmark rate role of the quotation of the Shibor has continued to improve, helping to transmit the intention of monetary policy of the central bank to the market and to provide an increasingly important guidance for the pricing of financial instruments. In 2007, the issuance of short-term financing bills, corporate bonds, floating-rate policy bonds, bill discount and inter-bank discount, and interest rate swap widely adopted a pricing mechanism linked with the Shibor. The launch of the Shibor is an important step in the process of market-oriented interest rate reform of China. It is essential to the improvement of the operating mechanism of financial

Figure 17 Transaction Volume and Value in Shanghai Gold Exchange, 2003~ 2007



Source: Shanghai Gold Exchange

institutions and helpful for monetary policy to change from quantity control to price control.

Laws and regulations were further improved The institutional building of inter-bank market was enhanced. On the basis of development and management experiences of inter-bank market over the past ten years, the newly revised *Rules on the Administration of Inter-bank Lengding/Borrowing* adjusted the stipulations in the inter-bank borrowing market on a comprehensive basis and broadened the breadth and depth of the market in order to provide policy support for the development of the inter-bank borrowing market. With the authorization of the PBC, the National Association of Financial Market Institutional Investors (NAFMII) promulgated *the Master Agreement for Financial Derivatives in the National Inter-bank Market,* which provided the basic principles for market participants to conduct financial derivative transactions, and embodied the important institutional arrangement for the development of China's financial market. It has great significance to the development of the inter-bank market as well as the whole financial market. In order to perfect relevant laws and regulations on asset securitization, the PBC released *The Public Announcement on Strengthening Information Disclosure of Basic Asset Pools of Credit Asset Securitization and The Public Announcement on Pledged Repurchase of Asset-backed Securities.* These had positive impact on regulating the issuance and transaction of asset-backed securities, forestalling market risks and promoting the asset securitization pilot program. In order to improve the information disclosure mechanism among participants in the inter-bank bond market, the PBC released *the Announcement on Further Improving the Information Disclosure Work of Financial Bonds in the Inter-bank Bond Market,* which helped regulate the information disclosure of the bond issuers in the inter-bank bond market, effectively discipline the behavior of issuers and enhance market transparency. To build the relevant law and regulation system on the issuance and transaction of corporate bonds, the China Securities Regulatory Commission (CSRC) promulgated *the Measures for Pilot Corporate Bond Issuance* and two supporting implementation rules on information disclosure of corporate bond issuance. The Stock Exchange also released *Listing Rules of Corporate Bonds* . The launch of corporate bonds would not only expand the scale of China's capital market but also helped to solve the structural problems of the financial market and diversify risks. In order to promote the healthy development of corporate bonds, the PBC released the Public Announcement (2007 No. 19), providing support to the issuance, circulation, trading, registration and custody of corporate bonds in the inter-bank market. For those corporate bonds already issued, they would be traded in the inter-bank market in line with the Public Announcement of the PBC (2005 No. 25). The standardized building of the stock market was advanced forward. *The Rules on Information Disclosure of Listed Companies and the Administration Measures for Significant Asset Restructuring of Listed Companies* were promulgated, which promoted the third-party custody and management business of client transaction settlement funds on a comprehensive basis. In the meantime, the investigation system of the securities market underwent a major reform.

The scope of market participants in the inter-bank bond market was broadened In January, the PBC and the Ministry of Labor and Social Security jointly issued the *Circular on Corporate Annuity Fund's Entry into Inter-bank Bond Market,* allowing corporate annuities to invest and conduct transactions in the inter-bank bond market, and setting out explicit standards for annuities on institutional arrangement, the condition for opening bond custody account, procedure and transaction management, etc. *The Circular* not only broadened the investing channels of corporate annuity funds, helping preserve and increase the value of assets, but also introduced new institutional investors into the inter-bank bond market to promote the diversification of market participants. At end-2007, there were 7 095 institutional investors in the inter-bank bond market, among which, there were 308 banking institutions, 112 securities companies, 113 insurance companies, and 4 940 non-financial legal entities.

Opening up to the outside world was further promoted On June 8, the PBC and the National Development and Reform Commission jointly promulgated *the Provisional Administrative Rules on RMB-Denominated Bond Issuance by Mainland Financial Institutions in the Hong Kong SAR*, and approved China Development Bank, the Export-Import Bank of China and Bank of China to issue RMB bonds of 10 billion yuan in the Hong Kong SAR. The issuance of RMB bonds was well received by the market, and the subscription amount was more than two times of issuance amount. In June, the PBC approved operational entities of foreign banks in China to be members of the Shanghai Gold Exchange and to participate in trading in the gold market. This measure helped to connect domestic gold market with the international gold market, minimize the difference of prices between markets, improve the gold price formation mechanism, give full play of the role of foreign banks by using their rich experiences gained in the international gold market, promote the development of China's gold market, improve the investor structure of the gold market and promote market liquidity.

Box

National Association of Financial Market Institutional Investors Was Established

On September 3rd, 2007, the National Association of Financial Market Institutional Investors (NAFMII) was established. Given its role as a self-regulatory institution in financial market, the establishment of the NAFMII is a milestone in the development of China's financial market

Background With the deepening of economic and financial globalization, financial market has witnessed significant expansion in terms of depth and width. Meanwhile, market risk factors become more complex and keep evolving. All of these have imposed more pressure on the regulation of financial markets worldwide. Strengthening self-regulation has become a general trend and internal requirement for the financial market to develop. The experience of advanced international markets shows that it is of great significance to establish an industry self-regulatory institution for drawing up self-regulatory rules, introducing uniform behavior regulations, and supervising and inspecting members' operation so as to improve market behaviors, safeguard market order, and forestall market risks.

Over the past ten years, China's inter-bank market has grown into a multi-layered and diversified market system mainly participated by qualified institutional investors with price enquire as the main trading pattern and comprising such sub-markets as inter-bank bonds market, inter-bank borrowing market, inter-bank bills market, inter-bank gold market, and inter-bank foreign exchange market. Market size has expanded rapidly, with market regulations gradually improving and institutional investors more experienced. It has become a pressing need for the market to develop and grow soundly by establishing a self-regulatory institution representing interests of market participants and functioning in self-regulation, rights protection, and service.

Mission The NAFMII, as a non-profit legal entity of social organization established under *the Administrative Regulation on Registration of Social Organization,* is the self-regulatory institution formed by participants of inter-bank bond market, inter-bank borrowing market, inter-bank bill market, inter-bank foreign exchange market, and inter-bank gold market. Its regulatory authority is the People's Bank of China. The mission of the NAFMII is to obey relevant laws, rules and regulations, conduct self-regulatory administration in the inter-bank market, serve the members and safeguard legitimate rights of the members, ensure fair competition order so as to promote the healthy development of the market.

Responsibilities and Functions The NAFMII, on behalf of all members, will forward suggestions and requirements of members to regulatory and legislative authorities, urge members to implement relevant regulations and operational requirements, enhance participants operational capability by organizing business training, and ensure market order. In addition, the NAFMII will suggest government agencies on how to manage financial market, promote market development, and accelerate integration of administration and self-regulation.

The NAFMII, upon the requirements of members, will introduce financial innovative products of risk identification and risk resilience. The introduction of new products will be registered at the NAFMII and filed with relevant regulatory authorities, instead of being subject to administrative approval.

The establishment of the NAFMII will improve industry self-regulation, create a fair market environment, contribute to bilateral commu-nications between market and government, safeguard investor interests, and enhance market operations and business exchanges, thus having a great significance to the smooth and sound development of China's inter-bank market, as well as the entire financial market