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Part I Overview

In 2016, despite of the slowdown of global economic recovery and the arduous tasks faced by domestic economic development and reform, China's economy witnessed sound operation with good momentum for growth. China's financial market accelerated institutional construction, deepened market depth and breadth, strengthened risk management, and pushed forward opening-up and market innovation, and thus played a positive role in promoting supply-side structural reform, optimizing resource allocation, and enhancing the effectiveness of economic development.

I. Analysis of the macro environment for China's financial market development in 2016

1.1 International economic and financial conditions

In 2016, global economic growth slowed down, yet economic activities in most economies began to strengthen in the second half. After a sharp decline early in the year, and a series of “Black Swan” events, market confidence had been gradually restored, and the international financial market maintained an overall upward trend. With increasingly positive factors in the world economy, commodity prices such as price of crude oil rebounded comprehensively.

1.1.1 Global economic recovery slowed down in 2016

1.1.1.1 Recovery in advanced economies slowed down, while growth in emerging economies resumed.

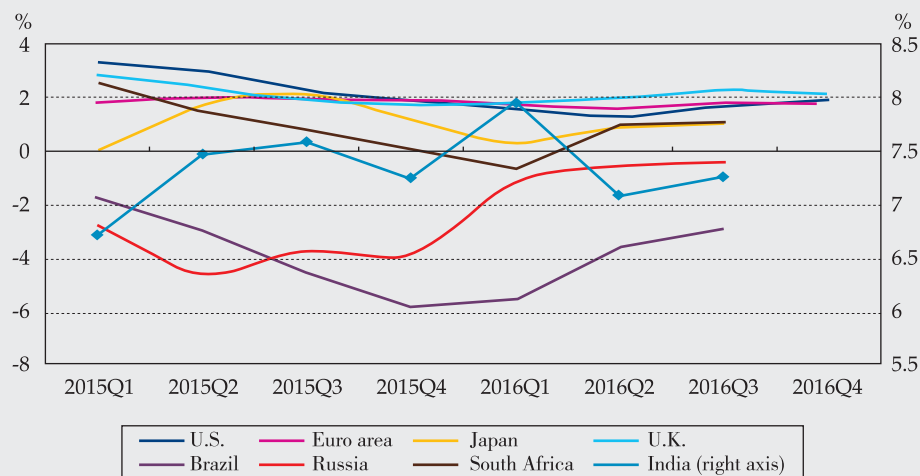
The growth momentum of the U.S. economy witnessed significant decline. Preliminary data shows that, in 2016, the average real gross domestic product (GDP) grew by 1.6% on a seasonally-adjusted basis, significantly lower than the growth rate of 2.6% in 2015. In the second half of the year, GDP growth rebounded to 1.8%. Downward pressure on the euro zone

economy continued to increase in the first half, while the economy gradually stabilized in the second half, with GDP growth of 1.7% for the year, slightly lower than 1.9% in 2015. Japanese economy recorded a significant slowdown in the first half of the year, which grew by 0.6% year on year, and the real GDP in the third quarter grew by 1% compared to the same period in 2015. The British economy expanded by 2.2% in the second half compared to the same period in 2015, which was beyond market expectation. Despite of the downward pressure on most emerging economies, there were clear signs of bottoming out and edging up. In the first three quarters, the economy of Brazil and Russia contracted by 2.9% and 0.4% respectively, compared with 5.8% and 3.8%. The growth in South Africa turned positive starting from the second quarter, and posted 1.1% in the third quarter. Indian economy maintained rapid growth, expanding by 7.4% in the first three quarters.

1.1.1.2 Global trade growth was sluggish, and direct investment declined significantly.

In 2016, the weak growth of global economy, particularly the downward pressure on major emerging economies, weighed on global trade significantly. The World Trade Organization (WTO) had reduced its forecast of global trade

Figure I-1 Economic Growth Rates of Major Economies, 2015–2016



Note: The real GDP growth rates for Russia, India and Brazil were not seasonally adjusted.

Source: Reuters DATASTREAM.

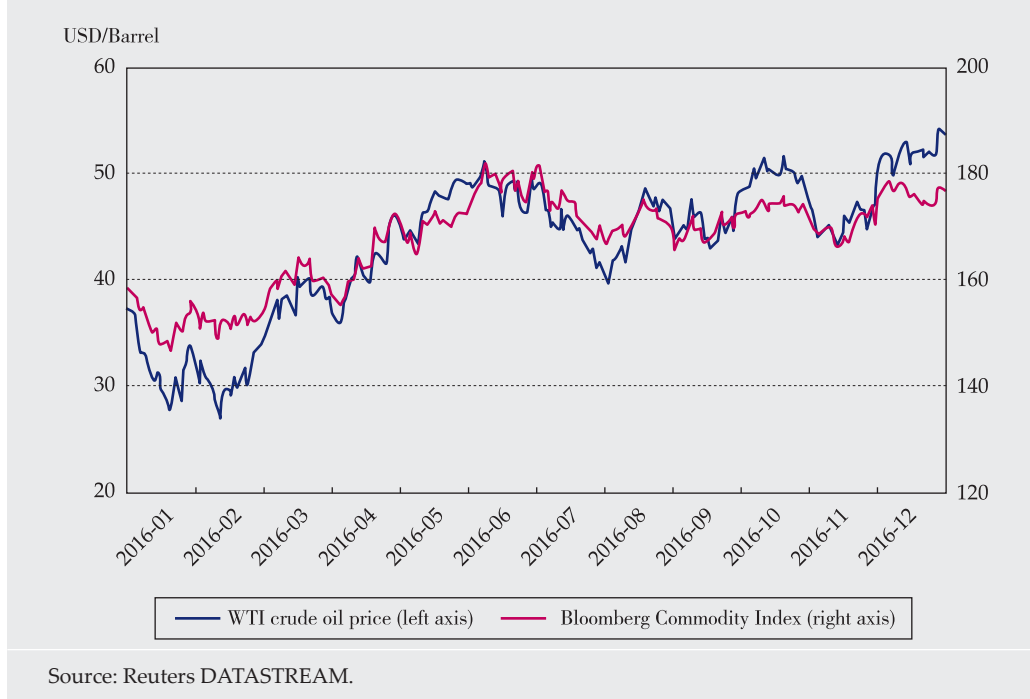
growth to 1.7%, the slowest growth since 2009. In the first quarter, the Baltic Dry Index (BDI), a leading indicator of global trade activities, continued decreasing to 290, although it started to recover in the second half. The year's average was 676, decreasing by around 6% from 2015. In the first half of 2016, foreign direct investment (FDI) was merely \$793 billion, decreasing by 5% month on month. The FDI inflows to OECD countries rose by 14% month on month, to \$568 billion, while the FDI outflows of OECD countries fell by 16% month on month. Advanced economies had become major recipients of FDI, while their direct investment to other countries declined sharply. The FDI inflows in most countries dropped significantly, among which, the inflows to Brazil, India, South Africa and Indonesia fell by 20%, 20%, 45% and 28% to \$29 billion, \$17.3 billion, \$1.3 billion, and \$6.3 billion respectively.

1.1.1.3 Crude oil and commodity prices rebounded.

In spite of the sluggish global economy,

commodity prices rebounded in 2016 due to marked decline in the early period. International oil price measured by the WTI declined to \$27 per barrel at the beginning of 2016, and edged up from Mid February. It fell slightly when the U.S. Dollar strengthened after the president election in November, and rose significantly after the oil producing nations finally reached a half-year agreement to limit the oil production. At the end of 2016, the WTI registered \$53.72 per barrel, growing by 44% in the year. Gold, silver and platinum prices in London market increased by 9%, 16% and 3.5% respectively, and aluminum, copper and nickel prices rose by 13.6%, 17.4% and 13.5% respectively in the year. Prices of most agricultural products experienced large increases. Compared with the beginning of the year, cotton price increased by 12.7%, and sugar price by 28.6%. Bloomberg Commodity Index stood at 117, up by 11.8% compared to the beginning of the year.

Figure 1-2 Movements of Crude Oil and Commodity Prices in 2016



1.1.2 Volatility continued in international financial markets

1.1.2.1 Monetary policies of major economies remained accommodative but diverged further.

In 2016, the U.S. economy maintained moderate recovery, labor market and inflation kept improving. The Fed raised the federal funds rate only once by 25 bps in December, and maintained the existing policy of reinvesting principal payments, showing prudent attitude on raising the rate. The European Central Bank (ECB) and the Bank of England (BOE) strengthened accommodative monetary policies. The ECB cut the interest rate on the deposit facility from -0.3% to -0.4%, extended twice the asset purchase program, with the amount of asset above 60 billion euro. In order to cope with potential negative impact of Brexit, the BOE cut the benchmark interest rate by 25 bps, and increased the stock of asset purchase program to 435 billion pounds by

adding 60 billion pounds. Japan's accommodative monetary policy was approaching the limit, which included introduction of negative interest rate policy, an increase in purchases of ETFs, the new policy framework of "Quantitative and Qualitative Easing with Yield Curve Control", and inflation overshooting commitment etc. Downward pressure faced by emerging economies heightened and most countries maintained accommodative monetary policy.

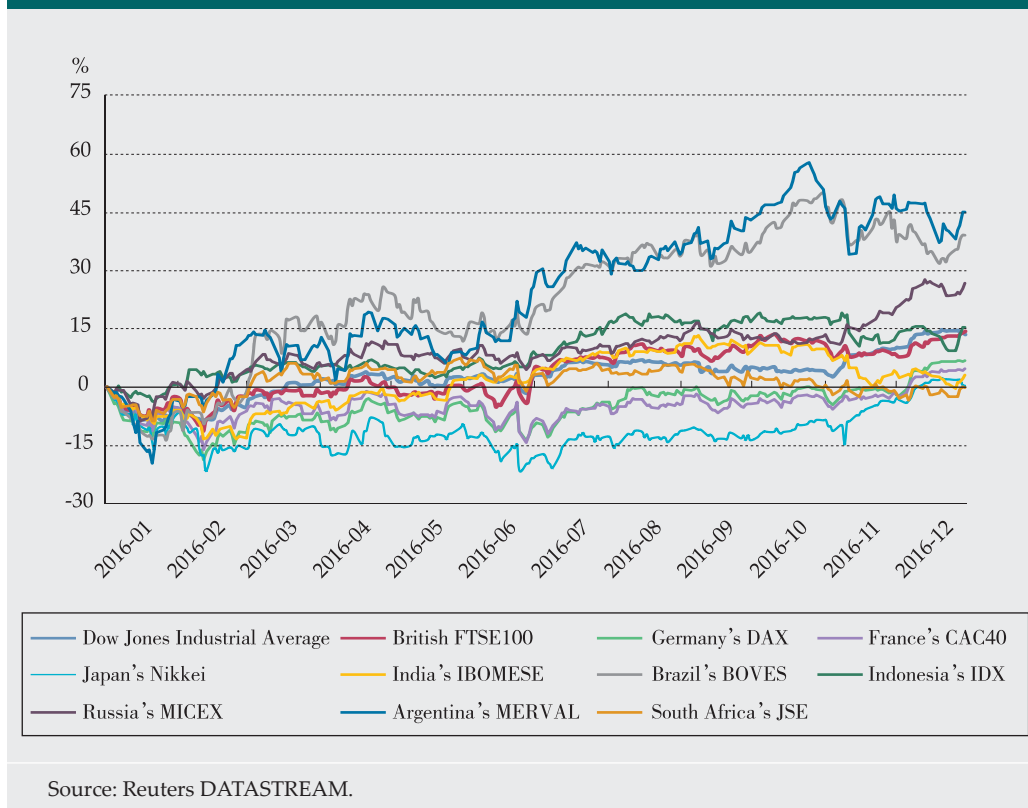
1.1.2.2 Global stock market dropped first and then rose, with frequent external shocks.

At the beginning of the year, risks in global financial market rose sharply, stock markets dropped around 10% in general, nearly 20% in some countries. From March, investors' confidence had been restored, and global stock market hit the bottom and edged up. The Brexit vote and the US presidential election shocked global financial

markets repeatedly, which caused intense reaction of major stock indexes with temporary turbulence. In major emerging economies, Russia's MICEX, Indonesia's IDX and India's IBOMESE went up by 27%, 15.3% and 3.2% respectively in 2016, while JSE of South Africa dropped slightly by

0.08%. The economic and financial situation of major countries in Latin America improved, stock markets rose significantly. Argentina's Merval jumped by 45% in the year, and Peru Lima Stock Composite Index surged by 58%.

Figure 1-3 Movements of Stock Indices in Major Economies in 2016

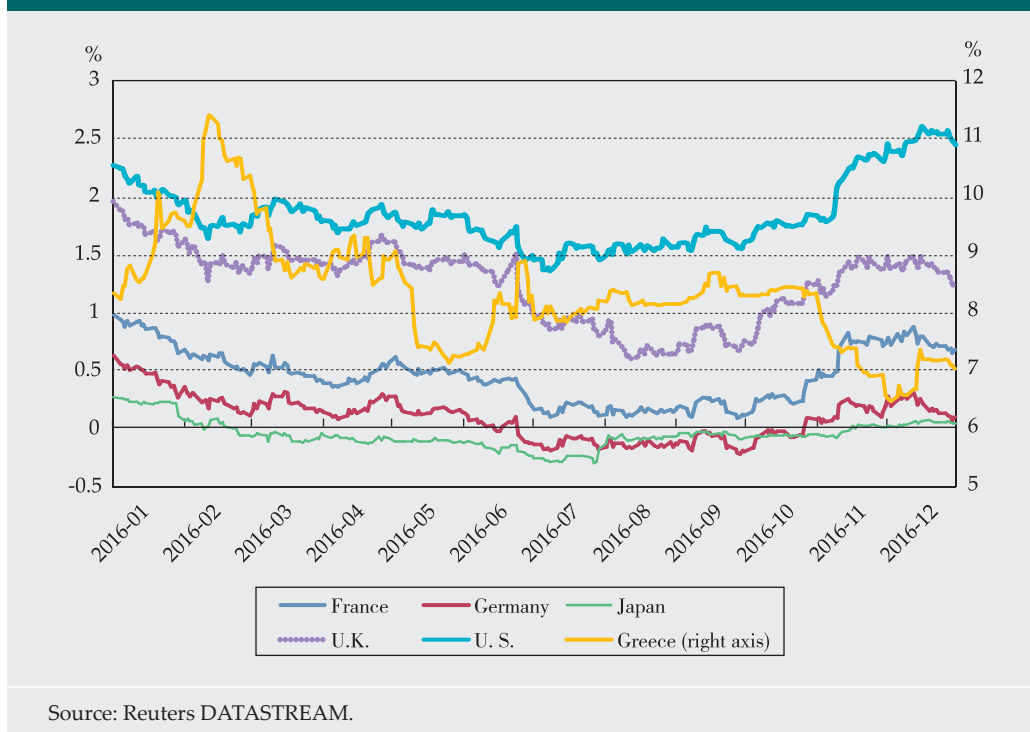


1.1.2.3 Interest rates in most economies moved down, the government bond yields in advanced economies moved up at the end of the year.

Most economies witnessed slow recovery and the interest rates moved down in general. The yield of Japan 10-year treasury bonds became negative from February and it lasted for 9 months, with the lowest level recording -0.295%. In March, the ECB lowered policy rates further. After Brexit vote in the end of June, the yield of Germany 10-year treasury bonds turned to negative as well and it

lasted for nearly 4 months. In early November, the yield of U.S. treasury bonds surged greatly, driving the upward movement of those in other advanced economies. At end-December, the yield of U.S. 10-year treasury bonds was 2.4467%, and that in the U.K., Japan, Germany and France was 1.2403%, 0.0481%, 0.1084% and 0.6853% respectively. Compared to those at end 2015, the yield of U.S. 10-year treasury bonds went up by 18 bps, while that of other advanced economies down by 72, 23, 53 and 30 bps respectively.

Figure 1-4 Movements of 10-year Treasury Bond Yields in Major Advanced Economies in 2016



1.1.2.4 Currencies in major economies witnessed periodic adjustment and external events proved significant impacts.

At the beginning of 2016, most currencies depreciated against U.S. dollar, while Japanese Yen became a safe-haven currency. With emerging positive signs, global foreign exchange markets gradually stabilized. In the whole year, currencies in major economies witnessed periodic adjustment. Currencies recorded substantial depreciation earlier appreciated in general, while currencies recorded appreciation or remained stable against U.S. dollar earlier depreciated in general. As the Brexit vote exceeded market expectations, British Pound Sterling depreciated substantially. At end-2016, GBP depreciated by 16% against U.S. dollar. US presidential election ended the upward movement of Japanese Yen, which almost returned to the level before

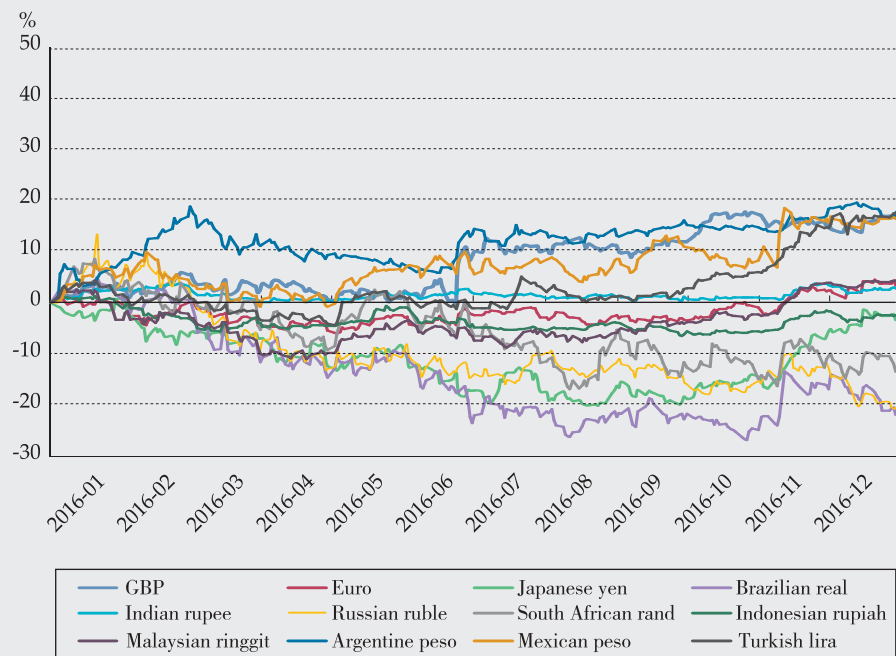
appreciation. The appreciation of Japanese Yen against U.S. dollar moved from 20% to 3%. Euro appreciated about 3% against U.S. dollar in the first 10 months of 2016, and depreciated substantially after the US presidential election, posted a depreciation of 3% for the whole year.

After significant depreciation in 2015, currencies of Brazil, Russia and South Africa strengthened sharply against U.S. dollar, which appreciated by 22%, 20% and 13% respectively in 2016. Indian rupee weakened by about 2.5% against U.S. dollar, less than the depreciation of 2015. Among major ASEAN economies, Indonesian rupiah and Malaysian ringgit stopped the downward trend in 2015 and went up gradually against U.S. dollar in early 2016, with the highest appreciation recording 5% and 10% respectively. During the year of 2016, Indonesian rupiah appreciated by

2.3% against U.S. dollar, while Malaysian ringgit depreciated by 4.3% due to the stronger U.S.

dollar at the end of 2016.

Figure 1-5 Movements of Major Currencies in 2016



Source: Reuters DATASTREAM and staff calculations.

1.2 Domestic economic and financial conditions

In 2016, China vigorously implemented supply-side structural reform. National economy registered a slower but stable performance with good momentum for growth, and got the 13th Five-Year Plan off to a great start. Under current economic conditions, financial sector reform was advanced steadily, and innovation was deepened, to serve the development of the real economy. Reforms had made positive progress, and the financial sector achieved overall stability and development.

1.2.1 The national economy grew steadily with good momentum

1.2.1.1 The development of national economy was slower but stable, GDP and its growth remained stable.

In 2016, GDP reached 74.4 trillion yuan, representing a growth of 6.7 percent, with the year-on-year growth of 6.7 percent, 6.7 percent, 6.7 percent and 6.8 percent in four quarters respectively. The performance of the national economy was stable, and positive signals showed the economic development was picking up.

1.2.1.2 The composition of demand continued to improve, and fixed asset investment growth was slower but stable.

In 2016, total retail sales of consumer goods increased by 10.4% year on year, hitting 33 trillion yuan, among which the contribution of final consumption expenditure to the economic growth was 64.6%, up 4.9 percentage points compared to a year earlier. The contribution of consumption to economic growth kept increasing. During the year, the value of exports and imports totaled 24.3 trillion yuan, declining by 0.9% from a year earlier, with the decrease down by 6.1 percentage points. In particular, the value of exports reduced by 2.0% from last year to 13.8 trillion yuan, and that of imports rose by 0.6% to 10.5 trillion yuan. The decrease of exports and imports dropped remarkably. During the year, fixed asset investment stood at 59.7 trillion yuan, increasing by 8.1%, with a growth down by 1.9 percentage points compared with 2015, or down by 0.1 percentage point compared with the first three quarters of 2016. In particular, investment on the primary industry increased by 21.1% year on year, and investment on the secondary industry and tertiary industry increased by 3.5% and 10.9% respectively. The fixed asset investment registered a slower but stable growth.

1.2.1.3 Consumer price rose moderately, resident income grew steadily.

During the year, the CPI rose by 2.0%, up 0.6 percentage points compared with the growth in 2015. Among it, the price of food, liquor and cigarette rose by 3.8 percent, while the price of health care rose by 3.8 percent, both contributed mainly to the CPI growth. The producer price index (PPI) declined first and increased then. During the year, the PPI lost 1.4% year on year. The PPI started to pick up in September of 2016, ending a continuous year-on-year decline of 54 months, and the PPI growth kept enlarging and

registered 5.5% year on year in December. The per capita disposable income of Chinese residents was 23,821 yuan, a year-on-year increase of 6.3% in real terms. Among it, the per capita disposable income of urban residents rose by 5.6% and that of rural residents by 6.2%, both in real terms.

1.2.1.4 Industrial structures continued to be optimized, supply-side structural reform achieved positive progress.

In 2016, the value added of the service sector in China was 38.4 trillion yuan, increasing by 7.8% year on year, and continued to outgrow the primary and secondary industries. The contribution ratio of the service sector to the GDP and to the growth of national economy kept rising. The added value of industries above a designated size increased by 6.0% compared with that of 2015, showing a stabilizing trend. The added value of high-tech industries rose by 10.8%, with a growing proportion in industries above a designated size. In 2016, the task of cutting overcapacity in coal and steel industries was accomplished, and the output of raw coal declined by 9.4% from that of 2015. The inventory of commercial housing was declining, and both the debt-to-asset ratio and the cost of industrial enterprises declined. During the year, investment on ecological conservation and environmental management, water conservancy, as well as agriculture, forestry, farming and fishery increased by 39.9%, 20.4% and 19.5% respectively, 31.8, 12.3 and 11.4 percentage points faster than the overall investment growth rate, showing that investment on areas of weakness gained speed.

1.2.2 Financial environment was stable in general

1.2.2.1 Monetary environment was appropriately accommodative.

At end-December, M2 posted 155.0 trillion yuan, rising by 11.3%, 2 percentage points lower than

the growth in the same period of the previous year, monetary aggregate increased steadily. Outstanding RMB deposits stood at 150.6 trillion yuan, rising by 11%, 1.4 percentage points lower than the growth in 2015. Outstanding RMB loans grew by 13.5% over last year to 106.6 trillion yuan, 0.8 percentage points lower compared to the growth in 2015. In 2016, all-system financing aggregates increased 17.8 trillion yuan, up 2.4 trillion yuan compared with that in 2015. In particular, RMB loans to the real economy increased 12.4 trillion yuan, accounting for 69.9% of the total, and up 1.2 trillion yuan on a year-on-year basis. Net financing by enterprise bonds registered 3 trillion yuan, increased 60.5 billion yuan on a year-on-year basis, accounting for 16.8% of the total. The domestic equity financing by non-financial enterprises posted 1.2 trillion yuan, increasing 482.6 billion yuan on a year-on-year basis, accounting for 7% of the total. As the all-system financing aggregates increased moderately, the percentage of direct financing such as enterprise bonds and stocks picked up. Deposit and loan rates of financial institutions fell slightly. In December 2016, the weighted average rate on loans to non-financial enterprises and other sectors was 5.27%, which was even with the same period of 2015. Besides, the weighted average rate on housing mortgage loans was 4.52%, down by 0.18 percentage points from the same period of 2015.

1.2.2.2 Overall performance of the financial sector was sound.

First, assets and liabilities of banking financial institutions continued to grow, quality of credit assets was stable, risk prevention ability was strong, and liquidity remained adequate. As of end-2016, domestic and foreign currency assets of China's banking financial institutions

totaled 232 trillion yuan, up by 15.8% year on year, and total domestic and foreign currency liabilities jumped by 16.0% to 215 trillion yuan. Outstanding non-performing loans (NPLs) posted 1.5123 trillion yuan, and the NPL ratio was 1.74%, which kept basically stable throughout the year. Net profit of commercial banks stood at 1,649 billion yuan, increasing by 3.54% year on year. The average return on assets (ROA) was 0.98%, and the average return on equity (ROE) was 13.38%. Thus, the profitability remained strong. Outstanding balance of loan loss provisions stood at 2,667.6 billion yuan, with a provision coverage of 176.40%, provision coverage for loans was 3.08%, and the capital adequacy ratio was 13.28%. The performance was at a good level among international counterparts.

Second, overall size and profitability of securities sector declined slightly. As of end-2016, total assets of 129 securities companies stood at 5.79 trillion yuan, with the net assets of 1.64 trillion yuan and the net capital of 1.47 trillion yuan. During the year, total operating revenues posted 327.994 billion yuan, cumulative net profits reached 123.445 billion yuan, and 124 firms made a profit.

Third, premium income of the insurance sector grew steadily, and overall asset continued to expand. As of end-2016, premium income of the insurance sector reached 3.1 trillion yuan cumulatively, a year-on-year increase of 27.5%, up by 7.5 percentage points than the growth of the previous year. Cumulative payments on claims rose by 21.2% year on year to 1.1 trillion yuan. Total assets of the insurance sector hit 15.1 trillion yuan, surging by 22.3% year on year, up by 0.6 percentage points compared with the growth of the previous year.

2. Main features of China's financial market performance in 2016

In 2016, China's financial market continued to grow, rapid development of traditional and innovative businesses kept expanding the depth and scope of the financial market. With the further deepening of two-way integration, the construction of market institution was improving. Market-based regulation was enhanced, which stimulated and strengthened the risk prevention ability of financial institutions. On the premise of its sound development, the financial market optimized its way of serving the real economy, which became the driving force of innovation and reform.

2.1 Traditional businesses and innovative businesses developed coordinately

In 2016, China's financial market operated steadily, and the size of deals concluded in financial markets continued to grow. Turnover of interbank funding amounted to 95 trillion yuan, and turnover of bond repurchases (repos) reached 600 trillion yuan, increasing by 48.48% and 36.84% year on year respectively. Bond issuance totaled 36 trillion yuan, with a year-on-year increase of over 50%. Trading of spot bonds on secondary market amounted to 132.2 trillion yuan, growing by 46.6% year on year. Both stock and increment of bond market increased steadily. Financing from the stock market increased significantly to 1.8 trillion yuan in 2016, a year-on-year increase of 12.54%. Daily average trading value of the A-share market hit 567.7 billion yuan, the second highest level on record. The turnover of inter-bank foreign exchange market reached 124 trillion yuan, up by 44% from the previous year. Trading volume of gold-based products traded in Shanghai Gold Exchange and gold futures traded in Shanghai Futures Exchange increased by 42.88% and 37.30% year on year respectively. China's gold

market outperformed other main gold markets in the world in terms of growth rate. Turnover of commodity futures posted a record high. Trading of treasury bond futures stood at 8.9340 million lots, or 8.90 trillion yuan in total, increasing by 48.09% or 46.76% year on year respectively.

While traditional businesses in the financial market kept a relatively high pace of development, innovative products and businesses grew rapidly, with market breadth expanding in 2016. Issuance and trading of certificate of deposits increased sharply, the cumulative issuance value amounted to 13.04 trillion yuan, and its trading in secondary market reached 70 trillion yuan, a year-on-year increase of 144% and 262% respectively. The market of electronic bills expanded greatly, for the first three quarters of 2016, the drawing and accepting value of electronic commercial drafts increased by 55.2% and 53.9% respectively, and the proportion of electronic bills in the bill market rose remarkably. Cumulative issuance value of green bonds was more than 170 billion yuan, and China had become the world's biggest green bond market. The issuance value of exchangeable bonds was 89.056 billion yuan, surging by 207.32% year on year. Number of foreign currency pairs listed on the interbank foreign exchange market increased to almost 30, covering main international reserve currencies, emerging market currencies and currencies used by countries along the Belt and Road. Turnover of foreign exchange forward derivatives witnessed exponential growth, more than 4 times as much as the level of the previous year, among which, turnover of central counterparty clearing grew by more than 6 times year on year.

2.2 Financial market construction and opening-up strategy continued to deepen

In 2016, improvements were made on the

issuance mechanism, trading system, and market structure of China's financial market. It strengthened self-construction to adapt to the increasingly open and harmonized new market system. On money market, reform of market access management and market-based regulation had further improved the operation efficiency of China's interbank funding market. The scope of issuer and investor of certificates of deposits was further broadened. Shanghai Commercial Paper Exchange Corporation Ltd. was established, and the development of China's bill market entered a new stage. On bond market, bond pre-issue mechanism and treasury bond market making support mechanism were launched. The issuance and trading mechanism was further improved. Investment and financing activities of non-financial enterprises bonds in the interbank market were further regulated. Individual investors gained access to interbank OTC bond market. Local government bonds were included as collaterals in treasury cash management. The treasury bond yield curve was further improved, and the green bond-related indexes emerged during the market development. On stock market, *Guidelines of Shanghai Stock Exchange on Stock Suspension and Resumption of Trading for Listed Companies Planning for Material Events* was released, regulations on stock suspension and resumption of trading were further established. A structured system of National Equities Exchange and Quotations was officially launched, construction of a multi-layered OTC market was pushed forward, and the resource allocation efficiency of capital market was promoted constantly. On foreign exchange market, messages of foreign exchange transactions confirmation and acquisition were officially registered and launched, and the Straight Through Processing (STP) mechanism was established covering the process of conducting, acquisition, confirmation and payment of transactions in the interbank

foreign exchange market. On futures market, white sugar options and soybean meal options got the approval for trading, and the commodity futures market would enter an era of options. On derivatives market, the business of central counter party clearing for foreign exchange options was approved, and non-incorporated products entered the interest rate swap market, presenting a pattern of diversified investors.

Combined with its development situation, the financial market timely and steadily pushed forward and implemented opening-up strategy in 2016. On market participants, the World Bank successfully issued bonds denominated in Special Drawing Rights (SDR) in the interbank bond market. The amount of issuers and issuance in Panda Bond market increased significantly. There were more qualified overseas institutional investors participating in the interbank bond market. Quota limits for overseas institutional investors were removed, and relevant administration process was streamlined. With the opening up of RMB purchases and sales business for overseas participating banks, each sub markets and all kinds of products in the interbank foreign exchange market had been opened to overseas institutions, which accounted for 10 percent of all market participants. Operation of the Shenzhen-Hong Kong Stock Connect attracted more long-term foreign capital into the A-share market. Investor structure and liquidity of China's stock market was further improved and enriched. On market institutions, the administration institutions of QFII and RQFII were improved, and administration methods were further optimized and unified. Operating hour of the foreign exchange market trading system was extended to cover European trading sessions, which benefited overseas institutions to better participate in the interbank foreign exchange market. In addition, financial market opening-up procedures in the

China (Shanghai) Free Trade Zone was unfolded comprehensively, a number of guidelines and rules for free trade zone financial businesses were introduced, and market service platform completed connection. Business of underlying financial products and derivatives were proceeded in full swing, including exchange-traded bond business, issuance of local government bonds, as well as interest rate swap.

2.3 Regulation and risk control of the financial market made progress

In 2016, the financial market continued to grow, and market-based regulation continued to strengthen. Regulation on bill businesses further standardized the interbank account management, prevented and controlled the risks in bill businesses. *Guidelines on Managing Comprehensive Risks of Banking Institutions* was issued, which brought forward new requirements on promoting comprehensive risk management capacity of banking institutions. The revised *Administrative Rules on Major Asset Restructuring of Listed Companies* was released, clearly identifying the direction of regulation on mergers and acquisitions. Administration on private equity firms was developed to separate that valuable from what is worthless. De-channelization or deleveraging process of interbank businesses gained speed. Negative list and eight bottom lines were specified in the regulation of private placement asset management business of securities and futures business institutions. Regulation on levered mergers and acquisitions became more and more strict. Limitation was made clear for financial asset management companies in the channel of disposing non-performing assets. Bank deposit channel for insurance asset management companies was further cleaned up and regulated, to prevent composite insurance asset management products

involving “pool of funds” or “embedded funds”. *Guidance for Risk Control on Trading and Settlement in Collateralized Repo of Bonds on Exchange-traded Market* was released, further defining requirements on risk control indicators such as entry of investors and use rate of standard bonds, repo lever and concentration degree of in-storage etc. A series of market regulatory measures were launched on trading fees, margin standard and daily limit range adjustment and etc. to restrain excessive speculation of some commodities and to maintain the smooth operation of commodity futures market in a timely and effective manner.

In 2016, measures were introduced in financial market in an orderly manner, to deepen risk prevention, safeguard financial security and smooth market operation. Those market-based risk management mechanisms stimulated and strengthened risk prevention capability of the financial market. *The Investor Protection Clauses Paradigm* of the interbank bond market was released to push forward and maintain the healthy and steady development of bond market on a legal and market-oriented footing. The revised *Regulations on Pilot Business of Credit Risk Mitigation Instruments in the Interbank Market* and related products guidance were released, which provided market participants with credit risk protection and hedging tools. The credit risk diversification and sharing mechanism was gradually established in the interbank market. Concurrent and ex post management was strengthened in the information disclosure of asset-backed securities, further safeguarding the legitimate rights and interests of investors. The establishment of the self-discipline mechanism in foreign exchange market would help maintain the fair-play competition, promoting the orderly operation and healthy development of the foreign exchange market. Cross-market accounts connect was realized in financial futures market,

effectively promoting joint regulation and cross-market regulation. Rectification of risks in internet finance was carried out, at the same time, self-discipline organization and long-term mechanism for internet finance regulation was established, laying a solid foundation for the steady growth of internet finance in the long run.

2.4 Financial market played an effective role in support of the economy and optimizing resource allocation

In 2016, the financial market made efforts to cater to the new demands arising from the development of the real economy, implemented China's five priority tasks, including cutting overcapacity, reducing excess inventory, deleveraging, lowering costs and strengthening areas of weakness, and actively steered supply-side structural reform. The guidance on debt to equity swap was formally introduced, to adapt to the new economic situation and market environment. In the direction of market-orientation and legal system, and in order to steadily reduce debt risks of enterprises, and to enhance the resilience of medium- and long-term development of the economy, the new round of debt to equity swap put into full play the decisive role of financial market in mitigating excess capacity, corporate mergers and acquisitions, reducing cost of enterprises, as well as deepening enterprise reform. Classified regulation was conducted on a trial basis for corporate bond issuance examination in real estate companies and industries with excess capacity. Meanwhile, regulatory requirements were enhanced on the use of corporate bond fund raised by relevant industries. The introduction of Special Purpose Vehicle (SPV) in the trading structure of Asset-Backed Notes (ABN), realized true sale and bankruptcy isolation, and promoted the launch of innovative trust ABN products. The successful issuance of the first Social Impact

Bond (SIB) initiated a new model in solving social problems with bond market capitals, and further made up the weakness of financing in the real economy.

In 2016, importance was attached to the effectiveness of financial markets in serving the real economy, and the efficiency of resource allocation kept improving, which strongly supported the transition and development of the real economy. Innovative startups bonds, renewable corporate bonds and small public offering bonds were issued successfully, which optimized the capital formation mechanism of Small- and Medium-sized Enterprises, and supported the startup and innovation of all kinds of science and technology enterprises, as well as micro- and small- enterprises. Issuance of asset securitization products was increasingly normalized, underlying assets became more diversified, and the scope of market participants was further expanded, which continued to play a role in invigorating stock assets, optimizing resource allocation and serving the real economy. The pilot of "insurance + futures" was further broadened in the futures exchange, insurance companies, futures business institutions and agriculture-related enterprises, and efforts to serve agriculture, rural areas, and farmers were further deepened. Special purpose financial bonds for poverty alleviation by relocation put into play the role of bond market in support of targeted poverty alleviation. A string of policies for green bond development had been launched, and a guiding principle comprehensively covering green finance—*Guidance on Constructing a Green Financial System* was promulgated, a relatively integrated system of green finance policy had been established in China. At the same time, the development of green bond market, carbon financial derivatives and other diversified green financial products gained speed, the type of

issuers was enriched, the product category was increased, and the listed market continued to expand, presenting strong potential of growth.

3. Prospects for China's Financial Market Development in 2017

In 2017, the CPC will hold its 19th National Congress, the implementation of the “13th Five-Year” plan will enter an important stage, and the structural reforms on the supply side will be further deepened. Efforts will be made to promote balanced economic, political, cultural, social, and ecological progress and implement the Four-Pronged Comprehensive Strategy, to remain committed to the underlying principle of making progress while keeping performance stable, to gain a strong understanding of and put into practice the new development philosophy, to adapt to, approach in the right way, and steer the new normal in economic development, to give central importance to improving the quality and returns of development, to focus on supply-side structural reform, to further promote innovation, opening-up and regulation, and to maintain sound and stable development of the financial market.

3.1 Financial market reform, opening-up and institution building will continue to deepen

The Central Economic Work Conference set the target of macroeconomic policy in 2017 as to “maintain stable growth, promote reform, make structural adjustments, improve living standards, and guard against risks”. For China's financial market, development is still the top priority. But to achieve the development of higher quality and higher level, we should not only expand the size, but also enhance the quality of the financial market. In 2017, China's financial market will

focus on further promoting market-oriented reforms of system and mechanism, especially the financial reform in key areas. First, market-based interest rate reform will be further promoted. Market-based interest rate formation, regulation and transmission mechanism will be improved, to enhance central bank's regulatory capacity on interest rate. Efficiency of the central bank operations, including Standing Lending Facility (SLF), Medium-term Lending Facility (MLF), and reverse repurchase, will be improved, to effectively put into play their role as the ceiling of interest rate corridor. Second, market-based RMB exchange rate formation mechanism will be further improved, to enhance the role of market in deciding the exchange rate, and to increase the flexibility of the RMB exchange rate against the US dollar. Efforts will be made to actively guide and stabilize market expectations, to balance cross-border capital flows, and to keep the RMB exchange rate basically stable at a reasonable and balanced level. Third, standardized regulation and steady operation of the financial market will be pushed forward. The establishment of the bond standards committee will be promoted, to unify the information disclosure and access standards of debenture bonds. Regulatory and healthy development of the asset securitization market will be advanced, to steadily expand the pilot program of non-performing assets securitization. Institution reform of the stock market will be carried out, to further develop and improve the multi-layered equity market. Futures and derivatives market will be steadily developed. Institution building of gold market will be strengthened. Construction and standardized management of the bill market will be pushed forward. And opening-up of the financial market will be further advanced. Fourth, pilot program of financial opening-up and innovation in the free trade zone will be moved forward, to promote the construction of green financial system, and

steadily push forward debt to equity swap on the market and legal basis.

3.2 Greater importance will be placed on preventing and controlling financial risks

The Central Economic Work Conference has pointed out that, in 2017, greater importance will be attached to curbing financial risk, decisions will be made to resolve a batch of risks, efforts will be taken to prevent asset bubbles, and to improve regulation capacity, so as to forestall systemic financial risks. Therefore, in 2017, efforts will be made in the following aspects. First, to strengthen macro-prudential management, effectively prevent all kinds of asset bubbles. To strengthen financial risks assessment and early warning, focusing on risks in industries with excess capacity, asset quality in banking sector, capital market, local trading sites, cross-market financial businesses, illegal fundraising and etc. To respect for the law of the market, timely defuse potential risks, and achieve sound and steady development of the market under the complex and changing environment. Second, to roll out the coordination mechanism of financial regulation, study and push forward reform of the financial regulatory system. To accelerate the construction of a regulatory system adapting to the development of modern financial market and businesses. To enhance financial regulation coordination with inter-departmental collaboration. To strengthen functional regulation and penetration of regulation on financial business. To establish a sound regulatory system adapting to the characteristics of internet finance. Third, to enhance the soundness of financial institutions and properly handle a number of high-risk financial institutions. To research and formulate regulatory standards and policies on risk assessment and handling of systemically

important financial institutions. To explore the market-based mechanism on handling risks of financial institutions. To carry forward the special rectification of risks in internet finance and construction of long-term mechanism for internet finance regulation. Fourth, to practice strict regulation in accordance with the law, crack down on all violations of laws and regulations. To implement the “law-based, strict, and comprehensive” regulatory requirements to maintain the stability of capital market.

3.3 The goal and function for the financial market to serve the real economy will be further highlighted

The Central Economic Work Conference has planed that, in 2017, the economic work will remain committed to the underlying principle of making progress while keeping performance stable, and focus on supply-side structural reform. The fundamental means of supply-side structural reform is to deepen the reform, and improve the mechanism that market plays a decisive role in resources allocation. In order to improve the quality and efficiency of the supply system, and enhance the momentum of sustained economic growth, it is necessary to allocate and utilize financial resources more effectively, so as to improve the efficiency of financial supply. This requires a comprehensive deepening of the financial system reform, increase of financial supply, and improvement of financial efficiency, to let the market play a decisive role in the allocation of resources. In 2017, China's financial market development will adhere to the fundamental purpose of providing service to the real economy. Financial market will play a bigger role in optimizing the allocation of resources, promoting the transformation and upgrading of economic structures, and supporting the supply-side structural reform. First, the financial

market will adapt to and steer the new normal in economic development, establish and implement new concept of development, steer toward higher-quality, more efficient, fair, and sustainable economic growth. Second, the financial market will continue to deepen the reform of mechanisms, strengthen market infrastructure, reinforce the incentive and restraint mechanism, improve the operation and service efficiency, so as to put into full play its role of optimizing the allocation of resources, guiding a rational flow of factors of production, managing risks and wealth, and to provide sustainable support for revitalizing the real economy. Third, the financial market will cooperate with the supply-side structural reform, to play a greater role in further promoting the strategic tasks of cutting overcapacity, reducing excess inventory, deleveraging, lowering costs and

strengthening areas of weakness. As for the capital market, efforts will be given to further deepen the reform of multi-layered market system, constantly optimize the financing structure, intensify equity financing, and thus provide a variety of financial service to the real economy and reduce the leverage ratio and financing costs of enterprises. Mergers and acquisitions mechanism and market-oriented reforms will be further promoted to better support the economic restructuring and industrial upgrading. Fourth, the financial market, especially the capital market, must maintain a steady growth, during the course of providing support to the real economy. The smooth operation of the financial market is the prerequisite and decisive factor in supporting the real economy, and also the foundation of reforms and development in future.