

# **China Monetary Policy Report Quarter One, 2014**

(May 6, 2014)

**Monetary Policy Analysis Group of  
the People's Bank of China**

## **Executive Summary**

In Q1 2014 growth of the Chinese economy was stable and the economic structure experienced positive changes. Household income grew fairly rapidly and consumption became a stronger driver of GDP growth. Real growth of investment recovered while the trade surplus narrowed. Performance of the agricultural sector was stable. Tertiary industry expanded faster than secondary industry; consumer prices were generally stable, and the employment situation was good. In Q1 the GDP reached 12.8 trillion yuan, up 7.4 percent year on year and the Consumer Price Index was up 2.3 percent year on year. Growth of GDP remained within a reasonable range and was consistent with anticipation of the goals of macroeconomic management and economic development.

In accordance with the decisions of the State Council, the PBC remained focused on the goals of macroeconomic management, continued its sound monetary policy, and conducted fine-tuning and preemptive adjustments when necessary. In view of the BOP and the liquidity supply and demand situation, the PBC used a combination of instruments to manage and adjust liquidity in the banking system. Branch offices of the PBC conducted pilot Standing Lending Facility (SLF) operations to provide short-term liquidity support to small- and medium-sized financial institutions. The allocation of financial resources was further optimized as measures were taken to make good use of new loans, to revitalize the stock of credit assets, to tap into the counter-cyclical role of the differentiated reserve requirement dynamic adjustment mechanism, to use credit policy and the central bank lending policy to facilitate improvements in the credit structure, and to encourage financial institutions to allocate more resources to key areas and weak links, including the agricultural sector, rural areas, farmers, and micro and small enterprises. The RMB exchange-rate regime was improved further, with the market playing a larger role in determining the exchange rate. Effective from March 17, 2014, the floating band of the RMB against the US dollar on the inter-bank spot foreign exchange market was widened from 1 percent to 2 percent. The market-based interest-rate reform was accelerated. On March 1, the ceiling of deposit interest rates for small-value foreign currency-denominated deposits was abolished in the China (Shanghai) Pilot Free Trade Zone. The foreign exchange administration system reform and the financial institution reform were deepened.

In general, liquidity in the banking system was at a proper level, growth of money, credit and all-system financing aggregates was generally stable, and the loan structure improved. At end-March 2014, broad money M2 was up 12.1 percent year on year; outstanding RMB loans were up 13.9 percent year on year, an increase of 3.01 trillion yuan from the beginning of 2014 and 259.2 billion yuan more than the growth registered in Q1 2013. The growth of loans to small and micro enterprises and agro-related loans both exceeded the average growth of total lending, the growth of

medium and long-term loans to the service sector recovered whereas the growth of medium and long-term loans to industries with excess capacity declined. In Q1, all-system financing aggregates totaled 5.60 trillion yuan, a reduction of 561.2 billion yuan year on year. Lending and deposit interest rates offered by financial institutions were generally stable. In March, the weighted average lending rate offered to non-financial enterprises and other sectors was 7.18 percent, a reduction of 0.02 percentage point from December 2013. Money-market interest rates, bond yields, trust products yields, and interest rates for financing in the non-financial sector all declined to varying degrees. At end-March, the central parity of the RMB against the US dollar was 6.1521 yuan per dollar, a depreciation of 0.9 percent from end-2013.

With economic growth changing gear and continuation of the transformation of the growth pattern, we will feel both the pains of the structural adjustments and the vitality released by the adjustment and reform measures. Looking at the growth potentials and dynamics, we expect that stable economic growth will be maintained in the near future. However, given the risks and uncertainties in terms of the global recovery, the domestic factors of the yet-to-be enhanced endogenous drivers, excess capacity in some industries, and stronger resource and environmental constraints, we need to pay special attention to potential risks. The tasks of structural adjustments and transformation of the growth pattern remain arduous.

The PBC will follow the strategic arrangements of the Party Central Committee and the State Council, continue to seek progress while maintaining stability, further reform and carry out innovations, continue the sound monetary policy, maintain policy stability and continuity, and promote the stance of keeping aggregates at stable levels and optimizing the structure. We will remain focused on macroeconomic management, adopt self-initiated measures, conduct fine-tuning and take preemptive adjustments when necessary, make the adjustment measures more forward-looking, targeted, and effective, strike a balance among preserving stable economic growth, promoting reforms, adjusting the economic structure, improving people's welfare, and preventing risks, and continue to provide a stable monetary and financial environment for the structural adjustments and the transformation and upgrading of the economic structure. A combination of both quantity and price-based monetary policy instruments will be used, and the macro-prudential policy framework will be improved to keep liquidity at a reasonable volume and to realize opportune growth of money, credit, and all-system financing aggregates. There will be continued efforts to mobilize the stock of credit assets, optimize the structure of new loans, and improve the financing and credit structures. Moreover, the reform will be integrated with the adjustment policies so that monetary policy will work closely with the reform measures to further tap into the decisive role of the market in terms of resource allocations. In light of the financial deepening and innovation, the mode of macroeconomic management will be improved and transmission mechanisms will be regulated. The quality of financial services will be improved by increasing supply and enhancing competition to improve the efficiency of the financial sector and its

capacity to serve the real sector. A comprehensive set of measures will be taken to safeguard the bottom line of not allowing the emergence of either systemic financial risks or regional financial risks.

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# **Part 1 Monetary and Credit Performance**

In the first quarter of 2014 liquidity in the banking system was appropriate, money, credit, and all-system financing aggregates grew in a stable manner, and the monetary and financial situations were basically stable.

## **I. The growth of money supply decelerated**

At end-March 2014, outstanding broad money (M2) stood at 116.1 trillion yuan, up 12.1 percent year on year; outstanding narrow money (M1) stood at 32.8 trillion yuan, up 5.4 percent year on year; and currency in circulation (M0) stood at 5.8 trillion yuan, up 5.2 percent year on year. In the first quarter of 2014, cash withdrawals from circulation amounted to 24.2 billion yuan, 104.3 billion yuan more than that during the corresponding period of the last year.

The deceleration of M2 at end-March from the end of last year by 1.5 percentage points was mainly due to a high base effect caused by the rapid growth of money during the corresponding period of the last year. The growth of M2 in 2013 showed a notable trend of acceleration followed by a deceleration, and at end-March 2013 the growth of outstanding M2 reached 15.7 percent. In addition, this was also related to deceleration of the RMB equivalent of official foreign exchange holdings, the moderate growth in the inter-bank business of commercial banks, and the increased issuance of financial bonds. In the first quarter of 2014, M2 registered an increase of 5.4 trillion yuan, with growth lower than that during the corresponding period of the last year. However, measured against the annual growth target of 13 percent, this progress was still faster than the normal level in past years.

At end-March, outstanding base money posted 27.5 trillion yuan, up 8.3 percent year on year and 372.1 billion yuan more than that at the beginning of the year. The money multiplier stood at 4.22, which was 0.14 higher than that at the end of 2013. The excess reserve ratio of financial institutions was 1.8 percent and that of rural cooperatives was 3.6 percent.

## **II. Growth of deposits in financial institutions slowed down**

At end-March, outstanding deposits of domestic and foreign currencies in all financial institutions (including foreign-funded financial institutions, the same hereafter) posted 112.2 trillion yuan, up 11.5 percent year on year. This was 5.0 trillion yuan more than

that at the beginning of the year, a deceleration of 2.0 percentage points from the end of the last year and a deceleration of 1.3 trillion yuan year on year. Outstanding RMB deposits posted 109.1 trillion yuan, up 11.4 percent year on year and a deceleration of 2.4 percentage points over end-2013. This was 4.7 trillion yuan more than that at the beginning of the year and a deceleration of 1.4 trillion yuan year on year. Outstanding deposits in foreign currencies posted USD507.4 billion, up 14.9 percent year on year. This was USD42.3 billion more than that at the beginning of the year and an acceleration of USD10.9 billion year on year.

Broken down by sectors, growth of household and non-financial business deposits moderated, while growth of deposits of non-deposit-taking financial institutions accelerated. At end-March, outstanding household deposits in financial institutions posted 49.4 trillion yuan, up 11.4 percent year on year. This was 3.3 trillion yuan more than that at the beginning of the year and a deceleration of 403 billion yuan year on year. Outstanding deposits in the non-financial corporate sector registered 36.2 trillion yuan, up 5.6 percent year on year. This was 319.9 billion yuan more than that at the beginning of the year and a deceleration of 1.3 trillion yuan year on year. Outstanding fiscal deposits posted 3.1 trillion yuan, representing an increase of 93 billion yuan from the beginning of the year and a deceleration of 1.9 billion yuan year on year. Outstanding deposits of non-deposit-taking financial institutions posted 7.0 trillion yuan, representing an increase of 1.1 trillion yuan from the beginning of the year and an acceleration of 1 trillion yuan year on year. This was mainly due to the rapid development of the off-balance-sheet wealth management business of commercial banks and money-market funds, as well as a larger year-on-year growth of deposits of financial institutions, such as securities firms, trading and clearing firms, and insurance companies.

### **III. New loans of financial institutions grew in a stable manner**

At end-March, outstanding loans in domestic and foreign currencies by all financial institutions registered 80.1 trillion yuan, up 13.7 percent year on year. This was 3.5 trillion yuan more than that at the beginning of the year and an acceleration of 296.6 billion yuan year on year. Outstanding RMB loans stood at 74.9 trillion yuan, up 13.9 percent year on year. This was 3.0 trillion yuan more than that at the beginning of the year and an acceleration of 259.2 billion yuan year on year.

The share of medium- and long-term loans picked up. RMB loans to the household sector continued to grow rapidly. At end-March, outstanding loans to the household sector posted 20.8 trillion yuan, up 21.4 percent year on year. This was 929.3 billion

yuan more than that at the beginning of the year and a deceleration of 45.9 billion yuan year on year. In particular, individual home mortgage loans increased by 450 billion yuan from the beginning of the year, representing an acceleration of 33.8 billion yuan year on year. The growth of home mortgage loans registered 20.4 percent at end-March, surpassing 20 percent for 11 months in succession and indicating that the demand for mortgages was not weak. Outstanding loans to non-financial enterprises and other sectors posted 53.9 trillion yuan, up 11.3 percent year on year, thus continuing the steady growth since the second quarter of 2013; this was also 2.1 trillion yuan more than that at the beginning of the year and an acceleration of 306.1 billion yuan year on year. In terms of the loan structure, compared with the beginning of the year outstanding medium- and long-term loans increased by 1.8 trillion yuan, representing an acceleration of 329.6 billion yuan year on year, with incremental loans accounting for 58.2 percent of the total new loans, up 6.5 percentage points year on year. Short-term loans, including bill financing, increased 1.2 trillion yuan from the beginning of the year, an acceleration of 106.5 billion yuan year on year. Among the different types of financial institutions, loans by Chinese-funded small- and medium-sized national banks and foreign-funded financial institutions registered larger year-on-year growth.

**Table 1 RMB Loans of Financial Institutions, Q1 2014**

Unit: 100 million yuan

	Q1, 2014		Q1, 2013	
	New	Acceleratio	New	Acceleratio
Chinese-funded large-sized national banks <sup>①</sup>	13,443	608	12,835	783
Chinese-funded small- and medium-sized national banks <sup>②</sup>	8,844	1,617	7,227	1,259
Chinese-funded small- and medium-sized local banks <sup>③</sup>	4,653	248	4,405	1,129
Small-sized rural financial institutions <sup>④</sup>	1,597	-471	2,068	-1,384
Foreign-funded financial institutions	250	181	69	-84

Notes: ① Chinese-funded large-sized national banks 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 national banks refer to banks operating across provinces with assets of less than 2 trillion yuan denominated in domestic and foreign currencies.

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

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

Source: The People's Bank of China.

Foreign currency-denominated loans grew in a stable manner. At end-March, outstanding foreign currency loans of financial institutions posted USD846.4 billion, up 12.2 percent year on year. This was USD69.5 billion more than that at the beginning of the year and a deceleration of less than USD1.4 billion. In terms of the loan structure, trade financing increased by USD32.4 billion, accounting for 47

percent of the total new foreign currency–denominated loans; outward lending and medium- and long-term domestic loans increased by USD13.7 billion, accounting for 20 percent of the total new foreign currency–denominated loans.

#### IV. The amount of all-system financing aggregates hit a second quarterly high

According to preliminary statistics, in the first quarter of 2014 all-system financing aggregates reached 5.60 trillion yuan, representing a decline of 561.2 billion yuan year on year and hitting a second historical quarterly high (the highest was registered in Q1 2013, posting 6.17 trillion yuan).

**Table 2 All-System Financing Aggregates**

Unit: 100 million yuan

Period	All-system financing aggregates <sup>①</sup>	Of which:						
		RMB loans <sup>③</sup>	Foreign currency-denominated loans (RMB equivalent)	Entrusted loans	Trust loans	Undiscounted bankers' acceptances	Enterprise bonds	Financing by non-financial enterprises via the domestic stock market
Q1 2013	61,654	27,547	4,453	5,235	8,244	6,706	7,573	617
Q1 2014	56,042	30,139	4,253	7,153	2,802	5,592	3,846	975

Notes: ① All-system financing aggregates refer to the total volume of funds 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 that were released in the past.

Sources: The 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.

In terms of the financing structure, RMB loans and entrusted loans registered larger growth, while the growth of enterprise bonds, undiscounted bankers' acceptances, and trust loans was muted. First, the share of new RMB loans among all-system financing aggregates rose notably. New RMB loans accounted for 53.8 percent of all-system financing aggregates during the same period, up 9.1 percentage points from the same period of the last year. Second, foreign currency–denominated loans increased by

roughly the same amount as during the corresponding period of the last year. Third, the amount of bond financing by enterprises increased month by month, and equity financing activities became somewhat more brisk. The amount of bond financing by enterprises in the first three months posted 37.1 billion yuan, 101.6 billion yuan, and 245.9 billion yuan respectively, and the amount of equity financing by non-financial firms in the first quarter posted 97.5 billion yuan, 35.8 billion yuan more than that during the same period of the last year. Fourth, the growth of off-balance-sheet financing by financial institutions, trust loans in particular, moderated, accounting for a much smaller share of the all-system financing aggregates. In the first quarter of 2014, the aggregate amount of financing by the real sector via entrusted loans, trust loans, and undiscounted bankers' acceptances posted 1.55 trillion yuan, 463.8 billion yuan less than that during the same period of the last year and accounting for 27.8 percent of all-system financing aggregates during the same period, down 5.0 percentage points year on year.

#### **IV. Deposit and lending rates of financial institutions fluctuated within small margins**

In March the weighted average lending rate offered to non-financial institutions and other sectors was 7.18 percent, down 0.02 percentage point from December 2013. In particular, the weighted average interest rate of loans was 7.37 percent, up 0.23 percentage point from December 2013; the weighted average bill financing rate was 6.28 percent, down 1.26 percentage points from December 2013. Home mortgage interest rates rose appreciably. In March, the weighted average home mortgage interest rate was 6.70 percent, up 0.17 percentage point from December 2013.

The shares of loans with interest rates lower or flat with the benchmark rates declined, whereas the shares of loans with interest rates higher than the benchmark rates rose. In March, the shares of loans with interest rates lower than or flat with the benchmark rates were 8.35 percent and 21.40 percent respectively, down 4.12 and 2.72 percentage points from December 2013, and the shares of loans with interest rates higher than the benchmark rates were 70.25 percent, up 6.84 percentage points from December 2013.

**Table 3 Shares of Loans with Rates at Various Ranges of the Benchmark Rate, January through March 2014**

Unit: %

Month	Lower	At the	Higher than the benchmark
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	than the benchmark	benchmark	Sub-total	(1.0, 1.1]	(1.1, 1.3]	(1.3, 1.5]	(1.5, 2.0]	Above 2.0
January	8.20	22.81	68.99	17.90	27.39	11.00	9.78	2.92
February	7.56	24.96	67.48	20.61	26.09	10.13	8.05	2.60
March	8.35	21.40	70.25	18.81	27.69	11.17	9.56	3.02

Source: The People's Bank of China.

Due to the interest-rate movements on international markets and changes in the supply and demand for foreign exchange in China, the deposit and lending rates of foreign currencies at the end of the quarter were generally higher than those at the beginning of the year. In March, the weighted average interest rates of large-value US dollar demand deposits and US dollar deposits with a maturity within 3 months were 0.25 percent and 2.60 percent respectively, up 0.07 and 0.62 percentage point from December 2013. The weighted average interest rates of US dollar loans with a maturity within 3 months and within 3–6 months (including 3 months) were 3.08 percent and 3.20 percent respectively, up 0.42 and 0.38 percentage point from December 2013.

**Table 4 Average Interest Rates for Large-value Deposits and Loans Denominated in US Dollars, January through March 2014**

Unit: %

Month	Large-value deposits						Loans				
	Demand deposits	Within 3 months	3–6 months (including 3 months)	6–12 months (including 6 months)	1 year	Over 1 year	Within 3 months	3–6 months (including 3 months)	6–12 months (including 6 months)	1 year	Over 1 year
January	0.21	2.41	3.43	3.48	3.54	2.68	2.82	2.90	3.14	2.88	3.56
February	0.20	2.50	3.54	3.68	3.66	3.08	3.08	3.13	3.46	3.10	3.08
March	0.25	2.60	3.68	3.63	3.85	2.72	3.08	3.20	3.35	3.30	3.16

Source: The People's Bank of China.

## **VI. The flexibility of the RMB exchange rate was strengthened in both directions**

Since the beginning of 2014, the RMB exchange rate has registered a mild depreciation but has moved in both directions with much stronger flexibility. At end-March, the central parity of the RMB against the US dollar was 6.1521 yuan per

US dollar, representing a depreciation of 552 basis points, or 0.90 percent, from end-2013. According to calculations by the BIS, in the first quarter of 2014 the NEER and REER of the RMB depreciated by 1.37 percent and 1.09 percent respectively. From the RMB exchange-rate regime reform in 2005 to end-March 2014, the RMB to dollar exchange rate appreciated 34.53 percent, while the RMB nominal effective exchange rate appreciated by 34.53 percent and the RMB real effective exchange rate appreciated by 40.59 percent.

## **Part 2 Monetary Policy Operations**

Since the beginning of 2014, in accordance with the overall arrangements of the State Council, the PBC followed the principle of making progress while maintaining stability, continued its sound monetary policy, and made innovations in the conduct of macroeconomic management. The PBC remained sober-minded, maintained a focus on policy measures, neither loosening nor tightening the supply of money, and when necessary conducted fine-tunings and preemptive measures with proper strength. These operations have played an important role in keeping economic growth within an appropriate range.

### **I. Flexible open market operations**

Open market operations were conducted in both directions and in a flexible way to adjust the level of liquidity in the banking system. The PBC strengthened its analysis and monitoring of factors influencing the demand and supply of liquidity in the banking system and the market environment, properly managed the direction, intensity and the pace of open market operations in view of the supply and demand for liquidity in each period, and, combined with the use of short-term liquidity operations (SLOs), adjusted liquidity in both directions when necessary and with proper strength, and guided smooth liquidity flows in the banking system. In response to seasonal features such as large cash deposits and withdrawals around the Spring Festival, the PBC optimized the maturity varieties of open market operations in a timely manner to realize its role in fine-tunings and preemptive measures. Prior to the Spring Festival, the PBC conducted 21-day repo operations to deal with the short-term liquidity volatility caused by seasonal factors; after the Spring Festival, the PBC conducted 14-day and 28-day reverse repo operations based on the cash withdrawal situation to keep the liquidity supply and demand in the banking system balanced. In the first quarter of 2014, a total of 525 billion yuan of repo operations was conducted, and the volume of reverse repo operations amounted to 870 billion yuan, while the amount SLO operations amounted to 100 billion yuan.

The interest rates of open market operations were kept at generally stable levels to guide market expectations. Against the background of a complex and volatile external

environment, the PBC strengthened analysis and monitoring of market interest-rate movements and kept interest rates of open market operations at basically stable levels to guide market expectations and promote the stable movement of market interest rates. At end-March, interest rates of 14-day and 28-day reverse repo operations were 3.8 percent and 4.0 percent respectively.

The PBC managed state treasury cash by making time-deposits with commercial banks. In the first quarter of 2014, a total of 140 billion yuan of state treasury funds was deposited with commercial banks in three separate operations, including 40 billion yuan in three-month time-deposits, 50 billion yuan in six-month time-deposits, and 50 billion yuan in nine-month time-deposits.

## **II. Standing Lending Facility (SLF) operations were conducted in an appropriate manner**

In the run-up to the 2014 Spring Festival, the PBC provided short-term liquidity support to qualified large commercial banks via the Standing Lending Facility (SLF) to keep money-market liquidity at an appropriate volume, and PBC branch offices in 10 pilot areas, i.e., Beijing, Jiangsu, Shandong, Guangdong, Hebei, Shanxi, Zhejiang, Jilin, Henan, and Shenzhen, provided short-term liquidity support to qualified small- and medium-sized financial institutions, thus helping to stabilize market expectations and promote smooth operations of the money market. After the Spring Festival, as cash gradually returned to the banking system and the situation regarding foreign exchange inflows changed, the PBC, in line with the liquidity situation in the banking system, fully withdrew the liquidity provided via the SLFs during the Spring Festival. In the first quarter of 2014, a total of 340 billion yuan of SLF operations was conducted; the outstanding balance at end-March was zero.

## **III. The dynamic adjustment of the differentiated reserve requirement continued to play a role in counter-cyclical management**

The PBC continued to use the dynamic adjustment mechanism of the differentiated reserve requirement as a way to strengthen macro-prudential management. Based on domestic and global economic and financial developments, the soundness of the financial institutions, and implementation of the credit policy, the PBC recalibrated the parameters of the differentiated reserve requirement to guide and encourage financial institutions to beef up credit support to small and micro enterprises, the agricultural sector, rural areas and farmers, and under-developed areas in central and western China. In addition, the inter-bank holding position of financial institutions

was factored into the policy parameters of the dynamic adjustment of the differentiated reserve requirement so as to prevent financial risks arising from an excessive expansion of the inter-bank business

#### **IV.A mix of measures was taken to optimize the credit structure**

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, continued to use central bank loans and discounts and the reserve requirement ratio to guide credit structural improvements, enhance coordination between monetary and credit policy and industrial policy and regional development policy, and strengthen the financial sector's capacity to serve the real economy.

The PBC brought into play the role of central bank credit policy lending to ratchet up credit support to the agricultural sector, rural areas and farmers, and small and micro enterprises. In early 2014, the PBC launched new credit policy lending tools, including central bank agro-linked loans and small enterprise-linked loans with preferential lending rates to ease financing difficulties and to reduce high financing costs. Since the beginning of 2014, an aggregate quota of 100 billion yuan in central bank credit policy loans was issued, including 50 billion yuan of agro-linked loans and 50 billion yuan of small enterprise-linked loans.

The toolkit of credit policy operations was enriched to guide financial institutions to optimize the credit structure. The PBC encouraged financial institutions to make use of modern information technologies and management to make innovations in financial products and services and to evaluate the operational performance to support key areas and weak links in the economy in accordance with the policy guidance. Efforts were made to beef up financial support to new types of agricultural entities such as family farms. Consumer finance was further developed. Financial services were improved to promote poverty alleviation and economic development. Financial services were enhanced to improve people's livelihood and to balance regional development. Credit inputs were enhanced to advanced manufacturing industries with a good market outlook, strategic emerging industries, modern IT industries for information utilization, labor-intensive industries, the services sector, transformation and upgrading of traditional industries, green and environment-friendly areas, and so forth. Reasonable funding needs of key ongoing and follow-up projects were guaranteed and efforts were made to support key livelihood projects, such as major infrastructure programs, including railway construction, urban infrastructure, and renovations of shanty dwellings. Lending to heavy energy-consuming, highly polluting industries, and those burdened with overcapacity was strictly controlled. For those enterprises that wanted to consolidate their excess capacity, targeted credit support was provided to support mergers and acquisitions and to address the

overcapacity problems. The pilot program of credit asset securitization was expanded to better manage the stock of credit assets.

The credit structure was further optimized. Growth of long- and medium-term loans to the services industry picked up, whereas growth of long- and medium-term loans to industries with overcapacity decelerated. Meanwhile, the strength of credit support for small and micro enterprises and the agricultural sector, rural areas, and farmers was maintained. At end-March, outstanding long- and medium-term loans to the services industry (the tertiary industry, excluding infrastructure and the real-estate sector) posted 3.74 trillion yuan, up 15.6 percent year on year, representing an acceleration of 1.9 percentage points over the end of 2013. Specifically, outstanding long- and medium-term loans to the cultural industry posted 169.8 billion yuan, up 39.3 percent year on year. Outstanding long- and medium-term loans to industries with an overcapacity stood at 2.08 trillion yuan, up 6.0 percent year on year, representing a reduction of 1.5 percentage points from the end of 2013, and outstanding RMB loans to small and micro enterprises grew 16.3 percent year on year, outpacing the growth of total loans by 2.4 percentage points. At end-March, outstanding RMB and foreign currency-denominated agro-linked loans increased 17.7 percent year on year, outpacing the growth of total loans by 4.0 percentage points.

## **V. Further improvements in the RMB exchange-rate regime**

The RMB exchange-rate regime reform was further improved in a self-initiated, controllable, and gradual manner. The market played a greater role in the formation of the RMB exchange rate to enhance two-way flexibility of the RMB exchange rate and to keep the exchange rate basically stable at an adaptive and equilibrium level. On March 15, 2014, in view of the development of the market, to give the market a greater role in exchange-rate pricing and to build a managed floating exchange-rate regime based on market supply and demand, the PBC decided to enlarge the floating band of the exchange rate of the RMB against the US dollar on the inter-bank spot exchange-rate market from 1 percent to 2 percent, effective from March 17, 2014.

In the first quarter of 2014, the central parity of the RMB against the US dollar peaked at 6.1521 yuan per dollar and reached a trough of 6.0930 yuan per dollar. It appreciated on 22 out of 58 trading days and depreciated on the remaining 36 days, with the largest day-to-day appreciation at 0.17 percent (or 101 points) and the sharpest day-to-day depreciation at 0.18 percent (or 111 points).

The RMB exchange rate moved in both directions against the euro, the Japanese yen, and other major international currencies. At end-March, the central parity of the RMB

against the euro and the Japanese yen registered 8.4607 yuan per euro and 5.9920 yuan per 100 yen, representing a depreciation of 0.49 percent and 3.59 percent respectively from the end of 2013. Beginning from the reform of the RMB exchange-rate regime reform in 2005 to end-March 2014, on a cumulative basis the RMB appreciated 18.36 percent and 21.93 percent against the euro and Japanese yen respectively.

To facilitate bilateral trade and investment between China and New Zealand, on March 19, 2014, direct trading between the RMB and the New Zealand dollar (NZD) was launched on the inter-bank foreign exchange market, and the two currencies began to have a direct exchange rate. Since the launch of direct trading, quotes and trading between the RMB and the NZD were brisk, with narrowed trading spreads. This move helped lower the currency conversion costs for economic entities and facilitated the use of the RMB and the NZD in bilateral trade and investment.

**Table 5 Trading Volume of the RMB against Other Currencies on the Inter-bank Foreign Exchange Spot Market, Q1 2014**

Unit: 100 million yuan

Currency	USD	Euro	Japanese Yen	HKD	GBP	Australian Dollar	New Zealand Dollar	Canadian Dollar	Malaysian Ringgit	Russian Ruble	Thai Baht
Trading volume	126553.4	689.1	1303.8	590.7	32.7	427.5	29.7	1.4	2.3	38.5	0.45

Source: China Foreign Exchange Trade System.

In the first quarter of 2014, based on the local currency swap agreements signed with the PBC, a total of 227 billion yuan of currency swap transactions were conducted with overseas monetary authorities. These played an active role in promoting bilateral trade and investment.

### **Box 1 The Floating Band of the RMB Exchange Rate Was Widened**

The Third Plenum of 18th CPC Central Committee called for the decisive role of the market in resource allocations. As the exchange rate is an important factor price and one of the decisive factors in efficiently allocating domestic and international resources, enlarging the floating band of the RMB exchange rate is conducive to enhancing the flexibility of the RMB exchange rate, optimizing the efficiency of capital allocations, further bringing into the decisive role of the market in resource allocations, and accelerating transformation of the growth pattern and making structural adjustments. In recent years, with the development of China's foreign exchange market due to the growing trading volume and the richer variety of products, the means for the corporate sector to manage exchange risks became more abundant, the capacity of market participants to control risks gradually improved, and market participants were more willing to set the trading prices on their own. Therefore, a

wider floating band is needed for the further development of the foreign exchange market.

The reform of the RMB exchange-rate regime was conducted in a self-initiated, controllable, and gradual manner, and took into full consideration the economic agents' ability to cope with the reform. In the process of the RMB exchange-rate regime reform, the floating band of the RMB exchange rate was expanded in a gradual manner. The floating band of the RMB exchange rate was 0.3 percent in 1994, 0.5 percent in 2007, and 1 percent in 2012, which was then maintained for about two years until March 2014. The further widening of the RMB floating band reflected gradual and sound reform principles. Based on the above considerations, the People's Bank of China announced on March 15, 2014, that it would expand the floating band of the RMB exchange rate from 1 percent to 2 percent, and the spread between the RMB/USD purchasing and selling prices offered by the designated foreign exchange banks to their clients would be expanded from 2 percent to 3 percent of the published central parity of the US dollar on that day, effective from March 17, 2014.

The widening of the floating band of the RMB exchange rate was well received both at home and abroad. The latest move was seen as a step at an opportune time, which will help curb expectations of a one-way appreciation, restrain inflows of speculative capital, and create conditions for furthering other financial reforms. This is a significant step in the establishment of a market-based floating exchange-rate regime in China. Going ahead, the RMB exchange rate will have sufficient two-way flexibility and will move in both directions, just like other major international currencies.

Since the expansion of RMB exchange-rate floating band, the foreign exchange market has functioned in a stable manner and the flexibility of the RMB exchange rate has been enhanced in two ways, with the market providing positive feedback. First, the RMB exchange rate fluctuated at a wider margin and its capacity to respond to supply and demand in the foreign exchange market was strengthened. From March 17 to April 30, the average fluctuation between the closing RMB exchange rate and the central parity posted 1.1 percent, with the largest fluctuation at 1,024 basis points, or 1.66 percent, the highest seen since the reform of the RMB exchange-rate regime in 2005. Second, the difference between the exchange rates in the domestic and overseas markets narrowed. From March 17 to April 30, the daily average spread between the RMB/USD exchange rate (CNH) in the Hong Kong market and the closing RMB/USD price in the domestic inter-bank market was 59 basis points, significantly narrower than the daily average of 161 basis points from the beginning of 2014 to the expansion of the RMB exchange-rate floating band. Third, net over-the-counter purchases by commercial banks declined somewhat and supply and demand in the foreign exchange market become more balanced. Meanwhile, the spread between spot US dollar purchasing and selling quotation prices over the commercial banks'

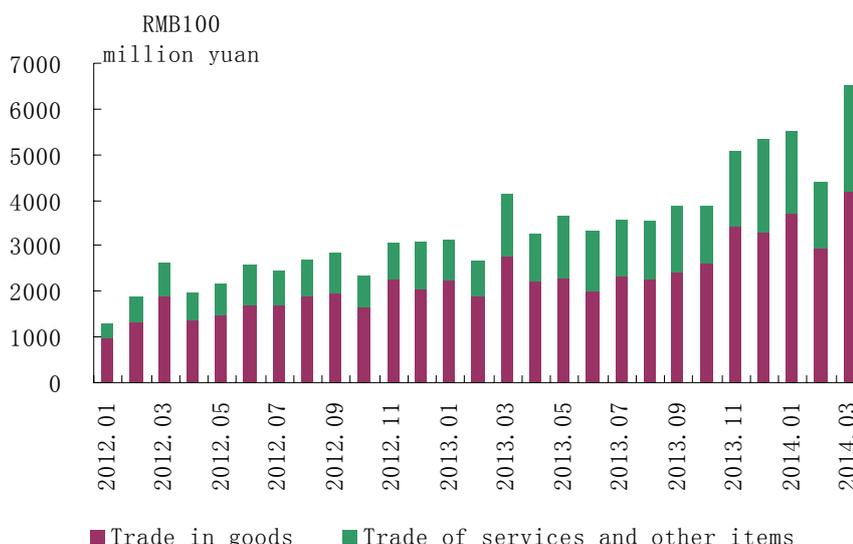
counters remained at about 250 basis points, flat with that during the previous periods. Fourth, expectations regarding the RMB exchange rate diverged, thus having a more neutral impact on the corporate sector. The PBC's survey of 2,999 export-oriented enterprises in the first quarter of 2014 showed that enterprises had weaker expectations of a RMB exchange-rate appreciation; 33.1 percent of the enterprises expected the RMB would "depreciate" in the next half-year, up 25.3 percentage points from the previous quarter, whereas 66.9 percent of enterprises expected the RMB would "appreciate"; 41.7 percent of enterprises believed that the recent exchange-rate movement had a positive impact on their operations, 24.6 percent believed it had a negative impact, while 33.7 percent of enterprises thought it was not obvious; there was a substantial increase in acceptance of RMB exchange-rate fluctuations by enterprises as 92.5 percent of enterprises believed that the current fluctuations were within an "acceptable" range, while 7.5 percent of enterprises considered the fluctuations to be "unacceptable," the lowest figure since the survey was first conducted.

Going forward, the reform of the RMB exchange-rate regime will become more market-oriented and the market will play a greater role in determining the RMB exchange rate so as to promote a balanced balance of payments. In the meantime, efforts will be made to develop the foreign exchange market, enrich the varieties of products traded on the market, and expand the width and depth of the market so as to better meet the demands of the corporate sector and residents. In line with the development of the foreign exchange market and the economic and financial market situations, the flexibility of the RMB exchange rate in both directions will be enhanced. The PBC will withdraw from routine interventions in the foreign exchange market and the RMB exchange rate will be kept basically stable at an equilibrium level.

## **VI. Cross-border RMB business continued steady growth**

The volume of settlements of cross-border trade and investments continued to increase rapidly. According to preliminary statistics, in the first quarter commercial banks processed 1.65 trillion yuan of RMB settlements of cross-border trade, up 64 percent year on year. In particular, settlements of trade in goods registered 1.09 trillion yuan and settlements in services and other items under the current account registered 561.3 billion yuan. Actual RMB receipts and payments in cross-border trade registered 541.59 billion yuan and 1.1 trillion yuan respectively, resulting in a receipt-payment ratio of 1:2. Bank settlements of cross-border RMB direct investments reached 193.09 billion yuan. In particular, outward direct investments settled in RMB totaled 27.82 billion, an increase of 2.5 times from the previous year, and foreign direct investments settled in RMB totaled 165.27 billion yuan, an increase of 1.1 times from the previous year.

**Figure 1 RMB Settlement of Cross-border Trade**



Source: People’s Bank of China.

To support the development of the China (Shanghai) Pilot Free Trade Zone, to serve the real economy, and to facilitate trade and investment, starting from February 2014 a number of cross-border RMB business innovations were launched in the China (Shanghai) Pilot Free Trade Zone to encourage cross-border use of RMB.

## VII. Deepening the reform of financial institutions

The reform of large commercial banks was deepened. Through continuous reform, the Industrial and Commercial Bank of China (ICBC), the Agricultural Bank of China (ABC), the Bank of China (BoC), the China Construction Bank (CCB), and the Bank of Communications increasingly improved their modern financial enterprise systems and provided better services to the real economy. Large commercial banks actively responded to a multiple of challenges, such as the accelerated process of the market-based interest-rate reform and the higher regulatory requirements. By improving the independent pricing and risk management capability, the business of large commercial banks continued its steady growth and their profitability and risk-prevention capability remained elevated.

**Table 6 Major Indicators of Performance of Five Large Commercial Banks, End-2013**

	CAR	NPL	Net Profits
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	(%)	(%)	Net profits (100 million yuan)	Year-on-year Growth (%)
ICBC	13.12	0.94	2,629.65	10.17
ABC	11.86	1.22	1,662.11	14.52
BOC	12.46	0.96	1,637.41	12.35
CCB	13.34	0.99	2,151.22	11.12
BOCOM	12.08	1.05	624.61	6.82

Source: Annual reports of the ICBC, ABC, BOC, CCB, and BOCOM.

The reform of the rural credit cooperatives (RCCs) produced remarkable results. First, the quality of assets was improved. At end-March, outstanding NPLs and the NPL ratio of the RCCs were 378.97 billion yuan and 3.9 percent respectively, down 0.2 percentage point from the end of 2013; their capital adequacy ratio stood at 10.2 percent. Second, agro-linked loans by RCCs witnessed year-on-year growth. At end-March, outstanding loans of RCCs stood at 9.7 trillion yuan, up 5.4 percent from the end of 2013. In particular, outstanding agro-linked loans and lending to rural households stood at 6.5 trillion yuan and 3.2 trillion yuan respectively, up 3.9 percent and 4.5 percent over the end of 2013. Third, corporate governance of the RCCs made progress. The structure of corporate governance of the RCCs, comprised of a shareholders' representative assembly, a board of trustees (directors), a board of supervisors, and senior management, was in place in the RCCs throughout the country and internal management was strengthened. The property rights of the RCCs were diversified. At end-March, there were 1,672 RCCs, 492 rural commercial banks, and 115 rural cooperative banks with legal-person status at the county (city) level.

### **Box 2 Financial Support for the Pilot Reform of Rural Credit Cooperatives**

In June 2003, the State Council released the *Notice on Deepening the Pilot Reform of Rural Credit Cooperatives* to deepen the reform of the rural credit cooperatives (hereafter referred to as RCCs) throughout the country. The PBC was responsible for developing and implementing a financial support policy for the pilot scheme (hereafter referred to as the “financial support policy”). After a review was conducted in the first quarter of 2004, a total of 32 batches of special notes was issued, subsequent redemptions and reviews were completed, and an aggregate amount of 169.9 billion yuan of such notes was redeemed from the RCCs in 2,408 counties (cities). In addition, a total of 1.4 billion yuan in special loans was extended to the RCCs in Xinjiang, Jilin, and Heilongjiang. Thus far, the financial support policy has been fully put into place and the policy goal of “spending some money to introduce a good mechanism” has been basically realized.

The PBC, in line with the principle of taking into account local specificities,

providing categorized guidance, preventing moral hazards, and providing ongoing positive incentives, has promulgated and implemented financial support policies and has guided RCCs to gradually upgrade to “higher levels.” The size of the issues of the special notes was determined based on 50 percent of the actual insolvent amount of the RCCs at the end of 2002, and the PBC promised it would issue special notes to those provinces where the RCCs had complied with the plans to raise the capital adequacy ratio and to reduce the NPL ratio (the “first level”); special notes were issued to those RCCs that met the compliance and qualification requirements (the “second level”); special notes were redeemed from those RCCs that made substantive progress in having a clear ownership, improved corporate governance, and strengthened internal management (the “third level”). To deepen the reform of the RCCs whose special notes had been redeemed, since 2011 a follow-up monitoring mechanism has been put into place and has been carried out in each year. Based on the results of an examination as part of the positive incentive mechanism, a total of 85 billion yuan of central bank agricultural loans was extended. Since 2014 assessment work has been conducted on a regular basis (the “fourth level”).

In implementing the financial support policies, the focus is on the following measures: The first is to strengthen the ongoing mechanism for positive incentives. The pace of offering financial support is linked to the progress in the reform of the RCCs, and the focus is on assessing internal controls, transformation of operational management, and improvement in corporate governance. The second is to enhance the cohesion of the policies. Efforts were made to assess local governments in terms of their support to the RCC reforms and to assess the associations of the RCCs at the provincial level for effective performance of their duties. During the advanced stage of the special notes’ redemption, the principle of “one set of specific policies for each RCC” was adopted, while local governments were required to step up policy support to effectively solve the redemption difficulties of some RCCs. The third is to reasonably increase financial support to those RCCs located in the old revolutionary base areas, areas inhabited by ethnic minorities, and border and poverty-stricken areas. A total of 3.3 billion yuan of the financial support quota was extended to 616 counties (cities) in the above-mentioned areas.

The policy goal of “spending some money to introduce a good mechanism” was basically achieved. First, a mix of policy measures has been put into place and the historical burdens have been effectively resolved. Since the reform of the RCCs, the PBC has provided a total of 171.3 billion yuan of financial support to the RCCs, which, together with other support provided by the fiscal and taxation departments, has resulted in a total amount of financial support of 260 billion yuan, helping the RCCs effectively resolve their historical burdens. A total of 112.5 billion yuan in losses was written off. The RCCs have seen their losses declining by 86 percent and have realized cumulative profits reaching 886.3 billion yuan. Second, corporate governance of the RCCs has made progress, and a sustainable development

mechanism has been basically established. The property rights of the RCCs have been clarified, the role of shareholders has been enhanced, and a corporate governance structure comprised of the shareholders' representative assembly, the board of directors, the board of supervisors, was operating, with the financial strength of the RCCs improving significantly. At the end of 2013, outstanding deposits and loans of RCCs stood at 14.3 trillion yuan and 9.2 trillion yuan respectively, an increase of 6.2 times and 5.6 times over the end of 2002. Third, provincial governments assumed responsibilities to regulate the RCCs and to dispose of financial risks according to the law, while the associations of RCCs at the provincial level acted as self-regulatory organizations for the industry by carrying out self-discipline, guidance, coordination, and services. Fourth, the asset quality of the RCCs has seen significant improvements, while the financial risks are under effective control. According to the five-category asset classification approach, as of the end of 2013 outstanding NPLs and the NPL ratio of the RCCs stood at 372.3 billion yuan and 4.1 percent respectively, a reduction of 287.3 billion yuan and 16.9 percentage points from the end of 2007; the capital adequacy ratio of the RCCs was 12.5 percent, up 12.6 percentage points from the end of 2007. Fifth, the extension of agro-linked loans has increased rapidly and financial services in the rural areas have further improved. As of the end of 2013, RCC agro-linked loans and loans to farmers stood at 6.2 trillion yuan and 3.0 trillion yuan respectively, an increase of 3 times and 2.6 times over the end of 2007.

During the next stage, efforts will be made to continue to strengthen the role of the RCCs in serving the agricultural sector, rural areas, and farmers. Based on market-based principles, a category-specific approach will be adopted to advance the reform of the RCCs. Private investments will be encouraged to improve the RCCs' sustainable development. The positive incentive mechanism linking policy support and the extension of agro-linked loans will be improved. The reserve requirement ratio, central bank agro-linked loans, and central bank discount policies will continue to play a role, while innovations in policy instruments will be made to support the RCCs and other rural financial institutions and to guide them in improving rural financial services.

## **VIII. Deepening the reform of foreign exchange administration**

Action was taken to facilitate trade and investment. The reform of foreign exchange administration under trade in goods was deepened, and the reform of foreign exchange administration under trade in services was advanced. The pilot program of foreign exchange payments for cross-border e-commerce by payment institutions was expanded. Foreign exchange administration for border trade was improved, and agency receipts of export payments in foreign currency and foreign currency cash settlements of border trade were regulated and facilitated. Continuous efforts were made to streamline administration and to delegate powers to lower-level governments. After abolishing most of the procedures for upfront reviews and approvals, 4 items

previously subject to administrative review and approval under foreign exchange administration were abolished, including the purchase and payment of foreign exchange under non-trade items and domestic transfers of foreign exchange.

Steady efforts were made to promote RMB convertibility under the capital account. During the first quarter, a total of USD4.07 billion of the investment quota was approved under the QFII scheme, 43 billion yuan of the investment quota under the RQFII scheme, and USD2.36 billion of the investment quota under the QDII scheme. Upfront cost management of outward direct investments was relaxed, and foreign exchange administration for the transfer of foreign debts to loans was simplified. The pilot program of centralized operations of foreign exchange funds of multinational companies was further expanded.

The monitoring and management system for cross-border payments and receipts was strengthened. Monitoring of cross-border capital inflows and outflows was further strengthened. Efforts were made to promote system integration and data sharing and to enhance ex-post monitoring and analysis and off-site supervisory capacity. Reviews of abnormal capital inflows were strengthened.

## **Part 3 Financial Market Analysis**

In Q1 2014 the performance of China's financial market was healthy and stable. Growth of transactions on the money market moderated and market rates declined considerably; the volume of bond transactions dropped year on year, while the volume of bond issuances increased; indices on the Shanghai and Shenzhen stock exchanges edged down amid fluctuations, and turnover on the stock markets increased slightly.

### **I. Financial Market Analysis**

#### **1. Growth in the volume of trading on the money market moderated and market interest rates declined considerably**

Growth in the volume of bond repo moderated on the inter-bank market and turnover of inter-bank borrowings declined year on year. In the first quarter of 2014, the turnover of bond repos on the inter-bank market totaled 38.8 trillion yuan, with an average daily turnover of 647.4 billion yuan, an increase of 2.7 percent year on year, continuing a slowing-down trend. Turnover of inter-bank borrowings reached 7.1 trillion yuan, with an average daily turnover of 118.9 billion yuan, down 30.6 percent year on year. In terms of the maturity structure, overnight products still dominated

bond repo and inter-bank borrowing transactions, though their share in the volume of total trading declined somewhat. In the first quarter of 2014, overnight bond repos and overnight inter-bank borrowings accounted for 78.1 percent and 79.0 percent of their total turnovers respectively, down 4.1 and 6.2 percentage points from the previous year. Total turnover of government securities repos on the stock exchanges soared 62.2 percent year on year to 19.1 trillion yuan, displaying a trend of rapid growth.

In terms of financing among financial institutions, the flow of funds had the following characteristics: first, although large banks remained net fund providers, the amount of their net lending declined notably; second, securities firms, fund management companies, and small- and medium-sized banks remained net fund borrowers, and their net borrowings registered large year-on-year growth, in particular that of securities firms and fund management companies; third, the demand for financing of other financial institutions and products and of insurance companies registered a large year-on-year decline.

**Table 7 Fund Flows among Financial Institutions, Q1 2014**

Unit: 100 million yuan

	Repo		Inter-bank Lending	
	Q1, 2014	Q1, 2013	Q1, 2014	Q1, 2013
Domestically-funded large banks <sup>①</sup>	-114,857	-127,464	-12,716	-19,508
Domestically-funded small- and medium-sized banks <sup>②</sup>	32,693	27,354	-7,179	-6,580
Securities and fund management companies	48,336	38,383	14,147	12,690
Insurance companies	11,762	18,544	35	0
Foreign-funded financial institutions	1,589	5,903	-2,147	3,311
Other financial institutions and vehicles <sup>③</sup>	20,478	37,280	7,860	10,087

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 sixteen 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. Some of these financial institutions and vehicles do 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.

Transactions of RMB interest-rate swaps became more brisk. In the first quarter of 2014, the aggregate notional principal of RMB interest-rate swaps amounted to 806.73 billion yuan, an increase of 9.4 percent year on year. In terms of the maturity structure, RMB interest-rate swaps with maturities within one year traded most briskly, and their aggregate notional principal amounted to 646.17 billion yuan, accounting for 80.1 percent of the total. In terms of the reference rate, the base rate of the floating end of the RMB interest-rate swaps mainly included the 7-day fixing repo rate and the Shibor, and their notional principals accounted for 83.9 percent and 15.0 percent of the total respectively.

**Table 8 Transactions of Interest-Rate Derivatives, Q1 2014**

	Interest-rate swaps		Bond forwards		Forward-rate agreements	
	Transactions (lots)	Amount of notional principal (100 million yuan)	Transactions (lots)	Amount (100 million yuan)	Transactions (lots)	Amount of notional principal (100 million yuan)
Q1 2013	5,533	7,375.8	1	1.0	—	—
Q1 2014	8,878	8,067.3	—	—	—	—

Source: China Foreign Exchange Trade System.

Money-market rates fluctuated before and after the Spring Festival and thereafter saw a steady downward trend. In the first quarter of 2014, as the RMB counterpart for holding foreign exchange reserves registered a large increase and fiscal deposits released more funds, the PBC carried out repo, reserve repo, and SLO operations on the open market and expanded the eligibility of the SLF operation in order to anchor market expectations. As a result, the supply of funds on the market was reasonably stable and the volatility of market interest rates around the Spring Festival was significantly lower than in past years. In March, the weighted average interest rate of bond-pledged repo and inter-bank borrowings posted 2.48 percent and 2.49 percent respectively, down 1.80 and 1.67 percentage points from December 2013 and at par with those during the same period of the last year. At end-March, overnight and 7-day Shibor rates posted 2.80 percent and 4.18 percent respectively, down 35 and 107 basis points from end-2013; 3-month and 1-year Shibor rates were 5.50 percent and 5.00 percent respectively, down 6 basis points and up 4 basis points from end-2013.

### **Box 3 Issuance and Trading of Certificates of Deposits on the Inter-bank Market**

As the market-based interest-rate reform has been steadily advanced, most interest rates have been market-based, such as the inter-bank lending rate, the bond rate, the commercial paper rate, and the bank lending rates. The only control is over the ceiling of the deposit rates of financial institutions. International experience shows that issuing certificates of deposits (hereafter referred to as CDs) and gradually expanding the self-pricing range of financial products is a feasible way to realize market pricing

of the deposit rate. CDs are certificates issued by commercial banks or by depository institutions for deposits. CDs, as one kind of certificate of deposits, are a book-entry time-deposit certificate issued by depository financial institutions to peer institutions in the inter-bank market. In recent years, with the rapid development in inter-bank financing, interest rates on the inter-bank market have been market-based, laying a solid foundation for the issuance of inter-bank certificates of deposits.

In December 2013, the PBC issued the *Provisional Rules on the Management of Inter-bank Certificates of Deposits*. Thereafter, ten financial institutions, including the Bank of China, the China Construction Bank, and the China Development Bank, issued the first batch of inter-bank CDs, and later on conducted transactions on the secondary market, supported by the two-way quotation and market-making system for inter-bank CDs. As of end-March 2014, a total of 25 CDs had been issued, with an aggregate amount of 68.77 billion yuan and a transaction volume of 5.58 billion yuan on the secondary market. The inter-bank CD market has assumed initial shape and its influence in the market has gradually expanded.

As an inter-bank financing instrument used by depository financial institutions in a market-based way, inter-bank CDs, an important instrument on the money market, have the following characteristics. First, they are issued and traded by members of the inter-bank market. Inter-bank CDs are issued by deposit-taking banking financial institutions and are traded among members of the inter-bank funding market, fund management companies, and fund products. Second, a market-based pricing principle has been adopted. The issue price of inter-bank CDs is market-determined and their interest rates are Shibor-based on fixed or floating rates. Third, the distribution of inter-bank CDs is standardized and transparent. Inter-bank CDs are issued electronically and are placed on the inter-bank market in a private or public way. The annual issuance plan, public announcement, and other relevant information are posted on [www.chinamoney.com.cn](http://www.chinamoney.com.cn) and the official Web site of the Shanghai Clearing House. Fourth, inter-bank CDs are fairly liquid on the secondary market. CDs that are publicly placed are negotiable and can be used as underlying assets for repo transactions.

As a pilot program for large-value certificates of deposits, the launch of inter-bank CDs will help broaden the financing channels for deposit money banks, improve liquidity management of financial institutions, improve transparency in the pricing of inter-bank business, guide and regulate the development of inter-bank business, and promote the stable operation of the inter-bank market. In addition, it is conducive to expanding the market base of Shibor applications, to support the benchmark for medium- and long-term Shibor rates, and to further improve the financial market benchmark interest-rate mechanism. As the market-based interest-rate pricing self-disciplinary mechanism of financial institutions continuously improves, more financial institutions that comply with the prudential requirements will become

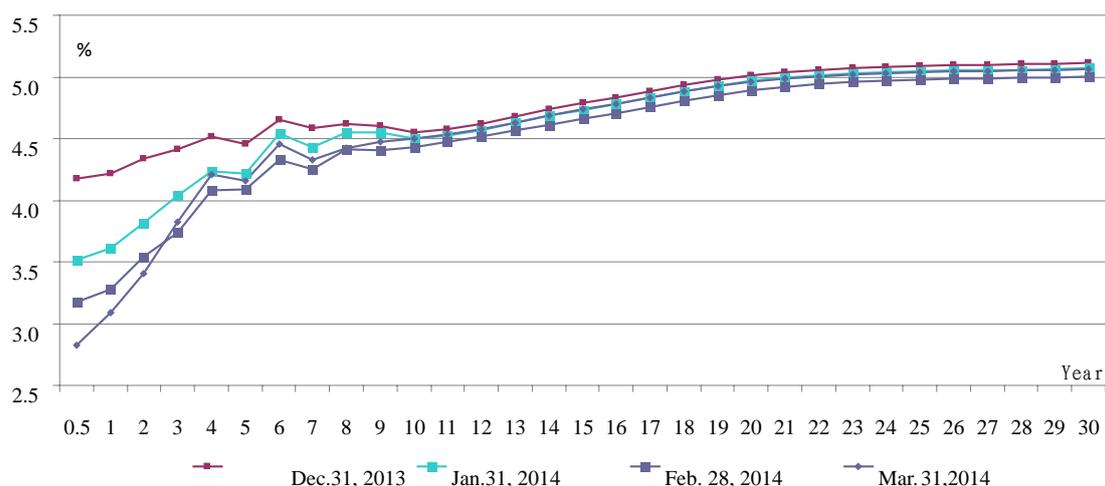
members of the self-disciplinary mechanism and will be able to issue interbank CDs on the inter-bank market after making relevant information disclosures. During the next stage, after taking stock of the relevant experiences, CDs will be issued to enterprises and individuals in a gradual manner so as to further increase market-based pricing of the liability products of commercial banks and to promote market-based interest-rate reform of bank deposits.

## **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 quarter of 2014, a total of 7.1 trillion yuan of bonds was traded, with a daily average of 118.2 billion yuan, down 67.3 percent year on year. In terms of trading entities, domestically-funded large banks changed from long-time net purchasers to net sellers, with net selling of 80.6 billion yuan in the first quarter of 2014; domestically-funded small- and medium-sized banks, and securities and fund management companies sold 215.5 billion yuan and 15.5 billion yuan respectively of bonds on a net basis; other financial institutions and products, foreign-funded financial institutions, and insurance companies were mainly net bond purchasers, with net purchases of 198.5 billion yuan, 88.7 billion yuan, and 24.5 billion yuan respectively. A total of 29.2 billion yuan of spot government securities was traded on the stock exchanges in the first quarter of 2014, 8.7 billion yuan more year on year.

Bond indices rose slightly. The China Bond Composite Index (net price) rose from 96.03 points in early January to 97.37 points at end-March, up 1.40 percent, whereas the China Bond Composite Index (full price) rose from 107.44 points to 109.20 points, up 1.64 percent. The Government Securities Index on the stock exchanges rose from 139.62 points in early January to 140.54 points at end-March, up 0.66 percent.

The yield curves of government securities on the inter-bank market became somewhat steeper. At end-March, the average yields of 6-month, 1-year, 5-year, and 7-year government securities were 69, 52, 6, and 11 basis points lower than those in early January respectively, whereas yields of government securities above 10 years were at par with those in early January and showed a trend of shifting downward at the short-ends and leveling off at the medium- and long-ends.



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

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

The volume of bond issuances expanded. In the first quarter of 2014, a total of 2.12 trillion yuan of bonds (including central bank bills) was issued, 168 billion yuan more than that issued during the same period of the last year. In particular, the issuance of financial bonds registered large year-on-year growth, whereas the issuance of government securities and corporate debenture bonds declined year on year. Among the corporate debenture bonds, the issuance of debt-financing instruments by the non-financial corporate sector continued to increase. At end-March, outstanding bonds posted 30.9 trillion yuan, an increase of 12.3 percent year on year.

**Table 9 Issuance of Major Bonds, Q1 2014**

Type of Bonds	Issuance (100million yuan)	Year-on-year growth(100 million yuan)
Government securities <sup>①</sup>	2,140	-493
Central bank bills	0	0
Financial bonds <sup>②</sup>	8,684	2,296
Of which: Financial bonds issued by the China Development Bank and policy financial bonds	6,630	1,734
Corporate debenture bonds <sup>③</sup>	10,423	-194
Of which: Debt-financing instruments of non-financial enterprises	8,475	997
Enterprise bonds	1,705	-456
Corporate bonds	169	-670
<b>Total</b>	<b>21,247</b>	<b>1,680</b>

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, 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, privately placed SME bonds, and so forth.

Sources: People's Bank of China, National Development and Reform Commission, China Securities Regulatory Commission, and China Government Securities Depository Trust and Clearing Co., Ltd.

The issuance rates of government securities picked up, whereas the issuance rates of corporate debenture bonds declined. The interest rate of 10-year government bonds issued in March 2014 was 4.42 percent, up 34 basis points from those of the same maturity issued in November 2013; the interest rate of the tenth batch of bonds issued by the China Development Bank in March 2014 was 5.90 percent, up 86 basis points from those of the same maturity issued in December 2013; the interest rate of short-term financing bills (rated A-1) issued by enterprises (rated AAA) in March 2014 was between 5.15 percent and 6.20 percent, lower than the range of 6.25 percent and 6.80 percent in December 2013; the interest rate of 7-year enterprise bonds (rated AAA) issued by enterprises (rated AA) was between 7.00 percent and 7.18 percent, lower than the range of 7.90 percent and 8.00 percent in December 2013. The Shibor played a greater role in bond pricing. In the first quarter of 2014, the 144 fixed-rate enterprise bonds were all based on the Shibor, with a gross issuance volume of 169.5 billion yuan; a total of 230.4 billion yuan of fixed-rate short-term financing bills was issued based on the Shibor, accounting for 96 percent of the total.

### **3. The volume of bill financing declined slightly and bill-financing rates showed a downward trend**

The bill acceptance business grew appreciably. In the first quarter of 2014, commercial bills issued by enterprises totaled 5.7 trillion yuan, up 4.5 percent year on year; outstanding commercial bills posted 9.5 trillion yuan at end-March 2014, representing an increase of 449.8 billion yuan from the beginning of the year and up 2.6 percent year on year. In terms of the issuing entities, outstanding bankers' acceptance bills were mainly issued by enterprises in the manufacturing, wholesale, and retail industries, with small- and medium-sized enterprises issuing about two-thirds of the total.

The outstanding volume of bill financing declined, and the bill-financing rates showed a downward trend. In the first quarter of 2014, financial institutions discounted 10.8 trillion yuan of commercial bills on a cumulative basis, representing year-on-year

growth of 13.7 percent; at end-March the outstanding balance of accepted drafts posted 1.9 trillion yuan, representing a decline of 12.5 percent year on year. At end-March, the outstanding balance of accepted drafts declined by 75.6 billion yuan from the beginning of the year, with a deceleration of 178.5 billion yuan year on year and accounting for 2.5 percent of all categories of loans, down 0.8 percentage point from the corresponding period during the last year. In the first quarter of 2014, liquidity in the banking system was generally abundant and money-market rates showed a downward trend. Due to balanced demand and supply in the bill market, bill-financing rates on the bill market moved downward.

#### **4. Stock indices declined and turnover on the stock markets increased slightly**

Stock indices declined while the Growth Enterprise Board Index continued to rise. At end-March, the Shanghai Stock Exchange Composite Index and the Shenzhen Stock Component Index closed at 2,033 and 1,040 points respectively, shedding 3.9 percent and 1.7 percent from end-2013. The Growth Enterprise Board (GEB) Index (Chinext Price Index) of the Shenzhen Stock Exchange closed at 1,328 points, gaining 1.8 percent from end-2013. The weighted average P/E ratio on the A-share market of the Shanghai Stock Exchange declined from 11.0 times at end-2013 to 10.7 times at end-March 2014, while that of the Shenzhen Stock Exchange plunged from 28 times to 25.6 times.

Trading volume on the stock markets increased somewhat. In the first quarter of 2014, turnover on the Shanghai and Shenzhen stock exchanges totaled 12.2 trillion yuan, up 8.7 percent year on year, and the daily turnover averaged 210.2 billion yuan, up 4.1 percent from the previous quarter. Among this total, the volume of transactions on the GEM Board amounted to 1.9 trillion yuan, representing an increase of 15.8 percent from the previous quarter. At end-March 2014, the combined market capitalization of the Shanghai and Shenzhen exchanges posted 19.7 trillion yuan, down 1.3 percent from end-2013; the market capitalization on the GEM Board amounted to 926.6 billion yuan, a hike of 12.7 percent from end-2013.

The amount of equity financing increased year on year. In the first quarter of 2014, a total of 134.4 billion yuan was raised by enterprises and financial institutions on domestic and overseas stock markets by way of IPOs, additional offerings, rights issuances, and warrant exercises, representing an increase of 26.1 billion yuan year on year. Among this total, 116.5 billion yuan was raised on the A-share market, 31.1 billion yuan more than that raised during the same period of the last year.

#### **5. Investment assets accounted for a larger share of total insurance assets**

In the first quarter of 2014, total premium income in the insurance industry amounted to 700 billion yuan, representing year-on-year growth of 35.9 percent, and total claim

and benefit payments amounted to 185.9 billion yuan, representing year-on-year growth of 25.0 percent. Specifically, total claim and benefit payments in the property-insurance sector increased 14.3 percent, while those in the life-insurance sector increased 35.2 percent.

Growth of insurance assets gained traction and the share of investment assets continued to rise. At end-March 2014, total assets in the insurance industry posted 8.9 trillion yuan, representing an increase of 16.7 percent year on year and an acceleration of 4 percentage points from end-2013. Among this total, bank deposits increased 4.3 percent year on year, while investment-linked assets increased 22.0 percent.

**Table 10 Use of Insurance Funds, End-March 2014**

	Outstanding balance (100 million yuan)		As a share of total assets (%)	
	End-March, 2014	End-March, 2013	End-March, 2014	End-March, 2013
Total assets	89,459	76,686	100	100
Of which: Bank deposits	25,031	23,992	28.0	31.3
Investments	57,197	46,875	63.9	61.1

Source: China Insurance Regulatory Commission.

## **6. Swap transactions on the foreign exchange market increased rapidly**

In the first quarter of 2014, the turnover of RMB/foreign exchange spot transactions totaled USD1105.6 billion, representing an increase of 21.2 percent year on year. The turnover of RMB/foreign exchange swap transactions totaled USD1002 billion, representing an increase of 38.2 percent year on year. Among this total, overnight USD swap transactions amounted to USD459.9 billion, accounting for 45.9 percent of the total; the turnover in the RMB/foreign exchange forward market totaled USD13.6 billion, representing an increase of 548.3 percent year on year. The turnover of foreign-currency pair transactions amounted to USD15.6 billion, a decline of 11.3 percent year on year. In particular, the Euro/USD accounted for the lion's share, or 44.3 percent, down 20 percentage points from the same period of the last year.

The number of participants on the foreign exchange market increased further. At end-March 2014, there were 420 members on the foreign exchange spot market, 90 members on the foreign exchange forward market, 89 members on the foreign exchange swap market, 81 members on the currency 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 rebounded**

The price of gold stabilized and rebounded before dropping slightly. In the first quarter of 2014, the price of gold on the international market reached a peak of USD1385.0 per ounce and a trough of USD1221.0 per ounce, and it closed at USD1291.8 per ounce at end-March, a rise of USD90.3 from the end of the last year, or up 7.5 percent. The movement in the price of domestic gold kept pace with that on the international market. The highest price (AU9999) on the Shanghai Gold Exchange was 273.6 yuan per gram, and the lowest price was 238.9 yuan per gram. At end-March, the price of gold on the domestic market closed at 257.8 yuan per gram, a rise of 21.3 yuan from the end of the last year, or up 9.0 percent. In the first quarter, the weighted price averaged 255.2 yuan per gram.

The volume of transactions on the Shanghai Gold Exchange increased steadily. In the first quarter of 2014, the trading volume of gold was 3,402 tons, an increase of 76.1 percent year on year, and the turnover posted 8,717.1 billion yuan, an increase of 37.7 percent year on year. The trading volume of silver was 93,687 tons, an increase of 72.9 percent year on year, and the turnover posted 390.8 billion yuan, an increase of 16.3 percent year on year. The trading volume of platinum was 20 tons, an increase of 37.3 percent year on year, and the turnover posted 5.9 billion yuan, an increase of 20.8 percent year on year.

## **II. Institutional building in the financial market**

### **1. Promoting the sound development of the inter-bank bond market**

Efforts were made to steadily promote infrastructural building on the inter-bank bond market. On January 28, 2014, the PBC issued the *Notice on the Establishment of an OTC Financial Derivatives Centralized Clearing Mechanism and Issues Related to the Centralized Clearing of the RMB Interest-Rate Swap Business* (PBC Document [2014] No.29). The establishment of the OTC derivatives centralized clearing mechanism was of great significance for safe and efficient operations and the sound development of the OTC financial derivatives market.

Commercial banks' investments of funds from the issuance of wealth management products on the inter-bank bond market were regulated. Both the conditions for commercial banks to open bond accounts in the inter-bank bond market with such funds and the requirements for managers and custodians of the bond accounts were clearly prescribed and market entry procedures were specified.

## **2. Improving institutional arrangements in the securities market**

The pilot program of preferred stocks was promoted. On March 21, the CSRC issued the *Administrative Rules on the Pilot Program of Preferred Stocks*, specifying that both listed and non-listed companies can issue preferred stocks. In particular, eligible listed companies mainly include the following: first, the listed companies should have ordinary shares of the constituent stocks on the SSE 50 Index; second, the issuance of preferred stocks is intended as a means of payment to acquire or merge with another listed company; third, companies that wish to repurchase common stocks for the purpose of reducing registered capital can publicly issue preferred stocks as a means of payment. Non-listed public companies can only issue preferred stocks to eligible investors, and the number of subscribers to each issue is subject to a limit of 200, and the number of subscribers with the same terms and conditions should not exceed 200. The launch of the preferred stock program will help accelerate the development of direct financing, support M&A activities, increase the varieties of securities products, and provide investors with diversified investment channels.

Steadily promoting reform of the Growth Enterprise Board. The financial threshold for first-time issues on the Growth Enterprise Board was lowered, and the issue conditions were simplified; the coverage of market services was expanded, and enterprises that wish to be listed on the Growth Enterprise Board are no longer limited to 9 main industries; a refinancing system tailored to the characteristics of the Growth Enterprise Board was established; the system of mergers and acquisitions on the Growth Enterprise Board was improved; a refinancing system consistent with the characteristics of the Growth Enterprise Board was launched; the rules for information disclosure for initial offerings on the Growth Enterprise Board were improved; and market exit measures were strictly enforced to protect the legitimate rights and interests of investors.

The scope of investments for QFIIs and RQFIIs was further relaxed. On March 19, the Shanghai Stock Exchange issued the *Implementation Rules on Securities Transactions by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors*. According to the Rules, QFIIs and RQFIIs can invest in a number of new financial instruments, such as preferred stocks, policy financial bonds, and asset-backed securities, in addition to stocks, bonds, mutual funds, and warrants. Meanwhile, the ceiling of holdings by all overseas investors in a single listed company on the A-share market was relaxed from 20 percent to 30 percent.

On April 10, the China Securities Regulatory Commission and the Securities and Futures Commission of Hong Kong released a *Joint Announcement* to approve the launch of the Shanghai–Hong Kong Exchanges Connectivity Mechanism (SHSECM)

pilot program. After the launch of the SHSECM pilot program, investors in mainland China and Hong Kong markets can entrust local securities companies (brokers) to trade eligible shares listed on the other's markets through an order-routing service provided by the Shanghai Stock Exchange and the Stock Exchange of Hong Kong Ltd. (SEHK). The pilot program of the Shanghai–Hong Kong stock exchanges connectivity mechanism will help strengthen the linkage of capital markets in mainland China and Hong Kong, further promote capital market development in mainland China and Hong Kong, and facilitate the process of RMB internationalization.

### **3. Improving institutional arrangements in the insurance market**

The insurance business was further regulated. Commercial banks' agency sales of insurance products were regulated. Insurance companies and commercial banks are required to sell the right products to the right persons, so as to protect low-income people, the elderly, and other specific groups of people while banks are encouraged to sell risk-protection products and long-term savings products on an agent basis. High cash-value products were regulated. The definitions of high-value cash products, product size, sales qualifications of insurance companies, and the upper limit of sales costs, and so forth were specified; the solvency ratio of insurance companies that sell high-value cash products shall be no less than 150 percent.

The market-based reform of insurance fund investments was accelerated. Insurance investment assets were divided into five major categories, i.e., liquidity assets, fixed-income assets, equity assets, real-estate assets, and other financial assets. Restrictions on the shares of some specific products were lifted, and requirements for risk concentration were established, so as to enhance the monitoring of asset liquidity and other indicators. A dynamic adjustment mechanism was established and a multi-layer ratio supervisory framework was preliminarily put in place. In addition, the CIRC allowed insurance funds to be invested in shares of companies listed on the Growth Enterprise Board, and it launched a pilot program of allowing stocks of funds from previous insurance policies to be invested in blue-chip companies.

The reputation of the insurance company risk management was strengthened. It is clearly stipulated that reputational risk management should be integrated into the overall risk management system of insurance companies. Insurance companies shall establish the necessary systems and mechanisms to identify and address reputational risks and to deal with reputational events, and the board of directors of insurance companies should assume ultimate responsibility for reputational risk management. In the meantime, supervision of the reputational risk of insurance companies was also included in the overall solvency regulatory framework.

#### **4. Steadily promoting innovation and development in the gold and foreign exchange markets**

Continued efforts were made to improve the institutional arrangements and to promote product innovation in light of market demand on the gold market. The Shanghai Gold Exchange promulgated and released the *General Agreement on the Gold Leasing Business of the Shanghai Gold Exchange* (2013 version) to promote the gold leasing business. In addition, the Shanghai Gold Exchange launched the mini gold AU(T+D) contract with 100 grams per lot and adjusted the amount of the AU99.99 gold contract from 100 grams per lot to 10 grams per lot to further meet investor demands.

Institutional arrangements in the foreign exchange market were improved and a foreign exchange options brokerage business was launched for money brokerage companies.

## **Part 4 Macroeconomic Analysis**

### **I. Global economic and financial developments**

The global economy continues to improve. The U.S. economy is steadily recovering and the negative impact of the severe weather has gradually diminished. The euro area faces a weak recovery, while the risk of deflation is on the rise. Japanese economic growth has slowed down, with a trade deficit for 21 successive months and greater fiscal pressures. The emerging market economies are facing larger downward pressures, while some economies are experiencing political instability, financial market turmoil, and rising risks. Rising geopolitical risks have become a global economic challenge.

#### **1. Economic development in the major economies**

The U.S. economy is recovering stably. Mainly affected by the severe weather, the U.S. GDP growth rate (quarter on quarter and annualized) slowed to 0.1 percent. As industrial production turned for the better and expansion of the manufacturing and service sectors accelerated, the PMI indicators for the manufacturing and non-manufacturing sectors, released by the Institute for Supply Management (ISM), rose to 53.7 and 53.1, respectively, in March. The unemployment rate in March remained at 6.7 percent and the inflation rate was still at a low level. To some extent, short-term fiscal risks have eased. At the end of March 2014, the fiscal deficit of the

federal government in fiscal year 2014 were USD413.3 billion, USD187.0 billion less than that during the same period of the last year.

The euro area continued its weak recovery. In 2013, GDP declined by 0.4 percent and the growth rate in the fourth quarter was 0.3 percent quarter on quarter, marking the third quarter of positive growth. In March 2014, the Euro Area Economic Sentiment Indicator rose to 102.5, the highest since August 2011; and the comprehensive Purchasing Managers Index (PMI) registered at 53.1, exceeding the 50-point threshold for nine successive months. The unemployment rate was still high and inflation still remained low. In March, the unemployment rate was 11.8 percent, while the Harmonized Index of Consumer Prices (HICP) was up 0.5 percent year on year.

The Japanese economy slowed down, but deflation eased. The GDP growth rate was 1.5 percent in 2013, and in the fourth quarter it was 0.7 percent, an apparent decrease from the first half of the year. Influenced by the consumption tax hike, the Consumer Confidence Index began to slide in November 2013 and by March 2014 it had declined to 37.5, the lowest level since September 2011. The depreciation of the Japanese yen has pushed up import costs, and in March the trade deficit reached 1.4 trillion yen, the 21<sup>st</sup> successive month of a trade deficit. The core CPI in the first three months of the year registered 1.3 percent, which represented a record high in the recent five years. In March, the unemployment rate had decreased to 3.6 percent, revealing a stable employment environment.

**Table 11 Macroeconomic and Financial Indices in the Major Economies**

Country	Index	2013Q1			2013Q2			2013Q3			2013Q4			2014Q1		
		Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
United States	Real GDP growth rate (annualized quarterly rate, YOY, %)	1.1			2.5			4.1			2.6			0.1		
	Unemployment rate (%)	7.9	7.7	7.5	7.5	7.5	7.5	7.3	7.2	7.2	7.2	7.0	6.7	6.6	6.7	6.7
	CPI (YOY, %)	1.6	2.0	1.5	1.1	1.4	1.8	2.0	1.5	1.2	1.0	1.2	1.5	1.6	1.1	1.5
	DJ Industrial Average (closing number)	13861	14054	14579	14840	15116	14910	15500	14810	15192	15237	16086	16577	15699	16322	16458
Euro Area	Real GDP growth rate (annualized quarterly rate, YOY, %)	-0.2			0.3			0.1			0.2					
	Unemployment rate (%)	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0	11.9	11.9	11.8	11.8	11.8	11.8
	HICP (YOY, %)	2.0	1.8	1.7	1.2	1.4	1.6	1.6	1.3	1.1	0.7	0.9	0.8	0.8	0.7	0.5
	EURO STOXX 50 (closing number)	2703	2634	2624	2712	2770	2603	2768	2721	2893	3068	3087	3109	3014	3149	3162
Japan	Real GDP growth rate (annualized quarterly rate, YOY, %)	4.5			4.1			0.9			0.7					

Unemployment rate (%)	4.2	4.3	4.1	4.1	4.1	3.9	3.9	4.1	4.0	4.0	3.9	3.7	3.7	3.6	3.6
Core CPI (YOY, %)	-0.2	-0.3	-0.5	-0.4	0.0	0.4	0.7	0.8	0.7	0.9	1.2	1.3	1.3	1.3	1.3
Nikkei 225 (closing number)	11139	11559	12398	13861	13775	13677	13668	13389	14456	14328	15662	16291	14915	14841	14828

Source: Statistical bureaus and central banks of the relevant economies.

Some emerging market economies encountered financial market turmoil. In January 2014, the Federal Reserve started moderating the pace of asset purchases, Argentina and some other emerging market economies experienced financial turbulence, featuring capital outflows and a dramatic depreciation of the local currencies. Since March, the financial markets of the emerging market economies have calmed down, while some countries may still face difficulties due to deteriorating economic fundamentals, domestic political turbulence, and rising geopolitical risks. Overall, the economic fundamentals in the emerging market economies are still sound and the depreciation and interest-rate adjustments have been useful in absorbing shocks. Some emerging market economies improved their capability to deal with risks through policy adjustments and structural reforms, and there is a low probability that they will see a large drop in their economic growth rates or a full-blown crisis.

## 2. Developments in global financial markets

The financial markets of the major advanced economies, such as the U.S. and the U.K., were stable, and government bond yields declined. The financial markets of some emerging market economies experienced turbulence, with local currencies depreciating dramatically, government bond yields rising, and stock indices falling.

The euro, pound sterling, and yen appreciated slightly against the US dollar, while the currencies of some emerging market economies depreciated dramatically against the US dollar. On March 31, the euro, pound sterling, and yen closed at 1.38 dollar per euro, 1.67 dollar per pound sterling, and 103.20 yen per US dollar, up 0.2 percent, 0.6 percent, and 2.0 percent respectively compared with the end of the last year,. During the same period, the currencies of some emerging market economies depreciated dramatically against the US dollar, with the Ukrainian hryvnia, the Argentinian peso, and the Russian ruble depreciating 22.3 percent, 18.5 percent, and 6.1 percent respectively.

The USD Libor and Euribor fluctuated at a subdued level. On March 31, the one-year Libor was 0.5581 percent, 2.5 basis points lower than that at the end of the last year; the one-year Euribor was 0.59 percent, up 3.4 basis points compared with the end of the last year.

Government bond yields in the advanced economies declined, while those in some of the emerging market economies rose. On March 31, 10-year government bond yields in the U.S., Germany, and Japan closed at 2.72 percent, 1.57 percent, and 0.65 percent respectively, declining 28 basis points, 37 basis points, and 9 basis points since the

end of the last year. During the same period, government bond yields in some emerging market economies rose quickly, with two-year government bond yields in Ukraine and Argentina and 10-year government bond yields in Russia rising by 300 basis points, 99 basis points, and 122 basis points, respectively.

The stock markets fluctuated slightly in the U.S. and Europe, while the stock indices in Japan and some emerging market economies dropped. On March 31, the Dow Jones Industrial Average and the EURO STOXX 50 closed at 16,458 and 3,162 respectively, which were basically the same as that during the last year. From the end of 2013 to late March 2014, the Nikkei 225 Index went down by 9.0 percent, and the Russian, Mexican, and Brazilian indices declined by 15.0 percent, 5.3 percent, and 2.1 percent respectively.

### **3. Monetary policies in the major economies**

The Federal Reserve has been moderating the pace of asset purchases, while the central banks in some major advanced economies are still implementing accommodative monetary policies. The Federal Reserve reduced the scale of asset purchases by USD 10 billion after its monthly meetings in January, March, and April, and updated forward guidance on interest rates after the March regular meeting, replacing the quantitative unemployment rate threshold of 6.5 percent and the inflation threshold of 2.5 percent (for one to two years in the future), with an assessment taking into account a wide range of information to determine upward policy rate adjustments. The European Central Bank maintained the policy rate at 0.25 percent after its monthly meeting in April, and expected the interest-rate level to be maintained or lowered in the near future. The Bank of Japan continued to increase the monetary base at a pace of 60 to 70 trillion yen per year and implemented a quantitative and qualitative easing monetary policy so as to reach the 2 percent inflation target within two years. After its monthly meeting in February, the Bank of Japan decided to extend the terms of the instruments to stimulate bank credit—the instrument to support growth and the instrument to support financial institutions in disaster areas—for one year and to double the scale of the former two instruments, thus further loosening monetary policy. The Bank of England maintained the policy rate of 0.5 percent and the scale of asset purchases at 375 billion pounds. With the unemployment rate approaching the threshold of 7 percent, the Bank of England adjusted forward guidance of monetary policy after its monthly meeting in February and ended linking the interest rate with a single unemployment indicator and instead linked it with a series of economic indicators.

Responding to pressures from the currency depreciation and capital outflows, some emerging market economies had to raise interest rates more than once. On January 15, February 26, and April 2, the Central Bank of Brazil raised the Selic rate on three occasions by a total of 100 basis points to reach 11 percent. On January 24 and February 6, the Central Bank of Argentina raised the rate for central bank short-term notes on two occasions by 930 basis points, a total of 28.8 percent. On January 28, the

Central Bank of the Republic of Turkey raised the overnight lending rate by 425 basis points to 12 percent, the overnight borrowing rate by 450 basis points to 8 percent, and the one-week repo rate by 550 basis points to 10 percent. On January 28, the Reserve Bank of India adjusted upward the policy rate by 25 basis points to 8 percent. On March 3, the Bank of Russia raised the policy rate from 5.5 percent to 7 percent, and on April 25 it adjusted it further to 7.5 percent. On January 29 the South African Reserve Bank raised the policy rate from 5.0 percent to 5.5 percent.

#### **4. World economic outlook and major risks**

Overall, the global recovery was strengthened in 2014, and to some extent the growth rate will pick up. There are four main reasons for this. First, the growth momentum in the advanced economies has strengthened, and the fiscal consolidation and financial conditions will support faster growth. Second, the fundamentals in the emerging market economies are basically sound and economic growth is not likely to experience a large decline. Third, the Doha Round of the World Trade Organization (WTO) negotiations has made progress, further improving the global trade and investment environment. Fourth, international economic cooperation will be further enhanced.

Looking ahead, the world economy may face the following risks:

First, the Fed's tapering of the quantitative easing might have an impact on the economic recovery and on stability in the financial markets in the U.S. and beyond. The pace of the tapering is still quite uncertain, which will affect stability in the financial markets and the production and investment activities of enterprises. The financial turbulence in some emerging market economies triggered by the tapering may also have a negative impact on the U.S.

Second, the euro area faces the risk of low inflation or deflation. Since the fourth quarter of 2013, the inflation rate in the euro area has declined to below 1 percent and the inflation rates in some periphery economies are close to zero. If the inflation level in the countries in the euro area continues to stay below target, the long-term inflation expectations for the euro area might decline and cause deflation risks, which might constrain economic growth in the euro area and affect the global economic recovery.

Third, downward pressures on the Japanese economy have increased. On April 1, 2014, the consumption tax was raised from 5 percent to 8 percent, but its impact on consumption and domestic demand remains to be seen. The depreciation of the yen has directly increased pressures on imports, while its stimulus effect on exports has not been obvious. At the same time, due to the slowdown in growth in some emerging market economies, the trade deficit in Japan might expand further. The Japanese government will have to face the dilemma between cutting debts or stimulating economic growth for a long time.

Fourth, in the short term risks in some emerging market economies might increase. The slow global recovery is unlikely to provide adequate external demand for the emerging market economies. The uncertainties in the pace of the Fed tapering and the concerns of investors about the fundamentals in the emerging market economies might cause financial market turbulence, capital outflows, and disorderly adjustments to the exchange rates. In addition, since the global financial crisis, due to problems such as the rising leverage in the private and public sectors, the excessive expansion of bank credit, and the increased imbalances in the macro economy, against the background of a tightening external environment, some emerging market economies might face additional pressures,

In addition, geopolitical risks might also have a negative impact on the global economy. The political crisis in Ukraine may not be resolved in the short term, and there is great uncertainty regarding where the crisis is heading. This may affect the energy supply in Europe and its economic recovery.

In the *World Economic Outlook* updated in April 2014, the International Monetary Fund (IMF) reduced its forecast for global growth by 0.1 percentage point to 3.6 percent. The forecast for U.S. economic growth was unchanged at 2.8 percent, the forecast for economic growth in the euro area was increased by 0.1 percentage point to 1.2 percent, the forecast for Japanese economic growth was raised by 0.3 percentage point to 1.4 percent, and the forecast for growth in the emerging market economies was decreased by 0.2 percentage point to 4.9 percent.

## **II. Analysis of China's macroeconomic performance**

In the first quarter of 2014, growth of the Chinese economy remained stable and the structural adjustments made progress. Household income grew rapidly, consumption grew in a stable manner, actual growth of investment rebounded somewhat, and the trade surplus narrowed. The outlook for the agricultural sector was stable and growth of the tertiary industries continued to outpace that of the secondary industries. The hike in consumer prices was mild and the employment situation was relatively good. In the first quarter, the Gross Domestic Product (GDP) reached 12.8 trillion yuan, up 7.4 percent year on year, a deceleration of 0.3 percentage point from the same period of 2013. The Consumer Price Index (CPI) rose 2.3 percent in year-on-year terms, a deceleration of 0.1 percentage point from the same period of 2013. The trade surplus posted USD16.74 billion, a decrease of USD25.28 billion from the same period of 2013.

### **1. Consumption grew in a stable manner, actual growth of investment rebounded somewhat, and the trade surplus narrowed**

The income of urban and rural residents grew rapidly, while consumer demand grew in a stable manner. In the first quarter, per capita disposable income of urban residents

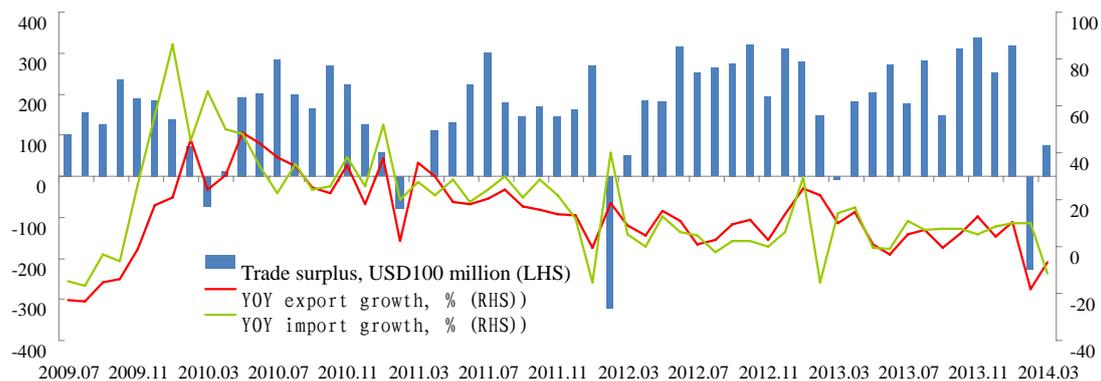
reached 8,155 yuan, representing year-on-year growth of 9.8 percent in nominal terms and price-adjusted real growth of 7.2 percent. The per capita cash income of rural residents registered 3,224 yuan, up 12.3 percent in nominal terms and 10.1 percent in real terms. The PBC Survey of Urban Depositors in the first quarter showed that the Residents' Income Sentiment Index rose 0.4 percentage points from the previous quarter to reach 50.7 percent. Retail sales of consumer goods totaled 6.2 trillion yuan, year-on-year growth of 12 percent in nominal terms or 10.9 percent in real terms, representing an acceleration of 0.1 percentage point from the same period of 2013. In particular, retail sales in the urban areas registered 5.4 trillion yuan, up 11.8 percent year on year, whereas retail sales in the rural areas grew 12.8 percent to reach 852.8 billion yuan.

Actual growth of fixed-asset investments was higher than that in the previous quarter, and private investments accounted for a greater share. In the first quarter, fixed-asset investments (excluding investments by rural households) totaled 6.8 trillion yuan, up 17.6 percent year on year, representing a deceleration of 3.3 and 2.0 percentage points respectively from the corresponding period of the last year and the last year as a whole. The price-adjusted real growth posted 16.3 percent, up 1.7 percentage points over the previous quarter. Among this total, investment by the private sector registered 4.4 trillion yuan, an increase of 20.9 percent over the same period of the last year. Private investments accounted for 64.8 percent of total investments, 1.5 percentage points more than that in the same period of 2013. In terms of the regional distribution, growth of fixed-asset investments in the central and western regions continued to outpace those in the eastern region, and year-on-year growth in the eastern, central, and western regions registered 16.4 percent, 20.2 percent, and 19.1 percent respectively. In terms of the sectoral distribution of fixed-asset investments, the primary, secondary, and tertiary industries grew 25.8 percent, 14.7 percent, and 19.6 percent year on year.

Import and export growth were within a reasonable range, and the trade surplus narrowed. In the first quarter, total imports and exports declined by 1 percent year on year to USD965.88 billion, with exports falling 3.4 percent to USD491.31 billion and imports rising 1.6 percent to USD474.57 billion. As a result, the trade surplus posted USD16.74 billion, a decrease of USD25.3 billion from the same period of 2013. However, the growth of exports and imports remained within a reasonable range if we exclude the special factors in the corresponding period of 2013 and the decrease in the price of commodities. In the first quarter, cargo freight for exports and imports grew 8.1 percent, higher than that in the same period of 2013. In terms of the trade modality, the volume of general trade gained 9.4 percent year on year, higher than that in the same period of 2013. In terms of the regional distribution, exports to the European Union, the United States, Japan, and the ASEAN countries maintained a growth momentum. In terms of the product structure, export growth of machinery and

electronic products and labor-intensive products moderated from the same period of 2013, while commodity imports, such as agricultural products, iron ore, and crude oil, grew rapidly. Utilized foreign direct investments registered USD31.55 billion in the first quarter, up 5.5 percent year on year, while domestic investors invested in 1,875 overseas enterprises in 137 countries and regions, bringing total non-financial direct investments to USD19.9 billion.

**Figure 3 Import and Export Growth and the Trade Surplus**



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

## 2. The outlook for the agricultural sector was stable, while growth of industrial output decelerated

The growth of tertiary industry outpaced that of secondary industry. In the first quarter, the value-added of the primary, secondary, and tertiary industries was 777.6 billion yuan, 5758.7 billion yuan, and 6285 billion yuan respectively, up 3.5 percent, 7.3 percent, and 7.8 percent year on year, and the three industries accounted for 6.1 percent, 44.9 percent, and 49 percent respectively of total GDP, with the share of tertiary industry rising by 1.1 percentage points from the same period of 2013.

The outlook for the agricultural sector was stable. A survey of the agricultural production plan of over 11,000 rural households throughout the country indicated that in 2014 the intended rice-growing acreage rose 0.15 percent, the intended wheat-growing acreage declined 0.56 percent, the intended corn-growing acreage rose 1.75 percent, and the planned cotton-growing acreage declined 6.77 percent. In the first quarter, the total output of meat (including pork, beef, mutton, and poultry) rose by 2 percent year on year to reach 23.47 million tons.

The growth of industrial output decelerated somewhat. In the first quarter, the value-added of statistically large enterprises grew by 8.7 percent year on year, representing a deceleration of 0.8 percentage point from the same period of 2013. The profits of statistically large enterprises increased by 10.1 percent year on year to reach

1294.24 billion yuan. Among this total, the profits from main businesses registered 1223.85 billion yuan, up 9.4 percent year on year. The profit/income ratio of the main businesses of statistically large enterprises was 5.4 percent, up 0.1 percentage point from the same period of 2013. The share of sold industrial products of statistically large enterprises was 97.1 percent, down 0.1 percentage point from the same period of 2013. The PBC Survey of 5,000 Industrial Enterprises in the first quarter indicated that both the output and profits and the equipment utilization rate declined, whereas the Entrepreneurs' Confidence Index picked up. The Business Index posted 55.3 percent, down 2.8 percentage points from the previous quarter; the Equipment Utilization Ratio posted 77.9 percent, down 1.7 percentage points; the Profitability Index posted 50.9 percent, down 6.7 percentage points; and the Entrepreneurs' Confidence Index posted 67 percent, up 1.1 percentage points.

#### **Box 4 Debate on the Potential Growth Rate of the Chinese Economy**

The potential growth rate refers to the maximum growth that an economy can attain after all sorts of resources in that economy or region are reasonably allocated, which is associated with full employment and price stability. To estimate the potential growth rate is of great importance in evaluating the actual performance of the real economy, developing an economic development strategy, and reasonably managing the intensity of macroeconomic measures. There are two main methods to estimate the potential growth rate. The first is to use a statistical method by finding the trend in the growth rate from historical data, e.g., finding the trend in growth from time-series data on economic performance as an estimate of potential output (such as the HP filter, the Kalman filter, and so forth); the other is to use an economic method, i.e., to build a model based on economic theory, e.g., by using the production function to estimate potential output after taking into account changes in the labor force, capital stock, and total factor productivity. Both these methods have pros and cons. The former relies on a large amount of historical data, while the latter requires assumptions about trends in the main variables in the production function. In reality, various methods are needed to make a comprehensive judgment.

As China's economic growth has witnessed some slowdown in recent years, there have been frequent discussions about its potential growth rate. When an economy is in the process of making structural adjustments and transformations, it is more difficult to determine the potential growth rate. Some economists assume that China's potential growth rate will decline to some extent. There are several reasons underlying this assumption. First, judging from demographic and other macroeconomic and structural factors, some economists believe that China has approached or has already surpassed its peak in terms of the population dividend, while the aging population will tend to reduce the savings rate, push up interest rates, and contain investment growth and potential economic growth. Existing growth drivers, such as the real-estate market and the export sector, have dwindled, and after many years of rapid growth the capacity of resources and the environment to support the traditional growth pattern is on the decline. The second is to determine the trend from country experiences. Some

studies show that after per capita GDP reaches a certain point, the economy will move from a high-speed growth phase to a medium or low-speed growth phase, with a significant decline in the growth rate. Other studies show that there is an inverted-U-shaped relationship between urbanization and the investment rate. After urbanization reaches a certain point, the investment rate will likely decline with the rising urbanization rate. Some scholars have pointed out that as China has experienced steady growth in its investment rate for more than a decade, the future investment rate is likely to gradually return to normal levels, which will put a drag on economic growth. Other studies find that as the industrial structure shifts from manufacturing to services, labor productivity as a whole will decline, which will influence the level of potential output. However, since the service industry has a strong capacity to create employment, the labor market will remain stable and the structure of income distribution will be optimized.

Other economists believe that the China's economy will maintain sustainable and rapid growth. They base their argument on several reasons. The first is based on a country comparison. Measured against China's current per capita GDP level, Japan, Korea, and Taiwan experienced a relatively long period of rapid growth after reaching this per capita GDP level. If China's structural imbalances can be eliminated, there will be great space for the economy to maintain sustainable and relatively rapid growth. In addition, compared with the developed economies, China's capital stock per capita is relatively low; in particular there is relatively large room for infrastructural investments and coordinated regional development. The second reason is based on possible changes in labor productivity. Some scholars believe that with increased inputs in education, China's human capital will continue to improve and accumulate, which will offset the potential impact from the decline in the volume of the labor force and the slowdown in investment growth. Higher labor productivity is an inexhaustible source of economic growth.

Comparatively, among the aforementioned discussions on the potential growth rate, the former mainly emphasizes constraint factors, such as population, capital stock, and the environment, while the latter focuses on the development potential and the room for improvement in labor productivity. In fact, the potential growth rate may be subject to change due to the interaction of these factors and the final equilibrium, while reform will be a key factor that can release the growth potential and extend the development space. Judging from the experience during the past few decades, the steady progress in reform and opening-up has had a huge impact on China's potential growth rate. Due to the impacts of the tighter labor supply, transformation in the growth pattern, and other factors, the potential growth rate is likely to slow down temporarily; the key to maintaining stable and relatively rapid growth at this junction is to improve efficiency and maintain economic vitality. We will provide an impetus by deepening reform, adjusting the economic structure, and improving people's livelihood so as to unleash greater dividends from reform and to promote sustainable

and healthy economic development.

### **3. Overall price levels remained basically stable**

Consumer prices registered a moderate increase. In the first quarter, the CPI rose 2.3 percent year on year, down 0.6 percentage point from the previous quarter, and the CPI in the first three months registered 2.5 percent, 2.0 percent, and 2.4 percent respectively. The drop in CPI growth was mainly due to the moderate growth of food prices. In the first quarter, food prices rose 3.5 percent year on year, down 2.0 percentage points from the previous quarter, driving the CPI up by about 1.2 percentage points; the prices of non-food items rose 1.7 percent year on year, up 0.1 percentage point from the previous quarter, driving the CPI up by about 1.1 percentage points. In terms of consumer goods and services, the growth of consumer goods decreased notably whereas the growth of services remained basically stable. In the first quarter, prices of consumer goods rose 1.9 percent year on year, a deceleration of 0.8 percentage point from the previous quarter, and prices of services rose 3.1 percent year on year, a deceleration of 0.1 percentage point from the previous quarter.

Producer prices declined by a larger margin. In the first quarter, ex-factory prices of industrial products fell 2.0 percent year on year, which was 0.6 percentage point more than the decline during the previous quarter, and the monthly rates of decline in the first three months read 1.6 percent, 2.0 percent, and 2.3 percent year on year. In particular, the prices of consumer goods declined 0.3 percent year on year, dragging down the PPI by about 0.1 percentage point, and the prices of capital goods declined 2.5 percent year on year, dragging down the PPI by about 1.9 percentage points. Producer purchasing prices declined by 2.1 percent year on year, which was 0.6 percentage point more than the decline during the previous quarter. The Corporate Goods Price Index (CGPI) fell by 2.0 percentage points year on year, which was 1.5 percentage points more than the decline during the previous quarter. Prices of agricultural products fell 1.2 percent, while prices of agricultural capital goods fell 0.6 percent.

Affected by the overall decline in commodity prices on the international market, the decline of import prices expanded further. In the first quarter, the average price of Brent Crude oil futures on the Intercontinental Exchange fell 4.2 percent and 1.4 percent respectively from the same period of 2013 and the previous quarter. Average LME spot copper and aluminum price fell 11.2 percent and 14.7 percent respectively from the same period of 2013, and fell by 1.6 percent and 3.4 percent respectively from the previous quarter. As a result, import prices declined by 5.0 percent year on year, widening the decline in the previous quarter by 3.5 percentage points.

The GDP deflator fell. In the first quarter, the GDP deflator (the ratio of nominal GDP to real GDP) was 0.4 percent, which was 1.3 percentage points lower than that during the same period of 2013 and 1.3 percentage points lower than that during the entire last year.

The price reform was advanced. On March 20, the NDRC issued the *Guidelines on Establishing and Improving the Residential Progressive Natural Gas Price System*. In developing relevant implementation rules in line with local circumstances, all local governments should endeavor to meet the residents' demand for natural gas for their basic living and should allow the price of natural gas to reflect the scarcity of natural resources. Moreover, the compensation cost should be combined with fair burden sharing. On March 25, the NDRC and other departments jointly issued a notice, stipulating that the price of all medical services offered by non-public medical institutions should be market-determined, and non-public medical institutions should set their medical service prices based on the principles of fairness, legality, and integrity.

#### **4. Growth of fiscal revenue and expenditures picked up**

In the first quarter, fiscal revenue posted 3502.57 billion yuan, up 9.3 percent year on year, which was 2.4 percentage points higher than that during the same period of 2013. Fiscal expenditures reached 3043.25 billion yuan, up 12.6 percent year on year, which was 0.5 percentage point higher than that during the same period of 2013. As a result, revenue was 459.33 billion yuan more than expenditures, which was 40.39 billion yuan less than that during the same period of 2013.

In terms of the structure of fiscal revenue, tax revenue registered 3018.78 billion yuan, up 10.2 percent year on year, and non-tax revenue registered 483.79 billion yuan, up 4.4 percent year on year. In terms of the tax categories, revenue from the domestic value-added tax, the domestic consumption tax, the business tax, the corporate income tax, the value-added tax on imported goods and excise tax, and the personal income tax rose by 9.4 percent, 4.8 percent, 4.2 percent, 8.9 percent, 12.2 percent, and 13.4 percent respectively. As for the structure of fiscal expenditures in the first quarter, fiscal expenditures for health care and medical services, urban and rural community affairs, social security and employment, and education grew relatively rapidly, increasing by 26.4 percent, 17.7 percent, 14.2 percent, and 14 percent respectively.

#### **5. The employment situation was generally stable**

In the first quarter, the registered unemployment rate in urban areas posted 4.08 percent, an increase of 0.03 percentage point from the previous quarter. A statistical

analysis in the first quarter conducted by the China Human Resources Market Information Monitoring Center on public employment service agencies in 102 cities revealed that overall labor supply and demand was in balance, with supply falling slightly short of demand, and the ratio of job seekers to job vacancies was 1.11, up 0.01 percentage point from the previous quarter and the same period of 2013. Broken down by industry, demand for labor in finance, real estate, transportation, warehousing and postal services, information transmission, computer and software services, and so forth showed substantial growth, whereas demand for household services and other service sectors, and leasing and commercial services fell. Compared with the same period of the last year, the number of unemployed young job seekers declined somewhat, whereas that of people who had lost their jobs and people who had come from rural areas or other cities increased. Regarding labor demand, 52.8 percent of the openings included explicit requirements for technical skills or titles; professionals with a medium-to-high skill levels and senior professionals were still in short supply.

## **6. The current account surplus narrowed**

According to preliminary statistics, the current account surplus in the first quarter of 2014 was USD7.2 billion, a decrease of USD40.4 billion from the same period of 2013; the surplus in the capital and financial account was USD118.3 billion, an increase of USD28.2 billion from the same period of 2013. Reserve assets grew by USD125.8 billion, a decline of USD31.3 billion from the same period of 2013.

The total external debt continued to grow. As of the end of 2013, the outstanding external debt posted USD863.2 billion, up 17.1 percent year on year. Among this total, the stock of registered external debt posted USD526.7 billion, rising 18.2 percent year on year and accounting for 61 percent of the total; outstanding short-term external debt posted USD676.6 billion, increasing 25.1 percent year on year and accounting for 78.4 percent of the total.

## **7. Sectoral analysis**

The growth of profits of industrial enterprises decelerated. In the first quarter, profits of statistically large industrial enterprises grew 10.1 percent year on year. Among 41 industries, 33 made more profits in their main businesses compared with the same period of 2013. Profits in the electricity and heat generation and distribution, auto, electronic machinery and equipment manufacturing, and non-metallic mineral product manufacturing sectors grew rapidly, with growth posting 32.3 percent, 29.8 percent, 28.2 percent, and 26.7 percent respectively. Due to insufficient demand and declining prices, profits in the major mining industries and the raw material production industries declined appreciably, while profits in the coal, electricity, oil, and

transportation sectors increased slightly. In the first quarter, crude coal output amounted to 858 million tons, at par with the same period of 2013; power generation increased 5.8 percent year on year to 1,271.94 billion kilowatt hours; crude oil output grew 0.2 percent year on year to 51.337 million tons. A total of 10.55 billion tons of cargo was transported, up 7.4 percent year on year.

### **(1) The real-estate sector**

In the first quarter, nationwide turnover of commercial housing declined year on year, fewer cities reported a quarter-on-quarter increase in housing prices compared with the previous quarter, and both growth of investment in real-estate development and in loans in the real-estate sector decelerated.

Fewer cities reported rising housing prices compared with the previous quarter. In March 2014, out of 70 large- and medium-sized cities, the price of newly-built commercial residential housing increased year on year in 69 cities, at par with that in December 2013; the price of newly-built commercial residential housing increased from the previous quarter in 56 cities, 9 cities less than in December 2013. The price of pre-owned residential housing increased year on year in 68 cities, one city less than in December 2013; the price of pre-owned residential housing increased from the previous quarter in 42 cities, 22 cities less than in December 2013.

Both the acreage and sales of commercial housing declined year on year. In the first quarter, nationwide sold floor area of commercial housing posted 200 million square meters, down 3.8 percent year on year, which was 3.7 percentage points more than the decline in January and February combined, while the sold floor area in 2013 registered annual growth of 17.3 percent. The sales value of commercial housing declined 5.2 percent year on year to 1,326.3 billion yuan, which was 1.5 percentage points more than the decline in January and February combined, while the sales value of commercial housing in 2013 registered annual growth of 26.3 percent. Among this total, the sold area and sales value of commercial residential housing accounted for 88.6 percent and 83.5 percent respectively of the total sold area and of the turnover in commercial housing.

Growth of investment in real-estate development decelerated. In the first quarter, nationwide investment in real-estate development totaled 1533.9 billion yuan, up 16.8 percent year on year, which was a deceleration of 2.5 percentage points and 3 percentage points from January and February combined and the previous year as a whole. In particular, investment in residential housing posted 1,053 billion yuan, accounting for 68.7 percent of the total investment in real-estate development. The floor area of newly-started housing projects declined 25.2 percent year on year to 290 million square meters, while the floor area of newly-started housing projects had

increased 13.5 percent year on year in 2013. The floor area of housing projects under construction grew 14.2 percent year on year to 5.47 billion square meters, a deceleration of 1.9 percentage points from the previous year. The floor area of completed housing projects declined 4.9 percent year on year to 190 million square meters, while that in the previous year registered year-on-year growth of 2 percent.

Growth of real-estate loans decelerated by a small margin. As of the end of March, outstanding real-estate loans of major financial institutions (including foreign-funded financial institutions) posted 15.4 trillion yuan, an increase of 18.8 percent year on year and down 0.3 percentage point from the end of 2013. Outstanding real-estate loans accounted for 20.6 percent of total outstanding loans, which was 0.4 percentage point less than that at the end of 2013. In particular, outstanding mortgage loans rose 20.2 percent year on year to reach 9.5 trillion yuan, a deceleration of 0.8 percentage point from the end of 2013; outstanding housing development loans gained 19.3 percent year on year to reach 2.8 trillion yuan, an acceleration of 3.5 percentage points from the end of 2013; outstanding land development loans rose 7.6 percent year on year to reach 1.1 trillion yuan, a deceleration of 2.2 percentage points from the end of 2013. In the first quarter, new real-estate loans registered 797.1 billion yuan, accounting for 26.4 percent of all types of new loans, a decline of 1.7 percentage points from 2013.

According to the *Report on the Work of the Government* released in 2014, efforts should be made to ensure the construction of welfare housing projects. Construction of more than 7 million government-subsidized housing units will be started, including the rebuilding of more than 4.7 million shanty housing units. At end-March, outstanding loans for welfare housing posted 778.3 billion yuan, representing year-on-year growth of 26.7 percent, with a growth rate 8.4 percentage points higher than that of real-estate development loans. In addition, the pilot program of using housing provident fund loans to support the construction of affordable housing was steadily promoted. At end-March, based on the construction progress, a total of 66.9 billion yuan of such loans was disbursed to support the construction of 316 welfare housing projects in 76 cities, and a total of 17 billion yuan of the principal was repaid.

## **(2) The photovoltaic sector**

China has an international competitive advantage in the photovoltaic (hereafter referred to as PV) sector, an emerging strategic industry. With global energy shortages and serious environmental pollution, PV power generation has become a high-tech industry attracting wide attention and becoming a focus for development around the world due to its cleanliness, safety, convenience, and efficiency. The development of the PV sector is of great significance to industrial transformation and upgrading, adjustment of the energy structure, social and economic development, and energy

conservation and emission reductions.

Although the PV sector is a new industry, it has witnessed rapid development. Since 2012, with the shift in the global PV market, China's PV sector has grown rapidly. At the end of 2012, more than 50 enterprises in China had the ability to produce poly-silicon, with an aggregate production capacity of 190,000 tons, ranking first in the world, and actual output reached 71,000 tons. The production capacity of solar PV cells with nuclear components reached more than 40 million kilowatts; the output of solar cells and solar modules reached 21 million kilowatts and 23 million kilowatts respectively, accounting about 63 percent of the total global output. At the same time, China is also the largest PV application market. In 2013, the newly installed capacity of PV power generation throughout the world was 37 million kilowatts, of which 11.3 million kilowatts were in China. China has become the main engine of worldwide growth of PV installed capacity.

Nevertheless, the PV sector faces a grim situation, burdened with overcapacity and massive losses. On the one hand, due to the extremely rapid expansion of capacity in 2011, the prices of major PV products saw rapid declines and the stockpiles of upstream and downstream products continued to rise. In the second half of 2012, the entire sector suffered from the problem of costs being higher than the sales prices, and production and operation of the sector encountered difficulties. Since 2013, despite some improvements in the fundamentals of the PV industry, the overall excessive leverage ratio and the debt repayment pressures have remained serious. Furthermore, weak demand in the European and U.S. markets and resurging trade barriers in the U.S., European Union, India, and other export destinations increased uncertainties about export performance in the PV sector, a sector that relies heavily on external demand.

It should be recognized that the problems and difficulties encountered by the PV sector represent both challenges for the sector's development and also an opportunity for the sector to transform and upgrade. We should have full confidence, seize the strategic opportunity from the rapid development of new energies throughout the world, and solve the problems through development. The first is to take a comprehensive approach to promote the transformation and upgrading of the PV sector. Efforts should be made to promote innovation in key technologies, upgrade the production technology, and make breakthroughs in research and development. We need to make use of market-driven mechanisms, encourage corporate mergers and acquisitions, accelerate the shutdown of backward PV production capacity, curb the construction of redundant low-level capacities, increase the efficiency of resource allocations and the concentration of industrial production, and promote resource integration. The second is to actively respond to international competition and adjust

the layout of the PV market. The main focus should be on expanding the domestic market as a means to promote the sustainable and healthy development of the sector, while also actively expanding the international market to maintain a reasonable market share. The third is to establish a policy system to support domestic PV applications and to build a long-term mechanism to promote the sustainable development of PV power generation. Efforts should be made to coordinate the industrial, fiscal and taxation, financial, human capital, and other supporting policies, to promote the building of a product testing, certification, and monitoring system, to strengthen coordination of policies and industrial self-discipline, to accelerate the building of market-based energy conservation and emission-reduction mechanisms, and to form a legal, policy, and standard system and market environment that is conducive to the sustainable and healthy development of the PV sector.

## **Part 5 Monetary Policy Stance to Be Adopted during the Next Stage**

### **I. Outlook for the Chinese economy**

The Chinese economy is shifting gear and undergoing a transformation of its growth pattern. The ongoing structural adjustments have caused pains, but at the same time the reforms and adjustments have released vitality. Looking at various factors including the growth potential and dynamics, we expect the Chinese economy to maintain its stable performance for a period to come. Looking at the fundamentals, due to the size of the economy, there is fairly large room for balanced development of new industrialization, application of information technology, urbanization, and modernization of the agricultural sector. Given the large gaps between the rural and urban areas and among the different regions and the imbalances in the industrial structure, optimization of the rural-urban structure, regional structure, and industrial structure will unleash a huge growth potential. In terms of the policy environment, in parallel with innovations macroeconomic management and the accumulation of experience, the adoption of a series of policy measures to promote reform, to adjust the economic structure, and to increase the people's welfare will enable the market to play a decisive role in the allocation of resources, improve factor productivity, and bolster growth. Although the growth of the secondary industries and investment has moderated, there are positive signs, including continued strong growth of the tertiary industries, improvements in the investment structure, a good employment situation, and stable income growth. In the majority of sectors in the tertiary industries, such as retail and wholesale, transportation, IT services, leasing, and business service sectors, the growth of investment has accelerated. A number of new technology industries and new business models have displayed good momentum for development and industries and enterprises that have actively pursued upgrading and independent innovation have become resilient to shocks and have registered strong growth. The public's enthusiasm to start their own businesses has been released as some regions are

experiencing rapid growth in the number of newly registered enterprises. With the progress in structural adjustments and the accelerated growth of the service sector, the growth of GDP per unit is creating more jobs. According to the Quarterly Urban Depositors Survey conducted by the PBC in Q4, the Household Employment Sentiment Index posted 40.6 percent, recovering 1.8 percentage points from the previous quarter; the Household Future Employment Index was 49.9 percent, up 0.2 percentage point from the previous quarter. In the external environment, a sustained global recovery is stabilizing external demand is likely to improve further. In April 2014, the IMF released a global-growth projection of 3.6 percent and 3.9 percent in 2014 and in 2015 respectively, compared to 3 percent in 2013.

Yet we need to note that the endogenous drivers are yet to be strengthened and the tasks of structural adjustments and reform are arduous. Some industries are overloaded with excess capacity and inefficient enterprises are using a lot of resources. Due to the moderation in growth and the ongoing structural reforms, the turnover rate of working capital has declined and the efficiency of fund use is low, and outstanding debt is continuing to build up fairly rapidly while debt expansion is playing a smaller role in supporting growth. As existing drivers, including external demand and the real-estate sector, are losing steam and new drivers of strong growth are yet to emerge, we need to pay attention to the potential risks. Moreover, the key difficulties in the structural adjustments are yet to be tackled, and serious air and water pollution and environmental and resource bottlenecks have become acute, reflecting the urgent need to adjust the growth pattern. Uncertainties in the pace of the policy adjustments in the U.S. may affect global capital flows and the cost of capital. Europe is facing deflationary risks. Japan has had trade deficits for several months in succession, posing a challenge to its long-term growth and debt sustainability. Turmoil in the emerging markets may also affect the environment for external demand. In general, facing a complex environment, we need to strike a balance among the aggregates, focus on structural optimization to solve the deep-rooted structural problems by deepening reform, release growth dynamics, and enhance competitiveness.

The price situation is generally stable. Price movements reflect the degree of how aggregate demand and supply are matched, and they are closely related to changes in the economic situation at home and beyond. The external environment is relatively stable, and the performance of the domestic economy is within a reasonable range. The relative stable monetary environment, sufficient industrial capacity, and the base factors that are largely at par with those of the previous year are conducive to the continued stability of the CPI. According to the Urban Depositors' Survey conducted by the PBC in Q1, the Household Future Price Expectation Index was 63.9 percent, a reduction of 8.3 percentage points from the previous quarter; 55.8 percent of the respondents felt the current level was high and difficult to accept, a reduction of 5.8 percentage points from the previous quarter. Yet there are still potential upward pressures on the prices of agricultural products and services; pricing reform may also increase upward pressures; housing price expectations and inflation expectations are

not yet stable. The consistently negative value of the PPI is a reflection of the serious problem of excess capacity and may be related to the decline in commodity prices in the global market. The future movements of the PPI to a large extent will depend on the recovery of endogenous drivers and the removal of excess capacity. It is necessary to monitor price movements in a dynamic way, considering the uncertainties in the movements of domestic and external demand and supply.

## **II. Monetary policy during the next stage**

The PBC will follow the strategic arrangements of the State Council, implement the decisions adopted at the 18<sup>th</sup> CPC National Congress, the 3<sup>rd</sup> Plenum of the 18<sup>th</sup> CPC Central Committee, and the Central Economic Work Conference and, as outlined in the Government Work Report, follow the principle of making progress while maintaining stability and continue to reform and innovate. The PBC will continue its sound monetary policy, maintain policy continuity and stability, uphold the stance of keeping the aggregates at stable levels and optimizing the structure, maintain the focus on macroeconomic management, take active measures, conduct fine-tuning and pre-emptive adjustment measures with proper intensity where appropriate, make macroeconomic measures more forward looking, targeted, and coordinated, and strike a balance among preserving stable economic growth, promoting reforms, adjusting the economic structure, improving people's welfare, and preventing risks in order to continue to provide a stable and opportune monetary and financial environment for the structural adjustments, upgrading, and transformation of the economy. Moreover, reform will be integrated with macroeconomic management measures to combine monetary policy conduct with the deepening of reform so as to enable the market to play to a fuller extent a decisive role in resource allocations. In view of the financial deepening and innovation, efforts will be made to further improve the mode of macroeconomic management and transmission mechanisms, increase supply and enhance competition to improve financial services, the efficiency of the financial sector, and the capacity to provide services to the real sector.

First of all, a combination of quantitative, price, and other monetary policy instruments will be used and the macro-prudential policy framework will be improved to keep liquidity at reasonable volumes and to realize a proper growth of money, credit, and all-system financing aggregates. In view of the changes in economic and financial conditions and the impact of financial innovations on liquidity in the banking system, a mix of instruments, including open market operations, the deposit reserve requirement ratio, central bank lending, central bank discounts, the Standing Lending Facility, Short-term Liquidity Operations, and so forth, will be used and the central bank collateral framework will be improved to manage and adjust overall liquidity and maintain stability in the money market. Furthermore, commercial banks will be guided to enhance liquidity and asset and liability management, to make good liquidity arrangements at various time-points, to properly manage asset and liability aggregates and their maturity structures, and to improve the quality of liquidity risk

management. The macro-prudential policy will continue to play a counter-cyclical adjustment role. The various parameters will be adjusted when necessary based on changes in economic performance, the soundness of the financial institutions, and implementation of the credit policy to guide financial institutions to support real-sector development in a more focused way.

Second, the stock of credit assets will be revitalized and the use of new loans will be optimized to support the structural adjustments, transformation, and upgrading. The direction and structure of liquidity inputs will be optimized to reduce financing costs for the transformation of shanty towns and other key activities and weak sectors, such as the agricultural sector, rural areas, farmers, and micro and small enterprises. Central bank credit policy lending will be actively used and the effects of credit policy guidance will be assessed on a continual basis to guide financial institutions to improve their credit structure. Financial institutions will be encouraged to make innovations in the organization, mechanisms, products, and modes of services, and to support operations featuring economies of scale and new types of business operators in the agricultural sector. Financial sector support will be enhanced to key sectors in the national economy, i.e., science and technology, culture, IT-based consumption, strategic new industries, and so forth; the conduct of credit policy will be improved to step up financial-sector support and services for livelihood enhancement programs, including poverty alleviation, employment creation, student loans, minority ethnic groups, migrant workers, and village officials recruited from among university graduates. While ensuring the reasonable demand for funds by ongoing and follow-up projects and programs, there will be support for railways and major infrastructure programs, urban infrastructure, government-subsidized housing construction, and other livelihood projects. Lending to energy-intensive industries and to those with high emissions as well as those with excess capacities will be strictly controlled to promote the removal of excess capacity. A green credit mechanism will be established to improve financial services for energy conservation, environmental protection, the circular economy, and prevention and treatment of air pollution, and to enhance credit support for technology upgrading in the relevant fields. The differentiated housing mortgage policies will be earnestly implemented to support the construction of welfare housing and ordinary commercial housing projects with apartments of modest floor plans and purchases of ordinary commercial housing by first-time home buyers, and to contain purchases for speculative investment purposes. The role of development finance will be further tapped to support the reconstruction of shanty town areas.

Third, the market-based interest-rate reform and the RMB exchange-rate regime reform will be furthered to improve the efficiency of allocation of financial resources and to improve the monetary policy framework. The self-regulatory interest-rate market pricing mechanism will be improved to build the capacity of financial institutions to carry out independent pricing. The issuing and trading of inter-bank certificates of deposit will continue while we explore issuing certificates of deposit to

corporate and individual customers and to gradually increase the range of liability products for market pricing. Efforts will be made to develop the Shibor and Loan Prime Rate and to build a fairly complete market interest-rate system. The central bank interest-rate adjustment framework will be improved to strengthen price-based adjustments and transmission mechanisms. The RMB exchange-rate regime will be further improved to allow market demand and supply to play a greater role, to enhance the two-way flexibility of the RMB exchange rate, and to keep the exchange rate basically stable at an adaptive and equilibrium level. Development of the foreign exchange market will be accelerated to provide exchange-rate risk management services to import and export enterprises that have concrete demands based on the principle of the financial sector providing services to the real sector. Measures will be taken to support the use of RMB in cross-border trade and investment activities and to expand the channels for inflows and outflows of RMB funds. Direct trading of RMB against other currencies will be promoted to provide better services for RMB settlements of cross-border trade activities. The impacts of the changing international situation on capital flows will be carefully watched and effective monitoring of cross-border capital will be strengthened.

#### **Box 5 Market-based Interest Rates and the Monetary Policy Framework**

The market-based interest-rate reform is a process of gradually removing direct controls on interest rates so that interest rates are determined by market players based on supply and demand for funds and a process of the central bank gradually enhancing price-based adjustments and transmission mechanisms. Interest-rate liberalization usually takes place during a period of rapid financial innovation. Financial innovation and market development are important drivers in the transformation of the monetary policy framework. Therefore, based on international experience, interest-rate liberalization usually progresses in tandem with the gradual transformation of the monetary policy framework. In the 1970s and 1980s, along with the rapid progress in interest-rate liberalization in the major economies, their monetary policy frameworks gradually moved from quantity-based to price-based. From a theoretical point of view, the choice of a monetary policy between a quantity-based framework and a price-based framework depends on the nature of the economic shocks. When uncertainties (random shocks) are mainly from the commodities market, it is proper to choose the money supply as the intermediate target; when uncertainties are mainly from the money market, it is proper to choose the interest rate as the intermediate target. As we learn from the IS-LM model, financial innovation and deepening will affect the impacts of the signal from the quantitative indicator; when the money demand function becomes unstable, continued use of quantitative objectives might cause price fluctuations and affect the stability of output. These are endogenous drivers to promote the gradual transformation of the monetary policy framework.

With the gradual liberalization of interest rates, many central banks have established a

policy operations framework that works effectively to guide and adjust market interest rates. The key is to set and adjust policy rates and an interest-rate corridor, and to conduct open market operations to guide the market interest rates to move with the policy rates to anchor expectations and to be transmitted to the interest rates of other maturities and other products, so as to affect investment and consumption behavior in the economy and to achieve the goals of stable prices and stable economic growth. The U.S. Fed has the federal funds rate as its policy rate, the ECB has the open market main refinancing rate as its policy rate, and some emerging markets use the open market operations interest rates as policy rates. Many central banks have established an interest-rate corridor mechanism, by which the interest rates move within the corridor. When the economy is in an upswing of the cycle or when there are inflationary risks, the central bank may announce a hike in the policy rates and drain in liquidity from the market to push up interest rates, which will help curb the expansion of consumption and will maintain price stability; conversely, the central bank can conduct the above operations in the opposite direction. As a reduction in the liquidity supply and an upward movement of interest rates take place at the same time, they are transmitted to all kinds of financial products and then affect the behavior of economic agents. Beginning from the 1980s, the central banks of the major economies stressed rule-based policy and transparency, and valued the role of stable expectations in the conduct of monetary policy. The key is to establish the credibility of the central bank and public confidence in the monetary policy. When the central bank is able to effectively guide expectations, the effectiveness of monetary policy can be enhanced, with the policy transmission improved significantly. The price-based adjustment has the advantage of transparency, which helps to anchor market expectations.

When the conduct of monetary policy is based on price instruments, there should be fairly developed financial markets, interest rate sensitive economic agents, and a sufficiently flexible exchange-rate regime. In general, the volume of base money and prices are related. However, in the emerging economies that have long been recipients of capital flows, the volume of base money and prices are not clearly related due to excess liquidity. As the BOP account becomes more balanced, the volume of base money and the price of money will be more closely related, indicating that the shift from quantity-based to price-based tools might be pending. The transformation is likely to be a process of gradual improvement and a stronger effect in the use of pricing tools. At the same time, the quantity tools and macro-prudential policy still play important roles in the conduct of monetary policy. Price and quantity tools can be used in combination to realize the goal of macroeconomic management. The major economies and international organizations reached a consensus on the combination of interest-rate adjustments and macro-prudential policy as they reflected on the lessons of the recent global financial crisis.

Fourth, the system of financial markets will be improved to enable financial markets to play a role in maintaining stable economic growth, promoting adjustments, transformation, and upgrading of the economic structure, furthering reform and

opening-up, and preventing financial risks. Innovation will be encouraged to diversify the products and layers of the bond market. The systems, mechanisms, and institutions will be improved and strengthened, and oversight and regulation will be enhanced. Efforts will be made to increase the diversity of financial market participants and to enhance market discipline and the risk-sharing mechanism. The market infrastructure will be enhanced. The opening-up of financial markets will be promoted to overseas participants. Direct financing will be further developed and work will be continued to build a multi-layer capital market, including increasing the varieties of instruments and products and enhancing the capacity to serve small- and medium-sized enterprises. The role of the corporate debenture bond inter-ministerial coordination mechanism will be tapped to enhance regulatory coordination.

Fifth, reform of financial institutions will be deepened to improve financial services through increased supply and competition. Reform of large commercial banks and other large financial institutions will be furthered so as to improve corporate governance, establish effective mechanisms for decision-making, execute checks and balances, and translate corporate governance requirements into everyday operations and risk controls in their respective institutions. The pilot reform program of the Rural Financial Business Division of the Agricultural Bank of China will be advanced to explore a sustainable model for market-based financial institutions to serve the agricultural sector, rural areas, and farmers, and to improve the quality of such financial services. The reform of the Export-Import Bank of China and the Agricultural Development Bank of China will be accelerated by strengthening their policy functions, following the principle of focusing on policy-based business and prudently developing proprietary business, requiring separate book keeping, accounting, and management of policy-based and proprietary business, establishing a sound regulatory capital requirement mechanism, and improving the governance structure and the fiscal and financial support policy for the purpose of creating a policy environment for developing policy financial institutions with Chinese characteristics that operate on a sustainable basis to provide good services to support economic development. The market-based transformation of asset management companies will be further promoted. With enhanced supervision, all kinds of financial institutions, financial service agencies, and financial intermediaries will be encouraged to develop and form a financial eco-environment in which all market participants can compete. The rapid development of Internet-based financial innovation, integrated with and complementing traditional finance, helps increase competition, develop inclusive finance, increase people's income, and improve the efficiency of resource allocations. However, along with innovations, problems include regulatory arbitrage and higher liquidity risks. It is necessary to further improve the relevant standards and arrangements, promote fair competition, strengthen industrial self-regulation, increase the capacity to manage risks, protect the rights and interests of investors, and promote the sound development of Internet-based financial activities.

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 and to urge them to strengthen internal controls and liquidity and risk management. While supporting financial innovations, the monitoring and prevention of potential risks in wealth management and internal bank business will be enhanced. The continued monitoring of local government debt and the debt servicing capacity will be strengthened to prevent and control debt risks, and we will explore using market mechanisms to resolve the problems of local government indebtedness. The systemic financial risk early-warning and assessment mechanisms will be improved to strengthen the monitoring of the credit default risks of local government financing platforms, industries with excess capacity, and lending to the real-estate industry, to prevent the spread to the financial system of the risks in some regions, industries, and enterprises and those arising from financing activities outside of the formal financial system. The role of the financial regulation coordination inter-ministerial meeting mechanism will be tapped to strengthen risk monitoring and regulatory coordination in cross-sectoral and cross-market financial products, to promote the balanced development of various financial markets and various products, and to establish a comprehensive financial statistical system and information-sharing mechanism. A crisis management and risk resolution framework will be established and the creation of a deposit insurance scheme will be promoted. A crisis management and risk resolution framework will be designed and established and the creation of a deposit insurance regime will be expedited. A comprehensive set of measures will be taken to preserve financial stability and safeguard the bottom line in preventing systemic and regional financial risks.