China Monetary Policy Report, Quarter Three

(November 2, 2012)

Monetary Policy Analysis Group of

the People's Bank of China

Executive Summary

In Q3 2012, growth of the Chinese economy slowed down and stabilized as positive changes continued to emerge. Consumer demand remained stable, growth of fixed-asset investments was stable and fairly rapid, and growth of exports recovered slightly. The outlook for the agricultural harvest was good; growth of output in the industrial sector stabilized. Growth of price levels declined further and the employment situation remained stable. In the period under review, GDP increased 7.7 percent year on year to 35.3 trillion yuan; the consumer price index was up 2.8 percent year on year.

The PBC has followed the overall arrangements of the State Council, continued to implement a sound monetary policy, made policy measures more forward-looking, targeted, and flexible, and increased the strength of fine-tunings and preemptive adjustments. The deposit reserve requirement ratio was cut one more time and the floating range of loan interest rates was widened. In view of the changes in liquidity supply, reverse repo operations were conducted to meet the reasonable demands of the banking system for liquidity and to guide market interest rates to move in a stable manner. Measures were taken to guide financial institutions to optimize the credit structure. The reform of financial institutions continued to make progress, and the flexibility of the RMB exchange-rate regime increased.

Money, credit, and all-system financing aggregates grew relatively rapidly and the loan structure continued to improve. At end-September 2012, the outstanding balance of broad money M2 increased 14.8 percent year on year to 94.4 trillion yuan; the outstanding balance of RMB loans was up 16.3 percent year on year and registered an increase of 6.72 trillion yuan from the beginning of 2012, 1.04 trillion yuan more than growth during the corresponding period of 2011. In the first three quarters of 2012, all-system financing aggregates posted 11.73 trillion yuan. The lending interest rates of financial institutions declined further. In September, the weighted average lending rate offered to non-financial enterprises and other sectors posted 6.97 percent, a reduction of 0.09 percentage points from June. At end-September, the central parity of the RMB against the US dollar was 6.3410 yuan per dollar, a depreciation of 0.25 percent from end-June, whereas the real effective exchange rate of the RMB depreciated 0.99 percent.

At the current stage, the fundamentals remain basically unchanged to support stable and fairly rapid growth in China. The Chinese economy is expected to continue steady and fairly rapid growth. With urbanization, informatization, industrialization, and modernization of the agricultural sector, the structure of the economy is moving in the anticipated direction. Yet, as the domestic and global environment for the Chinese economy remains complicated and external demand remains sluggish due to the continued impact of the financial crisis, endogenous drivers for growth need to be strengthened. Various factors, both structural and cyclical, have an impact on economic growth. This has made the task of structural adjustments and the transformation of growth patterns even more imperative. It is necessary to manage the macro-economy in view of the ongoing structural changes and in accordance with the law of economic performance, to continue to accelerate structural adjustments and reform, to consolidate and optimize asset allocations, and to allow the long-term growth potential to be fully unleashed.

Going forward, the PBC will continue to implement the overall arrangements of the State Council, focus on the theme of scientific development and transformation of the growth pattern, follow the principle of seeking progress amidst stability, properly handle the relationship among stable and fairly rapid growth, structural adjustments, and management of inflation expectations, and attach more importance to the goal of stable growth. The sound monetary policy will continue and the macroeconomic management measures will become more targeted, flexible, and forward-looking. Fine-tunings and preemptive adjustment measures will be strengthened to strike a balance among economic growth, price stability, and risk prevention. It is of vital importance to maintain a stable monetary environment and to create conditions for the internal self-adjustment and stability mechanism of the market economy to work. A variety of monetary policy tools will be used, and the macro-prudential policy framework will be improved to keep market liquidity at a reasonable volume and to guide money, credit, and all-system financing aggregates to grow in a stable and appropriate manner. Measures will also be taken to improve the effectiveness of monetary policy, optimize credit resource allocations, address structural problems in the supply and demand of credit, and strengthen financial services to the real economy. Steady steps will be taken to advance market-based interest-rate reform and to guide financial institutions to fully use their right to float interest rates. The RMB exchange-rate regime will be further improved to increase currency flexibility in both directions. Measures will be taken to promote the sound development of the financial market, to allow direct financing to play a greater role, and to meet diverse financing demands. Furthermore, efforts will be made to deepen the ongoing reform of financial institutions, to effectively prevent systemic financial risks, and to preserve the stability of the financial system.

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Part 1 Monetary and Credit Performance

In the third quarter of 2012, the China's economy continued to operate in a sound manner. Liquidity in the banking sector was abundant. Money, credit, and all-system financing aggregates saw relatively fast growth, and the credit structure improved further.

I. Money supply registered relatively fast growth

At end-September 2012, outstanding M2 stood at 94.4 trillion yuan, up 14.8 percent year on year, accelerating 1.2 percentage points over end-June. Outstanding M1 stood at 28.7 trillion yuan, up 7.3 percent year on year, accelerating 2.6 percentage points over end-June. Currency in circulation M0 totaled 5.3 trillion yuan, up 13.3 percent year on year, accelerating 2.5 percentage points over end-June. Net cash withdrawals in the first three quarters of 2012 totaled 268.4 billion yuan, 12.7 billion yuan more than that during the same period of the previous year.

Under the combined effects of a number of policy measures, such as open market operations, the deposit reserve requirement ratio, central bank lending and re-discounting, interest rates, and counter-cyclical macro-prudential measures, growth in the supply of aggregate money accelerated notably. At end-September, growth of M2 reached a new high since the latter half of 2011，and growth of M1 reached a new high to date in 2012. In particular, growth of M2 and M1 accelerated by 1.3 and 2.8 percentage points respectively from the end of August. The generally accommodative monetary stance was conducive to the stable and relatively rapid growth of the national economy.

At end-September, outstanding base money registered 23.6 trillion yuan, up 11.2 percent year on year and 1.14 trillion yuan more than that at the beginning of the year. The money multiplier stood at 4.00, which was 0.29 higher than that one year earlier, indicating robust money expansion. Liquidity in the banking sector was appropriate and abundant. At end-September, the excess reserve ratio of financial institutions stood at 2.1 percent, 0.7 percentage points higher than that in the previous year, and that of rural credit cooperatives (RCCs) stood at 3.8 percent, 0.4 percentage points higher year on year.

II. Deposits of financial institutions saw larger fluctuations

At end-September 2012, outstanding deposits in domestic and foreign currencies of all financial institutions (including foreign-funded financial institutions, the same hereinafter) stood at 92.6 trillion yuan, up 14.3 percent year on year and accelerating

1.1 percentage points over end-June. Outstanding deposits were 9.9 trillion yuan more that that at the beginning of the year, an acceleration of 1.7 trillion yuan year on year. Outstanding RMB deposits registered 90.0 trillion yuan, up 13.3 percent year on year, accelerating 1.0 percentage points from end-June. This was 9.0 trillion yuan more than that at the beginning of 2012, an acceleration of 924.3 billion yuan year on year. Influenced by factors such as the end-quarter performance evaluation and information disclosure, outstanding deposits continuously showed a trend of increasing substantially at the end of the season and dropping significantly at the beginning of the season. While new deposits in March, June, and September registered 3.0 trillion yuan, 2.9 trillion yuan, and 1.7 trillion yuan respectively, outstanding deposits at the beginning of each quarter of 2012 actually declined, dropping by 800 billion yuan, 465.6 billion yuan, and 500.6 billion yuan respectively at the beginning of January, April, and July. Outstanding deposits in foreign currencies posted USD413.8 billion at end-September, an increase of 61.9 percent year on year, or USD138.8 billion more than that at the beginning of 2012, which was USD108.8 billion more than the growth during the same period of the previous year.

Broken down by sectors, the growth of household deposits picked up and deposits of non-financial institutions increased steadily. At end-September, outstanding household deposits stood at 39.8 trillion yuan, up 18.1 percent year on year, accelerating by 0.9 and 2.0 percentage points respectively over end-June and end-March. This was 4.9 trillion yuan more than that at the beginning of 2012 and represented an acceleration of 1.3 trillion yuan year on year. Outstanding deposits of non-financial institutions registered 31.4 trillion yuan, up 7.9 percent year on year and accelerating by 2.2 and 1.7 percentage points from end-June and end-March respectively. This represented a rise of 1.4 trillion yuan compared with that at the beginning of year, constituting an acceleration of 95.5 billion yuan year on year. At end-September, outstanding fiscal deposits registered 3.3 trillion yuan, up 629.6 billion yuan from the beginning of the year and representing a deceleration of 534.1 billion yuan year on year.

III. Loan growth of financial institutions accelerated

At end-September, outstanding loans in domestic and foreign currencies of all financial institutions registered 65.5 trillion yuan, up 16.4 percent year on year, an acceleration of 0.5 percentage points over end-June. This was also 7.3 trillion yuan more than that at the beginning of the year, an acceleration of 1.3 trillion yuan year on year.

RMB loan extensions picked up. At end-September, outstanding RMB loans stood at 61.5 trillion yuan, up 16.3 percent year on year, the highest since September 2011, accelerating 0.3 percentage points over end-June. This was also 6.72 trillion yuan more than that at the beginning of 2012, an acceleration of 1.04 trillion yuan year on year. The growth of loans picked up for 5 successive months, indicating a strong desire on the part of financial institutions to extend loans to the real economy.

The overall credit structure continued to improve, with a remarkable rise in medium- and long-term loans and robust credit support to small- and micro-sized enterprises, agriculture, rural areas, and farmers. Growth of RMB loans to the household sector picked up, with loans to the household sector at end-September increasing 17.8 percent year on year, up 1.2 percentage points over end-June, yet down 3.1 percentage points over the end of 2011. This was 1.9 trillion yuan more than that at the beginning of 2012, at par with that during the same period of the last year. Loans to non-financial institutions and other sectors were relatively stable, growing 15.7 percent year on year at end-September, down 0.2 percentage points over end-June, but up 1.8 percentage points over the end of 2011. This was 4.8 trillion yuan more than that at the beginning of 2012 and represented an acceleration of 1.1 trillion yuan year on year. Broken down by maturities, the extension of medium- and long-term loans saw a larger increase. At end-September, medium- and long-term loans grew by 9.7 percent year on year, the highest growth in the past half-year and representing an increase of 2.4 trillion yuan from the beginning of the year. Newly extended medium- and long-term loans in the third quarter accounted for 42.1 percent of newly extended loans of all maturities, up 9.8 percentage points from the first half-year, and up 2.7 percentage points year on year. Short-term loans including bill financing went up 4.2 trillion yuan from the beginning of 2012, an acceleration of 1.5 trillion yuan year on year. Credit support to small- and micro-sized enterprises and agriculture, rural areas, and farmers remained robust. At end-September, outstanding RMB loans extended by the major financial institutions, rural credit cooperative financial institutions, urban credit cooperatives, and foreign-funded banks to small- and micro-sized enterprises rose 20.7 percent year on year, 9.9 and 4.0 percentage points higher than those extended to large- and medium-sized enterprises. In the first three quarters of 2012, domestic and foreign currency-denominated rural loans, agriculture loans, and farmer loans extended by major financial institutions, rural cooperative financial institutions, urban credit cooperatives, village and township banks, and finance companies increased by 2.0 trillion yuan, 323.3 billion yuan, and 494.1 billion yuan respectively, accelerating by 204.1 billion yuan, 88.7 billion yuan, and 11.1 billion yuan year on year. Broken down by institutions, loan growth of Chinese-funded large banks operating nationwide, Chinese-funded small and medium local banks, and rural cooperative financial institutions accelerated significantly year on year.

Table 1 RMB Loans of Financial Institutions in the First Three Quarters of 2012

Unit: 100 million yuan

	In first three quarters of 2012		In first three quarters of 2011	
	New loans	Acceleration year on year	New loans	Acceleration year on year
Chinese-funded large-sized national banks ①	31044	3270	27773	-5566

Chinese-funded small- and medium-sized national banks②	18507	750	17757	1039
Chinese-funded small- and medium-sized local banks③	9922	5833	4090	-371
Rural cooperative financial institutions④	10998	2162	8836	-1155
Foreign-funded financial institutions	559	-6	565	-545

Notes: ① Chinese-funded large-sized banks operating nationwide refer to banks with assets denominated in domestic and foreign currencies equivalent to no less than 2 trillion yuan (according to the amount of total assets in both domestic and foreign currencies at end-2008).
②Chinese-funded small- and medium-sized banks operating nationwide refer to banks operating across different provinces with assets of less than 2 trillion yuan denominated in domestic and foreign currencies.
③ Chinese-funded small- and medium-sized local banks refer to banks within a single province that have total assets of less than 2 trillion yuan denominated in domestic and foreign currencies.
④ Rural cooperative financial institutions refer to rural commercial banks, rural cooperative banks, and rural credit cooperatives.

Source: People's Bank of China.

Foreign currency-denominated loans grew steadily. At end-September, outstanding foreign-currency loans of financial institutions reached USD622.9 billion, up 18.9 percent year on year. This was USD84.5 billion more than that at the beginning of 2012, an acceleration of USD11.1 billion year on year. In terms of the loan structure, trade financing increased by USD56.7 billion, an acceleration of USD29.8 billion year on year, and overseas loans and medium- and long-term loans climbed by USD31.5 billion, an acceleration of USD5 billion year on year.

IV. All-system financing aggregates reached a historic high and the means of financing were diversified

According to preliminary statistics, in the first three quarters of 2011 all-system financing aggregates reached 11.73 trillion yuan, a historic high compared with the same period in previous years, an acceleration of 1.92 trillion yuan year on year.[1] In particular, all-system financing aggregates in September were 1.65 trillion yuan, 404.1 billion yuan, and 1.22 trillion yuan more than those in August and the same period of the previous year, and were higher than those in the same period of the previous year for 5 consecutive months. The main reason for the continuous growth in all-system financing aggregates during the first three quarters of 2012 was that RMB loans and trust loans accelerated since May and bond financing of enterprises was brisk. The above-mentioned three means of financing amounted to 8.99 trillion yuan,

[1] Year-on-year growth data in this report are calculated by comparable data.

an acceleration of 2.38 trillion yuan year on year and, in particular, an acceleration of 2.15 trillion yuan from May to September.

The financing structure showed the following characteristics: first, RMB loans registered a larger year-on-year increase and the extension of foreign currency-denominated loans accelerated. In the first three quarters of 2012, new RMB loans posted 6.72 trillion yuan, an acceleration of 1.04 trillion yuan year on year, accounting for 57.3 percent of all-system financing aggregates. New foreign currency-denominated loans posted the equivalent of 534.3 billion yuan, an acceleration of 57.3 billion yuan year on year and accounting for 4.6 percent of all-system financing aggregates. Second, bond financing of enterprises was brisk, bringing the share of direct financing to a historic high. Financing via the issuance of stocks and bonds in the first three quarters of 2012 amounted to 1.78 trillion yuan, an acceleration of 584.8 billion yuan year on year, accounting for 15.2 percent of all-system financing aggregates and hitting a record high. In particular, net bond financing of enterprises amounted to 1.56 trillion yuan, a historic high to date and an acceleration of 718.6 billion yuan year on year. Third, off-balance-sheet financing accelerated after decelerating for eight consecutive months. In the first three quarters, a total of 2.32 trillion yuan was financed through undiscounted bankers' acceptances, entrusted loans, and trust loans, an acceleration of 189.8 billion yuan year on year. Specifically, new trust loans registered 701.5 billion yuan, an acceleration of 617.6 billion yuan year on year.

Table 2 All-system Financing Aggregates Since the Beginning of 2002

Unit: 100 million yuan

	All-system Financing Aggregates ①	Of which:						
		RMB loans③	Foreign currency-denominated loans (RMB equivalent)	Entrusted loans	Trust loans	Undiscounted bankers' acceptances	Corporate bonds	Financing by domestic non-financial institutions via the domestic stock market
2002	20,112	18,475	731	175	—	-695	367	628
2003	34,113	27,652	2,285	601	—	2,010	499	559
2004	28,629	22,673	1,381	3,118	—	-290	467	673

2005	30,008	23,544	1,415	1,961	—	24	2,010	339
2006	42,696	31,523	1,459	2,695	825	1,500	2,310	1,536
2007	59,663	36,323	3,864	3,371	1,702	6,701	2,284	4,333
2008	69,802	49,041	1,947	4,262	3,144	1,064	5,523	3,324
2009	139,104	95,942	9,265	6,780	4,364	4,606	12,367	3,350
2010	140,191	79,451	4,855	8,748	3,865	23,346	11,063	5,786
2011	128,286	74,715	5,712	12,962	2,034	10,271	13,658	4,377
In the first three quarters of 2012	117,273	67,223	5,343	8,600	7,015	7,631	15,613	2,177

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

② Data for the current period are preliminary.

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

④"—" indicates that the data are not available or can be omitted due to a negligible transaction volume.

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

V. The deposit and lending rates of financial institutions declined

Affected by factors such as cuts in the benchmark deposit and lending rates and adjustments to the floating band of interest rates by the People's Bank of China on June 8 and July 6, the lending rates of financial institutions to non-financial institutions and other sectors generally declined. In September, the weighted average lending rate stood at 6.97 percent, down 0.09 percentage points compared with that at end-June. The weighted average interest rate of ordinary loans registered 7.18 percent, which was 0.37 percentage points lower than that at end-June. The weighted average bill financing rate posted 6.23 percent, up 1.16 percentage points compared with that at end-June. The weighted average residential rate declined steadily to 6.20 percent in September, down 0.48 percentage points compared with that at end-June.

The share of loans with interest rates applied to a lower floating range increased. In September， the share of loans with interest rates lower than the benchmark was 11.31 percent, up 3.39 percentage points from that in June, and the share of loans with interest rates flat with or higher than the benchmark stood at 24.57 percent and 64.12 percent respectively, down 0.51 and 2.87 percentage points from those in June.

Table 3 Shares of Loans with Rates Floating at Various Ranges of the Benchmark Rate, January through September 2012

Unit: %

Month	Lower than the benchmark	At the benchmark	Higher than the benchmark					
	[0.9，1.0）	1.0	Sub-total	(1.0，1.1]	(1.1，1.3]	(1.3，1.5]	(1.5，2.0]	2.0 以上
January	4.79	26.22	69.00	22.33	25.51	8.76	9.22	3.17
February	5.53	27.59	66.88	23.12	23.76	7.98	8.61	3.40
March	4.62	24.95	70.43	21.12	26.99	9.48	9.41	3.43
April	5.03	23.06	71.91	20.76	28.92	10.10	8.98	3.16
May	5.35	24.08	70.57	20.51	28.90	9.73	8.31	3.12
June	7.92	25.08	66.99	19.94	27.87	8.90	7.66	2.63
July	9.51	24.38	66.11	19.74	26.78	9.13	7.61	2.85
August	11.61	22.66	65.73	19.64	26.45	8.30	8.33	3.01
September	11.31	24.57	64.12	20.16	25.18	8.13	7.67	2.98

Note: The lower floating band for the statistical data in August and September 2012 was [0.7，1.0).

Source: People's Bank of China.

Affected by factors such as interest-rate movements on the international financial market and changes in domestic fund supply and demand, the demand interest rate and the weighted average interest rate of less than 3-month large-value US dollar deposits registered 0.17 percent and 0.63 percent in September, marking a decline of 0.09 percentage points and 1.44 percentage points respectively compared with the rates in June. The weighted average interest rate of less than 3 months and 3 months (inclusive) to 6 months US dollar loans posted 2.05 percent and 2.09 percent respectively, down 1.33 percentage points and 1.65 percentage points compared with the rates in June.

Table 4 Average Interest Rates for Large-value Deposits and Loans Denominated in US Dollars, January through September 2012

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	Above 1 year	Within 3 months	3-6 months (including 3 months)	6-12 months (including 6 months)	1 year	Above 1 year
January	0.34	3.29	4.24	4.73	5.46	5.87	3.78	4.35	4.81	4.47	4.27
February	0.29	3.16	3.93	4.34	4.64	4.50	3.51	4.08	4.35	4.28	4.29
March	0.27	2.91	3.61	4.34	4.76	5.35	3.56	4.00	4.36	4.03	3.53
April	0.21	2.69	3.54	3.97	4.40	3.32	3.54	3.96	4.44	4.07	3.99
May	0.26	2.37	3.33	3.92	4.12	4.16	3.50	4.11	4.27	4.21	3.90
June	0.26	2.07	2.93	3.39	4.07	4.36	3.38	3.74	3.72	4.02	4.10
July	0.19	2.80	2.57	3.06	3.78	2.13	3.01	3.29	3.54	3.00	3.76
August	0.20	0.96	2.08	2.43	3.21	1.59	2.48	2.70	3.11	2.44	4.04
September	0.17	0.63	1.45	1.65	2.13	1.88	2.05	2.09	2.24	2.15	3.36

Source: People's Bank of China.

VI. The flexibility of the RMB exchange rate increased significantly

In the third quarter of 2012, the RMB exchange rate moved in both directions yet remained stable, with much stronger flexibility and stable expectations. At end-September, the central parity of the RMB against the US dollar was 6.3410 per dollar, representing a depreciation of 161 basis points or 0.25 percent over end-June. From the reform of the RMB exchange-rate regime in July 2005 to end-September

2012, the RMB appreciated a cumulative 30.52 percent against the US dollar. The BIS estimated that in the third quarter the nominal effective exchange rate of the RMB depreciated 1.41 percent and the real effective exchange rate depreciated 0.99 percent, and from the RMB exchange-rate regime reform in 2005 to end-September 2012 the nominal effective RMB exchange rate appreciated 21.39 percent and the real effective exchange rate appreciated 28.76 percent.

Part 2 Monetary Policy Operations

In line with the overall arrangements of the State Council, the PBC continued to implement a prudent monetary policy in the third quarter of 2012, with a focus on making policies more forward-looking, better targeted, and more flexible and making timely preemptive adjustments and fine-tunings. The PBC further cut benchmark deposit and lending rates and widened the floating band of lending rates; conducted consecutive reverse repo operations in response to the evolving liquidity supply and demand, satisfying the reasonable liquidity needs in the banking system and guiding stable movements of market interest rates; encouraged financial institutions to continue improving the credit structure; moved forward with financial corporation reform; and further enhanced the floating flexibility of the RMB exchange rate.

I. Flexible open market operations

Based on close monitoring of domestic and international economic and financial developments and liquidity movements in the banking system, in the third quarter the PBC conducted flexible reverse repo operations in the open market, contributing to proper liquidity aggregates and stable liquidity movements in the banking system. Reverse repos were conducted with carefully designed turnover and frequency in response to changes in the supply and demand gap in the banking system, thus providing liquidity as appropriate and properly adjusting liquidity in the banking system. Reverse repos in the third quarter totaled 2.3 trillion yuan on a cumulative basis, while outstanding reverse repos reached 650 billion yuan at end-September. The maturity structure for reverse repos was improved. While combining 7-day and 14-day reverse repos, the PBC introduced 28-day reverse repo operations to address the short-term volatility in liquidity supply and demand caused by seasonal factors. The PBC properly managed the flexibility of reverse repo interest rates, which guided market expectations and contributed to stable movements of interest rates in the money market. At end-September, interest rates for 7-day, 14-day, and 28-day reverse repo operations were 3.35 percent, 3.45 percent, and 3.60 percent respectively.

The PBC properly conducted state treasury cash management operations. In the third quarter, the PBC deposited 170 billion yuan of state treasury funds in commercial banks on four separate operations, including 130 billion yuan of 3-month deposits and 40 billion yuan of 6-month deposits.

II. Further cuts in the benchmark deposit and lending rates and adjustments to the floating band of lending rates

As inflationary expectations moderated, the PBC further cut the benchmark deposit and lending rates on July 6, lowering the 1-year benchmark deposit rate from 3.25 percent to 3.00 percent and the 1-year benchmark lending rate from 6.31 percent to 6.00 percent, down by 0.25 percentage points and 0.31 percentage points respectively. At the same time, the floor of the floating band for lending rates was lowered to 70 percent of the benchmark lending rate. These adjustments created a more favorable policy environment for companies to reduce borrowing costs by promoting a decline in the interest rates of loans to companies by financial institutions.

Box 1 Shanghai Interbank Borrowing Rate (Shibor)

As a reference for the pricing of financial products, the market benchmark interest rate is one of the key components in the financial infrastructure required for market-based interest-rate reform. After a gradual process of interest-rate deregulation, the priority in advancing the market-based interest-rate reform shifted to developing money-market benchmark interest rates in China, which led to the creation of the Shanghai interbank borrowing rate (Shibor) in 2007. The Shibor follows the general technical practices adopted by the Libor, Euribor, Sibor, and other major international money markets, but its institutional arrangements had been designed to adapt to circumstances in China. In particular, the Shibor has stronger market discipline and supervision of quotations, which makes it unique among the international market benchmark rates.

The Shibor follows internationally adopted practices in interest-rate generation and selection of banks that provide quotations. The Shibor rates are unguaranteed wholesale simple interest rates, calculated as an arithmetic average of the interbank borrowing rates for RMB provided by a group of banks with high credit ratings. The Shibor has 16 maturity products, ranging from overnight to 1-year, 8 of which are publicly available. The design of the Shibor's generation system and selection of quotation banks drew on the examples of the major international money markets. First, the benchmark rates are generated by calculating the arithmetic average of quotations provided by quotation banks at a fixed time each day, after removing the highest and lowest quotations, and released by the National Interbank Funding Center, a third-party institution. Second, quotations are provided by banks with high credit ratings, large turnover in the money market, and a strong interest-rate pricing capacity. There are 18 quotation banks for the Shibor, including state-owned commercial banks, joint-stock commercial banks, city commercial banks, and foreign-funded banks. The diversity of quotation banks in terms of assets, business models, and competitiveness insures that the quotations have wide representation, which is important for discovering market prices and reflecting market liquidity developments.

The Shibor has developed institutional arrangements that focus on market discipline and supervision of quotations. Taking into account China's circumstances and its stage of financial market development, China developed the *Rules on Implementing the Shibor* as the Shibor was introduced to ensure its steady functioning.

First, responsibility for supervision is defined. The *Rules on Implementing the Shibor* provide a detailed description of the definition of the Shibor and standards for selecting quotation banks, as well as clear provisions on supervision of quotations and supported by mechanisms designed to prevent quotation violations. According to the *Rules*, the Shibor Working Group assesses quotation behavior monthly, quarterly, and annually, and examines the performance of the National Interbank Funding Center, as the designated publisher, on an annual basis. The National Interbank Funding Center examines the quality of quotations, urging banks to rectify and reporting to the Shibor Working Group if any violations are discovered.

Second, incentives are provided and trading obligations are highlighted. In accordance with the *Rules*, the *Indicators for Assessing the Quality of Quotations by Shibor Quotation Banks* have been developed, highlighting that quotations must be based on trading interest rates in the money market, and defining a series of indicators, including the influence in the funding market and the tradability of the quotations. This encourages the quotation banks to provide pricing on the basis of real trading and highlights the trading obligation for the quotations, ensuring the accuracy and objectivity of the quotations. Quotation banks are also subject to annual quality examinations of their quotations and will be disqualified if they rank last in the examination.

Third, third-party assessments are introduced to enhance market oversight. The assessment examination of quotation banks involves the National Interbank Funding Center, which, as a third party, conducts statistics and monitoring of money-market trading on a transaction-by-transaction basis and sends a quarterly electronic questionnaire on quotation quality, the result of which constitutes one indicator of the quality assessment. The assessment and examination process is also open to any participants in money-market trading, making sure that the results are objective and just.

These unique institutional arrangements help make sure that quotations are accurate and objective, and they enhance the Shibor's position as a benchmark. They also play an important role in avoiding Libor-style violations. After five years in operation, the Shibor has become an important benchmark in the Chinese financial market. It reflects money-market developments, movements of banking system liquidity, and policy expectations. It is adopted as a benchmark for pricing floating interest-rate bonds and derivatives, and it is used as a pricing reference for funding, repos, bills, and short-term financing bills. The development of the Shibor also encourages commercial banks to improve their own pricing mechanism. Commercial banks have now set up a preliminary profit-oriented interest-rate pricing framework and have put into place pricing mechanisms, including market-based products, lending, and internal transfers, contributing to a notably stronger risk pricing ability.

Going forward, the Shibor Working Group will continue to improve the Shibor generation mechanism, encourage Shibor-based financial product innovation, and strengthen supervision of the quotation banks in order to improve the Shibor's institutional capacity and to raise its credibility and its status as a benchmark.

III. Strengthened window guidance and credit policy guidance

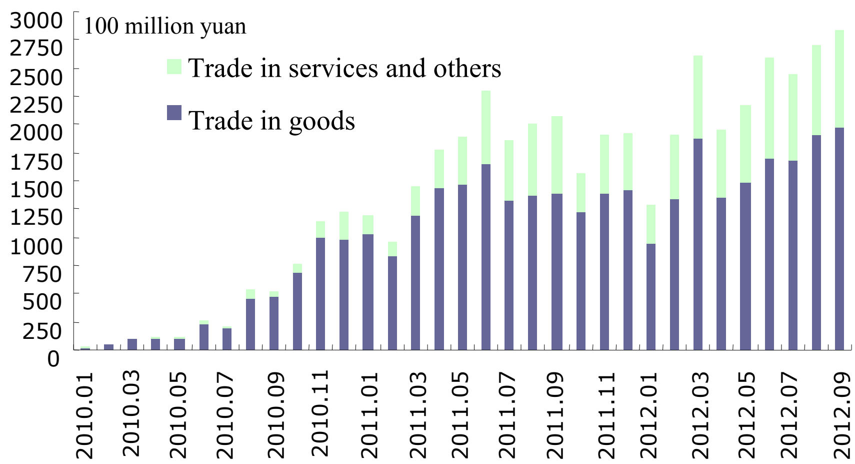
Following a differentiated approach to credit guidance, the PBC enhanced coordination between credit policy and industrial and regional development policies, and encouraged financial institutions to improve the credit structure and to strengthen financial services to the real economy and the people's livelihood in order to accelerate economic restructuring and shifts in the economic development pattern. The PBC promoted innovations in financial products and services and increased financial support to agriculture, rural areas, and farmers, including modern agricultural production, reform of collective forest rights and farmland irrigation programs, and to small and micro-sized enterprises. Efforts were made to satisfy the financial needs of railway projects and other key ongoing or follow-up national projects, and to step up financial support and financial services to the people's livelihood, including programs on employment, and for students in financial difficulties, poverty reduction, ethnic minorities, and migrant workers. The PBC guided financial institutions to improve financial services to scientific and technological innovation, cultural industry development, and other strategic emerging industries, and promoted the development of low-carbon financing. In line with the central government's regional development policies, the PBC improved financial support and financial services for regional development programs to promote regional economic restructuring and industrial redistribution. The PBC continued to support the development of affordable housing and small and medium-sized ordinary commercial residential property as well as purchases by first-time home buyers while restricting speculative trading. The PBC reined in lending to industries with heavy energy consumption, high emissions, and excessive capacity.

IV. Development of cross-border use of RMB

RMB settlement of cross-border trade and investment continued to grow rapidly. According to preliminary data, in the third quarter RMB settlement of cross-border trade recorded 798.96 billion yuan, up 34 percent year on year. This included 555.50 billion yuan in goods trade and 243.46 billion yuan in exports of services and other items under the current account. In the first three quarters, RMB settlement of cross-border trade totaled 2.1 trillion yuan, an increase of 32 percent year on year. Actual RMB receipts and payments under the RMB settlement of cross-border trade reached 929.08 billion yuan and 1118.96 billion yuan respectively, bringing the receipt-to-payment ratio from 1:1.4 in the first six months of 2012 to 1:1.2. In the first three quarters, RMB settlement of cross-border direct investments reached 176.61 billion yuan, including 22.10 billion yuan in outbound direct investments and 154.51

billion yuan in foreign direct investments.

Figure 1 RMB settlement of cross-border trade



Source: People's Bank of China.

New progress was made in building a cross-strait currency clearing mechanism. On August 31, monetary authorities on both sides of the strait signed the *Memorandum of Cooperation on Cross-strait Currency Clearing*, agreeing that the two sides will build a cross-strait currency clearing mechanism in accordance with the principles and cooperation framework established in the *Memorandum*, and each side will choose one currency clearing institution to carry out the settlement and clearing of local currency for the other side. This represents major progress in cross-strait financial cooperation and will play an active role in facilitating cross-strait investment and trade and in deepening cross-strait economic and trade ties.

V. Improvements in the RMB exchange-rate regime

The PBC further improved the RMB exchange-rate regime reform in line with the principle of making it a self-initiated, controllable, and gradual process. Focusing on the role of market supply and demand and adjustments with reference to a basket of currencies, the PBC enhanced the flexibility of the RMB exchange rate and kept it basically stable at an adaptive and equilibrium level. In the third quarter, the central parity of the RMB against the US dollar peaked at 6.3112 yuan per dollar and reached a trough of 6.3495 yuan per dollar. It appreciated on 33 out of the 65 trading days, and depreciated on the remaining 32 trading days, with the largest intraday appreciation at 0.16 percent (or 103 points), and the sharpest intraday depreciation at 0.25 percent (or 158 points).

The RMB exchange rate moved in both directions against the euro, the Japanese yen, and other major international currencies. At end-September, the central parity of the RMB against the euro registered 8.1885 yuan per euro, an appreciation of 3.88

percent from end-June, and the central parity of the RMB against the Japanese yen stood at 8.1648 yuan per 100 Japanese yen, an appreciation of 2.49 percent from end-June. Beginning from the reform of the RMB exchange-rate regime in 2005 to end-September 2012, on a cumulative basis the RMB appreciated 22.29 percent against the euro and depreciated 10.56 percent against the Japanese yen.

Table 5 Turnover of RMB Against Foreign Currencies in the Interbank Spot Foreign Exchange Market in the Third Quarter of 2012

100 million yuan

Currency	US dollar	euro	Japanese yen	Hong Kong dollar	Pound sterling	Australian dollar	Canadian dollar	Malaysian ringgit	Russian ruble	Thai baht
Turnover	52932.0	229.3	3398.0	489.4	5.9	41.4	0.6	2.8	17.2	3.9

Source: China Foreign Exchange Trading System.

VI. Deepened reform of financial institutions

Transformation of asset management companies made steady progress. On September 25, China Huarong Asset Management Co., Ltd. held its inaugural meeting in Beijing. The company has registered capital of 25.8 billion yuan, 98.06 percent of which is held by the Ministry of Finance and the remaining 1.94 percent is held by China Life Insurance (Group) Corporation. In accordance with the law, China Huarong has established a modern governance structure that consists of a shareholders assembly, board of directors, board of supervisors, and management. China Huarong will focus on banking business as well as trust, leasing, and other banking-related businesses while continuing to resolve non-performing loans.

Remarkable achievements were made in reforming the rural credit cooperatives (RCC). First, the RCCs' asset quality improved significantly. Based on the five-category loan classification, at end-September outstanding NPLs at the RCCs dropped to 352.8 billion yuan, or 4.5 percent, down by 12.1 billion yuan or 1 percentage points from end-2011, and the capital adequacy ratio rose 0.4 percentage points to 11.1 percent from end-2011. Second, the size of RCC business expanded significantly. At end-September, deposits at RCCs increased to 11.5 trillion yuan, or 12.8 percent of total deposits at all financial institutions, up 0.3 percentage points from end-2011, while RCC lending rose to 7.8 trillion yuan, or 12.6 percent of total lending by all financial institutions, an increase of 0.4 percentage points from end-2011. Third, agro-linked lending by RCCs grew rapidly. Outstanding agro-linked loans reached 5.3 trillion yuan at end-September, up 16.9 percent year on year. Fourth, steady progress was made in terms of RCC property rights reform. As of end-September, a total of 1,859 RCCs with legal-person status at the county (city) level, 276 rural commercial banks, and 163 rural cooperative banks were established.

Box 2 The 12th Five-year Plan for Financial Sector Development and Reform

On September 17, 2012, China released the *12th Five-year Plan for Financial Sector Development and Reform* (hereinafter the *Plan*). As a special national five-year plan approved by the State Council, the *Plan* was jointly completed by the PBC, CBRC, CSRC, CIRC, and SAFE in line with China's *12th Five-year Plan for Economic and Social Development* and relevant documents approved by the 2012 National Financial Work Conference.

The *Plan* begins with a review of the major achievements in financial sector development and reform during the 11th five-year plan period, followed by an analysis of the opportunities and challenges for financial-sector development in the 12th five-year plan period. It sets out the guiding philosophy, key objectives, and policy measures for advancing financial sector development and reform during the 12th five-year plan period, and identifies seven major tasks, i.e., improving financial management, updating the organizational structure, building financial markets, deepening financial reform, expanding opening-up, safeguarding financial stability, and enhancing infrastructure.

The 12th five-year plan period remains an important strategic opportunity period for the financial sector in China. It will be a key juncture for economic restructuring as well as a key time for financial development and reform. It is of great importance that China chose to release the *Plan* at this point in time to define the tone and direction of financial development and reform. Taking into account both domestic and global developments, the *Plan* provides a comprehensive and systematic plan for future financial sector reform and development that is substantiated by forward-looking strategies, feasible development objectives, and innovative policy measures, making it one of the overarching documents that guide financial sector development in the 12th five-year plan period.

Quantitative targets for financial-sector aggregates and structure are set out for the first time. The *Plan* identifies two quantitative targets for the 12th five-year plan period, i.e., financial service value-added as a percentage of GDP remains around 5 percent, and direct financing by non-financial corporations as a percentage of aggregate social financing rises to over 15 percent. This indicates the financial sector will grow in line with the real economy, focusing on the quality and pace of growth and striving for breakthroughs while ensuring consistency and stability. This also testifies to the importance of financial structural adjustments.

The *Plan* highlights the fundamental principle that financial development must serve the real economy. Drawing on the lessons from the subprime mortgage crisis in the United States, the *Plan* establishes that financial development must serve the real economy, and the flow of funds away from the real economy to the virtual economy as well as financial speculation must be controlled to prevent an industrial hollowing-out. Efforts shall be made to further increase financial support to scientific and technological innovation and economic restructuring, to the establishment of a national innovation framework, and to new energy, new materials, and other emerging strategic industries by improving the financial institutional system and the financial market system and by enhancing capacity for better financial services.

The *Plan* highlights the fundamental role of the market in allocating financial resources. *Market-based reform* is the tone and key word in the *Plan*. During the five-year plan period, China will continue to advance market-based reforms in key financial areas and key links and expects to make notable progress in market-based interest-rate reform, exchange-rate regime reform, cross-border use of RMB, RMB convertibility under the capital account, and the opening of the financial sector to private investments. The *Plan* also includes measures to deepen market-based reform of share issuances.

The *Plan* emphasizes that monetary policy will shift away from quantity-oriented management to price-oriented management. According to the *Plan*, efforts will be made to enhance macro-financial management, establish a countercyclical financial macro-prudential policy framework, improve the monetary policy management system, and further strengthen coordination among macroeconomic policies. The *Plan* presents an outline of the future monetary policy framework: In terms of the final objectives, price stability, or stability in price levels in a broader sense, will be given greater prominence. Among intermediate objectives, exclusive attention to money supply and new lending will be complemented by analysis of aggregate social financing. Regarding policy tools, the *Plan* envisages a shift from quantitative tools to interest rates and other price-based tools, and clearly states that efforts will be made to strengthen the role of open market operations in guiding money-market interest rates.

The *Plan* highlights the importance of deepening reforms of the financial organizational system and financial institutions. The *Plan* endorses efforts to guide financial institutions that satisfy the necessary conditions and have a clear strategy for financial conglomeration and an effective risk prevention system to run financial conglomerates on a pilot basis, and encourages pilot financial institutions to make decisions on financial conglomeration on the basis of their risk management capacity and comparative advantages. Financial institutions must pay special attention to the building of a risk prevention mechanism in advancing the financial conglomeration pilot program. Efforts will be made to continue to deepen the reform of large financial institutions, including further improving the governance structure and defining the responsibilities of the shareholders assembly, board of directors, board of supervisors, and management, thereby building effective mechanisms for decision-making, execution, and checks and balances. Action will be taken to encourage greater diversity in the shareholding structure of financial institutions, to explore a reasonable share of state-held shares in financial institutions owned and held by the state, and to improve the state-owned financial asset management system.

The *Plan* highlights the importance of establishing and improving the deposit insurance scheme and other financial safety nets. The authorities will continue to enhance financial regulation and supervision, make regulatory coordination more effective, and enhance pre-warning of systemic financial risks to avoid the eruption of any systemic or regional financial crises. On financial institution bankruptcy, the *Plan* stresses that measures will be taken to develop financial institution bankruptcy laws that suit Chinese circumstances, to define the procedures for financial institutions to exit from the market, and to establish a deposit insurance scheme. It is of great importance that a deposit insurance scheme and a wider financial risk prevention system be built as the market-based interest-rate reform makes progress and small- and medium-sized financial institutions develop at a rapid pace.

The *Plan* sets out the course of direction for capital market development. Priorities identified in the *Plan* include: improving a multi-layer capital market system by developing the bond market, improving the equity market and promoting the development of the futures market and financial derivatives market; encouraging securities company to enhance their strengths and to make securities and futures companies more competitive; developing asset management companies and encouraging greater diversity in institutional investors; advancing the reform of the system of share issuances; improving the exit procedures for public companies and promoting the healthy development of public companies; and regulating the development of venture capital funds and equity investment funds.

The *Plan* highlights the importance of achieving full coverage of financial services. The *Plan* calls for efforts to accelerate the establishment of an organizational system for community financial services and to improve the system for rural financial services; support small- and medium-sized enterprises to take advantage of the capital market; encourage insurers to provide more insurance products and to expand coverage of insurance services; encourage the banking, securities, and insurance sectors to enhance their financial services and to expand financial service coverage to address weaknesses in rural financial services and financing difficulties of small- and micro-sized enterprises, thereby making financial services more inclusive.

VII. Deepened reform of foreign exchange administration

Risk prevention was given top priority, and the systems and mechanisms designed to prevent cross-border capital flows were improved. Efforts were made to improve contingency policies against sharp volatility in cross-border capital flows, in particular irregular capital flows, by intensifying the frequency and intensity of monitoring and analysis and by reviewing potential foreign exchange risks. Monitoring and warning of foreign exchange risks in the banking system were strengthened. Off-site inspections and special inspections were conducted, and a tougher position was taken on key cases and on underground banking activities. As of end-September, a total of 2,263 cases were handled, and total fines and confiscations reached 304 million yuan.

Reform of the foreign exchange administration for trade in goods was implemented nationwide. Drawing on the experiences from the pilot programs, effective August 1 the reform of the foreign exchange administration for trade in goods was adopted across the country, replacing the existing case-by-case verification and writing-off policy for foreign exchange receipts and payments for trade in goods with a process that focuses on oversight over the aggregate amount and features continuous monitoring and category-specific supervision, thereby contributing to better risk prevention. Measures were taken to update the procedures for export declarations, streamline requirements for export rebates, and enhance joint supervision. As a result of steady and orderly progress in the reform, administrative approvals are noticeably reduced, foreign exchange receipts and payments for companies now take less time and are more efficient at banks, and regulatory synergy is improved, striking the right balance between facilitating trade and enhancing regulatory effectiveness.

Administration approaches and measures for the capital account were reformed. Procedures were streamlined and simplified based on a stocktaking of the regulations on direct investment, the capital market, and external debt management. Existing information systems for capital account management were integrated to lay a solid foundation for further promoting capital account convertibility. The Qualified Foreign Institutional Investor (QFII) and Qualified Domestic Institutional Investor (QDII) scheme were pushed forward steadily. In the first three quarters, the authorities approved an investment quota of USD 9.18 billion for 72 foreign institutional investors under the QFII scheme, and USD 10.65 billion for 16 institutional investors under the QDII scheme. As of end-September, the authorities had approved an investment quota of 39 billion yuan for 21 investors under the RMB QFII (RQFII) scheme, and had increased the investment quota for QFII and RQFII by 50 billion US dollars and 50 billion yuan respectively.

Measures were taken to facilitate trade and investment. Foreign exchange policies were simplified to make it easier for companies to send back outbound direct investments and to lend in foreign currencies in overseas markets, and for individuals to make external guarantees in an effort to support the going global of private capital. The floor of the bank position on a cash basis was removed and replaced by a band for the overall position of bank foreign exchange sales and purchases. Access to the foreign exchange market was made easier, more trading modalities were provided for currency swaps, and the pilot chartered business of local and foreign-currency exchange by individuals was expanded. Efforts were made to promote individuals' foreign exchange sales and purchases via online banking.

Part 3 Financial Market Analysis

In the third quarter of 2012, China's financial market continued to perform in a sound manner. Transactions on the money market increased significantly, while interest rates generally declined. Bond market indices declined slightly and bond issuances grew significantly. Stock indices went down, and both transactions and financing on the stock market declined.

I. Financial market analysis

1. Transactions on the money market increased significantly, and interest rates generally declined

Repo transactions and interbank borrowings on the money market were brisk, with the trading volume increasing significantly. In the first three quarters of 2012, the turnover of bond repos on the interbank bond market totaled 107.8 trillion yuan, with an average daily turnover of 573.3 billion yuan, up 49.2 percent year on year. The turnover of interbank borrowings reached 36.2 trillion yuan, with an average daily turnover of 192.6 billion yuan, an increase of 50.9 percent year on year. Overnight products still dominated bond repo and interbank borrowing transactions, accounting for 80.7 percent and 87.6 percent of their respective turnover, up 5.2 and 3.4 percentage points from the same period of the last year. The turnover of government securities on the stock exchanges soared 80.5 percent year on year to 24.5 trillion yuan.

In terms of financing entities, the flow of funds among financial institutions in the first three quarters of 2012 showed the following characteristics: first, domestically-funded large banks, on a whole, remained net fund providers, and the amount of their net lending continued to increase, totaling 49.5 trillion yuan in the first three quarters of 2012, 29.5 trillion yuan more than that during the same period of the last year. In particular, domestically-funded large banks became net lenders on the interbank borrowing market, and the amount of their net lending increased substantially; in contrast, during the same period of the last year they were net borrowers. In the first three quarters of 2012 net interbank lending of domestically-funded large banks amounted to 6.0 trillion yuan, 7.7 trillion yuan more that during the same period of the last year. Second, domestically-funded small- and medium-sized banks, securities and fund management companies, and other financial institutions had an increasing demand for financing, and their net borrowing registered 21.9 trillion yuan, 12.0 trillion yuan, and 9.7 trillion yuan respectively in the first three quarters of 2012, 15.2 trillion yuan, 7.0 trillion yuan, and 3.1 trillion yuan more than that during the same period of the last year. Furthermore, small- and medium-sized banks and foreign financial institutions became net borrowers, as opposed to being net lenders during the same period of the last year.

Table 6 Fund Flows Among Financial Institutions in the First Three Quarters of 2012

Unit: 100 million yuan

	Repo		Interbank borrowing	
	In the first three quarters of 2012	In the first three quarters of 2011	In the first three quarters of 2012	In the first three quarters of 2011
Domestically-funded large banks ①	-434,461	-216,016	-60,470	16,355
Domestically-funded small- and medium-sized banks ②	211,189	95,275	8,287	-27,808
Securities and fund management companies	92,837	42,429	26,892	7,214
Insurance companies	37,320	19,055	—	—
Foreign-funded financial institutions	14,507	5,441	6,768	-7,632
Other financial institutions ③	78,608	53,816	18,523	11,871

Notes: ① Domestically-funded large banks include the Industrial and Commercial Bank of China, the Agricultural Bank of China, the Bank of China, the China Construction Bank, the China Development Bank, the Bank of Communications, and the Postal Savings Bank of China. ② Domestically-funded small- and medium-sized banks include the China Merchants Bank and 16 other medium-sized banks, city commercial banks, rural commercial banks, rural cooperative banks, and village and township banks. ③ Other financial institutions 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, other investment vehicles, and so forth. ④A negative sign indicates net lending and a positive sign indicates net borrowing.
Source: China Foreign Exchange Trade System.

In the third quarter of 2012, interest rates on the money market witnessed some fluctuations and in general were lower than those during the same period of the last year. Although interest rates on the money market were relatively stable in July and August, they gradually moved up in late September due to seasonal factors such as large cash withdrawals from the banking sector before the National Day holidays, and quarter-end performance evaluations. In September, the weighted average interest rate of bond-pledged repo and interbank borrowing posted 3.01 percent and 2.93 percent respectively, up 20 and 21 percentage points from June, but down 74 and 81 basis points from the same period of the last year. As the People's Bank of China injected liquidity into the banking sector by continuously conducting reverse repos, interest rates on the money market generally declined. At end-September, the overnight and 7-day Shibor rates stood at 3.28 percent and 3.19 percent, down 32 and 92 basis points from end-June, and the 3-month and one year Shibor rates stood at 3.69 percent and 4.40 percent, down 39 and 35 basis points from end-June.

Trading of RMB interest-rate swaps and forward products declined slightly. In the first three quarters of 2012, there were 16,138 transactions of RMB interest-rate swaps, and their aggregate nominal principal amounted to 19,745.1 billion yuan, down 8.4 percent year on year. In terms of the maturity structure, RMB interest-rate swaps with maturities of one year or less traded most briskly, and their nominal principal amounted to 14,632.4 billion yuan, accounting for 74.1 percent of the total. 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 nominal principal accounted for 52.0 percent and 42.2 percent of the total. Transactions of bond forwards posted 16.61 billion yuan, and the nominal principal of interest-rate forwards amounted to 100 million yuan.

Table 7 Transactions of Interest-rate Derivatives, 2007--Q3 2012

	Interest-rate swaps		Bond forwards		Forward-rate agreements	
	Transactions	Amount of notional principal (100 million yuan)	Transactions	Amount of notional principal (100 million yuan)①	Transactions	Amount of notional principal (100 million yuan)
2007	1,978	2,186.9	1,238	2,518.1	14	10.5
2008	4,040	4,121.5	1,327	5,005.5	137	113.6
2009	4,044	4,616.4	1,599	6,556.4	27	60.0
2010	11,643	15,003.4	967	3,183.4	20	33.5
2011	20,202	26,759.6	436	1,030.1	3	3.0

Q1 2012	4,317	4,913.7	45	144.6	—	—
Q2 2012	5,173	6,821.2	7	15.9	2	1.0
Q3 2012	6,648	8,010.3	4	5.7	—	—

Note： ① In 2009 the statistics for forward bond transactions were changed to the settlement amount.

Source: China Foreign Exchange Trade System.

2. Indices of the interbank bond market declined somewhat, and bond issuances grew significantly

The volume of spot trading increased steadily on the interbank bond market. In the first three quarters of 2012, the turnover of spot bond trading totaled 54.8 trillion yuan, with a daily average of 291.3 billion yuan, up 14.1 percent year on year. In terms of trading entities, domestically-funded large banks and foreign financial institutions were net bond buyers on the interbank spot bond market, with net purchases of 364.8 billion yuan and 106.6 billion yuan respectively; domestically-funded small- and medium-sized banks, and securities and fund management companies were net bond sellers, with net sales of 330 billion yuan and 178.6 billion yuan respectively. A total of 69.2 billion yuan of spot government securities was traded on the stock exchanges in the first three quarters, 29.7 billion yuan less than that during the same period of the last year.

Bond indices on the interbank market declined somewhat. The China Bond Composite Index (net price) declined from 102.3 points at end-June to 101.1 points at end-September, or down 1.2 percent, while the China Bond Composite Index (full price) declined from 112.9 points at end-June to 111.8 points at end-September, or down 1.0 percent. The index of government securities on the stock exchanges rose from 133.7 points at end-June to 134.8 points at end-September, or up 0.8 percent.

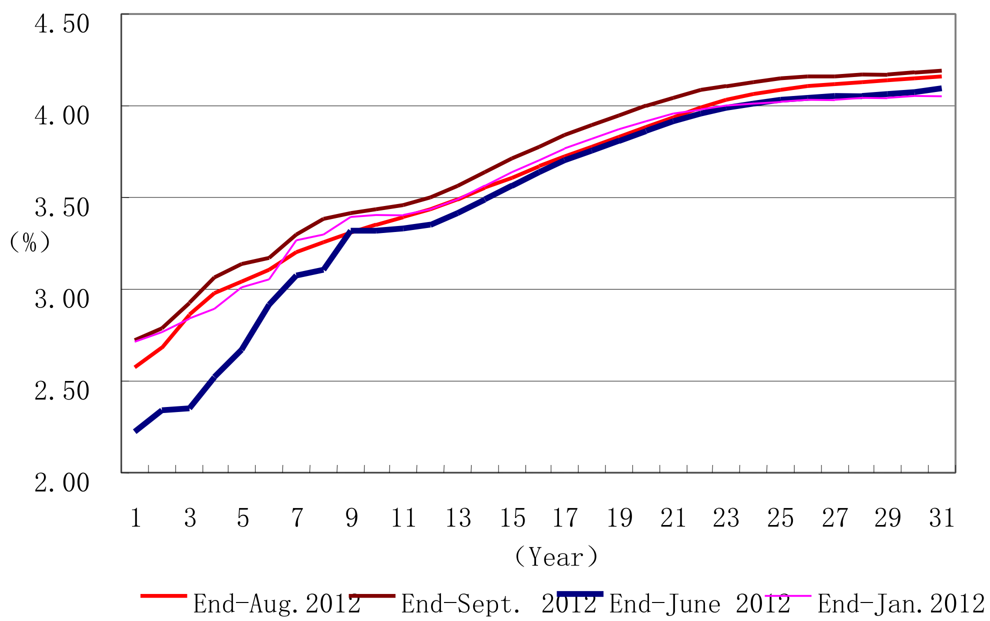


Figure 2 Yield curves of government securities on the interbank bond market

The yield curves of government securities showed an upward trend. At end-September, the average yields of 6-month, 5-year, 10-year, and 20-year government securities were 50, 25, 13, and 12 basis points higher respectively than those at end-June, and the yield curves of government securities leveled off somewhat during their upward movements.

Bond issuances grew significantly. In the first three quarters of 2012, a total of 5.84 trillion yuan of bonds (excluding central bank bills) was issued, 1.15 trillion yuan more than that during the same period of the last year. In particular, the issuance of enterprise bonds, super short-term commercial paper, and private placement of debt-financing instruments saw a larger increase, with respectively 382.3 billion yuan, 236.1 billion yuan, and 226 billion yuan more than that during the same period of the last year. At end-September, a total of 23.0 trillion yuan of bonds was deposited with the China Government Securities Depository Trust and Clearing Co., Ltd., an increase of 11.3 percent year on year. The Shibor played a greater role in bond pricing. In the first three quarters of 2012, 298 fixed-rate enterprise bonds issued on the primary bond market were all based on the Shibor, with a gross issuance volume of 434 billion yuan. In addition, a total of 265.7 billion yuan of short-term fixed-rate financing bills based on the Shibor was issued, accounting for 46 percent of the total issuance of short-term fixed-rate financing bills.

Table 8 Issuance of Bonds in the First Three Quarters of 2012

Type of bonds	Issuances (100 million yuan)	Year-on-year growth (100 million yuan)
Government securities	13,317	-700
Of which: Municipal bonds	2,473	1,057
Policy financial bonds issued by the China Development Bank and other policy banks	16,791	623
Bank subordinate bonds and hybrid bonds	607	-1,063
Bank ordinary bonds	1,565	1,545
Corporate debenture bonds①	25,892	10,180
Of which: Enterprise bonds②	5,399	3,823
Short-term financial bills	5,739	-1,442
Super short-term commercial paper	4,151	2,361
Medium-term notes	6,166	1,365
Corporate bonds③	1,602	628

Notes: ① Including enterprise bonds, short-term financing bills, super short-term commercial paper, medium-term notes, collective bills of SMEs, privately placed bond-financing instruments, asset-backed bills, corporate bonds, convertible bonds, bonds with detachable warrants, privately placed SME bonds, and so forth.

②Referring to bonds issued by non-publicly listed companies, which are governed by the *Administrative Measures on Enterprise Bonds* promulgated by the National Development and Reform Commission.

③Referring to bonds issued by publicly listed companies, which are administered by the China Securities Regulatory Commission in accordance with the *Law of the People's Republic of China on Securities*.

Sources: People's Bank of China, China Government Securities Depository Trust and Clearing Co., Ltd.

Box 3 Promoting Innovation and Development of Corporate Debenture Bonds in a Market-oriented Manner

In 2004, *Some Opinions of the State Council on Promoting the Reform, Opening, and Steady Growth of Capital Markets* (State Council Document [2004] No.3) was issued, allowing eligible enterprises to access debt financing. Thereafter, the People's Bank of China, jointly with the National Development and Reform Commission and the China Securities Regulatory Commission, earnestly implemented the arrangements of the State Council and in 2012 set up an inter-ministerial conference mechanism for corporate debenture bonds. In order to promote the development of the corporate debenture market in cooperation with industry entities, efforts were made to promote market products and tool innovations and to strengthen market self-regulation so as to serve eligible investors in line with market-based principles and to give priority to the development of over-the-counter markets.

The corporate debenture bond market made strides in development. From 2004 to the end of September 2012, the total issuance of corporate debenture bonds amounted to 10.45 trillion yuan, with an outstanding balance of 6.76 trillion yuan, approximately 43.2 times that at the end of 2004. The issuers of corporate debenture bonds were increasingly diversified, covering not only large and small- and medium-sized enterprises, but also state-owned enterprises and private entities. Product innovation on the corporate debenture market also made progress. After the launch of short-term financing bills, the People's Bank of China guided the National Association of

Financial Market Institutional Investors (NAFMII) to step up innovation in debt-financing instruments for non-financial enterprises, and the NAFMII unveiled a succession of new debt-financing instruments, such as medium-term notes, super short-term commercial paper, privately placed debt-financing instruments, collective bills of small- and medium-sized enterprises, and asset-backed bills. The National Development and Reform Commission and the China Securities Regulatory Commission also launched SME collective notes, corporate bonds, convertible corporate bonds, privately placed SMEs bonds, and so forth. Management of corporate debenture bonds issues has become more market-oriented, as the old examination/approval-based system has gradually migrated to more a market-based means, such as a filing-based or registration-based system.

The role of self-regulatory institutions in developing the corporate debenture bond market was brought into fuller play. To transform the role of government in regulating the corporate debenture market and to meet market demand, the National Association of Financial Market Institutional Investors (NAFMII) which is participated by market members on a voluntary basis was set up in September 2007, and thereafter the debt-financing instruments of non-financial institutions were administered by the NAFMII via a filing system. In recent years, debt-financing instruments of non-financial enterprises have developed rapidly. By the end of September 2012, the cumulative issuance of debt-financing instruments of non-financial enterprises totaled 7.44 trillion yuan, with an outstanding balance of 3.80 trillion yuan, accounting for 71.2 percent and 56.2 percent of the total respectively.

The risk diversification mechanism of the corporate debenture market was improved. With the development and expansion of the corporate debenture bond market, to meet the increasingly diverse needs of the main issuer and to bring into full play the role of corporate debenture bonds in addressing the financing problems of low creditworthy enterprises, in 2009 China Bond Insurance Co., Ltd. was set up, which is the first specialized bond creditworthiness enhancement institution in China. Credit risk mitigation tools were introduced on the interbank bond market to meet the demand of market participants in transferring their credit risks. A government debt-serving fund was introduced to bring into fuller play the role of fiscal funds in dealing with the financing problems of SMEs. A hierarchical design was introduced to differentiate the risks of bonds with different creditworthiness.

Institutional arrangements and infrastructure construction on the corporate debenture market were strengthened. The People's Bank of China and relevant government agencies released a succession of regulatory measures on the issuance, information disclosure, self-regulation, and ex-post supervision and management of corporate debentures, providing an institutional guarantee for the orderly development of the corporate debenture market. In 2009, the Shanghai Clearing House was established to provide central counter-party clearing services for the interbank market, and the construction of market infrastructure was strengthened. In December 2011, the net settlement mechanism was introduced in the corporate debenture market, which improved the efficiency of the use of funds on the interbank market, increased market liquidity, and reduced settlement risks.

The regulated yet rapid development of the corporate debenture market has yielded remarkable results. The development of the corporate debenture market not only promoted the development of China's financial market, it also deepened the functions of the financial market, broadened the direct financing channels of enterprises, and optimized the social financing structure. At end-2004, the ratio of outstanding corporate debenture bonds to RMB loans extended during the same period stood at 0.9 percent, and by end-September the ratio had risen dramatically to 11 percent, up 10.1 percentage points. In 2004, the share of debt financing took up a small proportion of total direct financing, but after 2005 the proportion of debt financing surpassed that of equity financing. At end-September 2012, corporate debenture financing instruments accounted for 89.4 percent of all direct financing. Overall, the rapid development of the corporate debenture market has strongly supported the financing needs of the real economy and has played an important role in promoting China's sustainable growth and economic restructuring.

3. The volume of bill financing increased

The bill acceptance business grew steadily. In the first three quarters of 2012, commercial bills issued by enterprises totaled 13.1 trillion yuan, representing year-on-year growth of 17.8 percent; the total volume of outstanding commercial bills at end-September posted 8.4 trillion yuan, representing year-on-year growth of 28.7 percent. By end-September, outstanding bankers' acceptance bills had increased by 1.8 trillion yuan from the beginning of the year. In terms of issuing industries, outstanding bankers' acceptance bills were mainly issued by enterprises in the manufacturing, wholesale, and retail industries, comprising 83.8 percent of the total. In particular, small- and medium-sized enterprises issued 70.1 percent of the total outstanding bills.

Bill financing increased somewhat. In the first three quarters of 2012, the cumulative amount of commercial bills discounted by financial institutions posted 22.5 trillion yuan, representing year-on-year growth of 23.7 percent; the outstanding balance of commercial bills at end-September increased 56.7 percent year on year to 2.3 trillion yuan. The balance of bill financing at end-September increased by 831.3 billion yuan from the beginning of the year, with an acceleration of 838 billion yuan year on year and accounting for 3.8 percent of all categories of loans, an acceleration of 1 percentage points from the corresponding period of the last year. In the third quarter, as financial institutions strengthened adjustment of their credit aggregates and structures, growth of the bill financing business slowed down. In the meantime, affected by a number of factors such as the changed supply and demand for bills, in the third quarter interest rates on the bill market went up slightly.

4. Stock indices declined, and both turnover and equity financing on the stock market declined

Stock indices declined. At end-September, the Shanghai Stock Exchange Composite Index and the Shenzhen Stock Exchange Component Index closed at 2086 points and 8679 points respectively, down 139 and 821 points from end-June. The Growth Enterprise Board (GEB) Index (Chinext Price Index) of the Shenzhen Stock Exchange closed at 690 points, shedding 37 points from end-June. The weighted average P/E ratio on the A-share market of the Shanghai Stock Exchange and the Shenzhen Stock Exchange declined from 11.9 times and 22.9 times respectively at end-June to 11.3 times and 21.5 times at end-September.

The volume of transactions on the stock markets declined. In the first three quarters of 2012, turnover on the Shanghai and Shenzhen stock exchanges totaled 24.7 trillion yuan, down 29.1 percent year on year, and the daily turnover averaged 135.8 billion yuan, down 28.3 percent year on year. The volume of transactions on the GEM Board amounted to 1.8 trillion yuan, representing an increase of 42.6 percent year on year. At end-September, the market capitalization of the Shanghai and Shenzhen stock exchanges posted 16.6 trillion yuan, up 0.5 percent from the end of the last year. The market capitalization on the GEM Board amounted to 309.6 billion yuan, up 23.6 percent from the end of the last year.

Financing on the stock market declined. In the first three quarters of 2012, a total of 308.3 billion yuan was raised by enterprises and financial institutions on the domestic and overseas stock markets by way of IPOs, additional offerings, and rights issuances, representing a year-on-year decrease of 34.2 percent. Among this total, 276.7 billion yuan was raised on the A-share market and 31.6 billion yuan was raised on the H-share market.

5. Total assets in the insurance industry registered stable growth

In the first three quarters of 2012, total premium income in the insurance industry amounted to 1.2 trillion yuan, representing year-on-year growth of 7.3 percent, and total claim and benefit payments amounted to 339.3 billion yuan, representing year-on-year growth of 18.1 percent. Specifically, total claim and benefit payments in the property insurance sector increased 30.9 percent, while those in the life insurance sector increased 4.2 percent.

Total assets of the insurance industry registered steady growth. At end-September, total assets of the insurance industry posted 6.9 trillion yuan, an increase of 18.3 percent year on year. Among this total, bank deposits increased 31.4 percent while investment-linked assets increased 10.7 percent.

Table 9 Use of Insurance Funds at End-September 2012

	Outstanding balance (100 million yuan)		As a share of total assets (%)	
	End-September 2012	End-September 2011	End-September 2012	End-September 2011
Total assets	69,000	57,257	100.0	100.0
Of which: Bank deposits	21,979	17,183	31.9	30.0
Investment	41,805	35,428	60.6	61.9

Source: China Insurance Regulatory Commission.

6. Swap transactions on the foreign exchange market increased rapidly

In the first three quarters of 2012, the turnover of spot RMB/foreign exchange transactions totaled USD2.6 trillion, representing a decline of 5.1 percent year on year. The turnover of RMB/foreign exchange swap transactions totaled USD1.8 trillion, representing an increase of 36.4 percent year on year; among this total, overnight RMB/USD swap transactions amounted to USD974.7 billion, accounting for 54.3 percent of the total. The turnover on the RMB/foreign exchange market totaled USD69.8 billion, a decrease of 60.5 percent year on year. The turnover of foreign-currency pair transactions amounted to USD63.1 billion, a decrease of 14.1 percent. In particular, USD/HKD transactions accounted for 44.1 percent, down 0.5 percentage points year on year.

The number of participants on the foreign exchange market expanded further. At end-September, there were 348 members on the foreign exchange spot market, 76 members on the foreign exchange forward and swap markets，and 30 members on the foreign exchange options market.

7. The price of gold rebounded slightly

Transactions on the gold market saw a year-on-year decline. In the first three quarters of 2012, a total of 2.6 trillion yuan of precious metals was traded on the Shanghai Gold Exchange, representing a decrease of 22.9 percent year on year. In particular, the trading volume of gold was 4709.0 tons, a decrease of 11.0 percent year on year, and turnover posted 1586.29 billion yuan, a decrease of 8.9 percent year on year; the trading volume of silver was 152268.8 tons, a decrease of 21.6 percent year on year, and turnover posted 978.24 billion yuan, a decrease of 38.2 percent year on year; the trading volume of platinum was 47.4 tons, a decrease of 5.6 percent year on year, and turnover posted 15.51 billion yuan, a decrease of 19.0 percent year on year.

The price of gold rebounded slightly. In late August it started to rebound strongly. In the third quarter, the afternoon fixing price of gold on the London market reached a peak of USD1,784.5 per ounce and a trough of USD1,556.3 per ounce, while the highest price (AU9999) on the domestic market was 363.0 yuan per gram, and the lowest price was 321.2 yuan per gram. The price of gold closed at 360.0 yuan per gram at end-September, up 11.7 percent from end-June.

II. Institutional building in the financial market

1. Re-activating the pilot credit asset securitization business

In May, with the approval of the State Council, the PBC, the CBRC, and the Ministry of Finance jointly released the *Notice on Matters Related to Further Expanding the Pilot Scheme of Credit Asset Securitization*, marking the re-activation of the credit asset securitization business. On September 7, the China Development Bank successfully issued 10.17 billion yuan of asset-backed securities on the interbank bond market, the first ever since the credit asset securitization business was re-activated, and so far the largest amount of a single business.

2. Strengthening integrity constraints on market participants in the securities and futures market and improving information security in the industry

In July, the CSRC issued the *Interim Measures for the Supervision and Administration of Integrity in the Securities and Futures Markets*. According to the *Measures*, the CSRC promised to establish an integrity file database for the capital market and to strengthen integrity constraints on market participants and their behavior by launching several institutional arrangements, i.e., carrying out integrity information inquiries, building an integrity supervision cooperation mechanism, imposing administrative punishments on illegal and dishonest acts, and so forth. In September, the CSRC issued the *Measures for the Management of Information Security and Assurance in the Securities and Futures Industries*, further specifying the legal obligations of market participants in ensuring information security, strengthening management of procurements of hardware and software products and services, and highlighting the responsibility of the regulatory agencies and self-regulatory bodies in the industry to ensure information security.

3. Steady progress in the construction of a multi-tier capital market

In August, the CSRC issued the *Interim Guidelines on Regulating Securities Companies in their Participation in Regional Property Rights Markets*, which specified the positioning of regional property rights exchanges and the methods for securities companies to take part in property rights markets, as well as the approval procedures, day-to-day supervision, management of investors, and market intermediaries' responsibilities. The guidelines note that on the basis of consolidating all kinds of property rights exchanges, regional equity transaction markets have been included in the construction of a multi-tier capital market system, helping to meet the diverse financing needs of small- and medium-sized enterprises.

4. Institutional building in the insurance market made headway

Institutional reform on the use of insurance funds was deepened. In July, the CIRC issued in succession the *Interim Measures on Entrusted Investments with Insurance Funds, the Provisional Measures on Bond Investments with Insurance Funds*, the *Notice on Issues Relating to Equity and Real-Estate Investments with Insurance Funds*, and the *Interim Measures on Asset Allocations of Insurance Funds*, allowing securities companies and fund management companies to provide asset management services to insurance companies and further relaxing restrictions on the variety, scope, and ratio of investments in bonds, equities, and real estate with insurance funds, therefore giving insurance companies more leeway in using their funds.

Supervision of the governance of insurance companies was strengthened. In July, the CIRC issued the *Administrative Measures on Controlling Shareholders of Insurance Companies*, specifying the definition of controlling shareholders of insurance companies, and making provisions in five specific areas, i.e., controlling behavior, transaction behavior, capital assistance, information disclosure and confidentiality, and regulatory coordination. In the same month, the CIRC issued the *Interim Guidelines on Remuneration Management of Insurance Companies*. Per the *Guidelines*, insurance companies are required to reasonably set remuneration standards according to their financial conditions, results of operations, risk management, and risk varieties based on the CIRC classified supervision categories, and a deferred payment system was put in place for performance payments of directors, supervisors, senior managers, and key staff.

The scope of insurance services was broadened. In July, the CIRC issued the *Notice on Comprehensively Promoting the Small-Amount Life Insurance Program*, which seeks to promote small-amount life insurance for low-income groups across the country, and the licensing process for conducting small-amount life insurance business was migrated from the current approval system to a filing system. Furthermore, the notice put forward the requirements for the types of products, the amount insured, product design, and the development of small-amount life insurance products, thus rendering policy support to insurance companies that conduct small-amount life insurance business in compliance with the regulations, such as regulatory fee relief.

Part 4 Macroeconomic Analysis

I. Global economic and financial developments

In quarter three of 2012, the global economy continued to grow at a sluggish pace. Fiscal woes in the United States saw no improvement. Downside risks remained elevated in the euro area due to the still-severe sovereign debt crisis. Recovery in Japan had not stabilized, causing outlook uncertainties. The momentum for growth in the emerging market economies and some countries continued to face inflationary pressures.

1. Economic developments in the major economies

Activities strengthened in the US, but fiscal woes persisted. Boosted by an increase in consumer and government consumption as well as a recovery in the housing market, in Q3 GDP picked up to an annualized 2.0 percent. However, declining non-residential fixed investments in Q3, the reduced agricultural inventory caused by drought in the central and western areas, and the first negative growth in exports in three years indicated that fiscal problems remained severe and the recovery lacked a strong footing. Currently, the US economy is facing uncertainties brought about by the fiscal cliff and debt ceiling. In September, the US Fed lowered its estimation of 2012 GDP growth to a range of 1.7-2.0 percent.

Economic activities in the euro area generally contracted and were hit hard by the deteriorating debt crisis. Though the release of the Outright Monetary Transactions (OMT) Scheme and the ECB's announcement of a resolution to provide a strong backstop to the euro provided some optimism, the market remained dubious about the taming of the EU debt crisis due to the slow progress in the fiscal consolidation programs in the heavily-indebted countries. Overall investment in the euro area slumped. In September, the PMI dropped to a thirty-nine-month low of 45.98, while the unemployment rate soared to 11.6 percent, the highest reading since the establishment of the euro area. Inflationary pressures bounced back somewhat, with the HICP reaching 2.7 percent. In September, the ECB cut its estimation of 2012 real GDP growth to 0.6 percent.

Due to shrinking exports and declining domestic demand, activities softened in Japan. In Q2, the annualized GDP dropped by a large margin from that in Q1, with less promising month-on-month consumer expenditures and public investments compared with those in Q1. The housing market also witnessed some corrections. An important reason for the contraction was that exports continued to be disappointing due to the negative impact from the EU crisis, putting a drag on the Japanese economy. In the first half of the year, Japan's current account surplus plummeted by 45 percent, the lowest record since 1985 when data first became available. In both July and August, there was a large trade deficit. Another problem is that the fiscal deficit and the debt problem became long-term hindrances on growth. Though the government passed a consumption tax hike bill, the effect and impact of which was yet to be observed. Furthermore, Japan was still trapped in a recession, with negative year-on-year CPI growth for five consecutive months.

Most emerging market economies saw decelerated growth, volatile cross-border capital flows, and rising inflationary pressures. Since the beginning of 2012, activities in the BRICS countries slowed down and trade conditions exacerbated further due to multiple factors, such as the tepid external demand and the downward economic cycle. In response, in August some of the BRICS, including Brazil, launched new stimulus policies. In Q3, inflationary pressures in some of the emerging market economies rose, translating into an elevated CPI level. The recent round of an accommodative monetary policy in the advanced economies might push up international commodity prices, especially those of grain, leading to imported inflation in the emerging market economies.

Table 10 Macroeconomic and Financial Indices of the Major Economies

country	Index	2011Q3			2011Q4			2012Q1			2012Q2			2012Q3		
		Jul.	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.
United States	Real GDP Growth Rate (annualized quarterly rate,	1.3			4.1			2.0			1.3			2.0（initial number）		
	Unemployment Rate（%）	9.1	9.1	9.0	8.9	8.7	8.5	8.3	8.3	8.2	8.1	8.2	8.2	8.3	8.1	7.8
	CPI（YOY,%）	3.6	3.8	3.9	3.5	3.4	3.0	2.9	2.9	2.7	2.3	1.7	1.7	1.4	1.7	2.0
	DJ Industrial Average (closing number)	12143	11613	10913	11955	12045	12218	12633	12952	13212	13214	12393	12880	13009	13091	13486
	NASDAQ (closing number)	2756	2579	2415	2684	2620	2605	2814	2967	3092	3046	2827	2935	2940	3067	3116
Euro Area	Real GDP Growth Rate (quarterly YOY, %)	1.3			0.6			0.0			-0.4			—		
	Unemployment Rate (%)	10.2	10.2	10.3	10.5	10.6	10.7	10.8	10.9	11.0	11.2	11.3	11.4	11.5	11.5	11.6
	HICP (YOY,%)	2.6	2.5	3.0	3.0	3.0	2.7	2.7	2.7	2.7	2.6	2.4	2.4	2.4	2.6	2.6
	EURO STOXX 50 (closing number)	2511	2238	2160	2318	2299	2370	2422	2477	2459	2423	2257	2381	2479	2509	2518

Japan	Real GDP Growth Rate (annualized quarterly rate, %)	6.9			0.3			5.3			0.7			—		
	Unemployment Rate (%)	4.7	4.4	4.2	4.4	4.3	4.2	4.6	4.5	4.5	4.6	4.4	4.3	4.3	4.2	4.2
	Core CPI (YOY,%)	0.1	0.2	0.2	-0.1	-0.2	-0.1	-0.1	0.1	0.2	0.2	-0.1	-0.2	-0.3	-0.3	-0.1
	NIKKEI225 (closing number)	9833	8955	8700	8988	8435	8455	8803	9723	10084	9521	8543	9007	8695	8840	8870

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

2. Global financial market development

In Q3, with some improvements in the EU sovereign debt crisis and the release of a new round of quantitative easing methods by the major advanced countries, capital flowed back to the emerging markets from the US, driving most currencies up against the US dollar and triggering a fall in the Trade Weighted US Dollar Index. By the end of September, the exchange rates of the euro and the Japanese yen against the US dollar stood at 1.2858 dollar per euro and 77.90 yen per dollar respectively, down 1.58 percent and up 2.40 percent respectively from June. The Chilean peso, Swedish krona, and Indian rupee appreciated by more than 5 percent against the US dollar.

The US dollar Libor continued to tilt downwards. On September 28, the 1-year Libor read at 0.973 percent, down 0.095 percentage points from the end of June. The Euribor dropped to a historical low due to rate cuts by the ECB and the launch of further monetary easing. On September 28, the 1-year Euribor registered 0.684 percent, down 0.529 percentage points from the end of June.

Yields of government securities in the heavily indebted countries receded. Bolstered by a rising risk appetite in the market, the yields of treasuries in the major safe-haven countries, such as the US, Germany, and Japan, edged up a bit. At the same time, government bonds in Italy and Spain, which were struggling with heavy debt, fluctuated downwards. On the heels of the launch of a new round of monetary easing by the ECB and the US Fed in September, the yields of debt-ridden countries fell but later stabilized, and the yields of the safe-haven treasuries temporarily also traded lower. Stock markets in the euro area and the US rallied amidst fluctuations in the policy stimulus, and the Japanese stock index drifted lower due to disappointing domestic economic performance.

International oil and gold prices rebounded. At the end of September, oil futures gained by 14.5 percent from end-June, and spot gold closed at USD1777 per ounce, up by 11.2 percent from end-June. Meanwhile, industrial metal and agro-products also picked up.

3. Monetary policies of the major economies

Against the background of the lingering European sovereign debt crisis and the sluggish recovery in both the US and the euro area, the major advanced economies further loosened their monetary policies. On September 13, the US Fed launched a third round of quantitative easing (QE3) with no clear quantitative limit, and decided to maintain the exceptionally low target range for the federal funds rate at 0 to 1/4 percent to at least mid-2015. It also announced the purchase of additional agency mortgage-backed securities at a pace of USD40 billion per month while keeping Operation Twist unchanged. On July 5, the ECB cut interest rates on the main refinancing operations, the marginal lending facility, and the deposit facility all by 25 basis points to 0.75 percent, 1.5 percent, and 0 percent respectively. On September 6, the ECB introduced its Outright Monetary Transactions Scheme to the secondary market, purchasing an unlimited number of short-term bonds with maturities of less than three years to drive down the financing costs of member states. On July 2012, the Bank of England's Monetary Policy Committee voted to maintain the official Bank Rate at 0.5 percent and to increase the size of the Asset Purchase Program by £50 billion to a total of £375 billion. The Bank of England also launched the Funding for Lending Scheme (FLS) on July 13 to provide funding to commercial banks and to building societies for an extended period at below the current prevailing market rates, in link with their performance in lending to the UK non-financial sector. On September 19 the Bank of Japan reported that it would ramp up its asset purchase program by 10 trillion yen to a total of 80 trillion yen and it would extend buying until the end of 2013.

Some emerging market economies launched further monetary easing in response to rising external uncertainties and the slowdown in activities at home. The Reserve Bank of India cut the statutory liquidity ratio to 23 percent from 24 percent on July 31 and reduced its cash reserve ratio by 25 basis points to 4.5 percent on September 17. The Central Bank of Brazil lowered its benchmark interest rate twice, on July 11 and August 29, by a total of 100 basis points to 7.5 percent. On July 12, the Bank of Korea cut the policy rate by 25 basis points to 3.0 percent. Many other economies also reduced their rates, including Vietnam, Philippines, Kazakhstan, and Hungary. However, Russia increased its refinancing rate from 8 to 8.25 percent, marking the first rate boost by an emerging market economy in 2012.

Box 4 Comparison of the New Round of Quantitative Easing by the ECB and the US Fed

To curb the risks arising from the spread of the EU debt crisis, to ease market tensions, and to facilitate recovery, the central banks in the euro areas and the United States launched a new round of quantitative monetary easing policies. On September 6, the ECB introduced Outright Monetary Transactions (OMT) to the secondary market and on September 13 the US Fed announced the implementation of a third round of quantitative easing (QE3).

Though the ECB's OMT and the US Fed's QE3 both fall under the category of quantitative easing policies and both are ex-ante unlimited in size, they have the following several differences. First, the ECB buys government bonds of member states with a maturity of between one and three years, whereas the US Fed purchases mortgage-backed securities. Second, the initiators of the operations are different. The ECB has tied the OMT to strict conditionality, and member states have to apply for implementation. Meanwhile, the US Fed is buying at a prescribed monthly pace but the duration of the program is open-ended. Furthermore, the US Fed can proactively enter the market for bonds. Third, the impacts on liquidity control are different. The ECB claims to fully sterilize the liquidity created through the OMT, with comparatively little impact on liquidity in the banking system. But the US Fed has no sterilization arrangement for QE3, which might directly increase the liquidity level in the banking system. Fourth, the risks facing the balance sheets are different. Because the ECB suspended application of the minimum credit-rating threshold in the collateral eligibility requirements for debt instruments issued or guaranteed by the central government, risks might build up on its balance sheets. In the case of the US Fed, though the purchased mortgage-backed securities are relatively safe, the lack of sterilization measures might result in a bulging balance sheet.

The timing of the launching of the new round of quantitative easing by the ECB and the US Fed was very much in line with market expectations. As a result, with the news financial markets rallied and confidence was bolstered. Due to the influence of the OMT, the yields of Spanish and Italian government bonds fell notably and the stock market was strengthened, showing that the plan was somewhat effective in safeguarding financial stability in the euro area. However, to judge whether the OMT is successful or not depends very much on if applicant member states can live up to their reform goals. Furthermore, bulk purchases by the ECB might distort market prices because the sovereign debt markets of the various EU countries are separate and with limited depth. In terms of the effect of the US Fed QE3, on the day of the news, yields of mortgage-backed securities dropped by a large margin and both the Dow Jones Industrials and the S&P 500 roared to their highest level since 2007. As to its impact on the real economy, if this round of easing by the US Fed proves to be a continuous impetus to demand, it will boost recovery and improve employment conditions. However, a potential byproduct of the quantitative easing policies by the ECB and the US Fed might be excessive liquidity, which could lead to large fluctuations in cross-border capital, price hikes of international commodities, and eventually growing inflationary risks.

4. World economic outlook and major risks

In the following several quarters, uncertainty about the global outlook might increase appreciably. The major risks include:

First, tail risks stemming from the EU debt crisis might dampen the world recovery. Though there seemed to be a silver lining in the EU debt problem, the market is still concerned about two kinds of tail risks. One is the possibility that a sharp deterioration in Spain might force it to ultimately seek a bailout. The other is the threat of a Greek exit. If the EU countries fail to deliver on their commitments by timely implementing consensus and rebuilding market confidence, the negative feedback loop among the deepening sovereign debt crisis, bank runs, and economic slack could intensify. The longer the loop lasts, the larger the pain will be for Europe and the world, and it could even lead to a double-dip in the global economy.

Second, uncertainties regarding US fiscal policy might continue to cause risks for US and global growth. As the election was not yet over, the congress and the government could not reach a medium-term fiscal consolidation plan. Policymakers had to face the dilemma between a “fiscal cliff” and an “unsustainable debt.”

Third, the impact of the new round of accommodative monetary policy on the global economy is not clear. Both the ECB’s OMT and the US Fed’s QE3 involve large uncertainties in terms of total size and duration. An accommodative monetary policy is like a double-edge blade. On the one hand, it will stimulate economic growth by injecting market liquidity, but, on the other hand, it might delay the process of fiscal consolidation and structural reform in the advanced countries, cause price hikes in international commodities, add to volatility in capital flows, and lead to spillovers in the emerging market economies.

Fourth, trade protectionism might come to the fore. Facing a gloomy outlook in most of the major economies, high unemployment rates, and frequent trade frictions, some countries might adopt measures to protect domestic industries, employment, and investments adding to the risks of rising trade protectionism throughout the world.

II. Analysis of China' s macroeconomic performance

In the third quarter of 2012, China's economic growth stabilized and continued to show positive signs. In September, readings of the major economic indicators turned for the better at an accelerated pace. Consumption remained stable and fixed-asset investments rose in a stable and relatively rapid manner. Exports also rebounded. The agricultural sector performed well, and growth of industrial production moderated. The increasing margin of price levels continued to fall, and employment was basically stable. In the first three quarters of 2012, the Gross Domestic Product (GDP) was 35.3 trillion yuan, increasing by 7.7 percent year on year in terms of comparable prices, which was 1.7 percentage points lower than that during the same period of 2011. In Q3, GDP grew 7.4 percent year on year, and 2.2 percent quarter on quarter.

1. Consumption grew steadily, and investment growth picked up. Export growth rebounded.

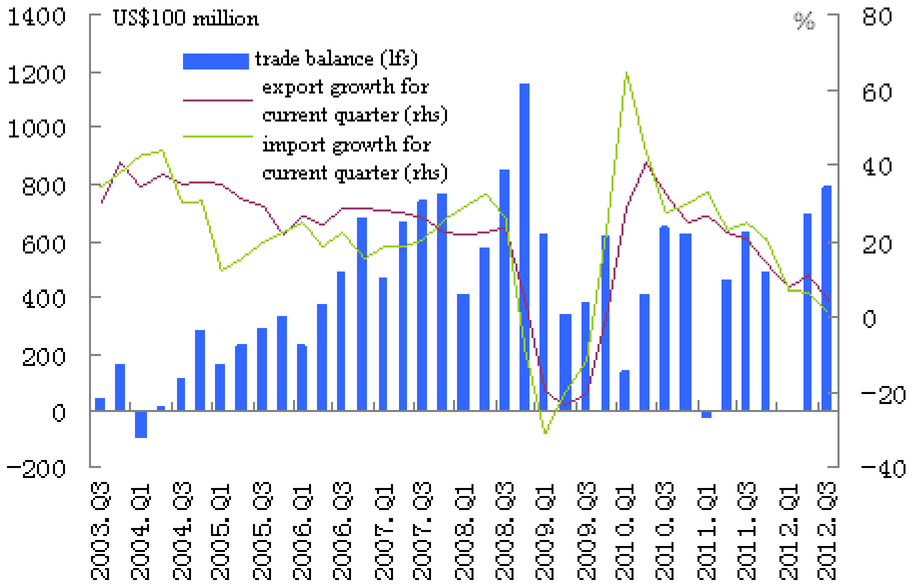
Income of urban and rural residents rose quite rapidly, and consumer demand grew steadily. In the first three quarters of 2012, per capita disposable income of urban households posted 180 thousand yuan, representing year-on-year growth of 13.0 percent and price-adjusted real growth of 9.8 percent. The per capita cash income of rural households registered 6,778 yuan, up 15.4 percent in nominal terms or 12.3 percent in real terms. The PBC survey of urban depositors in the third quarter shows that the residents' income index posted 50.2 percent, 0.1 percentage points more than that in the previous quarter, and the residents' income expectation index stood at 53.8 percent, up 0.6 percentage points compared with Q2. Cumulatively, retail sales of consumer goods totaled 14.9 trillion yuan in the first three quarters, up 14.1 percent year on year in nominal terms and increasing by 11.6 percent year on year in real terms, which was an acceleration of 0.3 percentage points. Broken down by urban and rural areas, retail sales in urban areas registered 12.9 trillion yuan, 14 percent more year on year, and retail sales in rural areas totaled 2.0 trillion yuan, up 14.4 percent over the same period of the last year.

Fixed-asset investments grew at a stable and relatively rapid level. In the first three quarters of the year, fixed-asset investments (excluding investments by rural households) totaled 25.7 trillion yuan, up 20.5 percent year on year. The price-adjusted real growth posted 18.8 percent. Broken down by region, fixed-asset investments in the eastern, central, and western regions grew 18.4 percent, 25.8

percent, and 24.1 percent respectively, showing that growth in the western and central regions was much faster than that in the eastern region. Broken down by industry, fixed-asset investments in the primary, secondary, and tertiary industries grew 32.2 percent, 22.4 percent, and 19.4 percent respectively year on year. Among this total, growth of investment in the primary sector accelerated by 6.7 percentage points year on year. In the first three quarters, total investments in newly started projects reached 22.7 trillion yuan, up 25.7 percent year on year. Total investments in projects under construction posted 64.1 trillion yuan, up 14.9 percent year on year.

Export growth rebounded. From Q1 through Q3, exports grew by USD 1.5 trillion, up 7.4 percent year on year. Among this total, exports in September hit a record high, rising by 9.9 percent year on year, which was faster than that in the previous two months. Imports registered USD 1.3 trillion, up 4.8 percent year on year. The trade surplus in the first three quarters was USD 148.3 billion, representing an increase of USD 41.2 billion year on year. Among this total, the trade surplus in Q3 alone was USD 79.4 billion. The share of China's exports took a larger market share in the emerging markets. In the first three quarters, shares in Brazil, Malaysia, and Thailand went up by 0.7, 1.7, and 1.4 percentage points respectively, compared with the shares at the end of 2011. The pace of growth of exports by private enterprises picked up. From Q1 through Q3 of 2012, exports by private enterprises grew by 19.2 percent year on year. Imports and exports in the western region grew faster than those in the central and eastern regions. In the first three quarters, imports and exports in the western region increased by 13.1 percent and 43.4 percent respectively year on year. As for the structure, exports of mechanical and electronic products grew 4.6 percent year on year, and exports of labor-intensive products[2] rose 3.5 percent compared with the same period of the last year. Imports of some energy and resource products posted slower growth.

[2] Labor-intensive products comprise five categories, namely textiles, garments, shoes, bags and suitcases, and furniture.



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

Figure 3 Growth of imports and exports, and the trade balance

2. Agricultural production performed well and industrial production grew steadily

The growth of tertiary industry accelerated slightly. In the first three quarters, the value-added of the primary, secondary, and tertiary industries reached 3.3 trillion yuan, 16.5 trillion yuan, and 15.5 trillion yuan respectively, up 4.2 percent, 8.1 percent, and 7.9 percent year on year, which were 0.1 percentage points lower, 0.2 percentage points lower, and 0.2 percentage points higher than that in the first half of 2012. The shares of the three industries in GDP were 9.4 percent, 46.8 percent, and 43.8 percent respectively.

Agricultural production maintained a stable momentum of development, and grain production registered growth for nine consecutive years. Summer grain output reached 130 million tons, up 3.56 million tons or 2.8 percent from the same period of the last year, marking the ninth consecutive year of an increase in output. There is sure to be a bumper harvest of autumn grain this year. From Q1 through Q3, the total output of meat, including pork, beef, mutton, and poultry, posted 57.28 million tons, up 5.0 percent year on year. Among this total, pork production totaled 37.54 million tons, increasing by 5.2 percent year on year.

The growth of industrial production rebounded in September. In the first three quarters, the value-added of statistically large enterprises grew by 10.0 percent year on year, representing a deceleration of 0.5 percentage points. Industrial production showed positive signs in September. The value-added of industrial production grew 9.2 percent year on year, representing an acceleration of 0.3 percentage points compared with that in August 2012, and rose 0.79 percent month on month after seasonal adjustments, marking an acceleration of 0.08 percentage points. The profits of industrial enterprises declined. From Q1 through Q3, the profits of statistically large enterprises were down by 1.8 percent year on year to 3.5 trillion yuan. Returns on total assets of statistically large enterprises from their main businesses posted 5.36 percent, down 0.07 percentage points from the first half of 2012. In the first three quarters of this year, 97.8 percent of all industrial products were sold, 0.3 percentage points more than the amount sold during the first half of this year.

3. The growth of consumer prices decelerated year on year, and the decline in the price level of industrial products continued to shrink month on month

The increase in consumer prices declined. In Q3, the Consumer Price Index (CPI) rose 1.9 percent year on year, representing a deceleration of 1.0 percentage points compared with that in Q2 of this year, with the year-on-year increasing margins of July, August, and September standing at 1.8 percent, 2.0 percent, and 1.9 percent respectively. Growth of food prices continued to decline, whereas the increase in the prices of non-food items was flat with that of Q2 2012. The price of food grew 2.8 percent year on year, representing a deceleration of 2.9 percentage points compared with the previous quarter and contributing to a CPI rise of 0.9 percentage points. The price of non-food items went up 1.5 percent year on year, contributing to an increase of 1.0 percentage points in the CPI. Broken down by goods and services, the growth of consumer goods prices continued to decline, whereas the rise in service prices accelerated. The prices of consumer goods gained 1.9 percent year on year, a deceleration of 1.4 percentage points from the previous quarter; the prices of services were up 2.1 percent year on year, representing an acceleration of 0.3 percentage points from the previous quarter. Among the 1.9 percent increase in the year-on-year CPI in Q3, 0.6 percent is attributed to base factors, whereas 1.3 percent is attributed to new price-rising factors, which were flat with that of the previous quarter.

The quarter-on-quarter decrease in producer prices continued to decline. As a result of rising commodity prices, the month-on-month decrease in ex-factory producer prices of industrial products in July, August, and September registered 0.8 percent, 0.5 percent, and 0.1 percent respectively, marking a shrinking declining margin. The month-on-month change in industrial producer purchasing prices was -0.8 percent, 0.5 percent, and 0.1 percent respectively. Due to the high base value last year, the year-on-year decline in industrial producer purchasing prices was significant. In Q3, ex-factory producer prices fell by 3.3 percent year on year. Among this total, prices of capital goods went down by 4.4 percent year on year, while prices of consumer goods rose 0.3 percent; industrial producer purchasing prices dropped by 3.9 percent year on year. In Q3, producer prices of agricultural products (the prices at which farmers sell their products) climbed by 0.1 percent year on year, and the prices of agricultural capital goods gained 3.2 percent. In the first three quarters, the CGPI declined by 1.4 percent year on year, representing a deceleration of 1.1 percentage points compared with that in the first half of the year. As for the monthly readings, the year-on-year increase in the CGPI rebounded slightly to -3.8 percent in September, after falling for 13 consecutive months, which was 0.1 percentage points more than that in August. The CGPI in September rose 0.1 percent month on month, up 0.3 percentage points compared with that in the previous month.

Commodity prices on international markets rose. In September, the average price of crude oil futures on the New York Mercantile Exchange grew by 14.7 percent compared with that in June. On the London Metals Exchange, the average price of spot copper rose by 9.1 percent from June. In accordance with the change in oil prices on international markets, and taking into consideration domestic and global economic developments, market supply and demand for oil products on the domestic market, and in line with the pricing mechanism of oil products on the domestic market, the National Development and Reform Commission adjusted the prices of oil products on three occasions, cutting the prices of petrol and diesel by 420 yuan and 400 yuan per ton respectively on July 11, raising the prices of petrol and diesel by 390 yuan and 370 yuan per ton respectively on August 10, and increasing the prices by 550 yuan and 540 yuan per ton respectively on September 11.

The decrease in import prices narrowed. In the three months of the third quarter, the year-on-year decline in import prices registered 3.8 percent, 4.2 percent, and 1.7 percent respectively, with an average of 3.2 percent. The year-on-year increase in export prices posted 1.1 percent, 1.3 percent, and -1.0 percent respectively from July through September, with an average of 0.5 percent.

The GDP deflator continued to decline. The GDP registered 35.3 trillion yuan in the first three quarters of 2012, up 7.7 percent year on year in real terms. The change in the GDP deflator (as a ratio of the nominal GDP versus the real GDP) was 1.9 percent, down 6.0 and 0.5 percentage points from the same period of the last year and the previous quarter respectively.

4. Growth of fiscal revenue slowed down and fiscal expenditures grew quite rapidly

In the first three quarters of the year, fiscal revenue (excluding debt income) surged by 10.9 percent year on year to 9.1 trillion yuan, representing a deceleration of 1.3 percentage points from the first half of the year, whereas fiscal expenditures registered 8.4 trillion yuan, up 21.1 percent year on year, representing a deceleration of 0.2 percentage points from the first two quarters of the year. As a result, revenue was 646.9 billion yuan more than expenditures. As for the structure of fiscal revenue, tax revenue posted 7.741 trillion yuan for the first three quarters of the year, up 8.6 percent year on year and representing a deceleration of 1.2 percentage points from the first half of the previous year. In particular, the domestic VAT, the VAT and excise tax on imported products, the corporate income tax, the business tax, the consumption tax, and the personal income tax were up 5.8 percent, 3.7 percent, 14.7 percent, 12.1

percent, 10.8 percent, and -8.4 percent respectively year on year. Revenue from these six tax items accounted for 78 percent of total national fiscal revenue. As for the structure of fiscal expenditures, in the first three months of the year the five fastest growing spending items were education, government-subsidized housing, agriculture, forestry and irrigation， urban and rural community affairs, as well as health and medical services, growing by 32.6 percent, 28.8 percent, 24.9 percent, 24.7 percent, and 24.4 percent year on year respectively. The five largest expenditure items were education, social security and employment, agriculture, forestry, and irrigation, urban and rural community affairs, and transportation, accounting for 15 percent, 11.2 percent, 8.7 percent, 7.6 percent, and 7 percent of total fiscal expenditures respectively.

5. The employment situation was generally stable

Data from the Ministry of Human Resources and Social Security show that in the first three quarters of the year 10.24 million people joined the work force, meeting the goal for 2012 ahead of schedule. A total of 4.32 million were reemployed, and 1.35 million people with employment difficulties found jobs. At end-September, the registered unemployment rate in urban areas posted 4.1 percent, at a par with that at end-June.

A statistical analysis in the second quarter conducted by the China Human Resources Market Information Monitoring Center on public employment service agencies in 100 cities shows that supply fell short of demand slightly in Q3, the ratio of job vacancies to job seekers exceeded 1 for eight consecutive months. Both job openings and job seekers grew compared with the same period of the previous year, but they declined from the previous quarter. Broken down by region, job vacancies dwindled year on year in the eastern region, while the central and western regions saw a substantial increase in both job openings and job seekers. Broken down by sectors, demand for labor rose most remarkably in construction, resident services, and other service sectors. In the labor market, talent with a medium-to-high level of skills was short in supply, and the demand for such talent gained significantly year on year.

6. The balance of payments improved further

According to the SAFE, in the first three quarters of this year China registered a current account surplus of USD147.8 billion, accounting for 2.6 percent of GDP during the same period, which was 0.3 percentage points less than that during the same period of the last year. There was a USD84.5 billion deficit under the capital and financial account, whereas there was a surplus of USD234.1 billion in the first three quarters of the previous year. A total of USD64 billion was added to foreign exchange reserves, a deceleration of 83 percent. Among this total, in Q3 alone there was a surplus of USD70.6 billion under the current account and USD71 billion under the capital and financial account.

The stock of external debt increased rapidly, and the share of short-term external debt continued to increase. As of end-June, the stock of China's external debt stood at

USD785.2 billion, up 22.2 percent year on year. Among this total, the stock of registered external debt posted USD495.1 billion, up 22.9 percent year on year; short-term external debt posted USD588.2 billion, a year-on-year increase of 27.3 percent and accounting for 74.9 percent of the total, which represented an acceleration of 3 percentage points year on year.

7. Sectoral analysis

Growth of industrial profits turned positive. In September, actualized profits of statistically large enterprises registered 464.3 billion yuan, up 7.8 percent year on year. In the first three quarters of this year, profits of statistically large enterprises declined by 1.8 percent year on year. Among the 41 industrial sectors, 26 reported year-on-year growth in profits, 14 saw lower profits compared with the same period of the last year, and 1 suffered losses as opposed to profits during the same period of 2011. Among industries, the profits of the agricultural and sideline food processing industry, the auto manufacturing industry, and the electricity and heat generation and distribution industry grew by 15.2 percent, 10.8 percent, and 44.6 percent respectively year on year; the profits of the chemical raw materials and chemical products manufacturing industry, and the ferrous metals smelting and rolling industry fell by 18.0 percent and 68 percent respectively year on year. The oil refinement industry and the coking and nuclear fuel-processing industry turned from profits during the same period of the last year to losses during the period of this year. In the first three quarters of the year, coal production grew 5.2 percent year on year to 2.97 billion tons, crude oil output rose 0.6 percent year on year to 154.2 million tons, power generation increased 3.6 percent year on year to 3.5834 trillion kilowatt hours, and the volume of cargo transportation gained 11.6 percent year on year to 29.69 billion tons.

(1) The real-estate sector

In the first three quarters of 2012, performance in the real-estate sector tended to be stable. The number of cities seeing a month-on-month housing price increase was declining, and investment in the real-estate sector declined slightly. The decrease in sales of commercial housing narrowed, and growth of real-estate credit rebounded.

The number of cities where housing prices registered a month-on-month increase declined for two consecutive months. In September, the price of newly built commercial residential housing increased month on month in 31 out of 70 cities, representing a decrease of 19 and 5 cities respectively compared with that in July and August, and the margins of the price hike were no more than 0.4 percent. The price of pre-occupied residential housing gained month on month in 35 cities, which was 3 cities less than that in August and no more than 0.7 percent.

The decrease in sales of commercial real estate continued to narrow. In the first three quarters of this year, the sold floor area of commercial real estate nationwide posted 680 million square meters, representing a decline of 4.0 percent year on year, which was a deceleration of 6 percentage points compared with the decrease in August.

Among this total, the sold floor area of commercial residential housing went down by 4.3 percent year on year in the first three quarters, continuing the slowdown in the decrease since the beginning of 2012. Sales of commercial real estate grew 2.7 percent to 4.0 trillion yuan year on year, as opposed to a year-on-year decrease of 5.2 percent in the first half of 2012.

Investment in real-estate development grew slightly slower. In the first three quarters of this year, completed investment in real-estate development rose 15.4 percent to 5.1 trillion yuan, representing a deceleration of 1.2 percentage points compared with the first half of this year. In particular, completed investment in commercial residential housing was up year on year by 10.5 percent to 3.5 trillion yuan, representing a deceleration of 1.5 percentage points in comparison to the first half of 2012 and accounting for 68.6 percent of the total investment in real-estate development. In the first three quarters, the floor area of newly built housing fell 8.6 percent to 1.35 billion square meters, representing an acceleration of 1.5 percentage points in contrast to that in the first half of 2012. The floor area of housing under construction grew by 14 percent to 5.25 million square meters, representing a deceleration of 3.2 percentage points compared with that in the first half of 2012. The floor area of completed housing increased 16.4 percent year on year to 510 million square meters, representing a deceleration of 4.3 percentage points in contrast to that in the first half of this year.

The growth of real-estate loans accelerated. By the end of September, outstanding real-estate loans of the major financial institutions in urban and rural areas, urban credit cooperatives, and foreign-funded banks picked up by 12.2 percent year on year to 11.7 trillion yuan, representing an acceleration of 1.9 and -1.8 percentage points from end-June of this year and end-2011 respectively and accounting for 19.7 percent of all outstanding loans. Among this total, outstanding mortgage loans rose 12.0 percent year on year to 7.2 trillion yuan, representing an acceleration of 1.7 percentage points from end-June and growing for the fourth consecutive month this year. Outstanding real-estate development loans gained 12.1 percent year on year to 3.0 trillion yuan, representing an acceleration of 0.8 percentage points from end-June. Outstanding land development loans increased by 7.3 percent year on year to 846.1 billion yuan, accelerating by 6.5 percentage points from end-June. In the first three quarters of 2012, new real-estate loans declined by 10.2 billion yuan year on year to 982.1 billion yuan. New loans in the real-estate sector accounted for 15.4 percent of total new loans, up 3.1 percentage points from the first half of this year, but down 2.1 percentage points from the annual figure for 2011.

According to the Ministry of Housing and Urban-Rural Development, 7.2 million units of apartments under the urban affordable housing program and shanty town renovation program broke ground, accounting for 97 percent of the planned volume. Approximately 4.8 million units were completed, and completed investment totaled 960 billion yuan. As of end-September, outstanding affordable housing development loans stood at 521.5 billion yuan, accounting for 23.5 percent of total real-estate development loans. In the first three quarters of this year, new affordable housing development loans registered 130 billion yuan, accounting for 86.4 percent of new loans for real-estate development. Moreover, the pilot program using housing provident fund loans to support the construction of affordable housing was advanced steadily. As of end-September, 41.9 billion yuan of loans was approved in the first batch of 29 cities, accounting for 83.5 percent of the total credit quota of 50.2 billion yuan. A total of 31.4 billion yuan of loans was disbursed to 101 projects under the affordable housing program based on their construction progress.

(2) The textile industry

The textile industry is a traditional pillar industry and a vital industry in China's national economy, and it formerly enjoyed remarkable international competitiveness. During the Eleventh Five-year Plan period, the average annual growth of added value of the statistically large enterprises in the textile industry was 12.6 percent, and the annual growth of their total profits averaged 27.7 percent. Meanwhile, the textile industry faced problems of an inefficient growth pattern and an over-reliance on external sources of raw materials. Since the beginning of 2012, the industry faced even more severe challenges in the context of the global slowdown. In order to achieve sustainable development on a higher level, the textile industry is in dire need of improving its growth pattern and of promoting industrial transformation and upgrading.

As a result of shrinking demand, the growth of production in the textile industry declined, but the declining margin narrowed. Foreign demand was depressed, with demand from the US and Europe in particular plummeting. In the first three quarters, China's exports of textile and garments rose by merely 0.5 percent to USD187.16 billion, representing a deceleration of 1.1 percentage points compared with the first half of this year. In the first three quarters, the volume of Chinese exports of textiles and garments increased by only approximately 2.5 percent. Growth of domestic demand also slowed down. From January through August, sales in the domestic market by statistically large enterprises in the textile industry were up 12.4 percent year on year, representing a deceleration of 3.9 and 0.9 percentage points in contrast to the first quarter and the first half of the year. In the first three quarters, the added value of 37 thousand statistically large enterprises in the textile industry grew 12.5 percent year on year, representing a deceleration of 2.6 and 0.5 percentage points in contrast to the first quarter and the first half of the year.

Due to turbulent swings in cotton prices and hikes in labor and energy costs, total profits in the textile industry were on a downturn compared with the same period of the last year. As of end-September, the China Cotton Index for 328-grade cotton reached 18,673 yuan a ton, and the Cotlook A Index closed at USD0.813 per pound, indicating that the domestic price of cotton was nearly 7000 yuan higher than the price of cotton on the international market. This price difference undermined the competitiveness of China's textile industry. From January through July, total profits of statistically large enterprises in the textile industry dropped by 1.1 percent year on year, representing a narrowing decline by 1.0 and 0.9 percentage points compared with Q1 and the first half of 2012.

The Twelfth Five-year Plan period is a crucial window for the textile industry to build scale and gain competitiveness. The entire industry faces the critical task of furthering industrial restructuring, accelerating the growth pattern of upgrading, and tackling the root causes of all sorts of external risks. Approximately 80 percent of capacity in the textile industry is concentrated in the eastern area. As the central and western regions have become increasingly ready to accommodate an industrial shift, the timing for initiating an orderly geographical shift in the textile industry is due. Such an opportunity should be seized to enable the textile industry to enjoy a comparative advantage in the eastern, central, and western regions and a well-coordinated geographical layout, thereby maintaining and enhancing its competitiveness on the international market. All favorable conditions should be tapped to establish a market-oriented mechanism for innovation in the textile industry, driven by enterprises and supported by research institutions, universities, and colleges, so as to form a seamless process of academic research, development, and customer-centered production. Such a mechanism will help improve quality, foster domestically-initiated brands, enhance added value, and improve the value chain in the industry. Efforts should also be made to further apply energy-saving technologies and to promote the re-use and recycling of resources so as to facilitate development in the textile industry in an innovative pattern.

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

I. Outlook for the Chinese economy

The fundamentals have remained basically unchanged to support stable and fairly rapid growth. There are good reasons to expect continued stable and fairly rapid economic growth in China. With ongoing urbanization, informatization, industrialization, and agricultural modernization, the incentives to seek potential growth remain strong. The localities are keen to pursue economic growth and the fiscal conditions of local governments are relatively sound. The outstanding volume of all-system financing aggregates continues to recover, and the effects of fine-tuning and preemptive adjustment measures as well as structural reform are gradually unfolding. Some important price signals have undergone corrections. All these are conducive to stable economic and consumption growth. The structure of the Chinese economy is moving in the anticipated direction. The service and other tertiary industries have expanded rather rapidly and domestic demand, in particular consumer demand, is playing a stronger role in economic growth. During the next period, structural adjustments will continue, further releasing the growth potential and contributing to the long-term and sustainable growth of the Chinese economy.

Yet the domestic and external environments remain complicated. The global economy has been undergoing a process of rebalancing since the outbreak of the global crisis, and a process of slowing down and self-adjustment is proceeding, as evident in the slow pace of the world recovery, the emerging trade protectionism, and the sluggish external demand due to the continued impact of the global crisis. The internal drivers still need to be strengthened, the basis for stable growth is yet to be consolidated, and the structural problem of a high savings rate and a low consumption rate is still unresolved. The combination of structural and cyclical factors will affect growth in China.

Furthermore, due to weak external demand, a slowdown in the growth of the working-age population, and a transformation of the growth pattern, China's potential growth rate is likely to moderate for a period to come. During this process, the impact of employment on the growth rate will become smaller while price levels will be more sensitive to the expansion of consumption. Thus, the tasks of structural adjustment and transformation of the growth rate will be more pressing. Therefore, macroeconomic policies need to seek a better balance among the growth rate, the structure, and prices, and macroeconomic management should be based on the law of economic performance and structural changes. In addition, structural adjustments and reform should be accelerated to optimize resource allocations and to release the long-term growth potential.

The overall price situation has been stable and future trends will depend on the domestic and global environments and aggregate demand. Since the beginning of this year, the year-on-year CPI has declined, and the month-on-month CPI has been on a par with the historical average. In September, the month-on-month CPI moderated. Given the stable economic growth rate, the increase in grain output for nine consecutive years, and the strong industrial capacity, the supply and demand relationship is conducive to stable price levels. Nevertheless, due to labor costs, upward pressures on the prices of resource products and non-tradable goods, price movements are still sensitive to consumption expansion and policy stimulus. Furthermore, attention should also be paid to input factors.

II. Monetary policy in the next stage

Going forward, the PBC will follow the overall arrangements of the State Council, take sustainable development as the central theme and acceleration in the shift of the growth pattern as the core of its policy conduct, follow the principle of making progress while maintaining stability, and properly handle the relationship among preserving relatively rapid and stable growth, economic restructuring, and managing inflation expectations and attaching even greater importance to preserving steady growth. We will continue to implement a sound monetary policy, make macroeconomic management measures even more targeted, flexible, and forward-looking, and strengthen fine-tuning and preemptive adjustments, strike a balance among economic growth, price stability, and risk prevention, and preserve stability in the monetary environment, allowing conditions for the self-adjustment and stability mechanism of the market economy to play a role.

First, a mix of monetary policy instruments will be used and the macro-prudential policy framework will be improved to keep market liquidity at a reasonable level and to guide the stable and proper growth of money and credit aggregates. In view of the balance of payments situation and the supply and demand for liquidity, a combination of liquidity management instruments will be used, such as the reverse repo, repo, central bank bills, deposit reserve requirement ratio, and so forth, to flexibly adjust liquidity in the banking system and to guide stable movement in market interest rates. The macro-prudential policy will continue to play a counter-cyclical role, and the parameters will be adjusted as appropriate in light of the actual economic performance, the soundness of financial institutions, and implementation of a credit policy to guide financial institutions to support real sector development in a more targeted and preemptive manner.

Second, credit resource allocations will be optimized to support structural adjustments and to better serve the real sector. Measures will be taken to improve the structure of the stock of credit assets. Coordination of credit and industrial policies will be enhanced and guidance of the macro credit policy improved. Financial institutions will be guided to strengthen organization, management, and product innovation and to increase financial support to small- and medium-sized enterprises, especially micro and small enterprises; a multi-layered, diversified, and reasonably competitive rural financial service system will be developed to support agricultural production, income gains for farmers, and the development of rural areas; measures will be taken to beef up support for major projects that are vital to the national economy and that can boost economic activities in the surrounding areas, and for key sectors in the national economy, such as science and technology development, the cultural and tourist industries, and the emerging strategic industries; efforts will be made to open up a new situation in terms of financial support to employment creation, poverty alleviation, and supporting students in need; banks will be encouraged to pursue product innovation and to explore modes of credit management, to give more support to energy conservation, emission reductions, and a low-carbon economy; to support national and regional economic development policies, and to take steps to provide financial support and services for balanced economic development. Strict controls will remain to restrict lending to highly polluting industries and to those with excess capacity. Differentiated housing mortgage policies will continue to support the construction of welfare housing and common commercial housing projects with apartments that have modest floor plans and to support purchases by first-time home buyers of common commercial housing for his/her own use, and to contain speculative purchases and purchases for investment purpose.

Third, the market-based interest-rate reform and the RMB exchange-rate regime reform will be advanced while efforts will be made to improve the efficiency of resource allocations of the financial system and to improve the macroeconomic management mechanism. Measures will be taken to cultivate a system of market base rates and to improve the central bank's capacity to guide market interest rates. Financial institutions will be encouraged to develop a risk pricing capacity, to use their autonomy to offer interest rates within a set range of the benchmark rates to properly price products, to strengthen non-deposit liability management and cost constraints, to assess interest-rate risks properly, to improve pricing capacity, to maintain pricing order, and to promote balanced development of the real economy and financial sector. The RMB exchange-rate regime will be improved to enhance RMB exchange-rate flexibility in both directions, so that market demand and supply will play a greater role, and to keep the exchange rate basically stable at an adaptive and equilibrium level. Development of the foreign exchange market will be further promoted to facilitate innovation in exchange-rate risk management. Measures will be taken to support the use of RMB in cross-border trade and investment and the channel for inflows and outflows of RMB funds will be broadened. Direct trading of the RMB against the emerging market currencies will be promoted on the inter-bank market to facilitate RMB settlement of cross-border trade. The impact of changes in the international situation on capital movements will be closely monitored and effective monitoring of cross-border capital flows will be enhanced.

Fourth, sound development of the financial market will be promoted and the reform of financial institutions will be deepened. Efforts will be made to further develop the bond market, to step up support for direct financing, and to broaden the financing channels for small and micro enterprises. Measures will be adopted to promote financial market innovation and to enhance risk awareness. Emphasis will be placed on the role of the market mechanism, on consolidating and strengthening market infrastructure and stronger supervision and regulation to promote the healthy and sound development of financial markets. Following the arrangements and decisions of the National Financial Work Conference at the beginning of 2012, the reform of large commercial banks will be deepened to improve corporate governance and the modern financial enterprise system, to strengthen internal governance and risk management, and to enhance innovation and development capacity and international competitiveness. The pilot program of the County Area Banking Division of the Agricultural Bank of China will be advanced to improve the bank's financial services to the agricultural sector. The development of overall financing policy will be considered comprehensively; the market reform of the China Development Bank will be deepened, while the reform of the Export-Import Bank of China and the Agricultural Development Bank of China will be advanced based on the principle of one set of specific policies for each bank and providing specific guidance. The reform of the Postal Savings Bank of China will be deepened and the market-based transformation of its asset management company will continue. The pilot reform of cross-sector operations will be implemented on a prudent and progressive basis, and the measures designed for the Pilot Comprehensive Financial Reform Area in Wenzhou will be put into practice to promote the sound development of private financing on the basis of legislation and regulation. Private capital will be encouraged to play a part in the reform of local financial institutions and to speed up the development of a new type of financial institutions.

Fifth, effective measures will be adopted to mitigate systemic financial risks and to preserve stability in the financial system. Macro-prudential regulation will be enhanced to guide financial institutions to operate on a sound basis. Financial institutions will be urged to strengthen internal control and risk management, better monitor and manage the risks in lending to local government financing platforms, in off-balance sheet operations, and in real-estate financing. The framework for systemic financial risk assessments and early warnings will be improved, and monitoring and assessments of cross-sector, cross-market, and cross-border financial risks will be strengthened to prevent the spread to the financial system of risks associated with the real economy in some regions, industries, and enterprises, and those arising from financing activities outside of the formal financial system. It is necessary to build a crisis management and risk disposal framework and to further efforts to build a deposit insurance scheme. A variety of measures will be taken to safeguard the bottom line of preventing systemic risks and regional financial risks.