China Monetary Policy Report
Quarter Three, 2013

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Monetary Policy Analysis Group of

the People's Bank of China

Executive Summary

In the third quarter of 2013 the Chinese economy, remaining stable, took a turn for the better and growth was within a reasonable range. Consumption expanded steadily and investment grew rapidly. The agricultural sector was in good shape and the structural adjustment of the industrial sector was making progress. The overall price level and the employment situation were generally stable. In the first three quarters, GDP reached 38.7 trillion yuan, up 7.7 percent year on year; the consumer price index was up 2.5 percent year on year.

In accordance with the decisions of the Central Economic Work Conference and the overall arrangements of the State Council, the PBC followed the principle of making progress while maintaining stability, continued the sound monetary policy, neither loosening nor tightening the supply of money, continued to improve the focus and coordination of policy measures, and when necessary conducted fine-tuning and preemptive adjustments with appropriate strength. The direction and size of liquidity operations were adjusted in a flexible manner based on changes in the liquidity situation. A number of instruments were used, including repos and the Standing Lending Facility (SLF), to effectively address short-term liquidity fluctuations caused by a number of factors. A certain portion of the matured three-year central bank bills were renewed in order to freeze long-term liquidity and provide short-term liquidity. To implement the State Council's decision on financial-sector support of the real sector, the parameters for the dynamic adjustment mechanism of the differentiated required reserve ratio were adjusted, coordination of credit policy and industrial policy was enhanced, the pilot program of credit asset securitization was further expanded, direct debt financing by non-financial enterprises was promoted, and financial institutions were encouraged and guided to allocate more credit resources to support key fields and weak links, including the agricultural sector, rural areas, farmers, and micro and small enterprises. The market-based interest-rate reform was advanced. After the controls on lending interest rates were completely removed on July 20, various new measures were rolled out, including the establishment of a financial institution self-regulatory pricing mechanism for market interest rates and a loan prime rate centralized quote and release mechanism. The RMB exchange-rate regime was improved, continuing the self-initiated, controllable, and progressive reform approach. The use of the RMB in cross-border trade and investment activities was expanded and the reform of financial institutions was advanced.

Looking at financial-sector performance indicators, money and credit grew rapidly and the loan structure improved. As of the end of September 2013, broad money M2 was up 14.2 percent year on year. Outstanding RMB loans were up 14.3 percent year on year, an increase of 7.28 trillion yuan from the beginning of 2013 and 557.0 billion yuan more than the growth registered in the first nine months of the last year. At end-September, outstanding small- and micro-enterprise loans were up 13.6 percent year on year, outpacing outstanding large- and medium-enterprise loans by 2.2 percentage points and 3.4 percentage points; outstanding loans to the agricultural sector, rural areas, and farmers were up 18.6 percent year on year, outpacing the growth of total outstanding loans by 4 percentage points. In the first three quarters, all-system financing aggregate totaled 13.96 trillion yuan, an increase of 2.24 trillion yuan year on year. Lending and deposit interest rates offered by financial institutions were generally stable. In September, the weighted average lending rate offered to non-financial enterprises and other sectors was 7.05 percent. At end-September, the central parity of the RMB against the US dollar was 6.1480 yuan per dollar, an appreciation of 0.5 percent from the end of June.

Based on a comprehensive view of all aspects, the Chinese economy is expected to maintain the momentum of stable growth and continue to make progress based on stability. Various factors, such as the big potential for economic growth, progress in the ongoing structural adjustments and reform, innovation in macro-economic management, and the experiences thus far accumulated, are conducive to continued and stable economic development. The high savings rate and adequate capital and reserves in the financial system are generally indicative of the strong resilience of the economy. However, there are still risks and challenges in terms of economic performance. As new drivers for strong growth have yet to emerge, it may take a long time for the economy to reduce leveraging and remove excess capacity. The problems in the real-estate market and local government obligations remain prominent and resource and environmental pressures are building, thus adjustment of the economic structure and transformation of the development pattern remain arduous tasks. A basis for stable consumer prices is not yet consolidated, and prices are still sensitive to changes in aggregate demand. Therefore, it is necessary to continue to guide and keep inflation expectations stable.

The PBC will follow the overall arrangements of the State Council and the principle of seeking macro-economic stability, enhancing vitality at the micro level, making progress and taking actions while maintaining stability, and improving quality amidst stability. Monetary policy will seek to maintain aggregate stability and structural optimization. The sound monetary policy will continue, policy stability and continuity will be maintained, and the focus and coordination of policy measures will be enhanced to allow policies to be well-targeted and with appropriate strength. Fine-tunings and preemptive adjustments will be conducted when necessary. Efforts will be made to strike a balance among preserving stable economic growth, adjusting the economic structure, promoting reform, and preventing risks. The focus is to create a stable financial and monetary environment so that market players will have reasonable and stable expectations and structural adjustments and transformation of the growth pattern will be facilitated. A variety of monetary policy tools will be used, including quantity-based and price instruments. The framework for macro-prudential policy will be improved and the adjustment of aggregate liquidity will be enhanced to guide money, credit, and all-system financing aggregates to grow in a stable and reasonable manner. Furthermore, allocation of financial resources will be optimized to secure policy implementation. Financial institutions will be encouraged to properly manage their stock of credit assets and to make good use of new loans, to step up support for the structural adjustments, to provide better services to the real economy, and to strengthen the good momentum of stable and upward economic growth. Reform will be deepened to enhance the role of the market mechanism, improve the transmission mechanism of monetary policy, improve the efficiency of allocation of financial resources, effectively ward off systemic risks in the financial sector, and promote sustainable and sound economic growth.

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Part 1 Monetary and Credit Performance

In the third quarter of 2013 the Chinese economy remained stable and took a turn for the better. Liquidity in the banking system was at an appropriate level. Credit aggregates increased relatively rapidly and the credit structure improved.

I. Money supply registered relatively rapid growth

At end-September 2013, outstanding M2 stood at 107.7 trillion yuan, up 14.2 percent year on year, an acceleration of 0.2 and 0.4 percentage points over end-June 2013 and end-2012 respectively. Outstanding M1 stood at 31.2 trillion yuan, up 8.9 percent year on year, a deceleration of 0.1 percentage points over end-June 2013 and an acceleration of 2.4 percentage points over end-2012. Currency in circulation M0 stood at 5.6 trillion yuan, up 5.7 percent year on year. In the first three quarters of 2013 net cash injections totaled 183.3 billion yuan, 85 billion yuan less than during the same period of the previous year.

At end-September, outstanding base money registered 26.3 trillion yuan, up 11.5 percent year on year and 1.08 trillion yuan more than that at the beginning of the year. The money multiplier stood at 4.09, which was the same as that at the end of June. The excess reserve ratio of financial institutions was 2.1 percent and that of rural credit cooperatives (RCCs) was 4.2 percent.

II. Deposits in financial institutions increased steadily

At the end of September, outstanding deposits in domestic and foreign currencies (including at foreign-funded financial institutions, the same hereinafter) posted 105.8 trillion yuan, up 14.3 percent year on year and an acceleration of 0.2 percentage points over both end-June 2013 and end-2012. This was 11.4 trillion yuan more than that at the beginning of the year and an acceleration of 1.5 trillion yuan year on year. Outstanding RMB deposits registered 103.1 trillion yuan, up 14.6 percent year on year, accelerating by 0.3 and 1.2 percentage points over end-June 2013 and end-2012 respectively. This was 11.3 trillion yuan more than that at the beginning of the year and an acceleration of 2.2 trillion yuan year on year. At end-September, outstanding deposits in foreign currencies were USD448.7 billion, up 8.4 percent year on year. This was USD38.5 billion more than that at the beginning of the year and a deceleration of USD100.3 billion year on year. The muted growth of deposits in foreign currencies was mainly due to the high base in the same period of the last year. It was also linked to the expected tapering of the QE3 by the U.S. Federal Reserve.

Broken down by sectors, both household deposits and deposits by non-financial enterprises accelerated year on year. At end-September, outstanding household deposits stood at 45.6 trillion yuan, up 14.6 percent year on year, an acceleration of 0.1 percentage points over end-June. This was 5.0 trillion yuan more than that at the beginning of the year and an acceleration of 94.7 billion yuan year on year. Outstanding deposits by non-financial enterprises registered 35.0 trillion yuan, up 11.6 percent year on year and an acceleration of 3.7 percentage points over end-2012. This represented a rise of 2.4 trillion yuan compared with that at the beginning of the year, and an acceleration of 982.9 billion yuan year on year. At end-September, outstanding fiscal deposits registered 3.9 trillion yuan, up 1.5 trillion yuan from the beginning of the year and an acceleration of 831.1 billion yuan year on year.

III. Loans of financial institutions increased in a stable and relatively rapid manner

At end-September, outstanding loans in domestic and foreign currencies by all financial institutions registered 75.0 trillion yuan, up 14.6 percent year on year and a deceleration of 0.5 percentage points over end-June. This was also 7.7 trillion yuan more than that at the beginning of the year and an acceleration of 411.7 billion yuan year on year.

RMB loans increased in a stable and relatively rapid manner. At end-September, outstanding RMB loans stood at 70.3 trillion yuan, up 14.3 percent year on year and an acceleration of 0.1 percentage points over end-June. This was also 7.28 trillion yuan more than that at the beginning of 2013 and an acceleration of 557 billion yuan year on year. Beginning in June, credit expansions maintained a strong momentum and loan extensions were generally concentrated at the beginning of each month. Against the backdrop of the large trade surplus, massive foreign-exchange inflows, and relatively abundant liquidity in the banking systems, pressure for money and credit expansions were still large.

Growth of medium- and long-term loans gradually picked up. RMB loans to the household sector increased relatively rapidly, with loans to the household sector at end-September increasing 23.7 percent year on year. This was also 3.1 trillion yuan more than that at the beginning of the year and an acceleration of 1.1 trillion yuan year on year. In particular, individual mortgage loans increased 1.2 trillion yuan from the beginning of the year. This was also an acceleration of 660.5 billion yuan year on year. Since the beginning of 2013, monthly new individual mortgage loans continued to exceed the mark of 100 billion yuan. As the aggregate amount and growth of mortgage loans remained at an elevated level , some of the demand for individual mortgage loans was difficult to meet. There are several reasons for this phenomenon. First, demand for mortgage loans was very large in some localities, exceeding the reasonable and prudent lending capacity of banks. Second, as economic activities rebounded, some banks strengthened the adjustment of their credit structures and provided more loans to the more profitable and policy-compliant small- and micro-sized enterprises, consumption areas, and other sectors. As a result, the growth of mortgage loans decelerated. Loans to non-financial enterprises and other sectors grew in a stable manner, rising 11.1 percent year on year. This was 4.2 trillion yuan more than that at the beginning of the year and 573.3 billion yuan less than the amount of new loans extended during the same period of the last year. In terms of loan maturity, compared with the beginning of the year new medium- and long-term loans increased by 3.9 trillion yuan. This represented an acceleration of 1.5 trillion yuan year on year. The proportion of incremental loans among total new loans was 53.3 percent, up 18.3 percentage points over the average level in 2012. At end-September, the growth of medium- and long-term loans stood at 12.7 percent, indicating an acceleration for nine consecutive months. Short-term loans including bill financing grew in a stable manner, rising 3.2 trillion yuan from the beginning of the year. Since the beginning of 2013, the share of new short-term loans has remained at about 45 percent. In terms of financial institutions, loans by Chinese-funded large-sized national banks, Chinese-funded small- and medium-sized national banks, and small-sized rural financial institutions registered larger year-on-year growth.

Table 1 RMB Loans by Financial Institutions in the First Three Quarters of 2013

Unit: 100 million yuan

	In the first three quarters of 2013		In the first three quarters of 2012	
	New loans	Acceleration year on year	New loans	Acceleration year on year
Chinese-funded large-sized national banks ①	33,218	2,174	31,044	3,270
Chinese-funded small- and medium-sized national banks②	22,933	4,426	18,507	750
Chinese-funded small- and medium-sized local banks③	9,550	-373	9,922	5,833
Small-sized rural financial institutions④	12,067	1,069	10,998	2,162
Foreign-funded financial institutions	253	-306	559	-6

Notes: ① Chinese-funded large-sized banks operating nationwide refer to banks with assets denominated in domestic and foreign currencies equivalent to no less than 2 trillion yuan (according to the amount of total assets in both domestic and foreign currencies at end-2008).

② Chinese-funded small- and medium-sized banks operating nationwide refer to banks operating across different provinces, with assets of less than 2 trillion yuan denominated in both domestic and foreign currencies.

③ Chinese-funded small- and medium-sized local banks refer to banks operating within a single province, with total assets of less than 2 trillion yuan denominated in both domestic and foreign currencies.

④ Small-sized rural financial institutions include rural commercial banks, rural cooperative banks, and rural credit cooperatives.

Source: People’s Bank of China.

The growth of foreign currency–denominated loans slowed down from an elevated level. At end-September, outstanding foreign-currency loans of financial institutions posted USD765.7 billion, up 22.9 percent year on year and down 11.9 and 10.3 percentage points from end-March and end-June respectively. This was USD82.3 billion more than that at the beginning of the year and a deceleration of USD2.2 billion year on year. In terms of the loan structure, trade financing increased by USD23.7 billion, accounting for 28.8 percent of total loans, while outward lending and medium- and long-term domestic loans increased by USD39.6 billion, USD8.1 billion more than the growth registered during the same period of the last year.

Box 1 Inter-bank Business and Money Creation

The inter-bank business is the flow of funds among commercial banks and between commercial banks and other financial institutions, mainly including inter-bank lending, inter-bank deposits, purchases, and resales (sales and repurchases), inter-bank borrowing, and so forth. In recent years, China's inter-bank business has been developing rapidly and has had a direct impact on money creation. For the source of M2 creation in China, lending and the RMB equivalent of official foreign-exchange holdings used to be the two major avenues. When commercial banks provided loans or purchase foreign exchange, the "new loans" or "RMB equivalent of official foreign- exchange holdings" were recorded on the corresponding asset side, and "RMB deposits" were recorded on the corresponding liability side. Because deposits are included in M2, they directly increased the money supply. In other words, as long as commercial banks extended more loans or purchased more foreign exchange, M2 would increase accordingly. Therefore, in the past changes in loans and the RMB equivalent of official foreign-exchange holdings could accurately indicate changes in monetary aggregates. Nevertheless, due to the rapid development of inter-bank business in recent years, the channels for money creation have undergone some changes. The reasons behind these changes are relatively complicated.

The means of creating money by commercial banks through inter-bank business can be regarded as the "inter-bank channel." Based on the different counterparties, this can be further divided into a non-bank channel and a bank channel. A non-bank channel refers to funding by commercial banks to non-deposit-taking financial institutions, and its counterparty includes the off-balance sheet wealth management business of commercial banks, insurance companies, and so forth. In this case, claims on these institutions (similar to bank loans) will be recorded on the asset side, while deposits with commercial banks (inter-bank deposits derived from the trading) will be recorded on the liability side. Thus, the money supply to the economy will increase. It is noteworthy that inter-bank deposits were not included in the M2 statistics until September 2011 when the statistical coverage was adjusted. The inter-bank channel means that commercial banks provide financing (similar to loans) to non-financial companies. But through certain accounting maneuvers, this kind of business is recorded as the use of inter-bank funds (and not included as loans) on the asset side, and it is recorded as deposits of non-financial companies with commercial banks on the liability side. Thus, money creation is achieved. Possible accounting treatments include “purchase and resale of bankers’ acceptances,” “pay on behalf of the other bank,” “purchase and resale of trust beneficial rights,” and so forth.

Due to its rapid development, inter-bank business has played a larger role in money creation during the last two years. Since 2013, the inter-bank channel contribution to M2 was second only to that of RMB loans, higher than the RMB counterpart of foreign-exchange reserves and securities investments. Since it is subject to the influence of seasonal factors, liquidity levels, regulatory policy, and other factors, inter-bank business is usually very volatile, affecting the stability of M2. Judging by the current situation, the inter-bank channel and the RMB equivalent of official foreign-exchange holdings tend to share the same fluctuation characteristics. When increased foreign-exchange inflows drive up liquidity in the banking system, the amount of inter-bank business will usually increase, and when the drop in foreign-exchange inflows reduces liquidity in the banking system, the amount of inter-bank business usually will decline. The rapid growth of M2 in the first several months in 2013 was associated with the increased foreign-exchange inflows and the rapid growth of inter-bank business. In June the growth of M2 declined by 1.8 percentage points from May. The sharp contraction in inter-bank business was the main reason for this deceleration of M2 growth.

Currently, inter-bank business has become an important channel for financial institutions to borrow or lend funds, manage assets and liabilities, create innovative products, and expand new sources of profits. However, when carrying out inter-bank business, some financial institutions exhibit the following irregular behavior, such as erratic operations, non-transparent information, serious maturity mismatches, and circumvention of supervision. In addition, some commercial banks use inter-bank business to receive financing similar to loans or to overstate the size of deposits. This increases liquidity management and risk prevention difficulties and compromises the effectiveness of macro-economic management and financial regulation.

During the next stage, efforts should be made to further improve regulation of inter-bank business, to make inter-bank business more standardized and transparent, to improve the relevant performance evaluation system and the regulatory mechanism, and to guide the sound development of inter-bank business. The financial statistical and accounting systems should be strengthened to better reflect credit expansions and operations of commercial banks in a more comprehensive and accurate way. Taking into account the more complex nature of financial innovation in the future, efforts should be made to further improve the framework for macro-financial management and to strengthen liquidity management and the price-based adjustment mechanism. In the meantime, continued efforts should be made to strengthen macro-prudential measures and to include more credit-creating operations in the macro-prudential framework so as to prevent excessive leveraging and pro-cyclicality in the financial industry.

IV. All-system financing aggregate was close to 14 trillion yuan

According to preliminary statistics, in the first three quarters of 2013 all-system financing aggregate reached 13.96 trillion yuan, representing an acceleration of 2.24 trillion yuan year on year. In particular, in the third quarter all-system financing aggregates posted 3.81 trillion yuan, a decline of 180 billion yuan and 138.8 billion yuan compared with that in the previous quarter and that in the corresponding period of the last year respectively.

In terms of the financing structure, all-system financing aggregates in the first three quarters of 2013 had the following features. First, RMB loans grew in a stable manner. Although RMB loans increased somewhat compared with the same period of the last year, their share fell. In the first three quarters of 2013, new RMB loans accounted for 52.1 percent of all-system financing aggregates, down 5.2 percentage points year on year. Second, foreign currency denominated loans increased rapidly before declining, and on an aggregate basis were at par with those during the same period of the last year. Specifically, from January to May new foreign currency denominated loans reached an equivalent of 565.8 billion yuan, 393.2 billion yuan more year on year; from June to September, new foreign currency denominated loans declined by an equivalent of 49.3 billion yuan on a net basis, 411 billion yuan less year on year. Third, net financing of corporate bonds increased before declining, and equity financing continued to remain at a subdued level. Specifically, from January to May net financing of corporate bonds amounted to 1.18 trillion yuan, 555.1 billion yuan more year on year; from June to September net financing of corporate bonds amounted to 344.2 billion yuan, 588.3 billion yuan less year on year. In the first three quarters of 2013, equity financing on the domestic stock market by non-financial companies declined by 55.2 billion yuan from the same period of the last year. Fourth, entrusted loans and trust loans registered a larger year-on-year increase and growth of undiscounted bankers' acceptances registered a year-on-year decline.

Table 2 All-system Financing Aggregates

Unit: 100 million yuan

	All-system financing aggregates [1]	Of which:						
		RMB loans [3]	Foreign currency–denominated (RMB equivalent)	Entrusted loans	Trust loans	Undiscounted bankers' acceptances	Enterprise bonds	Financing by domestic non-financial institutions via the domestic stock market
2010	140,191	79,451	4,855	8,748	3,865	23,346	11,063	5,786
2011	128,286	74,715	5,712	12,962	2,034	10,271	13,658	4,377
2012	157,631	82,038	9,163	12,838	12,845	10,499	22,551	2,508
In the first three	139,596	72,787	5,165	18,200	15,841	6,359	15,280	1,625

quarters of 2013②								

Notes: ① All-system financing aggregates refer to the total value of funds provided by the financial system to the real economy during a certain period of time. It is a flow rather than a stock value.

② Data for the current period are preliminary.

③ Data for RMB loans are the historical numbers released in the past.

Sources: People's Bank of China, National Development and Reform Commission, China Securities Regulatory Commission, China Insurance Regulatory Commission, China Government Securities Depository Trust & Clearing Co., Ltd., National Association of Financial Market Institutional Investors, and so forth.

V. Deposit and lending rates of financial institutions were generally stable

In September the weighted average lending rate offered to non-financial enterprises and other sectors was 7.05 percent, down 0.04 percentage points from August and up 0.14 percentage points from June. In particular, the weighted average interest rate of loans was 7.16 percent, up 0.06 percentage points from June; the weighted average bill financing rate was 6.61 percent, up 0.73 percentage points from June. The slight increase in bill financing rates was mainly due to the restructuring of assets and liabilities by financial institutions and the reduced size of the bill financing business. Home mortgage interest rates rose slightly. In September, the weighted average home mortgage interest rate was 6.39 percent, up 0.09 percentage points from June.

The shares of loans with interest rates lower than or flat with the benchmark rates declined slightly, while the share of loans with interest rates higher than the benchmark rates rose. In September, the shares of loans with interest rates lower than or flat with the benchmark rates were 10.70 percent and 23.31 percent respectively, down 1.85 and 1.21 percentage points from June, and the shares of loans with interest rates higher than the benchmark rates were 65.99 percent, up 3.06 percentage points from June. The changes in interest rates reflected warming economic activities and a relatively strong demand for funds.

Table 3 Shares of Loans with Rates at Various Ranges of the Benchmark Rate, January through September 2013

Unit:%

Month	Lower than the benchmark	At the benchmark	Higher than the benchmark					
			Sub-total	(1.0，1.1]	(1.1，1.3]	(1.3，1.5]	(1.5，2.0]	Above 2.0
January	10.62	25.08	64.30	19.84	25.23	7.87	8.28	3.07
February	11.69	25.05	63.26	19.57	23.96	7.88	8.83	3.02
March	11.44	23.79	64.77	19.55	24.71	8.15	9.28	3.09
April	10.56	23.53	65.91	18.96	25.52	8.96	9.23	3.24

May	11.89	22.45	65.66	19.65	25.92	8.84	8.46	2.79
June	12.55	24.52	62.93	19.47	24.95	7.95	8.04	2.52
July	10.54	23.32	66.14	19.99	27.07	8.61	7.96	2.51
August	10.23	21.95	67.82	19.70	27.33	9.46	8.60	2.73
September	10.70	23.31	65.99	19.59	26.58	9.33	8.03	2.46

Source: People's Bank of China.

The deposit and lending rates of foreign currencies fluctuated at a subdued level due to the movement of interest rates on international markets and changes in the supply and demand of foreign currencies in China. In general, they were slightly higher than those in June. In September, the weighted average interest rate of US dollar demand deposits and US dollar deposits with maturities of less than 3 months registered 0.19 percent and 1.58 percent respectively, up 0.07 and 0.51 percentage points from June. The weighted average interest rates of less than 3 months and 3 months (inclusive) to 6 months US dollar loans posted 2.28 percent and 2.80 percent, up 0.05 and 0.46 percentage points from June.

Table 4 Average Interest Rates for Large-value Deposits and Loans Denominated in US Dollars, January through September 2013

Unit: %

Month	Large-value deposits						Loans				
	Demand deposits	Within 3 months	3–6 months (including 3 months)	6–12 months(including 6 months)	1year	Above 1 year	Within 3 months	3–6 months (including 3 months)	6–12 months(including 6 months)	1year	Above 1 year
January	0.11	0.90	1.35	1.75	1.90	2.45	1.74	2.04	1.87	2.00	3.25
February	0.12	0.84	1.42	1.75	2.04	2.12	2.18	1.91	1.82	2.14	4.08
March	0.11	0.92	1.57	1.91	2.44	1.54	1.97	2.16	2.07	2.35	3.03
April	0.10	0.82	1.36	2.04	2.36	1.27	1.99	2.13	2.22	2.30	3.26
May	0.12	0.80	1.39	1.89	2.31	1.20	2.00	2.11	2.34	2.38	3.02
June	0.12	1.07	1.69	1.86	2.50	1.14	2.23	2.34	2.40	2.78	3.33
July	0.13	1.14	1.97	2.15	2.57	1.79	2.25	2.58	2.69	2.77	3.13
August	0.12	1.17	1.84	2.05	2.68	2.39	2.29	2.41	2.57	2.63	3.23
September	0.19	1.58	2.37	2.06	3.43	2.22	2.28	2.80	2.63	2.49	3.18

Source: People's Bank of China.

VI. The flexibility of the RMB exchange rate was strengthened

In the third quarter of 2013 the RMB exchange rate moved in both directions with stronger flexibility, but remained generally stable, and the exchange-rate expectations remained stable. At end-September, the central parity of the RMB against the US dollar was 6.1480 yuan per dollar, representing an acceleration of 307 basis points or 0.50 percent over end-June. From the reform of the RMB exchange-rate regime in 2005 to end-September 2013, the RMB appreciated 34.62 percent against the US dollar. According to the calculation of the BIS, in the third quarter the nominal effective exchange rate of the RMB appreciated 0.35 percent, and the real effective exchange rate appreciated 1.09 percent; from the RMB exchange-rate regime reform in 2005 to end-September 2013, the nominal effective RMB exchange rate appreciated 30.92 percent and the real effective RMB exchange rate appreciated 40.55 percent.

Part 2 Monetary Policy Operations

In the third quarter of 2013, in line with the overall arrangements of the State Council and the principle of seeking progress while maintaining stability, the PBC neither tightened nor relaxed liquidity supply in the financial system and continued to implement a sound monetary policy, with a focus on making policy measures better targeted and coordinated. Preemptive adjustments and fine-tunings were carried out in a timely and appropriate manner.

I. Flexible open market operations

Supported by strengthened analysis and monitoring of liquidity supply and demand, the PBC conducted flexible open market operations to facilitate stable movements of liquidity in the banking system and of money-market interest rates. The role of open market operations in preemptive adjustments and fine-tunings was brought into a full play. In view of the changing liquidity situation, the PBC flexibly conducted short-term repo operations to smooth out the volatilities in short-term liquidity caused by various factors. A certain portion of the matured 3-year central bank bills were renewed to freeze long-term liquidity while providing short-term liquidity and to reasonably adjust liquidity in the banking system. In the third quarter, a total of 470 billion yuan of repo operations was conducted, while 400.8 billion yuan of matured central bank bill operations was renewed. At end-September, outstanding repos totaled 80 billion yuan. In view of the complex situation in the international financial market and the increased volatility in the supply and demand for liquidity, the PBC strengthened analysis and monitoring of the market environment and interest-rate movements in the market, maintained interest rates in open market operations at a stable level, effectively guided market expectations, and promoted the smooth movement of money-market interest rates. At end-September, interest rates of 7-day and 14-day repo operations were 3.90 percent and 4.10 percent respectively.

The PBC properly conducted state treasury cash management operations. In the third quarter, a total of 250 billion yuan of state treasury funds was deposited in commercial banks in five separate operations, of which there was 200 billion yuan in three-month time deposits and 50 billion yuan in six-month time deposits.

II. Standing Lending Facility (SLF) operations were conducted to promote a general equilibrium of liquidity in the banking system

To maintain money-market liquidity at an appropriate level, the PBC provided liquidity in the form of Standing Lending Facility (SLF) to financial institutions that in the third quarter met the requirements of macro-prudential regulation and that achieved positive results. The PBC froze long-term liquidity in the market by renewing the issuance of 3-year central bank bills, and provided necessary short-term liquidity support via the SLF and repo operations. The combination of these two measures helped keep liquidity at a reasonable volume in view of future uncertainties in the balance-of- payments situation and maintained money-market stability. Since July, in view of the changed balance-of-payments situation and the increased capital inflows, SLF operations were conducted at a reduced pace to maintain stable liquidity in the banking system. At end-September, outstanding SLFs were 386 billion yuan, a decline of 30 billion yuan from end-June.

III. Macro-prudential regulation was strengthened through dynamic adjustments of the differentiated reserve requirement as a counter-cyclical tool

The PBC continued to use a dynamic adjustment mechanism of the differentiated reserve requirement as a way to strengthen macro-prudential regulation. Based on domestic and global economic and financial developments, the soundness of financial institutions, and implementation of the credit policy, the PBC calibrated the parameters of the differentiated reserve requirement to guide stable and reasonable credit growth, and utilized the dynamic adjustment mechanism to improve the resilience of financial institutions. In the third quarter, the PBC stepped up efforts to adjust the policy parameters in order to further encourage and guide financial institutions to increase credit support to small- and micro-sized enterprises, the agricultural sector, rural areas and farmers, and less developed areas in the central and western regions.

IV. Strengthened window guidance and credit policy guidance

The PBC followed the overall arrangements of the Central Economic Work Conference and the State Council to step up financial services to the real economy, implemented the decisions of the Seminar on Financial Services to Small- and Micro-sized Enterprises, continued to employ monetary policy tools, macro-prudential tools, and credit policies to guide structural improvements, and enhanced coordination with industrial policies in an effort to support the economic restructuring and upgrading and to strengthen the financial sector’s capacity to serve the real economy. Financial resources were consolidated to support the development of small- and micro-sized enterprises. By grouping high-quality enterprises in a region, small- and medium-sized enterprises were assisted in issuing collective bills, while commercial banks were encouraged to issue financial bonds earmarked for lending to small- and medium-sized enterprises. The PBC vigorously promoted financial innovation in products and services in the rural areas, encouraged and guided financial institutions to increase loans to the agricultural sector, rural areas, and farmers so as to promote the development of a modern agricultural industry. Financial institutions were guided to provide credit to ongoing and follow-up national key projects, the modern service sector, scientific and technology innovation, strategic emerging industries, and other important areas that are critical to social and economic development. Financial services were improved to contribute to the better livelihood of the people, to support job creation, students in need, and so forth. The pilot program of credit asset securitization was advanced to better manage stock credit assets. Strict controls continued to restrict lending to highly-polluting, energy-consuming industries, and to those industries with excess capacity. Targeted M&A loans were provided to those enterprises that sought to consolidate their overcapacity so as to help resolve their overcapacity problems. Implementation of the differentiated home mortgage loan policy was continued to contain speculative purchases and purchases for investment purposes. Continued efforts were made to support government-subsidized welfare housing projects, shantytown renovation, construction of small- and medium-sized residential units, and first-time home purchases.

The credit structure improved further, reflecting the implementation of differentiated treatment to different sectors. First, credit support to small- and micro-sized enterprises and to the agricultural sector, rural areas, and farmers maintained its strong growth momentum. At end-September, outstanding loans to small- and micro-sized enterprises grew 13.6 percent year on year, outpacing those to large and medium enterprises by 2.2 percentage points and 3.4 percentage points respectively; outstanding loans to the agricultural sector, rural areas, and farmers grew 18.6 percent year on year, outpacing the growth of total loans by 4 percentage points. Second, credit support to private enterprises was larger than that to state-owned enterprises. In the first three quarters of 2013, new loans to privately-owned enterprises accounted for 69.1 percent of the total new loans to all kinds of enterprises. Third, credit support to the service sector was enhanced. In the first three quarters of 2013, new loans accounted for 37.6 percent of total new loans to all kinds of enterprises, up 21.8 percent year on year, representing an acceleration of 1.8 and 2.2 percentage points over the same period and the end of the last year respectively. Fourth, lending to industries with excess capacity was strictly controlled. Since July 2011, growth of long- and medium-term loans to industries with excess capacity remained at a single-digit level. At end-September, outstanding long- and medium-term loans to industries with excess capacity totaled 2.04 trillion yuan, up 6.7 percent year on year.

V. Advancing the market-based interest-rate reform

According to the overall arrangement of the State Council, the PBC continued to steadily promote the market-based interest-rate reform. First, controls on the lending rates of financial institutions were completely removed. On July 20, 2013, the PBC removed the floor for lending rates of financial institutions (with the exception of mortgage loans). In the meantime, controls on the interest rate for bill discounting were removed, and the ceiling on the lending rates of rural credit cooperatives was removed. Second, a self-regulatory pricing mechanism for market interest rates was established. On September 24, 2013, the inaugural and first meeting of the self-regulatory pricing mechanism for market interest rates was convened. The self-regulatory pricing mechanism for market interest rates is a market-based self-regulatory coordination mechanism, with participation by financial institutions, aiming to apply self-regulatory management over interest rates that were independently determined by financial institutions on the money, credit, and other financial markets, under the precondition of complying with the relevant interest-rate regulations, so as to maintain market order for fair competition and to promote the healthy development of the financial market. Third, the loan prime rate centralized quote and release mechanism was put in place. On October 25, 2013, the loan prime rate (LPR) centralized quote and release mechanism formally began operations after a one-month trial run. The LPR is the most preferential lending rate offered by a commercial bank to its prime clients; other lending rates can be generated by adding or subtracting basis points based on the LPR. The authorized agency calculates a weighted average of the quotes provided by the panel banks as the average LPR rate and releases it to the general public.

On the first day of the operation of the LPR quote and release mechanism, China Construction Bank signed two one-year loan contracts with an aggregate amount of 550 million yuan. The offered interest rate was the LPR it quoted plus 90 bps. In the meantime, the Industrial and Commercial Bank of China struck four lending deals with its clients based on its LPR, with an aggregate amount of 9.82 million yuan. Since then, other banks have gradually issued LPR-based loans. On October 30, China CITIC Bank signed the first LPR-based interest-rate swap agreement with Citibank. The term of the agreement is two years, with a nominal principal of 100 million yuan. Use of the LPR is gradually expanding.

The establishment of the self-regulatory pricing mechanism for market interest rates and the centralized quote and release mechanism for base lending rates is of great importance for furthering the market-based interest-rate reform. First, they will provide incentives to financial institutions to strengthen financial discipline and to price their products in a rational manner. Second, the establishment of base lending rates in the credit market will provide a reference to financial institutions in pricing their credit products. Third, they will strengthen self-regulation over pricing practices and will maintain market order for fair and orderly competition.

Box 2 The Loan Prime Rate Centralized Quote and Release Mechanism

The loan prime rate (LPR) is the most preferential lending rate offered by commercial banks to its prime clients; other lending rates can be offered by adding and subtracting basis points based on the LPR. The LPR is the lending rate determined by financial institutions after taking into account their capital costs, credit risk costs, management fees, minimum return on capital, and other factors, and it can truly reflect the price of funds on the credit market.

The United States, Japan, and other major economies have basically established a LPR quote and release mechanism. For example, the U.S. Prime Rate is published by the *Wall Street Journal* based on the quotes of the prime rates of ten large banks. Currently, the U.S. Prime Rate is mainly used to price consumer loans and credit card overdrafts provided to retail clients. In Canada, the prime rate panel banks include the five largest commercial banks. Although the highest and lowest quotes are ignored, the prime rate is generated by calculating the arithmetic mean of the remaining three quotes. It is then published on the Web site of the Central Bank of Canada. In Japan, six major banks are the panel banks that report their prime rates to the Bank of Japan, which, in turn, releases the average, highest, and lowest short-term prime rates on its Web site. Judging from the experiences of the major countries and regions, the base lending rate mechanism is an important institutional arrangement in the process of market-based lending-rate reform. It generally exercises self-regulation over pricing behavior and provides a significant reference for China to steadily promote its market-based interest-rate reform.

Drawing on international experience, China's loan prime rate (LPR) centralized quote and release mechanism formally entered into operation on October 25, 2013. The first group of panel banks included nine commercial banks, i.e., the Industrial and Commercial Bank of China, the Agricultural Bank of China, the Bank of China, the China Construction Bank, the Bank of Communications, the China CITIC Bank, the Pudong Development Bank, the Industrial Bank, and the China Merchants Bank. At the initial stage, the one-year LPR will be released to the general public. In terms of generation and publication of the LPR, on each business day all panel banks give their LPR quotes to the National Inter-bank Funding Center. While the highest and lowest quotes are ignored, the rest are regarded as effective quotes. The effective quotes are weighted by the share of each panel bank's RMB loans in the total outstanding RMB loans at the end of the previous quarter to arrive at a weighted average for the LPR. The weighted average LPR will be posted on the Web site www.shibor.org on each business day. The self-regulatory pricing mechanism for market interest rates will monitor and assess the quality of data released by the panel banks on a yearly basis so as to improve the credibility of the LPR.

The LPR centralized quote and release mechanism is an important part of the self-regulatory pricing mechanism for market interest rates and represents an expansion of the Shibor's role in the credit market. It will strengthen the building of the base rate system in the financial market and will promote a smooth transition from the central bank regulated pricing mechanism to a market-based pricing mechanism; improve the efficiency and transparency of credit product pricing by financial institutions and strengthen their autonomous pricing capacity; reduce irrational pricing behavior and safeguard a fair pricing order on the credit market; help the central bank improve the interest-rate adjustment mechanism; and lay an institutional basis for furthering the market-based interest-rate reform.

VI. Further improvements in the RMB exchange-rate regime

The PBC further improved the RMB exchange-rate regime in line with the principle of making it a self-initiated, controllable, and gradual process. Focusing on the role of market supply and demand and adjustments with reference to a basket of currencies, the PBC enhanced the flexibility of the RMB exchange rate and kept it basically stable at an adaptive and equilibrium level. In the third quarter of 2013, the central parity of the RMB against the US dollar peaked at 6.1475 yuan per dollar and reached a trough of 6.1817 yuan per dollar. It appreciated on 34 out of the 64 trading days in the third quarter of 2013 and depreciated on the remaining 30 trading days, with the largest intraday appreciation at 0.14 percent (or 86 points) and the sharpest one-day depreciation at 0.11 percent (or 68 points).

The RMB exchange rate moved in both directions against the euro, the Japanese yen, and other major international currencies. At end-September, the central parity of the RMB against the euro registered 8.2983 yuan per euro, a depreciation of 2.95 percent from the end of June, and the central parity of the RMB against the Japanese yen stood at 6.2793 yuan per 100 Japanese yen, a depreciation of 0.30 percent from the end of June. Beginning from the reform of the RMB exchange-rate regime in 2005 to end-September 2013, on a cumulative basis the RMB appreciated 20.68 percent against the euro and 16.35 percent against the Japanese yen. Direct trading between the RMB and foreign currencies on the inter-bank foreign-exchange market remained brisk and market liquidity grew notably, bringing down the exchange costs for market participants.

Table 5 Trading Volume of the RMB against Other Currencies on the Inter-bank Foreign-Exchange Spot Market in the Third Quarter of 2013

Unit: 100 million yuan

Currency	USD	Euro	Japanese Yen	HKD	GBP	Australian Dollar	Canadian Dollar	Malaysian Ringgit	Russian Ruble	Thai Baht
Trading Volume	60399.7	794.3	2944.6	287.6	58.9	548.7	1.4	2.6	15.4	0.28

Source: China Foreign Exchange Trade System.

In the third quarter, based on the local currency swap agreements signed with the PBC, overseas monetary authorities carried out 296 billion yuan of transactions, with the actual use of funds amounting to 4.169 billion yuan. The local currency swap arrangements contributed greatly to bilateral trade and investment.

VII. Steady increase in cross-border use of the RMB

The role of the RMB in the settlement of cross-border trade and investment grew steadily. According to preliminary statistics, in the third quarter of 2013 the volume of cross-border trade settled in RMB reached 1.1 trillion yuan, up 37.5 percent year on year. This included 700 billion yuan in settlements of trade in goods and 400 billion yuan in settlements of trade in services and other items under the current account. Actual RMB receipts and payments for cross-border trade registered 440.07 billion yuan and 656.21 billion yuan respectively, bringing the receipt-payment ratio to 1:1.5. Bank settlements of cross-border RMB direct investments reached 137.66 billion yuan, including 29.81 billion yuan of outward direct investments and 107.85 billion yuan of foreign direct investments.

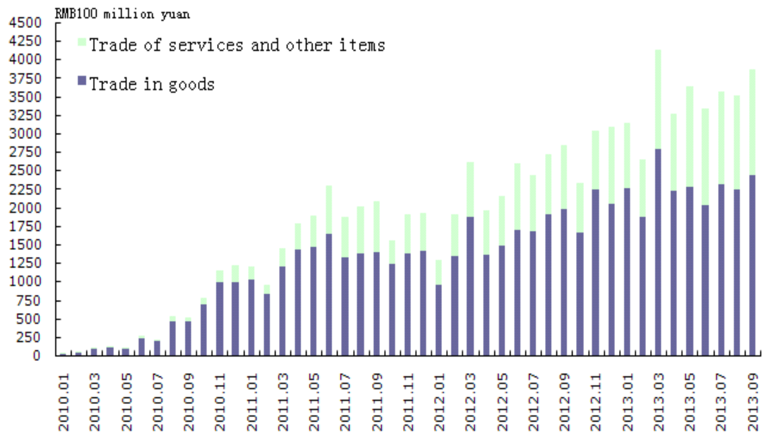


Figure 1 RMB Settlements of Cross-border Trade

Source: People’s Bank of China.

Approved by the State Council, the PBC and the ECB signed a bilateral local currency swap arrangement on October 9, 2013. The amount of the swap facility was 350 billion yuan/45 billion euro. The establishment of the bilateral local currency swap line will provide liquidity support for the further development of offshore RMB markets in the euro area, promote the use of RMB in overseas markets, and facilitate bilateral trade and investment.

VIII. Advancing reform of financial institutions

The pilot reform scheme of the Rural Financial Business Division of the Agricultural Bank of China (ABC) was advanced. After more than three years of experience with the pilot scheme, the institutional advantages of the rural financial services arm of the Agricultural Bank of China gradually unfolded, and the reform achieved notable progress and significant results. In order to implement the decisions of the State

Council Executive Meeting and the *Guidelines of the State Council General Office on Stepping up Financial Support for Economic Structural Adjustment, Transformation, and Upgrading* (State Council General Office Document No.67 [2013]), the PBC is working with other relevant departments to actively promote the expansion of the pilot scheme and it continues to improve relevant preferential policies so as to better serve the agricultural sector, rural areas, and farmers, and economic activities at the county level.

Reform of the rural credit cooperatives (RCCs) proceeded smoothly, and notable progress was achieved. First, the quality of RCC assets was strengthened significantly. Based on the five-category loan classification, at end-September the capital adequacy ratio of the RCCs was 10 percent, and the NPL ratio declined by 0.9 percentage points from end-2012 to 3.7 percent. Second, agro-linked loans by RCCs grew markedly. At end-September, aggregate outstanding deposits of RCCs posted 13.8 trillion yuan, up 14.9 percent from end-2012, while aggregate RCC lending registered 9.0 trillion yuan, an increase of 15.4 percent from end-2012. In particular, outstanding agro-linked loans and loans to rural households reached 6.1 trillion yuan and 3.0 trillion yuan respectively, up 14.3 percent and 14.6 percent from end-2012. Third, steady progress was made in RCC property-rights reform. As of end-September, a total of 1,738 RCCs with legal-person status at the county (city) level, 413 rural commercial banks, and 129 rural cooperative banks had been established.

IX. Deepening reform of foreign-exchange administration

Efforts were made to further facilitate trade and investment. On the basis of in-depth analysis of the reform program, regulations on foreign-exchange administration of trade in services were issued on July 2013. According to the regulations, starting from September 1, 2013 a reform of foreign-exchange administration for trade in services was implemented so as to facilitate trade and investment. The franchised business of retail foreign-currency exchanges was standardized and promoted, and the franchised retail foreign-currency exchange shops were permitted to carry out agent foreign-currency traveler’s check business on a pilot basis.

Steady steps were taken to promote RMB convertibility under the capital account. Solid progress was made in implementing the Qualified Foreign Institutional Investor (QFII), the RMB Qualified Foreign Institutional Investor (RQFII), and the Qualified Domestic Institutional Investor (QDII) schemes. In the first three quarters of 2013, a total of USD10.049 billion of the foreign investment quota for 78 investors was approved under the QFII scheme, 67.3 billion yuan of the investment quota for 65 investors under the RQFII scheme was approved, and USD2.75 billion of the outbound investment quota for 26 investors under the QDII scheme was approved. In the meantime, measures were taken to improve administration of the RQFII quota in order to make it fair and transparent. The pilot program that allows banks to issue small-value loans to domestic enterprises with overseas guarantees was expanded so as to support the private sector and the development of small- and micro-sized enterprises. The reform of foreign-exchange administration of cross-border guarantees was advanced and the relevant procedures were simplified.

Part 3 Financial Market Analysis

In the third quarter of 2013 China's financial market performed in a sound manner. Transactions on the money market registered moderated growth, while interest rates remained stable; the amount of bond issuances continued to grow; stock indices rebounded, and trading on the stock market rose; and insurance assets maintained steady growth and the foreign-exchange market traded briskly.

I. Financial market analysis

1. Growth of the volume of trading on the money market moderated and market interest rates were generally stable

The growth of bond repos moderated and the turnover of inter-bank borrowings declined year on year. In the first three quarters of 2013, the turnover of bond repos on the inter-bank market totaled 117.6 trillion yuan, with an average daily turnover of 625.7 billion yuan, up 9.1 percent year on year and representing a deceleration of 4.2 percentage points from the first half of the year. The turnover of inter-bank borrowings reached 28.4 trillion yuan, with an average daily turnover of 151 billion yuan, down 21.6 percent year on year. The daily turnover declined substantially in June and July compared with that during the same period of the last year, and increased slightly in August and September. Overnight products still dominated bond repo and inter-bank borrowing transactions, accounting for 79.4 percent and 83.2 percent of their respective turnovers in the first three quarters, down 1.3 and 4.4 percentage points from the same period of the last year. The total turnover of government securities repos on the stock exchange soared 67.4 percent year on year to 41 trillion yuan.

In terms of financing among financial institutions, the flow of funds revealed the following characteristics: first, although domestically-funded large banks remained the net fund providers, the amount of their net lending declined year on year. In the first three quarters of 2013, net inter-bank lending of domestically-funded large banks amounted to 37.1 trillion yuan, 12.4 trillion yuan less than that during the same period of the last year. In particular, in the third quarter their net inter-bank lending declined 5.7 trillion yuan year on year. Second, borrowings by small- and medium-sized banks declined year on year. Small- and medium-sized banks turned from net fund borrowers to net fund lenders on the inter-bank lending market and, together with large banks, provided funding to other borrowers. Third, the demand for financing of securities firms, fund management companies, and insurance companies continued to increase, while that of other financial institutions and products declined compared with the same period of the last year.

Table 6 Fund Flows among Financial Institutions in the First

Three Quarters of 2013

Unit:100 million yuan

	Repos		Inter-bank borrowing	
	In the first three quarters of 2013	In the first three quarters of 2012	In the first three quarters of 2013	In the first three quarters of 2012
Domestically-funded large banks ①	-341,606	-434,461	-29,584	-60,470
Domestically-funded small- and medium-sized banks ②	114,220	211,189	-22,159	8,287
Securities and fund management companies	115,445	92,837	30,679	26,892
Insurance companies	44,073	37,320	—	—
Foreign-funded financial institutions	11,950	14,507	4,340	6,768
Other financial institutions and vehicles ③	55,918	78,608	16,723	18,523

Notes: ① Domestically-funded large banks include the Industrial and Commercial Bank of China, the Agricultural Bank of China, the Bank of China, the China Construction Bank, the China Development Bank, the Bank of Communications, and the Postal Savings Bank of China.
② Domestically-funded small- and medium-sized banks include the China Merchants Bank and 16 other medium-sized banks, small-sized city commercial banks, rural commercial banks, rural cooperative banks, and village and township banks.
③ Other financial institutions and vehicles include urban credit cooperatives, rural credit cooperatives, finance companies, trust and investment companies, financial leasing companies, asset management companies, social security funds, investment companies, corporate annuities, and other investment vehicles, among which some financial institutions and vehicles did not participate in the inter-bank funding market.
④ A negative sign indicates net lending and a positive sign indicates net borrowing.
Source: China Foreign Exchange Trade System.

In the third quarter, as the RMB equivalent of foreign-exchange reserves increased slightly, the People's Bank of China conducted open market operations (OMOs) in a flexible way so as to maintain a balanced supply and demand of liquidity in the banking system. Commercial banks became more cautious in their asset allocations, and money-market rates declined from their high levels in the second quarter and remained stable. In September, the weighted average interest rate of bond-pledged repos and inter-bank borrowings posted 3.49 percent and 3.47 percent respectively, slightly above their postings in August, and their month-on-month growth declined by 10 and 6 basis points from the same period of the last year. At end-September, the overnight, 1-week, 3-month, and 1-year Shibor rates stood at 3.13 percent, 4.20 percent, 4.67 percent, and 4.40 percent respectively.

Trading of RMB interest-rate swaps declined somewhat. In the first three quarters of the year, the aggregate nominal principal of RMB interest-rate swaps posted 2.1 trillion yuan. In particular, in the third quarter the aggregate nominal principal of

RMB interest-rate swaps posted 586.05 billion yuan, a decline of 26.8 percent year on year. In terms of the maturity structure, RMB interest-rate swaps with maturities of one year or less traded most briskly, and their aggregate nominal principal amounted to 443.49 billion yuan, accounting for 75.7 percent of the total. The base rates of the floating end of the RMB interest-rate swaps mainly included the 7-day fixing repo rate and the Shibor, with their nominal principal accounting for 71.5 percent and 27.3 percent of the total respectively.

Table 7 Transactions of Interest-rate Derivatives

	Interest-rate swaps		Bond forwards		Forward-rate agreements	
	Transactions (lots)	Amount of notional principal (100 million yuan)	Transactions (lots)	Amount (100 million yuan)	Transactions	Amount of notional principal (100 million yuan)
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	60.0
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	2.0
Q1 2013	5,533	7,375.8	1	1.0	0	0
Q2 2013	7,007	7,960.0	0	0	0	0
Q3 2013	5,816	5,860.5	0	0	1	0.5

Source: China Foreign Exchange Trade System.

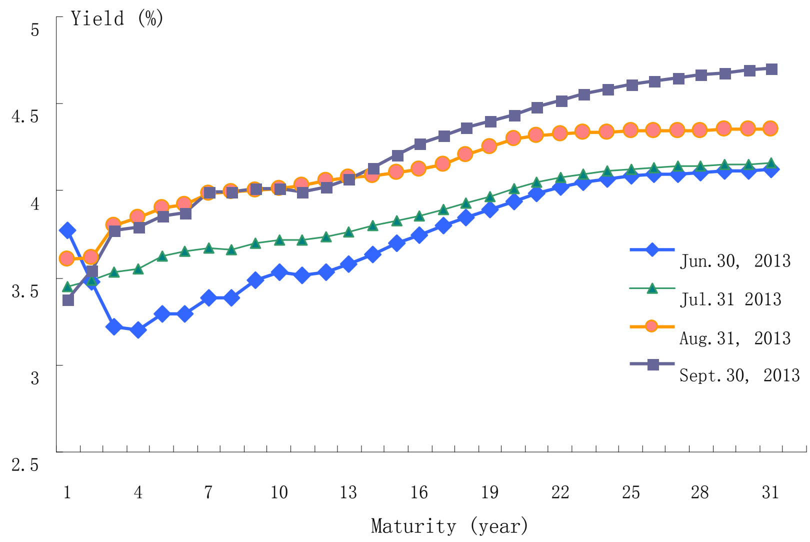
2. Bond transactions saw a year-on-year decline whereas bond issuances continued to increase

The turnover of spot bond transactions on the inter-bank market declined year on year. In the first three quarters of 2013, the turnover of spot bond trading totaled 36.4 trillion yuan, with an average daily turnover of 193.7 billion yuan and down 33.5 percent year on year, mainly due to a reduction of 8.1 trillion yuan in the second quarter and a further reduction of 17.1 trillion yuan in the third quarter. In terms of trading entities, domestically-funded large banks, other financial institutions and vehicles, and foreign-funded financial institutions were mainly net purchasers on the spot bond market, with net purchases of 230.3 billion yuan, 182.6 billion yuan, and 147.6 billion yuan respectively; domestically-funded small- and medium-sized banks were mainly net bond sellers, with a net amount of 530.1 billion yuan. A total of 58.9 billion yuan of government securities was traded on the stock exchanges in the first three quarters, 10.3 billion yuan less than that during the same period of the last year.

Bond indices on the inter-bank market declined. The China Bond Composite Index (net price) declined from 101.07 points at end-June to 98.92 points at end-September, or down 2.13 percent, while the China Bond Composite Index (full price) declined from 112.58 points at end-June to 110.42 points at end-September, or down 1.92 percent. The index of government securities on the stock exchanges rose 0.40 percent, from 138.10 points at end-June to 138.65 points at end-September.

Overall, the yield curve of government securities on the inter-bank market moved up, with the yield curve with long ends moving up more than that with short ends. At end-September, except for government securities with a short maturity, the yields of other maturities were higher than those at the end of June. In particular, the yields of 1-year, 5-year, 10-year, and 20-year government securities were respectively 6, 58, 48, and 49 basis points higher than those at end-June.

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



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

Bond issuances continued to grow. In the first three quarters of 2013, a total of 6.9 trillion yuan of bonds was issued, 1.1 trillion yuan more than that during the same period of the last year. In particular, the issuance of central bank bills and debt-financing instruments of non-financial enterprises registered a larger year-on-year increase. At end-September, the total volume of outstanding bonds posted 29.1 trillion yuan, an increase of 13.8 percent year on year.

Table 8 Issuance of Major Bonds in the First Three Quarters of 2013

Types of bonds	Issuance (100 million yuan)	Year-on-year growth (100 million yuan)
Government securities①	15,639	2,322
Central bank bills	5,148	5,148
Financial bonds②	19,970	641
Of which: Financial bonds issued by the China Development Bank and policy financial bonds	15,384	-1,406
Corporate debenture bonds③	28,600	2,708
Of which: Debt-financing instruments of	22,664	3,898

non-financial enterprises		
Enterprise bonds	4,467	-932
Corporate bonds	1,248	-353
Total	69,358	10,819

Notes: ① Including municipal bonds issued by the Ministry of Finance on behalf of local governments.
② Including financial bonds issued by the China Development Bank, policy financial bonds, policy financial bonds, ordinary bonds issued by commercial banks, subordinated bonds issued by commercial banks, hybrid bonds issued by commercial banks, bonds issued by securities firms, and so forth.
③ Including debt-financing instruments issued by non-financial enterprises, enterprise bonds, corporate bonds, convertible bonds, bonds with detachable warrants, and privately placed SME bonds.
Sources: People's Bank of China, National Development and Reform Commission, China Securities Regulatory Commission, China Government Securities Depository Trust and Clearing Co., Ltd.

The issuance rates of government securities of all maturities edged up. The interest rate of 5-year government bonds issued in July was 3.09 percent, at par with those of the same maturity issued in June; the interest rate of 7-year government securities issued in September was 3.46 percent, up 17 basis points from those of the same maturity issued in June; the interest rate of 10-year government securities issued in August was 4.08 percent, up 72 basis points from those of the same maturity issued in June. The Shibor played a larger role in bond pricing. In the first three quarters of the year, the issuance amount of floating-rate bonds based on the Shibor on the primary bond market was 167 billion yuan, accounting for 59 percent of the issuance volume of all floating-rate bonds; the 276 fixed-rate enterprise bonds were all based on the Shibor, with a gross issuance volume of 365.3 billion yuan. In addition, a total of 289.1 billion yuan of short-term financing bills based on the Shibor was issued, accounting for 46 percent of the total issuance of short-term fixed-rate financing bills.

3. The volume of bill financing declined slightly and bill financing rates were generally stable

The growth of bill acceptances moderated. In the first three quarters of the year, commercial bills issued by enterprises totaled 15.2 trillion yuan, representing year-on-year growth of 15.6 percent; at end-September outstanding commercial bills posted 8.9 trillion yuan, representing year-on-year growth of 6.3 percent. At end-September, the outstanding balance of accepted drafts had increased by 0.6 trillion yuan from the beginning of the year, representing a deceleration of 1.2 trillion yuan from the same period of the last year. In terms of financing entities, outstanding bankers' acceptances were mainly issued by enterprises in the manufacturing, wholesale, and retail industries, with small- and medium-sized enterprises issuing 69.1 percent of the total.

The amount of bill financing declined slightly, and bill financing rates were generally stable. In the first three quarters of 2013, the cumulative amount of commercial bills discounted by financial institutions posted 34.6 trillion yuan, representing year-on-year growth of 54.1 percent. At end-September, the outstanding balance of discounted commercial bills declined 12.1 percent year on year to total 2.1 trillion yuan. The outstanding balance of bill financing at end-September increased by 10.3 billion yuan from the beginning of the year, with a deceleration of 820.9 billion yuan year on year and accounting for 2.9 percent of all categories of loans, down 0.9 percentage points from the corresponding period of the last year. In the third quarter, as financial institutions strengthened adjustment of their credit aggregates and structure and maintained the growth of bill financing at a reasonable level, the amount of bill financing declined by 268.9 billion yuan compared with the amount at end-June. Affected by a number of factors, such as the change in supply and demand for bill financing, at the beginning of July interest rates on the bill market declined from the end of June, and were generally stable in August and September.

4. The stock indices rebounded and turnover on the stock markets increased substantially year on year

The stock indices rebounded on the Shanghai and Shenzhen stock markets, while the indices on the Growth Enterprise Board rose. At end-September, the Shanghai Exchange Composite Index and the Shenzhen Stock Exchange Component Index closed at 2,175 and 8,515 points respectively, shedding 94 and 602 points from end-2012, but they rebounded significantly from end-June by gaining 195 and 820 points respectively. The Growth Enterprise Board (GEB) Index (Chinext Price Index) of the Shenzhen Stock Exchange closed at 1,368 points, gaining 654 points from end-2012. The weighted average P/E ratio on the A-share market on the Shanghai Stock Exchange declined from 12.3 times at end-2012 to 11.2 times at end-September 2013, while that on the Shenzhen Stock Exchange rose from 22.2 times to 27.8 times during the same period.

The volume of trading on the stock markets increased significantly year on year. In the first three quarters of 2013, the turnover on the Shanghai and Shenzhen stock exchanges totaled 34.5 trillion yuan, representing an increase of 39.6 percent year on year, and the average daily turnover posted 194.9 billion yuan, 59.1 billion yuan more than that during the same period of the last year. In particular, the volume of transactions on the Growth Enterprise Board amounted to 3.5 trillion yuan, up 89.3 percent year on year. At end-September 2013, the market capitalization of the Shanghai and Shenzhen stock exchanges posted 20 trillion yuan, up 20.5 percent year on year, and the market capitalization of the Growth Enterprise Board amounted to 773.3 billion yuan, up 149.8 percent year on year.

Financing on the stock markets declined year on year. In the first three quarters of 2013, a total of 260.7 billion yuan was raised by enterprises and financial institutions on domestic and overseas markets by way of IPOs, additional offerings, rights offerings, and warrant exercises, representing a decrease of 47.6 billion yuan year on year. Among this total, 217.6 billion yuan was raised on the A-share market, 59.1

billion yuan less than that was raised during the same period of the last year.

5. Total assets in the insurance industry registered stable growth

In the first three quarters of 2013 total premium income in the insurance industry amounted to 1.3 trillion yuan, representing year-on-year growth of 11.2 percent, and total claim and benefit payments amounted to 450.9 billion yuan, representing year-on-year growth of 32.9 percent. Specifically, total claim and benefit payments in the property insurance sector increased 20.6 percent, while those in the life insurance sector grew 49.5 percent.

Total assets of the insurance industry registered steady growth. At end-September, total assets of the insurance industry posted 8.1 trillion yuan, an increase of 16.7 percent year on year, 0.3 percentage points higher than that an end-June. Among this total, bank deposits increased 4.1 percent year on year, a slight acceleration from the end of June; investment-linked assets increased 22.7 percent year on year, a growth rate slightly below that at the end of June.

Table 9 Use of Insurance Funds, End-September 2013

	Outstanding balance (100 million yuan)		As a share of total assets (%)	
	End-September, 2013	End-September, 2012	End-September, 2013	End-September, 2012
Total assets	80,530	69,000	100	100
Of which: Bank deposits	22,879	21,979	28.4	31.9
Investments	51,280	41,805	63.7	60.6

Source: China Insurance Regulatory Commission.

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

In the first three quarters of 2013, the turnover of spot RMB/foreign-exchange transactions totaled USD1062.09 billion, representing a year-on-year increase of 18.1 percent. The turnover of RMB/foreign-exchange swap transactions totaled USD899.81 billion, representing a year-on-year increase of 36.5 percent. Among this total, overnight RMB/USD swap transactions amounted to 475.79 billion, accounting for 52.9 percent of the total; the turnover on the RMB/foreign-exchange market totaled USD 3.61 billion, a decrease of 32.2 percent year on year. The turnover of foreign-currency pair transactions amounted to USD15.92 billion, a decrease of 21.7 percent. In particular, USD/EURO transactions accounted for the bulk of the total turnover, or 35.9 percent, up 7.7 percentage points year on year.

The number of participants on the foreign-exchange market expanded further. At end-September, there were 388 members on the foreign-exchange spot market, 86 members on the foreign-exchange forward market, 80 members on the foreign-exchange swap market, and 33 members on the foreign-exchange options market. In addition, there were 31 market-makers on the spot market and 27 market-makers on the forward and swap markets.

7. The price of gold declined amid fluctuations

The gold market operated in a stable manner and traded briskly. In the first three quarters of 2013, the turnover of all sorts of precious metals on the Shanghai Gold Exchange saw a large increase, while during the same period the turnover of gold and silver hit historical highs. The total trading volume of gold was 8,564.4 tons, an increase of 81.9 percent year on year, and its turnover posted 2448.61 billion yuan, an increase of 54.4 percent year on year. The trading volume of silver was 344,376.6 tons, an increase of 126.2 percent year on year, and its turnover posted 1,619.51 billion yuan, an increase of 65.6 percent year on year. The trading volume of platinum was 65.1 tons, an increase of 37.5 percent year on year, and its turnover posted 20.17 billion yuan, an increase of 30.0 percent year on year.

The price of gold first rebounded and then declined. In the third quarter, the spot price of gold increased from a trough of USD1180.1 at the end of June to USD1328.1 at the end of August, before declining to USD1328.1 per ounce at the end of September. The highest gold price on the Shanghai Gold Exchange (AU9999) was 340.8 yuan per gram, and the lowest gold price on the Shanghai Gold Exchange (AU9999) was 239.3 yuan per gram. At end-September, the price of gold on the domestic market closed at 265.7 yuan per gram, up 22.2 yuan per gram from the end of June or an increase of 9.1 percent.

II. Institutional building in the financial market

1. Trading and clearing behavior on the inter-bank market was further regulated

In July 2013 the PBC issued the Announcement No. 8 stating that all bond transactions shall be carried out via the National Inter-bank Funding Center system and shall not be revoked or changed after the transaction is completed. In the meantime, the National Inter-bank Funding Center and the bond depository trust and clearing institutions shall improve their verifications of basic information and of the information-sharing mechanism. To prevent market risks and improve market efficiency, the PBC issued Announcement No. 12 in August, further strengthening the requirements for Delivery Versus Payment (DVP) on the inter-bank bond market.

2. Institutional building of the securities market was improved

The market-oriented reform of merger and acquisition of listed companies was accelerated. On September 13, the CSRC announced that beginning in October a separate lane system would be applied to the M&A of listed companies. Based on the competence of the financial advisors, the performance and credibility of the listed companies, the industrial policy, and the types of transactions, a differentiated review and approval system was to be implemented.

Trading of government bond futures was reactivated. On September 6, trading of government bond futures was resumed on the China Financial Futures Exchange. The launch of government bond futures helps to improve the issuance system of government bonds, promote the market-based interest-rate reform, optimize the allocation of resources, and promote financial institutions to diversify their risk management tools and to enhance their ability to serve the real economy.

3. Institutional building of the insurance market was improved

Efforts were made to regulate the handing of insurance consumer complaints. On July 1, the CIRC issued the *Administrative Rules for Handling Insurance Consumer Complaints*. The rules make specific provisions regarding the division of responsibility for the handling of insurance consumer complaints, the operating system, supervision and management, and so forth, to further improve the mechanism for insurance consumer protection.

Reform of the life insurance premium rate policy was launched. On August 1, the CIRC issued the *Notice on the Reform of the Life Insurance Premium Rate*, and the reform of the life insurance premium rate was formally launched. The guiding principle of the reform is to “let free the front end and take hold of the rear end.” On the front end, the insurance products’ premium rate will be determined by market supply and demand, and the ceiling of 2.5 percent will be abolished. On the rear end, the premium rate of statutory reserves will be decided by the regulatory authority based on the yields of a “basket of assets,” the yield-to-maturity of long-term Treasury bonds, and other factors. Measures taken at the rear end are aimed at promoting reasonable pricing at the front end so as to strengthen statutory reserves and solvency supervision and to guard against operational risks.

Measures were taken to promote the insurance industry to support the economic restructuring, transformation, and upgrading. In August, the CIRC issued the *Guiding Opinions for the Insurance Industry to Support the Economic Restructuring, Transformation, and Upgrading*. The opinions put forward the requirements for the insurance industry in ten areas, such as strengthening insurance support to key areas and weak links in the economy, serving small- and micro-sized enterprises, improving the agricultural sector safeguard system, making innovations in the use of insurance funds, and providing a favorable environment for economic restructuring, transformation, and upgrading.

Part 4 Macro-economic Analysis

I. Global economic and financial developments

After entering the third quarter, the world economy continued to recover. Though the recovery dynamics strengthened in the U.S., the policy risks still remained. As the

European debt crisis was in a relatively quiet period, the economy in the euro zone showed positive signs. The Japanese economy rebounded but it remained to be seen whether the dynamics could be sustained. Growth slowed down in some emerging market economies, with intensified volatility in the financial markets and rising risks.

1. Economic development in the major economies

The momentum for an economic recovery strengthened in the U.S. Driven by private consumption, investment, and export growth, in the second quarter real GDP grew by 2.5 percent quarter on quarter (annualized), notably higher than the 1.1 percent growth in the first quarter and beating market expectations. In the third quarter, the property market continued to recover, private investment accelerated, and industrial activities improved, all of which indicated a strengthened growth momentum in the private sector. In September, the Purchasing Managers Index (PMI) in the manufacturing industry rebounded to 56.2, and the unemployment rate dropped to 7.2 percent, the lowest level since December 2008. However, some consumption indicators seemed weak. Growth of retail sales decelerated from July and in September posted -0.1 percent month on month; the Consumer Confidence Index declined to 77.5 in September, and slid further to 73.2 in October, recording a new low since January 2013. At present, given that the fiscal impasse has only been temporarily addressed and not fundamentally resolved, the QE tapering and other uncertainties will adversely impact corporate investments and private consumption and, in turn, will adversely affect the sustainability of the recovery. On September 18, the Federal Reserve cut the real GDP growth forecast to 2.0–2.3 percent from 2.3–2.6 percent in June.

The economy in the euro zone showed signs of a turnaround. As the European sovereign debt crisis was in a relatively quiet period, market confidence strengthened. In the second quarter, real GDP was up 0.3 percent quarter on quarter, ending the contraction of the past six consecutive quarters. Portugal, Germany, and Finland were the best performers, recording 1.1 percent, 0.7 percent, and 0.7 percent quarter-on-quarter growth respectively. In September the Consumer Confidence Index rose to -14.9, the highest level during the past two years; in August the manufacturing PMI was revised to 51.4, the highest level since July 2011, but in September it slid appreciably to 51.1. On September 5, the European Central Bank (ECB) raised the 2013 economic growth projection for the euro to -0.4 percent, from -0.6 percent in June.

The Japanese economy rebounded. As of the second quarter, private consumption in Japan had recorded three quarters of quarter-on-quarter growth. Due to stronger private consumption and export growth because of the weaker yen, real GDP in the second quarter grew by 3.8 percent quarter on quarter (annualized), much higher than that during the same period of the previous year. In September the core CPI gained 0.7 percent year on year, recording the fourth consecutive month of growth. On October 1, the Abe administration announced it would raise the consumption tax starting from April 2014 and at the same time it would launch a 5 trillion yen stimulus plan to lessen the adverse impact of the increase. However, it is expected that the increase in the consumption tax will contain personal consumption and will influence the growth of domestic demand. In addition, the possibility of a yen depreciation and a slowdown in some of the emerging market economies may influence the growth of Japan's export sector. As a result, it remains to be seen whether the recovery momentum can be sustained.

Table 10 Macro-economic and Financial Indices of the Major Economies

Country	Index	2012Q3			2012Q4			2013Q1			2013Q2			2013Q3		
		Jul.	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May.	Jun.	Jul.	Aug.	Sep.
United States	Real GDP Growth Rate (annualized quarterly rate, 5)	2.8			0.1			1.1			2.5					
	Unemployment Rate（%）	8.3	8.1	7.8	7.9	7.8	7.8	7.9	7.7	7.6	7.5	7.6	7.6	7.4	7.3	7.2
	CPI（YOY，%）	1.4	1.7	2.0	2.2	1.8	1.7	1.7	2.0	1.5	1.1	1.4	1.8	2.0	1.5	1.2
	DJ Industrial Average (closing number)	13009	13091	13486	13096	13025	13104	13861	14054	14579	14840	15116	14910	15500	14810	15130
Euro zone	Real GDP Growth Rate (annualized quarterly rate, 5)	-0.1			-0.5			-0.2			0.3					
	Unemployment Rate（%）	11.4	11.5	11.6	11.7	11.8	11.9	12.0	12.0	12.0	12.1	12.1	12.1	12.2	12.2	12.2
	HICP（YOY, %）	2.4	2.6	2.6	2.5	2.2	2.2	2.0	1.8	1.7	1.2	1.4	1.6	1.6	1.3	1.1
	EURO STOXX 50 (closing number)	2479	2509	2518	2525	2551	2569	2641	2647	2698	2725	2662	2605	2699	2671	2776
Japan	Real GDP Growth Rate (annualized quarterly rate, 5)	-3.5			1.1			4.1			3.8					
	Unemployment Rate（%）	4.3	4.2	4.2	4.2	4.1	4.3	4.2	4.3	4.1	4.1	4.1	3.9	3.8	4.1	4.0
	Core CPI (YOY, %)	-0.3	-0.3	-0.1	0.0	-0.1	-0.2	-0.2	-0.3	-0.5	-0.4	0.0	0.4	0.7	0.8	0.7
	NIKKEI225 (closing number)	9007	8695	8840	8928	9446	10395	11139	11559	12398	13861	13775	13677	13668	13467	14456

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

Growth in some of the emerging market economies slowed down, and their financial markets experienced volatility. Since the beginning of 2013, as growth in some emerging market economies slowed down, their balance of payments deteriorated, and their foreign-exchange reserves went down while the fiscal and debt conditions in some of them deteriorated. Affected by expectations of a QE tapering by the Federal Reserve, beginning in May the directions of international capital movements reversed, which led to financial market fluctuations, including currency depreciations, stock market slumps, and rising yields of government bonds in some emerging market economies.

Box 3 Financial Market Volatility in Asian Emerging Market Economies

1. Recent financial market volatility in some Asian emerging market economies

Most emerging market economies have experienced capital outflows since late May

2013. Emerging Portfolio Fund Research (EPFR) data show that USD12.1 billion flowed out of equity funds in the emerging markets, marking the second quarter of net capital outflows, whereas capital outflows from emerging market bond funds reached USD17.4 billion dollars. At the same time, the emerging economies, including India and Indonesia, experienced large fluctuations in their financial markets. In terms of currency depreciations, in late August the Indian rupee, the Indonesian rupiah, and the Thai baht depreciated against the US dollar by 18 percent, 15 percent, and 6 percent respectively. At end-August, the stock indices in India, Indonesia, and Thailand tumbled from the end of May by 9 percent, 17 percent, and 17 percent respectively, and 10-year treasury bond yields in India, Indonesia, and Thailand soared by 136, 243, and 80 basis points respectively. Foreign exchange reserves also dropped. From May to July 2013, foreign exchange reserves in the emerging market economies decreased by USD81 billion. In particular, reserves in the Indian and Indonesian central banks decreased by 5.5 percent and 13.6 percent respectively. On September 19, with the announcement by the Federal Reserve that the QE tapering would be postponed, financial markets in the emerging market economies rallied and volatility was eased.

2. Reasons behind the financial market volatility

Stronger expectations for a QE tapering by the Federal Reserve and the reversal in international capital flows were the direct reasons that triggered the financial market volatility in some of the Asian emerging market economies. Starting in 2013, as there were stronger market expectations that the Federal Reserve would begin the QE tapering within the year, the cost of US dollar carry trade increased and assets denominated in US dollars became more attractive. In May, Fed Chairman Bernanke signaled a possible QE tapering. Since the start of June, the stock and bond markets in the major emerging economies saw massive outflows; bond markets in particular experienced a reversal from inflows to outflows.

Weak fundamentals in these emerging market economies were the fundamental reason for the volatility. First, fiscal conditions were not satisfactory. Fiscal deficits remained at a high level in India and in other Asian emerging market economies. To make up for the shortfall, some countries attracted international capital inflows through their capital markets. When the QE tapering expectations became stronger, capital fled, leading to an economic slowdown and dragging fiscal conditions into a vicious cycle. Second, the current-account deficit widened. The current account deficit in India began to widen from the beginning of 2009. As of the second quarter of 2013, Indonesia had experienced seven consecutive quarters of deficit in the current account. With the recent yen depreciation squeezing room for exports from the emerging market economies, the deteriorating current account conditions increased dependence on capital inflows. In the context of QE tapering expectations, short-term capital inflows were no longer a reliable source to finance their current-account deficits and to support their capital markets, thus increasing their risks significantly. Third, factors such as the economic slowdown made the emerging market economies less attractive destinations for cross-border investments. Growth in some of the emerging market economies slowed down. For example, in the first two quarters of 2013 real GDP growth in India and Indonesia decelerated markedly from the same period of the previous year. In addition, returns on capital in domestic financial markets dropped because capital had already flowed in after the excessive monetary easing policies were launched, so these economies were less attractive to international investors.

3. Implications and outlook

The recent bout of financial turbulence in some Asian economies shares similarities with the Asian financial crisis of 1997 in terms of the external environment, i.e., monetary and financial tightening in the advanced economies and signs of international financial investors adopting a bearish view of the Asian emerging market economies. However, the fundamentals in these economies are much better today than they were in 1997. First, the exchange-rate regimes are more flexible. After 1997 most Asian emerging economies adopted floating exchange-rate regimes, thus weakening incentives for cross-border capital flows. Second, most Asian economies run a current -account surplus and are more capable of responding to capital outflows. Third, substantial increases in foreign-exchange reserves help strengthen market confidence. Fourth, external debt pressures have been reduced. The current debt to GDP ratio in most Asian emerging economies has greatly improved compared with the ratio in 1997 when the Asian financial crisis erupted. In addition, most government bonds are denominated in local currencies, so capital outflows do not have a significant impact on debt sustainability of government. Fifth, while liberalizing the capital account, the Asian economies have adopted flexible and prudential attitudes and took macro-prudential measures to strengthen management over short-term capital, thus, to some extent playing a role in identifying anomalies in cross-border capital flows. Furthermore, a regional financial cooperation mechanism was gradually established following the 1997 Asian financial crisis, thereby strengthening the regional financial safety net and improving the ability to mitigate external shocks and capital outflows. In general, the fundamentals of most Asian emerging market economies remain sound, risks are generally controllable, and the chances that a massive crisis will erupt in Asia are slim.

However, it is worth noting that the circumstances are very different among the various economies. The fundamentals in several countries have been greatly impacted by capital outflows and the spillover effects generated by a possible exit from the quantitative easing in the advanced economies might create great uncertainties regarding the future direction of capital flows. To avoid the negative spillover effects that a QE exit would have on the emerging market economies, the advanced economies, in particular the major reserve currency issuing countries should make their policies more transparent and predictable and they should improve their communications with the market.

2. Development of the global financial market

In the third quarter, international capital continued to flow out of the emerging market economies and to return to the advanced economies. Affected by this development, performance of the financial markets in the advanced economies and in the emerging market economies diverged, gaining strength in the former but fluctuating violently in some of the latter.

The euro, the pound, and the yen appreciated against the US dollar, whereas the currencies in the major emerging market countries continued to depreciate against the US dollar. On September 30, the exchange rate of USD/EUR, USD/GBP, and JPY/USD closed at 1.35, 1.62, and 98.21 respectively, appreciating from end-June by 4.0 percent, 6.4 percent, and 0.9 percent respectively. Most of the currencies in the emerging market economies continued their trend in the direction of devaluation. Among them, the Indian rupee tumbled to 68.8 INR/USD and the Turkish lira depreciated to 2.17 TRY/USD, both hitting historical lows. As of September 30, the Indonesia rupiah and the Indian rupee had depreciated by 14.3 percent and 4.9 percent respectively over end-June; the Russian ruble and the South African rand were fluctuating against the US dollar at low levels, at par with the levels at end-June.

The USD Libor fluctuated at a subdued level. Expectations that the Federal Reserve would scale back the quantitative easing were strengthened, but the Federal Fund Rate will remain at 0-0.25 percent for some time to come. As a result, the USD Libor generally fluctuated at a low level. As of September 30, the 1-year Libor was 0.6294 percent, a decline of 6 basis points from the end of June. The Euribor remained generally stable and edged up slightly. As of September 30, the 1-year Euribor registered 0.5390 percent, an increase of 1 basis point from the end of June.

Government bond yields in the U.S. and Germany rose modestly, whereas yields were rose in some of the emerging market economies. On September 30, 10-year government bond yields in the U.S. and Germany closed at 2.615 percent and 1.780 percent respectively, up 12.8 and 5.1 basis points respectively compared with end-March. The 10-year government bond yield in Japan closed at 0.688 percent, down 15.6 basis points from the end of June. Most emerging market economies experienced substantial increases in their 10-year government bond yields, in particular Indonesia, India, Brazil, and Turkey, with increases of 137, 131, 52, and 42 basis points respectively from the end of June.

The major stock indices in the advanced economies rallied slightly, but they fluctuated greatly in some of the emerging market economies. On September 30, the Dow Jones Industrial Average Index, the Nikkei 225 Index, and the STOXX50 Index closed at 15129.7, 14455.8, and 2776.2 points respectively, up 1.5 percent, 5.7 percent, and 6.6 percent from the end of June. After plunging in the second quarter, stock market indices in most of the emerging market economies fluctuated around subdued levels, with some of them fluctuating rather greatly. In the third quarter, the stock market indices in Indonesia, Turkey, and India fluctuated by 20.4 percent, 23.0 percent, and 15.3 percent respectively.

3. Monetary policies in the major economies

The major advanced economies maintained monetary easing policies. In its July, September, and October statements, the Federal Open Market Committee (FOMC) announced that it would keep the target range for the federal funds rate at 0 to 0.25 percent, continue to link the adjustment of the interest rate with the development at inflation and the unemployment rate, and maintain the asset purchase pace of USD85 billion per month and wait for more evidence indicating continued improvements in economic activity and in the labor market before starting to adjust the pace of asset purchases. The ECB announced that it would maintain the minimum bid rate on the main refinancing operations at 0.5 percent and would maintain the rate on the marginal lending facility and the rate on the deposit facility at 1 percent and 0 percent respectively. The ECB emphasized that it would maintain an easy monetary stance and it is expected that the benchmark interest rates will remain at current or even lower levels for a long period to come. The Bank of Japan (BOJ) continued to target the monetary base for monetary policy operations and continued to implement quantitative and qualitative monetary easing by increasing the monetary base and purchasing long-term Japanese Government Bonds (JGB), as well as extending the average remaining maturity of JGB purchases, so as to achieve the 2 percent inflation target within two years. The Bank of England maintained the Bank Rate at 0.5 percent and the size of asset purchases at 375 billion pounds, launched the "forward guidance for monetary policy" on August 7, and announced that it had no intention of raising interest rates until the unemployment rate drops to below 7 percent.

The monetary policies pursued by the emerging markets continued to diverge, with some countries tightening their monetary policy stance in response to capital outflows and pressures for a depreciation of local currency. To uphold its currency, the Reserve Bank of India (RBI) raised the benchmark interest rate on July 25 by 200 basis points to 10.25 percent. As the U.S. Federal Reserve postponed the QE tapering and the exchange market fluctuations eased, the RBI announced it would lower the interest rate on the marginal lending facility by 75 basis points to 9.5 percent and would increase the policy repo rate by 25 basis points to 7.5 percent in response to the rising inflationary pressures. In order to improve liquidity conditions, on October 7 the RBI again lowered the interest rate on the marginal lending facility by 50 basis points to 9.0 percent. The Bank of Indonesia raised the benchmark interest rate on July 11, August 29, and September 12 by 50, 50, and 25 basis points respectively to 7.25 percent. The Central Bank of Brazil increased the benchmark interest rate on July 10 and August 28 by 50 basis points respectively to 9.0 percent. The Central Bank of the Republic of Turkey increased the overnight lending rate on July 23 and August 20 by 50 basis points respectively to 7.75 percent. In addition, the Central Bank of Hungary cut the benchmark interest rate on July 23, August 27, and September 24 by 25, 20, and 20 basis points respectively to 3.6 percent. The Central Bank of Egypt cut the overnight deposit rate, the overnight lending rate, the rate on the main policy instrument, and the discount rate each by 50 basis points respectively, to 8.75 percent, 9.75 percent, 9.25 percent, and 9.25 percent.

4. World economic outlook and major risks

In the *World Economic Outlook* released in October, the International Monetary Fund (IMF) revised downward the projection for global growth to 2.9 percent, about 0.3 percentage points lower than the projection in July. The projections for growth in the U.S., the euro zone, and Japan were 1.6 percent, -0.4 percent, and 2.0 percent, and the projection for the emerging market and developing economies was adjusted downward from the July projection by 0.5 percentage points to 4.5 percent.

Going forward, major risks in the global economy include the following:

Fiscal and monetary policy uncertainties in the U.S. are likely to impact the U.S. and global economic recovery as well as financial market stability. The fiscal impasse caused by the polarized politics and bipartisan disputes over the 2014 government budget and the "debt ceiling" are unlikely to be resolved within a short period of time and might drag economic growth and even impact the world economic recovery. At the same time, uncertainties in the timing and steps of the Federal Reserve's exit from the accommodative monetary policy will heighten the volatility of cross-border capital flows, global exchange markets, asset prices, and commodity prices. Going forward, it is likely that financial market turbulence will increase and uncertainties will grow.

It will take time before some of the emerging market economies overcome their current difficulties. On the one hand, how the recovery in the advanced economies will influence the emerging market economies remains to be seen, and there are persistent uncertainties regarding the QE tapering and its adverse impact on the emerging market economies. On the other hand, there is limited room for the emerging market economies to implement monetary and fiscal policies, and the structural problems that will constrain economic development in the long run are not likely to be resolved within a short period of time. Affected by these internal and external factors, the difficulties in the emerging market economies are likely to persist, thus increasing the risks for a global economic recovery.

The European sovereign debt crisis is now in a relatively quiet period, but the euro zone as a whole still faces many structural problems. For example, the building of a firewall remains an arduous task; risks in the banking sector cannot be underestimated, including the slow deleveraging process and the weak lending activities; the fiscal union will require long-term efforts; and the government debt is still rising and the structural imbalances cannot be resolved in the near future.

The risks of trade and investment protectionism should be guarded against and the geopolitical situations are not optimistic. The persistently high unemployment rate, the lack of policy tools and policy space for stimulating economic growth, and the acute political polarization in some of the advanced economies make regional trade frictions vulnerable to being hyped and politicized, therefore generating an adverse impact on the global economic recovery. In addition, the deteriorating political situations in East Asia and the Middle East, in particular the worrying situation in Egypt and Syria, might increase the volatility of commodity prices and obstruct the recovery of the world economy.

II. Analysis of China's Macro-economic Performance

In the third quarter, the Chinese economy remained stable and took a turn for the better. Consumption grew in a stable manner while investment rose rapidly. The outlook for the agricultural sector was good and progress was made in the restructuring of the industrial sector. The inflation and employment situations were basically stable. It is estimated that GDP totaled 38.7 trillion yuan in the first three quarters of 2013, up 7.7 percent year on year. The GDP growth rate for Q3 was 7.8 percent year on year, up 0.3 percentage points from Q2. In the first three quarters, the CPI rose by 2.5 percent year on year and the trade surplus posted USD169.36 billion.

1. Consumer demand registered steady growth, investment grew in a fairly rapid manner, while the growth of exports and imports remained stable

Growth of household income and consumption demand was stable. In the first three quarters of 2013, per capita disposable income of urban households posted 20,169 yuan, representing year-on-year growth of 9.5 percent and price-adjusted real growth of 6.8 percent. The per capita cash income of rural households registered 7,627 yuan, up 12.5 percent in nominal terms and 9.6 percent in real terms. In the first three quarters of the year, retail sales of consumer goods totaled 16.9 trillion yuan, representing year-on-year growth of 12.9 percent, or 11.3 percent in real terms, which was 1.2 and 0.3 percentage points lower than that during the same period of the last year. The deceleration can be mainly attributed to the slowdown of the catering industry, in particular luxury catering services. Retail sales in the urban areas registered 14.6 trillion yuan, up 12.7 percent year on year, whereas retail sales in the rural areas grew 14.5 percent year on year to reach 2.3 trillion yuan.

Fixed-asset investments grew fairly rapidly. From the first through the third quarter, fixed-asset investments (excluding investments by rural households) totaled 30.9 trillion yuan, up 20.2 percent year on year in both nominal and real terms, representing an acceleration of 0.1 percentage points compared with that during the same period of the last year. Among this total, investment by the state-owned or state-controlled sector was 9.9 trillion yuan, representing year-on-year growth of 17.6 percent, while investment by the private sector registered 19.7 trillion yuan, increasing by 23.3 percent over the same period of the last year. In terms of the regional distribution, growth of fixed-asset investments in the central and western regions outpaced that in the eastern region; growth in the eastern, central, and western regions registered 18.8 percent, 23.4 percent, and 23.0 percent respectively. In terms of the sector distribution, fixed-asset investments in the primary, secondary, and tertiary industries grew 31.1 percent, 17.1 percent, and 22.3 percent respectively, with the growth of tertiary industry investments accelerating by 2.9 percentage points year on year. In the first three quarters of 2013, total planned investment in new projects grew 13.3 percent year on year to reach 26.5 trillion yuan, representing a deceleration of 12.4 percentage points from the same period of the last year. Total planned investments in projects under construction grew 18.6 percent year on year to reach 76.0 trillion yuan.

Imports and exports registered stable growth, and the trade surplus increased. In the first three quarters of this year, imports and exports gained 7.7 percent year on year to reach USD3060.37 billion. Among this total, exports rose 8.0 percent year on year to reach USD1614.86 billion, while imports rose by 7.3 percent to reach USD1445.5 billion. The trade surplus grew by 14.6 percent to reach a cumulative USD169.36 billion. With stronger incentives in the corporate sector to upgrade the growth model, the export structure continued to improve. Exports of machinery and electronic products grew steadily and traditional labor-intensive products remained competitive. Exports of high energy-consuming, high polluting, and resource-reliant products declined. From the first quarter through the third quarter, exports of machinery and electronic products went up 8 percent year on year, accounting for 57.2 percent of total exports. Exports of hi-tech products were enhanced by 13.3 percent year on year. The growth of seven categories of labor-intensive products, including textiles, garments, as well as bags and suitcases, grew 10.3 percent year on year. Exports of coal and crude oil dropped 20.7 percent and 29.8 percent respectively year on year. In the first three quarters of 2013, utilized foreign direct investment increased by 6.2 percent year on year to reach USD88.6 billion.

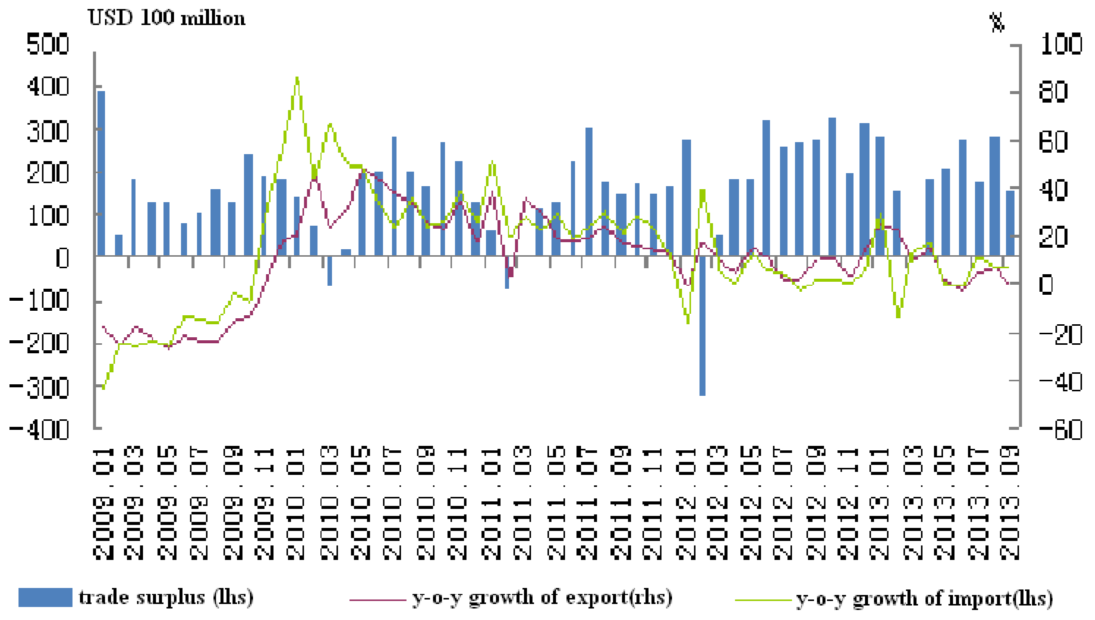


Figure 3 Import and Export Growth and the Trade Balance

Sources: General Administration of Customs, People's Bank of China.

2. The outlook for the agricultural sector was good and the growth of the

industrial output rebounded.

In the first three quarters of 2013, the value-added of the primary, secondary, and tertiary industries was 3.6 trillion yuan, 17.5 trillion yuan, and 17.6 trillion yuan respectively, up 3.4 percent, 7.8 percent, and 8.4 percent year on year. This accounted for 9.2 percent, 45.3 percent, and 45.5 percent of total GDP respectively. The share of tertiary industry in GDP was 1.6 percentage points higher year on year.

The outlook for the agricultural sector was positive. The summer grain output rose by 1.5 percent to reach 131.89 million tons. The output of early season rice went up 2.4 percent year on year to reach 34.07 million tons. A bumper harvest of autumn grain was in sight. In the first three quarters, the total output of meat (including pork, beef, mutton, and poultry) rose by 1.3 percent year on year to reach 58.03 million tons. Among this total, the output of pork totaled 38.31 million tons, up 2.1 percent year on year.

The growth of industrial output edged up. From the first quarter through the third quarter, the value-added of statistically large enterprises grew 9.6 percent year on year, representing an acceleration of 0.3 percentage points compared with that during the first half of this year. The profits of statistically large enterprises increased by 13.5 percent to reach 4045.28 billion yuan, representing an acceleration of 2.4 percentage points compared with that during the first two quarters. The profit margin calculated from total profits posted 5.49 percent, up 0.09 percentage points compared with the first half of 2013. The sales-to-production ratio reached 97.7 percent, accelerating by 0.2 percentage points compared with the first half of this year. A survey of 5,000 industrial enterprises conducted by the PBC indicated that market demand remained stable and profitability of the corporate sector improved despite the low business index. In the third quarter, the business index posted 56.3 percent, a decline of 0.8 percentage points compared with the second quarter and a decline of 4.8 percentage points compared with the same period of the last year. The enterprise export order index stood at 50.1 percent, growing by 0.2 and 2.6 percentage points respectively compared with the last quarter and the same period of the last year. The domestic order index registered 48.2 percent, dropping by 2.1 percentage points quarter on quarter and growing by 0.1 percentage points year on year. The corporate profitability index posted 55.1 percent, edging down by 0.5 percentage points compared with the previous quarter and rising by 3.7 percentage points compared with the same period of the last year.

3. Growth of consumer prices was basically stable

Growth of consumer prices picked up slightly. In Q3, the CPI rose 2.8 percent year on year, representing an acceleration of 0.4 percentage points from Q2. The CPI in July, August, and September went up by 2.7 percent, 2.16 percent, and 3.1 percent respectively compared with the last year. In terms of food and non-food items, the acceleration in the growth of food prices was the major contributor to the pick-up in CPI growth. In Q3, food prices rose 5.3 percent year on year, representing an acceleration of 1.3 percentage points quarter on quarter and contributing 1.7 percentage points to CPI growth. The price of non-food items went up by 1.6 percent, which was the same as that during the last quarter, contributing 1.1 percentage points to CPI growth. In terms of consumer goods and services, the growth of prices of consumer goods accelerated while the price of services remained generally stable. In Q3, the price of consumer goods grew 2.8 percent year on year, representing an acceleration of 0.6 percentage points; the price of services increased by 2.8 percent compared with the same period of the last year, flat with the growth during the last quarter.

The growth of producer prices slowed down. Ex-factory prices of industrial products fell 2.3 percent, 1.6 percent, and 1.3 percent respectively in July, August, and September year on year and in Q3 declined an average of 1.7 percent, which was 1.0 percentage points slower than that in Q2. The price of capital goods went down by 2.3 percent year on year, which was 1.3 percentage points less than that during the previous quarter; the price of consumer products registered no growth, which was 0.1 percentage points slower than the growth during Q2. In Q3 the Corporate Goods Price Index (CGPI) fell by 0.7 percent year on year and in September it went down by 0.4 percent, representing a narrowing decrease for the fourth consecutive month. The price of upstream products rebounded and the decline in the price of midstream products narrowed, whereas the price of downstream products edged up. In September, the price of primary, intermediate, and final products grew by 1.72 percent, -1.21 percent, and 1.03 percent respectively year on year. The decline in the price of investment goods narrowed and the rise in the price of consumer goods picked up. In September, the prices of investment goods and consumer goods grew by -0.74 percent and 2.26 percent respectively year on year. In Q3 of 2013, the price of agricultural products rose by 4.3 percent year on year, representing an acceleration of 3.2 percentage points compared with the previous quarter; the price index of agricultural capital goods increased by 0.8 percent year on year, representing a deceleration of 0.4 percentage points compared with the previous quarter.

The rise in commodity prices led to a slower decline in import prices. Seasonal factors and the tensions in Syria pushed up the price of crude oil by a large margin. In Q3, compared with the previous quarter, the average price of WTI crude oil futures on the New York Mercantile Exchange surged by 12.4 percent, while the average price of Brent Crude oil futures on the Intercontinental Exchange rose by 6.1 percent from the last quarter. The average LME spot copper and aluminum prices fell by 1.0 percent and 2.9 percent respectively from Q2. In Q3 import prices declined by 1.1 percent year on year, representing a deceleration of 1.8 percentage points compared with the previous quarter, and the declines in July, August, and September were 0.9 percent, 1.4 percent, and 1.1 percent respectively. Export prices went down by 1.2 percent year on year; this was 0.6 percentage points more than the decline in the last quarter. The growth of export prices in July, August, and September were -2.3 percent, -2.1 percent, and 0.7 percent respectively.

The GDP deflator rebounded. In the first three quarters of 2013, the GDP deflator (the ratio of nominal GDP to real GDP) was 1.5 percent, which was 0.4 percentage points lower than that during the same period of the previous year and 0.4 percentage points more than that during the first half of the year.

The resource products pricing reform made new progress. On September 16, the National Development and Reform Commission released a notice on implementation of quality-based pricing for fuel upgrading. Car petrol and diesel meeting quality standards for phase 4 of the upgrading would be priced 290 yuan and 370 yuan more per ton respectively, and another 170 yuan and 160 yuan per ton would be added to car petrol and diesel upgraded to phase 5. The purpose of such mark-up standards is to require the polluters to cover the costs of fuel upgrading. It is based on an assessment of the costs for the fuel upgrading. Some of the costs have already been absorbed by the fuel companies.

4. The growth of fiscal revenue and expenditures gradually picked up

In the three quarters of 2013, fiscal revenue grew 8.6 percent year on year to reach 9.8 trillion yuan. Specifically, fiscal revenue in Q1, Q2, and Q3 registered 6.9 percent, 8.1 percent, and 11.2 percent respectively. In Q3 fiscal revenue of the central government rebounded significantly as a result of a pick-up in growth and trade. In the first three quarters, tax revenue increased by 9.0 percent to reach 8.4 trillion yuan. Among this total, revenue from the domestic value-added tax, the domestic consumption tax, the turnover tax, the corporate income tax, and the personal income tax rose by 8.2 percent, 3.8 percent, 10.9 percent, 14.3 percent, and 10.8 percent respectively year on year, whereas the revenue from the value-added tax on imported goods and the consumption tax declined by 10.4 percent year on year. Fiscal expenditures rose 8.8 percent to reach 9.2 trillion yuan, representing a deceleration of 12.3 percentage points compared with the same period of the last year. Broken down, fiscal expenditures for urban and rural community affairs, health care and medical services, and social security and employment grew relatively rapidly, increasing by 20.7 percent, 14.6 percent, and 12.1 percent respectively year on year. In the first three quarters, the fiscal surplus posted 685.67 billion yuan, which was 38.76 billion yuan more than that during the same period of 2012.

China's urbanization is taking place quite rapidly. Fiscal revenue in local governments is not sufficiently abundant to finance the huge demand for funds required by such urbanization. In this context, many local governments set up financing vehicles to fill the gap; these played a positive role in promoting economic and social development. However, the size of the debt and the operational irregularities of some local government financing vehicles grew rapidly. In 2010 the State Council released the *Notice of the State Council on Strengthening Management of Local Government Financing Vehicles* (State Council Document No. 19, 2010) to clean up the local government financing vehicle debts. The coming years will mark a key juncture for

China to press ahead with a new type of urbanization. As local governments fervently pursue growth, there is significant pressure to keep the aggregate debt of local government financing vehicles under control. In order to prevent and mitigate the risks derived from the borrowing of local government financing vehicles, efforts should be made to improve the fiscal and taxation system, establish a positive incentive mechanism, and develop a well-regulated and efficient financing mechanism that suits the socialist market-economy system.

5. The employment situation was generally stable

New employment in the urban areas continued to increase. In the first three quarters of 2013, new urban employment registered 10.66 million. By end-Q3, the registered urban unemployment rate stood at 4.04 percent. A statistical analysis conducted by the China Human Resources Market Information Monitoring Center on public employment service agencies in 100 cities in Q3 showed that both labor supply and demand declined and were generally in balance. The ratio of job seekers to vacancies registered 1.08, posting a slight increased compared with the previous quarter and compared with the same period of the last year. Broken down by areas, supply and demand in the labor market declined in the western, central, and eastern regions, but the decline in the western regions was the most significant. Broken down by industry, more than 80 percent of the demand for labor came from the manufacturing industry, retailing and wholesale industry, catering industry, resident services industry, other services industry, leasing and commercial services industry, and construction industry. The demand for labor from the financial industry, real-estate industry, education, and mining industries grew by a large margin. Broken down by employers, more than 90 percent of the job openings were concentrated in the corporate sector, whereas those in governmental agencies and public institutions accounted for a mere 0.6 percent. In terms of the backgrounds of the job seekers, newly unemployed youth and freshly laid-off workers both increased compared with the previous quarter, and the number of college students unemployed upon graduation rose significantly. In the meantime, the number of job seekers who came from local rural areas and other provinces plunged. As for the structure of the job vacancies, medium- and high-level skilled workers were increasingly short of demand. In particular, the ratio of vacancies to job seekers posted 2.19, 2.19, and 2.11 for technicians, senior technicians, and engineers respectively.

Box 4 Growth and Employment

As the most populous developing country in the world, China has always regarded growth and employment as its top priority in economic development. After years of high-speed growth, the balance between growth and employment is attracting increasing attention during this critical juncture of restructuring.

Theories on the relationship between growth and employment are evolving. In classic economics, supply creates demand, and full employment is a natural outcome in a market economy. Keynesians held that a lack of effective demand leads to a decline in employment, making policy adjustments necessary to stimulate growth and to manage full employment. The Phillips Curve depicts a negative correlation between inflation and unemployment. As inflation is generally positively correlated with growth, the curve is also used to describe the relationship between growth and employment. Okun's Law is an empirically observed negative relationship between growth and unemployment. In the U.S., real GDP is 2 percentage points lower than potential GDP when the real unemployment rate is 1 percentage point below the natural unemployment rate. There is also research focusing on the relationship between the economic structure and employment. U.S. economist William Lewis has explored unemployment in a two-polar development model. The traditional agricultural sector features low labor productivity and large hidden unemployment, whereas a modern industrialized sector which features higher productivity and attracts labor to transfer out of the agricultural sector. The accelerated growth of a modern industrialized sector can reduce unemployment. The Petty-Clark Theorem depicts the evolution of the employment structure in the primary, secondary, and tertiary industries. As the economy grows and per capita national income rises, the share of added value and employment in primary industry declines, while that in secondary industry goes up. With progress in economic development, tertiary industry begins to take up a larger share in terms of added value and employment.

Looking at the relationship between growth and employment, China's reform and opening-up process has gone through the following stages. The first stage lasted from 1978 to the early 1990s. Rapid economic growth contributed to fast employment growth, with the elasticity for employment growth exceeding 0.25, namely one percentage point of growth bringing approximately 0.25 percentage points of employment growth. The second stage was from the early 1990s to the eve of this the round of the global financial crisis, when there was a downward trend in employment elasticity. The major reason for this was that the supply of surplus labor in the rural areas was moving into the industrial and service sectors at an accelerated pace during the urbanization process, which was also a period of technical progress and capital deepening. As the services industry accelerated its development and as restructuring made headway, employment elasticity rebounded.

At present, a number of factors may help reduce unemployment pressures during the economic transition. First, the growth of the population, especially those of working age, has slowed down. The momentum for a large sustained increase in the labor force is about to change. The UN estimates that the total population will peak in 2025 and then will decline. The peak of the working-age population will come even earlier. Data of the National Statistics Bureau indicate that the population aged 15 to 59 dropped by 3.45 million in 2012. Second, the improved economic structure will facilitate employment growth. Since the 1990s, the employment elasticity of the agricultural sector was negative, meaning that employment in the agricultural sector registered negative growth, and the surplus labor from the primary sector was moving into the secondary and tertiary sectors. During this period, employment elasticity in the industrial sector was about 0.15 and that of the services sector was more than 0.2. With higher income, residents pay greater attention to their quality of life, leading to accelerated development of a service sector. Moreover, employment created by the service sector exceeded that of the industrial sector in 1994 and exceeded that of the agricultural sector in 2011. In recent years, urban employment brought about by per unit GDP growth continued to grow. Taking into account the influence of restructuring, based on the estimation of the working-age population by the UN, the assumption is that the productivity of the three industries will increase at the pace indicated by historical trends and that the labor participation rate will equal the historical average; a growth rate that is slightly slower than the current level may also create enough demand for employment.

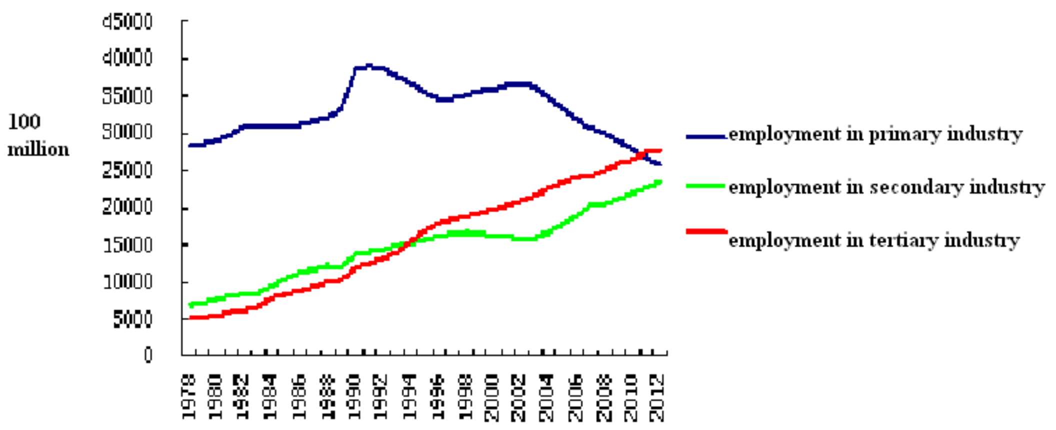


Figure 4 Employment in the Primary, Secondary and Tertiary Sectors

Source: National Bureau of Statistics.

However, the challenges that still remain in terms of employment should not be neglected. First, as Chinese society evolves, it will become more difficult for the new generation of migrant workers to re-engage in agricultural production due to changes in their mentality and skill profiles. The role of the agricultural sector as a pool for absorbing labor will be weakened, adding to the employment pressures. Moreover, some enterprises are reluctant to fire their employees when they encountered temporary difficulties so as to avoid a potential shortage of labor supply on the market in the future, thus complicating an assessment of the employment situation. Second, an unemployment structural problem has been observed. Unemployment coexisted with a shortage of eligible candidates and higher wage offerings on the market. Higher economic growth alone cannot fix these problems. On the one hand, efforts should be made to promote restructuring and to foster the development of the service sector, the advanced manufacturing sector, and other industries that can bring more job opportunities so as to improve the economic and employment structure. On the other hand, efforts should be made to improve the labor security system and to optimize the structure of education by enhancing vocational education and training in order to improve the employability of job seekers.

6. The balance of payments remained in surplus

In the first three quarters, the current-account surplus stood at USD138.2 billion, while the surplus under the capital and financial account registered USD162.4 billion. Foreign-exchange reserves grew by USD300.6 billion.

The growth of external debt declined. By end-June, outstanding external debt posted USD771.95 billion, a decrease of 1.7 percent year on year. Among this total, the stock of registered external debt posted USD462.45 billion, a decrease of 6.6 percent year on year and accounting for 59.9 percent of the total; short-term outstanding external debt posted USD598.63 billion, an increase of 1.8 percent year on year and accounting for 77.5 percent of the total.

7. Sector analysis

Profits of industrial enterprises grew rapidly, and new profits were less concentrated in certain industries and became more broadly distributed. In the first three quarters of 2013, among 41 industries, 24 made more profits in their main businesses compared with the same period of the previous year, and 2 earned profits, reversing their loss-making situation in the last year. An accelerated growth of sales, a rebound in ex-factory prices, and a decline in per unit costs contributed to the rapid rise in profits in the third quarter. In September, the profits of the ferrous metal pressing and smelting industry, non-metal mineral product industry, automobile manufacturing industry, petroleum refining and coking industry, and agricultural and sideline product processing industry accounted for 37.6 percent of the total new profits of statistically-large enterprises. This was 15.2 percentage points less than the share in August.

(1) Real-estate sector

Nationwide, the growth of sales of commercial housing declined and housing prices continued to rise. The growth of real-estate development investment declined and real -estate loans grew in a stable manner.

The number of cities witnessing a year-on-year increase in housing prices remained the same as that during Q2, and the number of cities where housing prices registered month-on-month growth climbed. In September 2013, the price of newly-built commercial residential housing increased year on year in 69 out of 70 cities, which was the same as that in June, with the largest margin of increase at 20.6 percent. The price of pre-owned residential housing gained year on year in 68 cities, the same as that in March. The price of newly-built commercial residential housing went up month on month in 65 cities, compared with 3 cities in June. The price of pre-owned homes grew month on month in 63 cities, which was 8 more than that in June.

The growth of sales of commercial real estate continued to decline. In the first three quarters of 2013, nationwide sold floor area of commercial real estate gained 23.3

percent year on year to reach 840 million square meters, representing a deceleration of 5.4 percentage points compared with the first half of 2013. The sales volume of commercial real estate was up 33.9 percent year on year to reach 5.4028 trillion yuan, representing a deceleration of 9.3 percentage points from the first two quarters. In particular, the sold area and turnover of commercial residential housing accounted for 89.4 percent and 84.1 percent respectively of the total sold area and of the turnover of commercial housing respectively.

Growth of investment in real-estate development decelerated. Investment in real-estate development in the first three quarters of 2013 totaled 6.1120 trillion yuan, up 19.7 percent year on year and representing a deceleration of 0.6 percentage points. In particular, investment in residential housing was 4.1979 trillion yuan, accounting for 68.7 percent of the total. The floor area of newly-built housing rose 7.3 percent year on year to reach 1.45 billion square meters, representing an acceleration of 3.5 percentage points from the first half of 2013. The floor area of housing under construction grew 15 percent year on year to reach 6.04 billion square meters, representing a deceleration of 0.5 percentage points from the first half of the year. The floor area of completed housing climbed by 6.3 percent year on year to stand at 530 million square meters, representing a deceleration of 2.1 percentage points from the first two quarters.

Growth of real-estate loans edged up. As of end-September 2013, outstanding real-estate loans of major financial institutions (including foreign-funded financial institutions) posted 14.2 trillion yuan, an increase of 19 percent year on year and an increase of 0.9 percentage points from end-June. Outstanding real- estate loans accounted for 20.2 percent of the total outstanding loans, a decline of 0.4 percentage points from the end of June. Among this total, outstanding mortgage loans rose 20.9 percent year on year to reach 8.7 trillion yuan, representing a rise of 0.1 percentage points from the end of Q2; outstanding real-estate development loans gained 13.1 percent year on year to reach 1.1 trillion yuan, representing a deceleration of 4.1 percentage points from the end of the previous quarter; new real-estate loans reached 1.9 trillion yuan, accounting for 26.1 percent of the total new loans, which was 1 percentage point lower than that during the first half of the year.

Credit support for welfare housing was further reinforced. As of end-September 2013, outstanding loans for welfare housing rose 31.3 percent year on year to reach 686.34 billion yuan, which was 16.4 percentage points higher than the growth of real-estate development loans. Moreover, the pilot program of using housing provident fund loans to support the construction of affordable housing was steadily advanced. As of end-September 2013, based on their construction progress, a total of 57.32 billion yuan of such loans was disbursed to 258 projects in 64 cities under the affordable housing program and a total of 10.5 billion yuan of the principal had been recovered.

(2) Information industry

The information industry is a leading industry of fundamental and strategic importance. The information industry can boost innovation and productivity in a wide range of industries. Against the backdrop of informatization, industrialization, urbanization, and the modernization of the agricultural sector, the consumption patterns of Chinese citizens are undergoing an upgrading. During this stage, promoting the development of the information industry not only responds to the urgent need to restructure the economy and to tackle energy and resource constraints, but also is a significant policy to improve social management and to enhance competitiveness.

In the context of more moderate growth and deepening structural reforms, informatization has played an increasingly important role in supporting economic growth and social development. First, the information industry continued its rapid growth. In 2011 business income in the information industry reached approximately 10.5 trillion yuan. In 2012 revenue in the electronic information industry, as the largest component of the information industry, grew 15 percent year on year to reach 11 trillion yuan. Second, the information industry has contributed to the creation and fostering of consumption demand, and prominently boosted the development of other industries. In 2012 the consumption of information goods and services grew 29 percent to reach 1.72 trillion yuan, accounting for 3.3 percent of GDP and contributing 0.64 percentage points to GDP growth. Third, development of the information industry facilitates the transformation of the development model. The integration of informatization and industrialization is vital in terms of breaking the bottlenecks in industrial upgrading and in driving the development of the emerging industries. The information industry provides a resource base for sustainable economic growth. By promoting progress in information technology and its application, we can monitor and analyze the resource costs and energy and environment costs in key industries, answering the need to enhance energy efficiency and to end the resource and energy constraints.

At present, China has become a major manufacturer of global electronic products and is also an important provider of information network services, but it is still lagging behind the developed countries. Capabilities for technological research and innovation need to be enhanced and there is still large room for improvement in infrastructure, such as wide-band networks and network and information security. The cost-ineffective model of development relying on external demand and expansion without productivity gains can hardly be sustainable. During the next stage, efforts should be made to promote the transformation and upgrading of the information industry, to build a more facilitating environment for innovation, to further enable enterprises, and to promote innovation-driven development in the information industry. Work still needs to be done to link information network infrastructures, public information networks of various kinds, and industry-specific information networks, to increase the supply of information products, to foster new areas of consumption, and to promote an upgrading of the industrial structure. An open and orderly market environment should be developed to deepen technological exchanges and cooperation. China should take an active part in the international division of labor so as to align the development of its information industry with international standards. Information technology should be more closely integrated with traditional industrial technologies so as to merge informatization and industrialization. Meanwhile, a information security review mechanism should be set up in order to strengthen the protection of personal information, to carry out a rigid review of information technology and products, and to coordinate the development of the information industry and information security as part of a national strategy.

Part 5 Monetary Policy Stance to Be Adopted in the Next Stage

I. Outlook for the Chinese economy

The Chinese economy has entered a new stage of development and is undergoing a profound structural adjustment and transformation of its growth pattern. The growth potential will be gradually released and new drivers will emerge as the structural adjustment progresses. In a comprehensive view of all aspects, the Chinese economy is expected to maintain the momentum of stable growth and continue to make progress based on stability. First of all, the growth potential is very large, supported by the large scope for industrialization, urbanization, and informatization, the complementarities between the central and western regions on the one hand and the coastal regions on the other, and the strong drive to promote economic growth in the localities. Therefore, the fundamentals in the economy have not changed. Second, progress in the structural adjustment and reform, including the adoption of policies to change government functions, simplify administrative procedures, and delegate powers to lower-level governments, implement structural tax reductions, and create the China (Shanghai) Free Trade Zone, will help increase the vitality of economic performance. Further progress in the financial sector reform, including new measures to promote the market-based interest rate and the exchange rate, the diversification of financial products, financial institutions and services, the rise of new business models, and greater access to the financial market are expected to enhance efficiency in resource allocations and to beef up support for the real sector. At present, a number of new technology industries and new business models are developing at a good momentum. Industries and enterprises that have initiated upgrading, transformation, and innovation have become very resilient and have displayed dynamic growth. With the rise in income levels and progress in technology, tourism- and IT-based consumption is driving the upgrading of the consumption structure. Third, macro-economic policy has always focused on striking a balance among pursuing stable growth, adjusting the economic structure, and promoting reform. The macro-economic management framework has been further improved, as policy measures have become more innovative and new experiences have accumulated. This will contribute to maintaining short-term stability and strengthening the basis for long-term growth. The high savings rate, adequate capital, and reserves in the financial system are generally indicative of the strong resilience of the economy. In terms of the external environment, with structural and deep-rooted institutional problems yet to be resolved, and the recovery path and monetary policy stance differing among the various economies, it is still too early to be optimistic about the global outlook, but by and large the world economy is stable. This will help maintain a relatively stable external-demand environment.

Yet we must be sober-minded about the risks and challenges in the economy. The growth pattern featuring dependence on external demand and local government driven massive investments is undergoing transformation, but there is yet to be new drivers to support strong growth. As a result, the performance of the economy often displays pulse-like frequent and small fluctuations. After a large increase of leveraging during the past years, the economy is likely to go through a prolonged period of deleveraging and a closing down of excess capacity. Problems in the real-estate market and local government obligations are relatively conspicuous and resource and environmental pressures are building. It is worth noting that to a very large extent the economic structure determines the financial structure. Massive investments dominated by local governments and the tilting of resources to real estate and other fields may lead to the crowding out of small and medium enterprises, exacerbating their lack of financing, and driving up the costs of providing them funding. Structural factors have also affected the outcome of aggregate policy. In the external environment, uncertain incidents frequently occurred. As the U.S. is expected to taper QE operations in the future, long-term interest rates may go up. The emerging market economies will need to respond to the shocks from changes in capital flows and financing costs, and macro-economic management will face new requirements. In general, the domestic and external environments are both complex and the tasks of adjusting the economic structure and transforming the growth pattern remain arduous. Breakthroughs have not yet been made to tackle the most difficult and crucial parts of the adjustment and transformation.

The overall price situation is relatively stable, but uncertain changes should be closely watched. The external economy has not yet taken a clear turn for the better. Moreover, the Federal Reserve may start to taper the QE operations. Generally stable commodity prices, adequate capacity in domestic industries, and the expected bumper grain harvest are all conducive to stable overall prices. However, due to the upward pressures on the prices of labor, services, and rents, the basis for stable consumer prices is not yet solid. Prices are sensitive to changes in aggregate demand, and the expansion of consumption exerts growing pressures on prices. As a result of the recent upturn in economic activities, the decline in the PPI has narrowed. This, combined with the base effect, may push up the CPI year on year in Q4 and consequently affect inflation expectations. According to the quarterly depositors' survey conducted by the PBC in Q3, the current price satisfaction index was at 21.4 percent, a reduction of 0.4 percentage points from Q2, while the future price expectation index posted 70.5 percent, 3.7 percentage points higher than that in Q2. Moreover, real-estate prices were higher, particularly in first-tier cities. Higher home prices may be transmitted to rents and other prices, thereby pushing up cost pressures. In the depositors' survey, the share of respondents who thought that current home prices were "high and difficult to accept" was 0.9 percentage points higher than the same share in the previous quarter. Taking all these factors into consideration, it is not possible to be overly optimistic about the price situation in the short run. As there are upside risks in price movements, it is necessary to continue to guide and stabilize inflation expectations.

II. Monetary policy during the next stage

The PBC will follow the overall arrangements of the State Council, follow the principle of seeking macro-economic stability, enhancing vitality at the micro-level, making progress and improving quality amidst stability, and will properly manage the macro-economic policy framework. As performance of the economy has remained generally stable and in view of the difficulties and challenges, policy should focus on supporting the structural adjustment and promoting reform and transformation of the growth pattern. Monetary policy will seek to maintain aggregate stability and structural optimization. The sound monetary policy will continue, and the stability and continuity of the policy will be continued. The focus of policy will be maintained and the policy measures will be well-targeted and carefully calibrated. The focus and coordination of policy measures will be enhanced to strike a balance among pursuing stable growth, adjusting the economic structure, promoting reform, and preventing risks. The key is to create a stable financial and monetary environment so that market players will have reasonable and stable expectations and the structural adjustment and transformation of the growth pattern will be facilitated. In the meantime, the allocation of financial resources will be further optimized and policies will be implemented earnestly. Financial institutions will be encouraged to manage their stock of credit assets properly and to make good use of new loans, to step up support for the structural adjustment and provide better services to the real economy, and to strengthen the good momentum of stable and upward economic growth. Reform will be deepened to enhance the role of the market mechanism, improve the transmission mechanism of monetary policy, improve the efficiency of financial resource allocation, and promote sustainable and sound economic growth.

First, a mix of quantity-based and price monetary policy tools will be used, the macro-prudential policy framework will be improved, and the management of aggregate liquidity will be enhanced to guide the reasonable and stable growth of money, credit, and all-system financing aggregate. In light of the BOP and the liquidity supply and demand situation, a combination of open market operations, the reserve requirement ratio, central bank lending, central bank discounts, short-term liquidity operations, the Standing Lending Facility, and other instruments will be used to manage and adjust liquidity in the banking system, enhance communications with the market and the public, keep expectations stable, and guide market interest rates to move steadily. Moreover, commercial banks will be guided to strengthen management of liquidity and balance sheets, to properly arrange liquidity at all points in time, to properly manage the total volume of assets and liabilities and their maturity structure, and to improve liquidity risk management. The macro-prudential policy will continue to play a counter-cyclical role. Based on the changes in macro-economic performance, the soundness of financial institutions, and the implementation of the credit policy, the relevant parameters will be adjusted to guide financial institutions to support development of the real economy.

Second, financial institutions will be encouraged to properly manage the stock of credit assets, make good use of new loans, and support economic structural adjustment, transformation, and upgrading of the growth model. Financial resources will be consolidated to support small- and micro-sized enterprises and to increase credit support to the agricultural sector, rural areas, and farmers. Consumer finance will be further developed to promote an upgrading of consumption. Financial institutions will be guided to provide credit to ongoing and follow-up national key projects, modern services industries, emerging industries, and green and environmental friendly industries, and to promote the transformation and upgrading of key areas and industries. Financial services will be further improved to contribute to a better livelihood of the people, to support job creation, poverty reduction, and students in need of loans, to support the regional development policies, and to provide financial support and services for balanced regional development. Lending to energy-intensive, highly-polluting industries and those with excess capacity will be strictly controlled to facilitate resolution of the problem of overcapacity. Differentiated housing mortgage policies will be properly implemented to support the construction of welfare housing and common commercial housing projects with apartments with modest floor plans and for purchases by first-time home buyers of common commercial housing, and to contain purchases for speculative investment purposes. Financial institutions will be guided to take differentiated approaches based on their specific circumstances to adjust and properly manage their stock of credit assets. The performance evaluation and incentive mechanism will be improved to evaluate the performance of banking institutions, optimize the organization system of the financial system, and further improve financial services.

Third, the market-based interest-rate reform and the RMB exchange-rate regime reform will be furthered to improve allocation efficiency in the financial system and to improve the monetary policy framework. The market-based interest-rate reform will be advanced to allow the market to play a fundamental role in the allocation of financial resources, to improve the central bank's ability to guide and adjust the market interest rates, and to strengthen the price transmission and adjustment mechanism. The market interest-rate pricing self-regulatory mechanism has been established in an orderly manner. The loan prime rate quote mechanism has been established, and the issuing and trading of inter-bank certificates of deposit has started. The RMB exchange-rate regime was further improved to allow market demand and supply to play a fundamental role to a larger extent, to enhance two-way flexibility of the RMB exchange rate, to keep the exchange rate basically stable at an adaptive and equilibrium level, and to promote a balanced position in the BOP account. Development of the foreign-exchange market will be accelerated to facilitate innovation in exchange-rate risk management. Measures will be taken to support the use of RMB in cross-border trade and investment activities, and more channels will be made available for inflows and outflows of RMB funds. Direct trading of the RMB against other currencies will be promoted to provide better services for RMB settlement of cross-border trade activities. The impact of the changing international situation on capital flows will be carefully watched and effective monitoring of cross-border capital will be strengthened.

Fourth, continued efforts will be made to promote the sound development of financial markets, to support the development of direct financing, and to broaden the direct financing channels available to small- and micro-sized enterprises. The bond issuance pricing mechanism and regulation of bond issuances will be improved. Innovation will be encouraged and awareness of risk prevention in the financial market will be strengthened. The focus is to allow the market mechanism to function and strengthen market infrastructure building. Supervision and regulation will be strengthened to promote the sound development of financial markets. The diversification of financial markets, financial products, investors, and intermediaries will be promoted to increase the share of direct financing. The diversity of participants on the gold market will be promoted, and product innovation will be encouraged while risk monitoring, early warnings, and risk prevention will be strengthened to promote the stable development of the market.

Fifth, reform of financial institutions will be expanded. Reform of large commercial banks will be deepened so that they will continue to improve corporate governance and the modern financial enterprise system, accelerate the transformation of the growth pattern and profit model, and build a capacity for innovation and international competitiveness. The pilot reform program of the Rural Financial Business Division of the Agricultural Bank of China will be advanced to build a stronger capacity to provide services to the agricultural sector, rural areas, farmers, and economic activities at the county level. The development of policy-based finance will be considered as an independent category of financial institutions; reform of the China Development Bank will be deepened, and reform of the Export-Import Bank of China and the Agricultural Development Bank of China will be advanced. Work will continue to promote the market-based transformation of asset management companies. A pilot reform of cross-sectoral operations will be implemented on a prudent but progressive basis. The pilot program for regional financial sector reform will be continued. Private capital will be allowed more access to the financial sector, and experiments will be initiated for private capital to establish banks, financial leasing companies, and consumer finance companies that are responsible for their own risks and that provide differentiated and highly efficient financial services with wide coverage to the real sector.

Sixth, effective measures will be adopted to mitigate systemic financial risks and to preserve stability in the financial system. Macro-prudential regulation will be enhanced to guide financial institutions to operate on a sound basis. Financial institutions will be urged to strengthen liquidity management, internal controls, and risk management. While supporting financial innovation, measures will also be taken to continue to strengthen monitoring and to prevent the potential risks of wealth management products, bill businesses, and inter-bank transactions. The market mechanism will be used to solve the problem of local government debt and to explore the establishment of a local government debt financing mechanism that will be well regulated, financially transparent, long term, and will keep risks under control, and to prevent the spread to the financial system any risks associated with the real economy in some regions, industries, and enterprises and those arising from financing activities outside the formal financial system. The financial regulation coordination inter-ministerial conference mechanism will be implemented to improve the early warning, prevention, and assessment system for systemic risks. A crisis management and risk resolution framework will be established and the creation of a deposit insurance scheme will be promoted. A comprehensive set of measures will be implemented to preserve financial stability and to safeguard the bottom line for preventing systemic and regional financial risks.