China Monetary Policy Report
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Monetary Policy Analysis Group of

the People's Bank of China

Executive Summary

The Chinese economy withstood the severe test of the global financial crisis in 2009. In the face of the extremely complex domestic and international situation, China kept a proactive fiscal policy and a moderately loose monetary policy, and continued to implement a package of policy measures with timely adjustments. As a result, China was among the first that saw the economic recovery and an upturn in the economy. In 2009, China's Gross Domestic Product (GDP) grew 8.7 percent year on year to 33.5 trillion yuan, with the growth gaining pace quarter on quarter. The Consumer Price Index (CPI) declined 0.7 percent, despite a rise at the end of the year.

In accordance with the overall arrangements of the State Council, the People's Bank of China (PBC) implemented a relatively loose monetary policy. It maintained adequate liquidity in the banking system, guided financial institutions to increase credit extension and optimize the credit structure, and stepped up financial support for economic growth. In general, the relatively loose monetary policy was transmitted effectively, playing a key role in expanding aggregate demand, supporting the economic upturn, and alleviating the deflation expectations at the beginning of the year. The PBC also paid much attention to ensure steady and sustainable credit growth and to prevent financial risks. To this end, it adjusted its policy focus, intensity, and pace in a forward-looking and flexible manner. As a result, credit growth moderated in the third and fourth quarters at a more stable pace, which helped prevent and resolve risks that may harm long-term economic stability and development.

At end-2009, broad money M2 posted 60.6 trillion yuan, a year-on-year rise of 27.7 percent and an acceleration of 10.0 percentage points from the growth during the same period of the last year. Narrow money M1 registered 22.0 trillion yuan, an increase of 32.4 percent from the same period of the last year, which was 23.3 percentage points higher in year-on-year terms. M1 accounting for a larger share indicates more dynamic economic activities. Deposits increased quickly, with demand deposits accounting for an increasing share, whereas loans expanded at a rapid pace, and medium- and long-term loans rose by a large margin. At end-2009, RMB loans stood at 40.0 trillion yuan, a rise of 31.7 percent year on year and an acceleration of 13.0 percentage points. This also represents growth of 9.6 trillion yuan from the beginning of the year, which is 4.7 trillion yuan more than the increase during the same period of the last year. Lending rates offered by financial institutions climbed after initial declines. In December, the weighted average RMB lending rate for non-financial institutions and other sectors was 5.25 percent, down 0.31 percentage points from the beginning of 2009. The RMB exchange rate remained basically stable at an adaptive and equilibrium level. At end-2009, the central parity of the RMB against the US dollar posted 6.8282 yuan per dollar.

Supported by many favorable factors, the Chinese economy is expected to maintain sound and relatively rapid growth in 2010. But this growth will face challenges from the complex domestic and global situations. At the global level, despite the improved performance of the world economy, new sources of growth are not yet clear and the major economies have limited policy space to further expand stimulus measures. Moreover, rising trade frictions, the end of the stimulus policies, and other uncertainties will also affect the international economy and the external environment for China's development. With regard to the domestic situation, though there has been a rebound in demand, it has not been established on a balanced foundation, and the role of private investment and the contribution of domestic demand to growth need to be strengthened. Boosting household consumption and improving the economic structure remain demanding tasks, and efforts are needed to monitor price movements and watch out for financial risks. In an effort to accelerate the shift in the growth model it is important that favorable conditions are created for long-term development and that sound and rapid growth for the short term is ensured.

During the next stage, in line with the overall arrangements of the State Council, the PBC will enhance the momentum of economic improvements and an upturn in the economy by combining market-based mechanisms and macroeconomic management and by striking a balance between supporting sound and rapid economic growth, restructuring the economy, and managing inflation expectations. The PBC will continue the relatively loose monetary policy, properly manage the intensity, pace, and focus of policy implementation, and maintain the consistency and stability of its policies. It will also make its policies better targeted and more flexible in response to new developments so as to ensure that financial support to growth will be sustainable and that the financial system will perform in a healthy and stable manner. The PBC will enhance liquidity management and will employ a variety of policy tools to guide the proper growth of aggregate money and credit supply and will step up financial support to facilitate a shift in the growth model and economic restructuring. The PBC will press ahead with the market-based interest rate reform and improve the RMB exchange rate mechanism. It will accelerate financial product innovation, promote the healthy development of financial markets, and deepen the reform of financial institutions.

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Part 1 Monetary and Credit Performance

In 2009 the Chinese economy recovered and displayed a good upturn momentum. Rapid growth of money and credit played a key role in reversing the decline in the growth rate and realizing a recovery against the backdrop of the liquidity crunch in global financial markets and the deep recession in the global economy.

I. Money supply grew rapidly

At end-2009 the outstanding balance of broad money M2 grew 27.7 percent year on year to 60.6 trillion yuan, an acceleration of 10.0 percentage points from 2008. The outstanding balance of narrow money M1 reached 22.0 trillion yuan, representing an increase of 32.4 percent year on year and an acceleration of 23.3 percentage points from 2008. Cash in circulation M0 grew 11.8 percent year on year to 3.8 trillion yuan, representing a deceleration of 0.9 percentage points from 2008. Net cash injections for the entire year totaled 402.7 billion yuan, 7.1 billion yuan less than the injections in 2008.

Aggregate money supply continued its rapid growth, with M1 accounting for a larger share, thus indicating more dynamic economic activities. In the first 11 months, growth of M2 and M1 continued an accelerated momentum, especially in the first half of 2009. At end-December, the growth of M2 and M1 decelerated somewhat but still remained at a high level due to the high base growth at end-December 2008. At the beginning of 2009, M1 grew relatively slowly, at only 6.7 percent at end-January, 12.1 percentage points lower than the growth of M2 during the same period. In mid-2009, M1 growth accelerated markedly and rebounded to its pre-crisis level. In September, growth of M1 began to surpass that of M2, remaining above 30 percent in the fourth quarter.

II. Growth of deposits of financial institutions accelerated, with a larger increase in demand deposits

At end-2009, the outstanding balance of deposits of all financial institutions (throughout this Report, “all financial institutions” includes foreign-funded financial institutions) denominated in both RMB and foreign currencies increased by 27.7 percent year on year to 61.2 trillion yuan, 8.4 percentage points higher than the growth in 2008, representing an increase of 13.2 trillion yuan from the beginning of the year and an acceleration of 5.4 trillion yuan year on year. In particular, the outstanding balance of RMB deposits rose 28.2 percent year on year or 13.1 trillion yuan to 59.8 trillion yuan, representing an acceleration of 8.5 percentage points or 5.4 trillion yuan from the growth in 2008. The outstanding balance of foreign currency deposits rose 8.4 percent, or US$16.2 billion, to US$208.9 billion, representing a deceleration of 3.6 percentage points, or US$15.7 billion, from the growth in 2008.

Broken down by sectors and maturities, the growth of deposits of non-financial companies was higher than that of household deposits, indicating a concentration of demand deposits. Due to the gradual economic recovery and the dynamic capital market, households and individuals invested more heavily in production and business, and growth of household deposits decelerated remarkably. The outstanding balance of household RMB deposits increased by 19.3 percent year on year to 26.5 trillion yuan at end-2009, a deceleration of 7.0 percentage points from 2008 but an increase of 4.3 trillion yuan from the beginning of 2009, representing a deceleration of 329 billion yuan year on year. The acceleration of non-financial corporate RMB deposits was obvious in 2009. In particular, after May their growth remained higher than that of household deposits. At end-2009, the outstanding balance of RMB deposits of non-financial companies stood at 29.8 trillion yuan, an increase of 37.2 percent year on year and an acceleration of 22.0 percentage points from the growth in 2008, representing an increase of 8.1 trillion yuan from the beginning of the year and an acceleration of 5.2 trillion yuan year on year. In particular, corporate deposits grew rapidly, indicating the generally stronger payment capacity of the corporate sector. At end-2009, corporate deposits had increased by 6.6 trillion yuan from the beginning of the year, representing an acceleration of 4.2 trillion yuan year on year. Demand deposits accelerated markedly, among which corporate demand deposits and household demand deposits accelerated by 3.1 trillion yuan and 1.1 trillion yuan respectively year on year. At end-2009, the outstanding balance of fiscal deposits had increased 24.2 percent year on year to 2.2 trillion yuan, representing an increase of 436.8 billion yuan from the beginning of the year and an acceleration of 409.8 billion yuan year on year.

III. RMB loans issued by financial institutions grew rapidly, and there was a large-scale rise in the share of medium- and long-term loans

At end-2009, the outstanding balance of loans issued by all financial institutions in both RMB and foreign currencies grew 33.0 percent year on year to 42.6 trillion yuan, representing an acceleration of 15.1 percentage points from 2008, an increase of 10.5 trillion yuan from the beginning of the year or an acceleration of 5.5 trillion yuan year on year. The bulk of medium- and long-term loans in both RMB and foreign currencies went to the infrastructure sector (transportation, warehousing and postal services, production and supply of electricity, gas, and water, water conservation, environmental protection, and public facility management), the leasing and business service sector, the real estate sector, and the manufacturing sector. In 2009 new medium- and long-term loans of major financial institutions (including state-owned commercial banks, policy banks, joint-stock commercial banks, and city commercial banks) to the above-mentioned four sectors stood at 2.5 trillion yuan, 640.4 billion yuan, 601.3 billion yuan, and 502.5 billion yuan respectively, accounting for 50.0 percent, 13.1 percent, 12.3 percent, and 10.2 percent of all new medium- and long-term loans respectively.

Growth of RMB loans remained brisk. At end-2009, the outstanding balance of RMB loans had grown by 31.7 percent year on year to 40.0 trillion yuan, 13.0 percentage points higher than the growth in 2008, representing an increase of 9.6 trillion yuan from the beginning of the year and an acceleration of 4.7 trillion yuan year on year. Broken down by institutions, the share of national financial institutions in all new loans was 2 percentage points higher than that in 2008, among which state-owned commercial banks registered a large increase of 6 percentage points, whereas the share of local financial institutions in aggregate credit generally declined. In terms of loan destinations, the growth of household loans accelerated gradually, whereas lending to non-financial institutions and other sectors posted relatively rapid growth. At end-2009, the outstanding balance of household loans had grown 43.3 percent year on year, 29.6 percentage points higher than the growth in 2008, representing an increase of 2.5 trillion yuan from the beginning of the year and an acceleration of 1.8 trillion yuan year on year. Consumer loans, especially individual housing mortgage loans, accelerated notably. The outstanding balance of loans issued to non-financial institutions and other sectors grew 29.1 percent year on year, an acceleration of 9.1 percentage points from 2008, representing an increase of 7.1 trillion yuan from the beginning of the year or an acceleration of 2.9 trillion yuan year on year. In particular, medium- and long-term loans grew rapidly, by 5.0 trillion yuan from the beginning of the year and accelerating 2.9 trillion yuan year on year. Paper financing increased by 456.3 billion yuan from the beginning of 2009, a deceleration of 189.9 billion yuan year on year, and posted a large increase in the first half of 2009 but a decline in the second half. Financial institutions continued to strengthen credit support to small- and medium-sized enterprises (SMEs). In 2009 lending to SMEs by banking institutions increased by 3.4 trillion yuan, representing growth of 30.1 percent year on year and an acceleration of 16.6 percentage points. In particular, lending to small-sized enterprises grew 41.4 percent year on year, 34.2 percentage points higher than at the beginning of 2009.

Table 1: RMB loans of financial institutions

Unit: 100 million yuan

	2009		2008	
	New loans	Acceleration year on year	New loans	Acceleration year on year
Policy banks①	9496	3578	5917	1637
State-owned commercial banks②	41021	22909	18022	4967

Joint-stock commercial banks	22283	10877	11406	3690
City commercial banks	7920	3959	3962	983
Rural cooperative financial institutions③	9727	3819	5908	823
Foreign-funded financial institutions	18	−610	628	−1076

Note: ① Policy banks include the China Development Bank, the Export-Import Bank of China, and the Agricultural Development Bank of China. Due to the reform the China Development Bank has become a share-holding company and is in a transition period, so in statistical terms it is included with the policy banks.

② State-owned commercial banks include the Industrial and Commercial Bank of China, the Agricultural Bank of China, the Bank of China, and the China Construction Bank.

③ Rural cooperative financial institutions include rural cooperative banks, rural commercial banks, and rural credit cooperatives.

Source: The People's Bank of China.

Global financial markets were seriously affected after the emergence of the global financial crisis. In order to control risks and increase returns, financial institutions repatriated their overseas assets to support the issuance of foreign exchange loans when the demand for foreign exchange loans grew rapidly, but the growth of foreign exchange deposits was limited. At end-2009, the outstanding balance of foreign exchange loans had grown 56.0 percent year on year to US$379.9 billion, up 44.1 percentage points from 2008, representing an increase of US$136.2 billion from the beginning of the year or an acceleration of US$110.5 billion year on year. In particular, the acceleration registered US$60 billion in the fourth quarter year on year due to the gradual recovery of foreign trade and the "going global" process of enterprises. In terms of loan orientations, foreign trade financing and medium- and long-term loans increased in 2009 by US$57.97 billion and US$58.94 billion respectively, representing an acceleration of US$58.28 billion and US$21.12 billion year on year. The growth of foreign exchange credit moderated at year-end as room for reducing overseas liquidities was limited.

Box 1: Manage Well the Growth and Pace of Money and Credit Supply, Guide Financial Institutions in Improving the Credit Structure

To cope with the global financial crisis, money and credit supply played an important role in supporting economic development in 2009, and credit supply volatility increased along with the changing situation. In 2010 attention should be paid to managing the pace of credit supply according to the credit demand of real sectors, improving credit services, and focusing on an improvement in the credit structure.

1. A review of money and credit growth, pace, and structure in 2009

Aggregate credit increased rapidly in 2009. M2 and M1 grew 27.7 percent and 32.4

percent at year-end, the highest growth since 1996 and 1993 respectively. New RMB loans in 2009 totaled 9.59 trillion yuan, representing an acceleration of 4.69 trillion yuan or an increase of 31.7 percent year on year, the highest growth since 1985. Credit support for economic development was strengthened.

In terms of a quarterly breakdown, the first half of 2009, especially Q1, saw a concentrated issuance of credit. New loans in each quarter registered at 4.58 trillion yuan, 2.79 trillion yuan, 1.30 trillion yuan, and 0.93 trillion yuan respectively. This can be partly attributed to the special needs at the beginning of the year to counter the financial crisis, as well as the effect of the "early issue, early return" mentality of financial institutions. Paper financing and short-term loans experienced relatively large volatility. Volatility of medium- and long-term loans was rather moderate, with new loans registering 1.86 trillion yuan, 1.91 trillion yuan, 1.69 trillion yuan, and 1.23 trillion yuan in the four quarters of 2009 respectively.

In terms of loan orientations, project loans were issued fairly rapidly. Consumption-based loan growth continued to accelerate and paper financing grew in the first several months and then declined. Credit support to the agricultural sector, small enterprises, and other weak sectors was strengthened. Medium- and long-term loans, excluding consumption-based loans, grew by 5.15 trillion yuan during the whole year, representing an acceleration of 2.99 trillion yuan and supporting implementation of the 4-trillion yuan investment plan. New individual consumption-based loans registered 1.80 trillion yuan, representing an acceleration of 1.30 trillion yuan, including 650.8 billion yuan in the first half of 2009 and 1.15 trillion yuan in the second half of 2009, which indicated an obvious acceleration in momentum. Among the newly issued individual consumption-based loans, about 75 percent went to housing mortgage loans, which is closely related to housing consumption. Paper financing increased by 1.48 trillion yuan and 224.8 billion yuan in Q1 and Q2 respectively, but declined by 826.2 billion yuan and 424 billion yuan in Q3 and Q4 respectively. Agricultural-related loans and lending to small enterprises grew by 2.36 trillion yuan and 1.41 trillion yuan respectively in 2009, accounting for 22.4 percent and 24.8 percent of all new loans, indicating a clear upward trend.

2. The PBC took various measures to guide reasonable credit growth

While guiding financial institutions to strengthen support for economic development, the PBC paid attention to stable and sustainable credit growth, improvements in the credit structure, and prevention of financial risks, thus adjusting the policy priorities, strength, and flexibility according to a forward-looking philosophy. In April and May of 2009, the PBC provided window guidance to commercial banks, requiring commercial banks to become "stabilizers" rather "amplifiers" by reasonably controlling the speed of credit issuance and striking a balance between credit support and risk prevention. Since the middle of 2009, with domestic demand gradually supporting economic growth, the PBC strengthened window guidance and required financial institutions to strengthen risk assessments of extended credits. Open market operations were intensified gradually to guide an increase in the interest rate. At the beginning of July, the PBC renewed the issuance of 1-year central bank bills to increase the withdrawal of liquidity and changed to continued net withdrawals of liquidity from net injections of a small amount of liquidity and issued special central bank bills to commercial banks with relatively rapid credit extension to encourage them to pay attention to a stable and proper increase in credit. Based on the principle of "differentiated treatment," the PBC guided financial institutions to strengthen credit support to the agricultural sector, small- and medium-sized enterprises, post-disaster reconstruction, and important areas and weak sectors of the national economy, to strictly restrain lending to enterprises in high energy-consuming, heavily-polluting industries, and industries with excess capacity, and to closely monitor potential systemic financial risks in the local financing platform. With the combined effects of various measures, credit growth in Q3 and Q4 decelerated. In terms of its distribution during the entire year, credit growth remained relatively high and the momentum of growth tended to be stable.

3. Efforts should be made in 2010 to realize appropriate credit aggregates, a balanced pace, and an optimized structure

In line with the spirit of the Central Economic Work Conference and the overall arrangements of the State Council, efforts should be made in 2010 to strike a balance between supporting stable and relatively rapid economic development, adjusting the economic structure, managing deflation expectations, and promoting the transformation of the mode of economic development. Therefore, in 2010 efforts should be made to consider the real demand of economic growth, price movements, and domestic and global market liquidity conditions to reasonably guide monetary conditions to return to the normal pre-crisis level. Financial institutions are encouraged to earnestly manage the pace of credit extensions, realize balanced credit growth, and avoid large quarterly or monthly volatility.

At the same time, attention should be given to improving the credit structure, implementing a differentiated-treatment credit policy so that credit can be used by the real economy and support is strengthened for important fields and weak sectors. First, credit funds should be used mainly to support ongoing projects and lending to new projects should be strictly controlled. Of the new medium- and long-term project loans, 20 percent to 30 percent should be allocated to new projects and the rest should go to old projects. Second, the structure of credit maturity should be optimized. The share of new medium- and long-term loans of all loans should be lower than the level in 2009 and should return to the average in normal years. Third, credit support for the agricultural sector should be further strengthened. As the spring farming season grows near, the growth of agricultural loans in principle should not be less than the average growth of all loans. Fourth, efforts should be made to increase credit support for small enterprises and private enterprises. The objective is for the growth of lending to small enterprises to be greater than the growth of all lending to enterprises and for a larger share of new small enterprise loans in all new enterprise loans. Fifth, efforts should be made to further develop individual consumption-based credit to beef up consumption.

IV. Liquidity in the banking system was sufficient

At end-2009, the outstanding balance of base money had increased by 14.1 percent year on year to 14.7 trillion yuan, representing an increase of 1.8 trillion yuan from the beginning of the year. The money multiplier at end-2009 was 4.11, down 0.53 from the high at end-August but up 0.43 from end-2008, representing generally strong capacity for money creation. At end-2009, the excess reserve ratio of financial institutions registered 3.13 percent. In particular, the excess reserve ratio of the four state-owned commercial banks, joint-stock commercial banks, and rural credit cooperatives was 1.72 percent, 3.13 percent, and 8.78 percent respectively.

V. The interest rate for loans from financial institutions rose after declining and was generally lower than the level in 2008

In the first three quarters of 2009, the interest rate for loans to non-financial institutions and other sectors declined and remained low. Until September, the weighted average interest rate for loans to non-financial companies and other sectors stood at 5.05 percent, down 0.51 percentage point from the beginning of the year. In Q4, the interest rate rebounded slightly due to changes in the market environment. In December, the weighted average interest rate for loans to non-financial companies and other sectors rose to 5.25 percent, but was still 0.31 percentage points lower than that at the beginning of the year. In particular, the general weighted average lending rate and the weighted average paper financing rate stood at 5.88 percent and 2.74 percent, down 0.35 and 0.15 percentage point from the beginning of the year respectively. In December, the weighted average interest rate of housing mortgage loans stood at 4.42 percent.

As for the adjusted interest rate, the proportion of loans with interest rates adjusted downward from the benchmark rate increased. In December, the share of loans to non-financial companies and other sectors with interest rates adjusted downward or at the benchmark rate registered 33.19 percent and 30.26 percent respectively, up 7.63 and 0.13 percentage points from the beginning of the year; the share of loans with interest rates adjusted upward from the benchmark rate accounted for 36.55 percent, down 7.76 percentage points from the beginning of the year.

Affected by movements in global financial markets and changes in supply and demand for domestic funds, the interest rates of domestic foreign currency declined. In December, the weighted average US dollar lending rate for maturities of less than three months and for between three months and six months in the domestic market stood at 1.59 and 1.66 percent respectively, down 2.06 and 2.36 percentage points respectively from the beginning of the year. The weighted average rate of domestic US dollar demand deposits and large-value US dollar deposits with a maturity of less than 3 months stood at 0.17 and 0.46 percent respectively, down 0.68 and 0.76 percentage point from the beginning of the year. From end-2008 to the first half of 2009, several financial institutions cut their interest rates for small-value foreign currency deposits on a number of occasions. In particular, the 1-year US dollar deposit rate was cut from 3 percent to around 0.8 percent. In order to increase the sources of foreign currency funds, several financial institutions raised the interest rate for small value foreign currency deposits in September; for example, the 1-year US dollar deposit rate was adjusted to around 1 percent.

Table 2: Shares of loans with rates adjusted at various ranges, January through December 2009

Unit: Percent

	Adjusted downward	At benchmark	Adjusted upward					
	[0.9， 1)	1	Sum	(1.0， 1.1)	(1.1， 1.3]	(1.3， 1.5)	(1.5， 2.0]	Above 2.0
January	23. 51	34. 27	42. 21	14. 62	12. 79	4. 97	6. 98	2. 86
February	28. 82	33. 56	37. 62	12. 29	10. 36	4. 82	6. 98	3. 18
March	28. 38	35. 18	36. 43	12. 21	10. 46	4. 37	6. 64	2. 75
April	26. 72	33. 48	39. 8	12. 18	11. 07	5. 46	7. 97	3. 12
May	27. 34	32. 4	40. 26	13. 03	11. 46	5. 18	7. 49	3. 1
June	30. 47	33. 7	35. 83	12. 66	10. 24	4. 7	5. 82	2. 41
July	32. 76	32. 18	35. 06	11. 89	9. 16	4. 52	6. 55	2. 94
August	30. 91	30. 79	38. 31	13. 34	10. 68	5. 03	6. 45	2. 81
September	31. 82	30. 61	37. 57	12. 55	10. 81	5. 07	6. 41	2. 73
October	30. 27	30. 90	38. 83	12. 40	10. 85	5. 25	7. 16	3. 17
November	30. 19	30. 53	39. 28	11. 96	11. 14	5. 37	7. 44	3. 38
December	33. 19	30. 26	36. 55	11. 37	10. 01	5. 13	6. 64	3. 40

Source: The People's Bank of China.

Table 3: The average interest rates of large value deposits and loans denominated in US dollars, January through December 2009

unit: %

	Large value deposits						Loans				
	Demand Deposits	Within 3-months	3–6 months	6–12 months	1-year	Above 1-year	Within 3-months	3–6 months	6–12 months	1-year	Above 1-year

January	0.34	0.55	1.36	1.26	1.91	1.46	2.89	3.33	3.48	3.04	3.62
February	0.16	0.48	1.46	1.79	1.95	5.01	2.18	2.87	3.13	2.61	2.74
March	0.15	0.55	1.32	1.77	2.20	1.30	2.23	2.44	3.05	2.51	3.39
April	0.10	0.36	1.13	1.39	1.58	3.73	1.98	2.26	2.37	2.14	3.59
May	0.11	0.36	0.90	1.17	1.49	5.00	1.59	1.86	1.79	1.49	2.63
June	0.11	0.32	0.76	1.05	1.68	1.12	1.49	1.48	1.52	1.44	3.53
July	0.10	0.32	0.65	1.08	1.52	1.98	1.51	1.47	1.51	1.36	2.61
August	0.10	0.35	0.67	0.93	1.89	1.66	1.41	1.37	1.42	1.53	2.71
September	0.13	0.37	0.61	0.74	1.82	2.33	1.33	1.37	1.51	1.59	2.59
October	0.13	0.43	0.57	0.95	1.60	0.50	1.96	1.41	1.52	1.54	3.04
November	0.12	0.51	0.79	1.35	1.59	1.63	1.42	1.48	1.68	1.76	2.56
December	0.17	0.46	0.75	1.35	1.21	2.84	1.59	1.66	1.91	1.87	2.59

Data source: The People's Bank of China.

VI. The RMB exchange rate remained broadly stable at an equilibrium and adaptive level

In 2009 the RMB exchange rate remained broadly stable at an equilibrium and adaptive level to cope with the global financial crisis. At end-2009, the central parity of the RMB against the US dollar was 6.8282 yuan per US dollar, an appreciation of 64bps, or 0.09 percent, from the end of 2008; the central parity of the RMB against the euro and Japanese yen was 9.7971 yuan per euro and 7.3782 yuan per Japanese yen respectively, depreciations of 1.41 percent and 2.53 percent respectively from the end of 2008. From the initiation of the exchange rate regime reform in July 2005 to end-2009, the RMB had appreciated by 21.21 percent against the US dollar and 2.21 percent against the euro, and had depreciated by 0.98 percent against the Japanese yen. According to the BIS calculation, from the initiation of the exchange rate regime reform to December 2009, the nominal effective exchange rate of the RMB had appreciated by 12.7 percent, whereas the real effective exchange rate had appreciated by 16.3 percent.

In 2009 the peak and trough central parities of the RMB against the US dollar were 6.8201 yuan per US dollar and 6.8399 yuan per US dollar respectively. The largest appreciation and depreciation of the RMB central parity against the US dollar in a single business day was 0.07 percent (50 basis points). Among the 244 trading days, the inter-bank foreign exchange market saw RMB appreciations on 129 days, at par on 1 day, and RMB depreciations on 114 days. Since 2009, the RMB exchange rate against the US dollar has remained stable, moving within a band between 6.81 and 6.85 yuan per US dollar, with relatively stable expectations.

Part 2 Monetary Policy Conduct

In 2009, in face of the serious impact of the international financial crisis, the PBC implemented a relatively loose monetary policy in line with the overall arrangements of the CPC Central Committee and the State Council. Due to such efforts, the PBC has managed to maintain adequate liquidity in the banking system and has guided financial institutions to expand credit extensions, providing stronger financial support for economic development. In general, the relatively loose monetary policy was effectively transmitted, playing a key role in stimulating aggregate demand, bolstering the economic recovery, and curbing deflationary expectations at the beginning of 2009. Meanwhile, to attach great importance to stable and sustainable credit growth and to prevent financial risks, the PBC adjusted the focus, intensity, and pace of relevant policies in a forward-looking and flexible manner. As a result, credit growth in Q3 and Q4 moderated compared with that during the first half of the year. The more stable growth helped prevent and mitigate risks that will threaten stable economic development in the long run.

I. Open market operations were conducted in a timely manner and with appropriate strength

Since 2009, the PBC has closely monitored the latest economic and financial developments and changes in the market environment, strengthened the forecast and analysis of liquidity supply and demand in the banking sector, and conducted open market operations in a flexible manner in line with the relatively loose monetary policy, so as to keep reasonably adequate liquidity in the banking system and to manage stable movement of interest rates in the money market. First, the strength and frequency of open market operations have been properly handled in accordance with the liquidity changes at different stages to strengthen liquidity management in a flexible and appropriate manner. A total of 4.0 trillion yuan of central bank bills was issued, and 4.2 trillion yuan of repo operations were conducted. As of end-2009, the value of outstanding central bank bills stood at 4.2 trillion yuan. Second, a reasonable mix of open market operation instruments was designed. Based on the economic and financial situations both at home and abroad and the liquidity supply and demand in the banking system, short-term operations with a maturity of 3 months or less dominated operations in the first half of the year. The issuance of 1-year central bank bills was resumed in July to freeze liquidity in an extended the time-frame. In the meantime, the maturity structure of repo operations with a maturity of no more than 3 months was adjusted, supplementing the maturity structure of central bank bills. This adjustment improved the targeting and flexibility of liquidity management. Third, the flexibility of interest rates was enhanced in open market operations. Interest rates of open market operations were generally stable in the first half of the year. In the second half, economic stabilization and recovery were further established and interest rate fluctuations were on a rise after the resumption of IPOs. In this context, the PBC adjusted the interest rates of open market operations with more flexibility in a timely manner. The interest rates of open market operations stabilized after a moderate increase. This helped promote a reasonable rebound of money market interest rates and put into better play the role of market interest rates in adjusting the supply and demand of funds. At end-2009, the interest rates of 28-day repo and 3-month central bank bills registered 1.18 percent and 1.3280 percent respectively, up 28 percentage points and 36 percentage points over the beginning of the year. The issuance rate of 1-year central bank bills posted 1.7605 percent, increasing by nearly 26 basis points since the resumption. Fourth, time deposit business of state treasury fund with commercial banks was carried out in a timely manner. In an effort to strengthen coordination and cooperation with the pro-active fiscal policy, the PBC enhanced the frequency and size of time deposit operations with commercial banks for state treasury cash management and further diversified the types of operations. A total of 11 open operations with a total value of 310 billion yuan were conducted and their outstanding value at year-end stood at 120 billion yuan.

II. Guide financial institutions to pace credit extensions and to optimize the credit structure

Efforts have been made to improve the coordination and cooperation of monetary policy with fiscal and industrial policies, to guide financial institutions to strengthen the extension of supporting loans for central government-invested projects, and to provide supporting financial services for welfare programs such as *electronic home appliances to the countryside* and *automobiles to the countryside*. The differentiated approach will be maintained in the credit extension policy to strengthen credit support to key sectors and weak links in the national economy, including agriculture, farmers and rural areas, SMEs, western development, energy conservation and emission reduction, job creation, students in need, and post-disaster reconstruction and to impose strict control over credit extensions to enterprises in high energy-consuming or heavily-polluting industries with excessive production capacities. Efforts have been made to improve management of rediscounts. Agro-linked bills and bills issued, accepted, and held by county-level enterprises and small- and medium-sized financial institutions had rediscount priority over other bills. This helped promote financing for agro-linked industries and SMEs. Meanwhile, the PBC closely monitored loans extended via local investment and financing platforms to discover factors that have the potential to cause systemic financial risks. Commercial banks were urged to pace their credit extensions, strike a balance between providing financial support to economic development and preventing risks, implement regulatory requirements, such as a capital adequacy ratio, loan concentration, and a minimum capital requirement for fixed-asset investment projects, to maintain healthy and sustainable development and financial stability.

III. Stabilize benchmark deposit and lending rates

After cutting the benchmark deposit and lending rates on five occasions since September 2008, the PBC maintained the benchmark rates at a stable level in 2009, with the 1-year benchmark deposit rate and the lending rate registering 2.25 percent and 5.31 percent respectively. Meanwhile, the market reform of interest rates has been steadily promoted. Continued efforts have been made to foster a benchmark interest rate on the money market and to guide financial institutions to improve the pricing mechanism for interest rates.

IV. The PBC has actively participated in the cooperative response to the international financial crisis and has steadily pressed ahead with pilot RMB settlements of cross-border trade transactions.

To respond to the needs of neighboring countries and regions, the PBC signed six swap agreements of local currencies, with South Korea, Hong Kong, Malaysia, Indonesia, Belarus, and Argentina, with a total value of 650 billion yuan. Active efforts were made to promote bond issuances by the IMF. The PBC signed an agreement with the IMF to purchase IMF bonds of up to US$50 billion. The PBC has actively promoted regional currency and financial cooperation, such as the multilateralization of the Chiang Mai Initiative. On December 24 2009, the ASEAN 10+3 and Hong Kong (China) signed an agreement on the multilateralization of the Chiang Mai Initiative, with a total value of US$120 billion. The PBC has also taken an active part in the Trade Finance Program of the International Finance Corporation and the Inter-American Development Bank.

Vigorous efforts have been made to facilitate trade and investment and the pilot RMB settlements of cross-border trade transactions have proceeded smoothly. As approved by the State Council, 365 enterprises in Shanghai, Guangzhou, Shenzhen, Zhuhai, and Dongguan have been covered by the pilot project of RMB settlement of cross-border trade transactions since July 2007. The project aims to help enterprises avert exchange rate risks, reduce foreign exchange losses, and strengthen trade and economic ties with neighboring countries and regions. Since the day of its launch, the pilot cross-border RMB receipt and payment information management system has performed in a stable manner, with orderly financing operations under the RMB account, financing of cross-border projects, and the purchase and sale of RMB. By virtue of well-defined policies and operational processes for RMB settlement, export tax refunds (exemptions), and custom declarations of imports and exports and due to the convenient and smooth cross-border RMB clearing, enterprises were not required to submit foreign exchange verification forms for custom declarations and settlement of RMB and refunds of the export tax, nor were they required to transfer export revenue into the account for verification. This has streamlined the administrative procedures for enterprises, accelerated fund transfers, and reduced transaction expenses. At end-2009, banks had conducted 409 cross-border RMB settlement transactions for enterprises, with a total value of 3.58 billion yuan. Domestic agent banks have opened 160 inter-bank RMB fund transfer accounts for participating banks overseas, with an outstanding value of 690 million yuan. The Bank of China Hong Kong has opened 53 inter-bank RMB fund transfer accounts for participating banks overseas, with an outstanding value of 48.62 billion yuan.

V. The reform of financial institutions has been steadily advanced

The reform of the four large state-owned shareholding commercial banks, namely the Industrial and Commercial Bank of China (ICBC), the Bank of China (BOC), the China Construction Bank (CCB), and the Bank of Communications, has been deepened, improving their performance and efficiency. Since its inauguration on January 16, 2009, the Agricultural Bank of China (ABC) Co. Ltd. has basically established a modern corporate governance structure, progressively advanced internal reform, upgraded its operation mechanism, and made progress in a pilot multi-divisional reform of county-level agro-related services, which was being extended nationwide. The China Development Bank accelerated the pace for its market-oriented reform by strengthening risk management and internal controls. At end-August 2009, China Development Finance Co. Ltd. was inaugurated to develop equity investment in addition to the traditional business of the China Development Bank. Meanwhile, continued efforts have been made to advance the reform of policy financial institutions. According to the arrangements of the State Council, in March 2009 the PBC and relevant agencies established a working group on the reform of the China Export and Import Credit Insurance Company to study the feasibility of its reform plan and the revision of its articles of association, focusing mainly on its functional positioning, scope of business, coordination mechanisms, and measures to support its reform. The China Agricultural Development Bank also pressed ahead with its internal reform by strengthening risk management and internal control mechanisms and developing new business lines in order to pave the way for a comprehensive reform in the future.

Table 4: Major indicators for the four listed state-owned commercial banks at end-September 2009

	Total Assets (trillion yuan)	Capital Adequacy Ratio (%)	NPL Ratio (%)	Pre-tax Profits (100 million yuan)
ICBC	11.67	12.60	1.68	1289
Bank of China	8.34	11.63	1.60	848
CCB	9.35	12.11	1.57	1116
Communications Bank of China	3.30	12.52	1.44	293

Sources: Reports of the ICBC, Bank of China, CCB, and Communications Bank of China for Q3 2009.

The reform of the rural credit cooperatives (RCCs) has yielded positive results at the current stage. The smooth implementation of the financial support policy served as a positive incentive to promote the rural credit cooperative reform. As a result, the RCCs' credit quality has significantly improved. At end-2009, a total of 164.1 billion yuan of special bills was redeemed for RCCs in 2,340 counties (cities), accounting for 97 percent of all bills issued for this purpose, and 2.1 billion yuan of earmarked loans was disbursed. At end-2009, based on the four-category loan classification, the total volume and share of non-performing loans (NPL) registered 349 billion yuan and 7.4 percent respectively, down 165.7 billion yuan and 30 percentage points respectively compared with end-2002. The lending ability of the RCCs improved significantly and agro-linked services were notably strengthened. At end-2009, the total deposits and outstanding loans of the RCCs stood at 7 trillion yuan and 4.7 trillion yuan respectively. The outstanding loans of the RCCs accounted for 12 percent of the total of all financial institutions, an acceleration of 1.4 percentage points over end-2002. The outstanding agricultural loans issued by the RCCs posted 2.1 trillion yuan, accounting for 44 percent and 95 percent of the RCCs' total credits and the total agricultural credit of all financial institutions respectively, up 4 percentage points and 14 percentage points over end-2002. Reform of the property rights system proceeded smoothly and the legal person governance structure was preliminarily established. As of end-2009, a total of 2,054 RCCs with a legal person status at the county (city) level, 43 rural commercial banks, and 195 rural cooperative banks had been established. Some RCCs explored ways to improve the property rights system and legal person governance, producing preliminary results. In order to further deepen the RCC reform, focused efforts should be made to improve the relevant institutional arrangements and to establish a long-term sustainable development mechanism. During the reform, RCCs should be urged and guided to provide better financial services for agriculture, farmers, and rural areas and to make clear progress in defining property rights and reforming the property rights system. In order to maintain a generally stable legal person status at the county (city) level, RCCs should be given discretion to make property rights arrangements to advance their market-oriented reform. Market access and exit mechanisms should be established to introduce competition and bolster external stimuli for the RCCs. A long-term system of policies supporting rural finance should be set up to help the RCCs realize sustainable development.

VI. Reform of foreign exchange administration was deepened

Adjusting the direction and focus of foreign exchange administration in a timely manner, the PBC launched a series of measures in response to the international financial crisis in order to support the stable development of the external sector. Efforts were made to improve the networked verification and management of foreign exchange receipts and settlement of export and import transactions and to raise the basic ratios, such as advanced sales revenue, deferred payments, etc. All new short-term external debt issued by financial institutions as a result of the rise in the quota in 2009 was channeled to support the trade financing of enterprises.

Reform of foreign exchange administration was deepened to better serve economic development. Procedures for verification and examination of foreign exchange receipts and sales of outsourcing service enterprises were streamlined to provide eligible enterprises with facilitating policies, such as account openings and fund remittances. A disclosure-based rather than an approval-based approach was adopted to verify the source of foreign exchange funds used for overseas investment and outbound remittances of funds, and funds channeled for overseas direct investment enjoyed an advantageous remittance policy. The pilot program for chartered currency exchange for individuals was expanded to cover 13 provinces (municipalities or autonomous regions) and 4 cities specifically designated in the state plan, so as to satisfy the needs for currency exchange by individuals in international tourist destinations and areas with a developed external sector. The QFII and QDII-related foreign exchange management was improved. The investment quota for the QDII was increased. The status of examination and approval of the investment quota for qualified institutional investors was disclosed to enhance the transparency of administrative licensing. At end-2009, a total of 83 QFIIs was approved, with an investment quota of US$16.5 billion, and 65 QDIIs were approved, including commercial banks, fund management companies, insurance companies, etc., with an investment quota of US$63.3 billion.

The monitoring of cross-border capital flows was improved to prevent risks caused by abnormal changes. Efforts were made to standardize supervision of foreign exchange receipts and sales to end evasion of regulations by way of different means and to regulate the sales of foreign currency cash held by individuals. The *Measures on the Examination of Banks' Implementation of the Rules on Foreign Exchange Administration* were amended to advance management of bank compliance with foreign exchange businesses. Efforts were made to fight illegal and irregular foreign exchange activities such as underground money shops.

VII. The formation of the exchange rate mechanism was improved

The managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies was further improved in a self-initiated, controllable, and gradual manner to enable market supply and demand to play a fundamental role in the yuan exchange-rate formation and to keep the exchange rate basically stable at an adaptive and equilibrium level.

Part 3 Financial Market Analysis

In 2009 China's financial market performed in a sound manner and market liquidity was adequate. Trading on the money market was brisk and interest rates recovered from their earlier lows. Bond yield curves gradually moved upward and bond issuances grew rapidly. Trading on the stock market expanded notably and stock indices rose by a large margin.

In 2009 the aggregate financing volume of the domestic non-financial sector (including the household, corporate, and public sectors) grew rapidly to the total of 13.1 trillion yuan, an increase of 1.2 times over 2008. Loans dominated the financing structure even though their share of total financing declined. As the effects of an proactive fiscal policy unfolded, the volume of financing through government securities grew notably, accounting for a larger percentage of the total financing. The volume of financing through stocks and enterprise bonds maintained a momentum of strong growth, but represented a smaller share of the financing structure.

Table 5: Financing by domestic non-financial sectors

	Volume of financing (100 million yuan)		As a percentage of total financing (%)	
	2009	2008	2009	2008
Financing by domestic non-financial sectors	130747	60486	100.0	100.0
Bank loans[1]	105225	49854	80.5	82.4
Equities[2]	5020	3527	3.8	5.8
Government securities [3]	8182	1027	6.3	1.7
Enterprise bonds[4]	12320	6078	9.4	10.1

Notes: 1. Bank loans in this table include loans denominated in both domestic and foreign currencies.

2. Equity financing in this table includes financing through convertible bonds but it excludes financing by financial institutions on the stock market.

3. The financing volume of government securities in 2009 includes municipal bonds issued by the Ministry of Finance on behalf of local governments.

4. Enterprise bonds include enterprise bonds, corporate bonds, equity warrant bonds, collective bonds, short-term financing bills, and medium-term notes.

Source: The People's Bank of China.

I. Financial market analysis

1.Trading on the money market was brisk and interest rates recovered from their earlier lows

In 2009 the volume of bond repos and inter-bank borrowing on the money market maintained relatively rapid growth. The turnover of bond repos totaled 70.3 trillion yuan, with an average daily turnover of 281.2 billion yuan, up 21.4 percent year on year. The turnover of inter-bank borrowing reached 19.4 trillion yuan, with an average daily turnover of 77.4 billion yuan, an increase of 29.1 percent year on year. Overnight products dominated bond repo and inter-bank borrowing transactions, accounting for 77.7 percent and 83.6 percent of their total turnovers, up 14 percentage points and 12.8 percentage points respectively over 2008. The total turnover of government securities repos on the stock exchanges posted 3.6 trillion yuan, up 46.2 percent year on year.

The financing structure on the money market was characterized by the following: 1) due to their abundant liquidity, state-owned commercial banks played a more dominant role in the supply of funds; 2) Due to the relatively low yields on the money market and considerations of asset allocation strategies, net lending by other commercial banks fell notably compared with 2008; 3) With the rise in the stock market and frequent IPOs in the second half of 2009, non-banking financial institutions, such as securities and fund management companies and insurance companies, had much stronger financing needs; 4) The expansion of assets of foreign-funded financial institutions slowed down, subsequently their needs for financing weakened.

Table 6: Fund flows among financial institutions in 2009

Unit: 100 million yuan

	Repo		Inter-bank borrowing	
	2009	2008	2009	2008
State-owned commercial banks	-254127	-136684	-17539	24597
Other commercial banks	-8636	12690	4367	-35809
Other financial institutions	232790	92373	7030	2540
Of which：Securities and fund management companies	94468	33836	1739	2916
Insurance companies	40327	26538	—	—
Foreign financial institutions	29973	31621	6142	8672

Note: “Other financial institutions” in this table include policy banks, associations of rural credit cooperatives, finance companies, trust and investment companies, insurance companies, securities companies, and fund management companies. A negative sign indicates net lending; a positive sign indicates net borrowing.

Source: The People's Bank of China.

The market for interest rate derivatives operated in a stable manner. The trading of bond forwards was brisk. Its trading volume increased 31.1 percent year on year, 63.4 percent of which was 2- to 7-day products. The trading volume of interest rate swaps steadily increased 12 percent over 2008, among which products with a maturity of one year or less accounted for 56.5 percent of the total. The trading of interest rate forward agreements was relatively slack and the nominal principal declined year on year. The Shibor has played an increasingly important role in the pricing of interest rate derivatives. In 2009, Shibor-based interest rate swaps accounted for 28 percent of the total RMB interest rate swaps and forward rate agreements were all based on the Shibor.

Table 7: Transactions of interest rate derivatives

	Bond forwards		Interest rate swaps		Forward rate agreements	
	Transactions	Value (100 million yuan)	Transactions	Value of nominal principal (100 million yuan)	Transactions	Value of nominal principal（100 million yuan）
2005	108	178.0	—	—	—	—
2006	398	664.5	103	355.7	—	—
2007	1238	2518.1	1978	2186.9	14	10.5
2008	1327	5008.1	4040	4121.5	137	113.6
2009	1599	6556.4①	4044	4616.4	27	60.0

Note: ① *Since 2009, the trading volume of bond forward transactions has been calculated according to the real settled value.*

Source: China Foreign Exchange Trade System.

Interest rates on the money market were higher during the second half than during the first half of 2009, but were generally lower than 2008. With the implementation of the active fiscal policy and relatively loose monetary policy, liquidity in the banking system was adequate. In addition, interest rates paid on excess reserves were cut at end-2008. As a result, the monthly weighted average interest rates of both bond pledged repo and inter-bank borrowing hovered around 0.85 percent, which was a quite low level. In the second half of 2009, due to the stabilization and recovery of the economy, concentrated IPOs, and the rise in the interest rates for the issuance of central bank bills, interest rates on the money market rebounded from their earlier lows. In December, the monthly weighted average interest rate of bond pledged repo and inter-bank borrowing registered 1.26 percent and 1.25 percent respectively, up 35 basis points and 34 basis points respectively over June. At end-2009, overnight and 7-day Shibor was 1.1467 percent and 1.5650 percent respectively, an increase of 6 basis points and 36 basis points over end-June; three-month and 1-year Shibor stood at 1.8319 percent and 2.2505 percent respectively, up 51 basis points and 38 basis points over end-June.

Box 2: The role of the Shibor as the benchmark interest rate on the money market has been consolidated

The Shanghai Inter-bank Offered Rate (Shibor) was officially released in January 2007, marking the beginning of a benchmark interest rate system on China's money market. After 3 years of development, the Shibor-based pricing mechanism has been improved and more widely applied. The Shibor has served as the benchmark interest rate.

The role of the Shibor as the benchmark interest rate on the money market has been gradually established. Generally, the Shibor is the price at which commercial banks with high credit ratings acquire funds from the market. The Shibor reflects panel banks' perception of cost, the supply and demand of funds on the market, and expectations of future monetary policy and is influential on the money market. In the past 3 years, the Shibor with a maturity of 3 months or less was backed by transactions on the money market and consistent with the interest rate of inter-bank borrowing and bond repos, and thus reflected the change in fund supply and demand on the market; based on the panel banks' policy expectations and their perception of the funds' cost, the Shibor with a maturity of 3 months or more have had reasonable spreads with key market interest rates, such as those of central banks bills and government securities. The Shibor panel banks are major participants on the money market and have played a positive role in promoting market trading. In 2009, turnover on the money market increased 23 percent from 2008 and 212 percent from 2006 to 89.6 trillion yuan, and the panel banks participated in 80 percent of the transactions.

The Shibor has provided a benchmark for the pricing of products on the financial market. First, the Shibor has played an increasingly greater role in the pricing of bonds. The first Shibor-based floating rate bond was issued in June 2007. Since then, 23 such bonds have been issued, with a total value of 186 billion yuan. Issuers include policy banks, commercial banks, and enterprises. Those bonds were issued on either the mainland or Hong Kong markets. With respect to fixed-rate products, all enterprise bonds, with a total issuance of 800 billion yuan, have been priced based on the Shibor since April 2007 and more than 400 billion yuan worth of short-term financing bills were priced based on the Shibor, accounting for 37 percent of the total. Second, the Shibor-based derivative market has deepened further. At the end of 2009, the turnover of the Shibor-based interest rate swaps stood at 250.1 billion yuan, representing 22 percent of the total. All forward rate agreement transactions worth a total of 18.41 billion yuan were priced based on the Shibor. Moreover, currency swap agreements signed between the PBC and the central banks of Malaysia, South Korea, and other countries, worth a total of 650 billion yuan since October 2008, were all based on the Shibor.

The Shibor has played a significant role in intra-bank and inter-bank pricing. First, the Shibor served as a benchmark for the fund transfer pricing (FTP) within the commercial banks. At present, the FTP of all 16 panel banks is determined based on the Shibor to various degrees. On the one hand, commercial banks use the Shibor plus certain basis points as the FTP prices for bond repos, inter-bank borrowing, and bills; on the other hand, panel banks take the FTP price of market-based products as the basis for the Shibor quotation. There has been a good interaction between the Shibor and FTP prices. Second, the Shibor has helped improve the pricing mechanism for the inter-bank discount. After the launching of the Shibor, the panel banks have conduct ed bilateral quotations of the inter-bank discount of Shibor-based bills on www.chinacp.com.cn on a daily basis. Due to this practice, multiple panel banks have established a pricing mechanism for the inter-bank discount rate based on the Shibor. Moreover, the electronic commercial paper system launched by the PBC in October 2009 uses the Shibor as a reference. This will improve the formation mechanism of the discount rate and strengthen the benchmark role of the Shibor for maturities of 3 months and above. Third, the Shibor has facilitated more scientific pricing of inter-bank deposits. Inter-bank deposits are mutual fund deposits between financial institutions. The interest rate of inter-bank deposits is similar to the Shibor in nature. Currently, inter-bank deposits of most panel banks are determined based on the Shibor to varying degrees. In 2009, the total value of inter-bank deposits in China reached 4 trillion yuan. The Shibor-based pricing of inter-bank deposits greatly facilitates the smooth functioning of interest rate transmission.

2. The bond yield curve moved upward and issuances of bonds grew rapidly

Trading on the inter-bank bond market was brisk. In 2009 turnover on the inter-bank bond market totaled 47.3 trillion yuan, with an average daily turnover of 189.1 billion yuan, up 27.9 percent year on year. State-owned commercial banks were the major net buyers, with net purchases of 1242.3 billion yuan in 2009; other commercial banks and other financial institutions had net sales of 1086.4 billion yuan and 155.9 billion yuan respectively. The spot trading of government securities on the stock exchanges registered 208.5 billion yuan, basically flat with the previous year.

Bond indices on the inter-bank bond market declined. In 2009 the index of the total return on the inter-bank bond market fell 1.42 percent, from 132.11 points at the beginning of 2009 to 130.23 points at the end of the year. The clean price index dropped 3.92 percent, from 105.25 points at the beginning of the year to 101.13 points at end-2009.[1]

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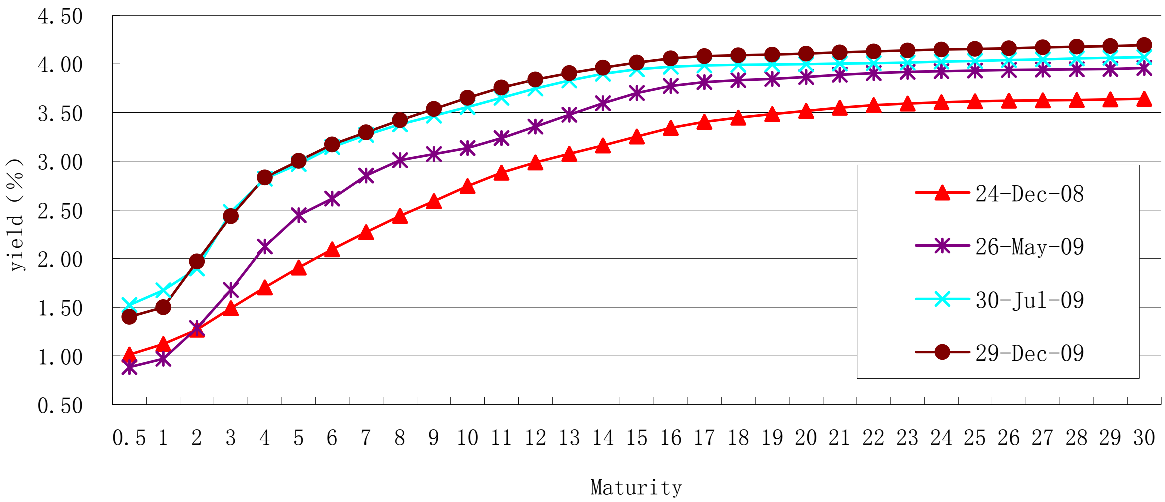
[1] The total return index is calculated based on the bonds' price plus the accrued, including in the calculation the reinvestment of the interest paid on the interest payment date; the clean price index is based on the clean price of the bonds, without counting the accrued interest and the interest reinvestment. The clean price index depicts the change in the bond yields more objectively.

The yield curve of bonds on the inter-bank bond market moved upward. In 2009 in the context of the economic recovery, the expanded issuance of bonds, and fluctuations in market expectations, the yield curve of bonds on the inter-bank bond market went upward and steepened. The upward movement of the yield curve of government bonds on the inter-bank bond market is noteworthy, with the yield of 5-10 year medium-term government bonds grew 100 basis points in 2009.

Figure 1: Yield curve of government securities on the inter-bank bond market



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

Bond issuances grew rapidly. In 2009, a total of 4.9 trillion yuan of bonds (excluding central bank bills) was issued, up 64.3 percent year on year. The issuance of government securities, bank subordinated bonds, medium-term notes, and enterprise bonds grew more than 100 percent year on year, providing strong support for the stabilization and recovery of the Chinese economy. At end-2009, outstanding bonds deposited with the China Government Securities Depository Trust and Clearing Co. Ltd. totaled 17.5 trillion yuan, up 16.0 percent over end-2008. The issuance interest rate of bonds continued to rise and the interest rate of 10-year book-entry government bonds grew 63 basis points, from 3.05 percent in March to 3.68 percent in November.

Bond issuance has undergone innovation. In order to provide supporting funds for central government-invested projects, the Ministry of Finance (MOF) for the first time issued municipal bonds on behalf of local governments, with a total value of 200 billion yuan in 2009. In November 2009, joint bonds were successfully issued, providing SMEs with a new financing channel. Moreover, the launch of option-embedded medium-term notes and dollar-denominated medium-term notes has satisfied the diversified financing needs on the market.

Table 8: Issuance of bonds in 2009

Type of bonds	Total value (100 million yuan)	Year-on-year growth (%)
Government securities ①	17927	109.5
Of which: municipal bonds	2000	—
Policy financial bonds	11678	7.9
Bank subordinated bonds and hybrid capital bonds	2746	279.3
Bank ordinary bonds	100	-60.0
Enterprise bonds ②	16629	77.7
Of which: short-term financing bills	4612	6.5
medium-term notes	6987	302.3
corporate bonds	735	155.2

Note: ① Including 200 billion yuan of municipal bonds issued by the Ministry of Finance on behalf of local governments.

② Including enterprise bonds, corporate bonds, equity warrant bonds, joint bonds, short-term financing bills, and medium-term notes.

Source: The People's Bank of China.

The Shibor played a greater role in the pricing of bonds. In 2009 all 190 enterprise bonds were priced based on the Shibor, with a total value of 425.2 billion yuan, up 80 percent over 2008; short-term financing bills worth 127.2 billion yuan were priced based on the Shibor, accounting for 28 percent of the total; Shibor-based floating rate bills issued by the policy banks registered 72.8 billion yuan, about 19 percent of the total issuance.

3. Bill financing grew rapidly

Bill financing grew rapidly amid large fluctuations. In 2009 a total of 10.3 trillion yuan of commercial drafts was issued by the corporate sector, up 45.0 percent year on year. Discounted bills registered 23.2 trillion yuan, an increase of 71.4 percent over 2008. Rediscounted bills amounted to 24.88 billion yuan, up 126.8 percent year on year. At end-2009, outstanding commercial bills registered 4.1 trillion yuan, an increase of 29.4 percent year on year. Outstanding discounted bills posted 2.4 trillion yuan, up 23.7 percent over end-2008. Outstanding rediscounted bills reached 18.12 billion yuan, up 684.8 percent year on year. In the first half of 2009, commercial banks made strenuous efforts to expand their bill business. Their bill financing registered a rapid increase, which was faster than loan growth during the same period. At end-June, outstanding bill acceptances exceeded 5 trillion yuan and outstanding discounted bills were over 3.6 trillion yuan, both reaching historical highs. In the second half of 2009, due to the commercial banks' adjustment of the asset structure, the value of bill acceptances and outstanding discounted bills declined month by month, decreasing by 0.9 trillion yuan and 1.2 trillion yuan respectively by year-end compared with end-June 2009.

Interest rates on the bill market declined and then recovered, but were generally lower compared with those in 2008. With implementation of the stimulus package, bill interest rates dropped significantly at the beginning of 2009 and remained at a historical low level. Since June, as a result of the economic stabilization and recovery, the resumption of IPOs, and the rise in interest rates on the money market, bill market interest rates gradually recovered and remained stable at a relatively high level at end 2009.

4. Trading on the stock market expanded significantly and stock indices grew by a large margin

Due to gradual recovery of the economy, adequate liquidity in the market, and the profit rebound of listed companies, trading on the stock market expanded remarkably and stock indices rallied. In 2009 the total turnover on the Shanghai and Shenzhen Stock Exchanges registered 53.6 trillion yuan, up 26.9 trillion yuan year on year. The daily turnover stood at 219.7 billion yuan, up 100.7 percent year on year. At end-2009, the market capitalization of tradable shares amounted to 15.1 trillion yuan, up 2.3 times year on year. The average P/E ratios on the Shanghai and Shenzhen Stock Exchanges recovered to 29 times and 47 times respectively from 15 times and 17 times at end-2008.

Funds raised from the stock market rose remarkably. In 2009 a total of 608.4 billion yuan was raised by enterprises on the domestic and foreign stock markets by way of IPOs, secondary offerings, and convertible bond issuances, an increase of 242.3 billion yuan year on year. Among this total, 503 billion yuan or 82.7 percent was raised in the second half of 2009. With the launch of the Growth Enterprise Board (GEM) in October, a multi-tiered capital market has taken shape in China. At end-2009, 36 enterprises had been listed on the GEM and raised a total of 20.4 billion yuan, accounting for 3.4 percent of stock market financing. The 161 billion yuan of GEM capitalization represented 0.7 percent of the total of the Shanghai and Shenzhen Stock Exchanges.

5. The insurance industry continued stable and relatively rapid growth

Total premium income exceeded an unprecedented 1 trillion yuan for the first time ever in 2009. Demand for insurance services remained stable in the year and annual premium income totaled 1.1 trillion yuan, up 13.8 percent year on year. The premium income of property insurance grew 23.1 percent and that of life insurance grew 10.9 percent. Total compensation and claim payments stood at 312.5 billion yuan, up 5.2 percent year on year.

Growth in total assets in the insurance industry registered a steady recovery. At the end of 2009, the total assets in the insurance industry posted 4.1 trillion yuan, up 21.6 percent year on year, an acceleration of 6.4 percentage points over end-2008. In particular, bank deposits accounted for 25.9 percent of the insurance sector's total assets at end-2009, 1.7 percentage points over that at end-2008. Investment products represented 66.2 percent of the total, a decrease of 1.0 percentage point compared with that at end-2008.

Table 9: Use of insurance funds in 2009

	Outstanding balance (100 million yuan)		As a share of total assets (%)	
	End-2009	End-2008	End-2009	End-2008
Total assets	40635	33418	100. 0	100. 0
Of which: Bank deposits	10520	8088	25. 9	24. 2
Investment	26897	22465	66. 2	67. 2

Source: China Insurance Regulatory Commission.

6. The foreign exchange market operated in a stable manner

The foreign exchange market operated soundly. RMB foreign exchange swaps played a greater role in mitigating foreign exchange risks, with a total turnover of US$ 801.8 billion, up 82.1 percent year on year and an acceleration of 42.5 percentage points. The US dollar remained the most traded currency on the foreign exchange swap market and transactions with short maturities accounted for a larger share. The turnover of overnight RMB/USD swaps accounted for 64.8 percent in the total, up 21 percentage points year on year. RMB foreign exchange spot transactions continued their steady growth and most were OTC transactions. Turnover on the RMB foreign exchange forward market totaled US$9.8 billion, down 43.8 percent year on year. The turnover of foreign currency pairs amounted to US$40.7 billion, falling 35.8 percent over 2008. The USD/HKD and EUR/USD currency pairs accounted for 78.8 percent of the total. The turnover of forward and spot trading of currency pairs registered US$2 billion and US$3.9 billion respectively, increasing 2.8 times and 4 times year on year.

7. The price of gold grew

The trading volume on the Shanghai Gold Exchange rose steadily. In 2009 a total of 4710.8 tons of gold was traded, up 5.5 percent over 2008. The total turnover registered 1028.8 billion yuan, an increase of 18.3 percent year on year. The average daily turnover stood at 19.3 tons, up 6.3 percent compared with 2008. The trading volume of silver registered 16247.8 tons, up 267.6 percent over 2008. The average daily trading volume stood at 66.6 tons, up 270.6 percent year on year. The trading volume of platinum reached 56.7 tons, exceeding 50 tons for the first time and representing an increase of 29.5 percent year on year. The turnover of platinum totaled 15.53 billion yuan, up 2.6 percent year on year, and its average daily trading volume was 0.23 tons, an increase of 30.5 percent over 2008.

The price of gold went upward. In 2009 the price of gold on the international market reached historical highs, exceeding US$1000 per ounce and US$1100 per ounce, and reaching a peak of US$1183 per ounce in November. The price of gold on the Shanghai Gold Exchange was also on a rise, setting a record high of 269 yuan per gram. At end-2009, the price of gold closed at 245 yuan, up 27.0 percent over the beginning of 2009, and the weighted average of the price of gold in 2009 stood at 215 yuan, an increase of 18 yuan over 2008.

II. Financial market institutional building

1. Improvements in the institutional arrangements for the inter-bank bond market

First, regulation has been improved. Efforts have been made to improve regulation of the issuance of financial bonds, enhance the transparency of issuance examination, and strengthen market discipline and the risk-sharing mechanism. Information disclosure practices for financial bonds on the inter-bank bond market are standardized and defined in detail so as to enhance market transparency. Depository trust and clearing of bonds have been standardized to protect the legitimate rights and interests of investors and to avoid relevant risks. Meanwhile, the minimum bond issuance requirement of 500 million yuan was lifted, providing a more enabling policy environment for SMEs' micro financing via bond issuances.

Second, bond types and issuers have been diversified. In November 2009, the collective bond of non-financial SMEs was launched on the inter-bank bond market. The collective bond as the first standardized financing product tailored to the needs of the SMEs provides them with a new channel for direct financing and diversifies their investment products on the inter-bank market. Moreover, financial leasing companies and automobile financing companies were permitted to issue financing bonds. This helps expand the scope of financial bond issuers while keeping risks under control.

Third, the institutional infrastructure has been steadily promoted. On November 28, 2009, the Shanghai Clearing House was inaugurated to provide a clearing service for domestic and foreign currency transactions and the trading of derivatives. This will help enhance the efficiency and lower clearing cost, improve market transparency, and prevent systemic financial risks. The new domestic currency trading system for the inter-bank market was officially launched in June 2009. Based on pilot projects, the standard contract of inter-bank discounts of bank acceptance bills and commercial acceptance bills was introduced nationwide in October 2009. Meanwhile, the electronic commercial paper system was launched, beginning the e-age of the commercial paper business in China.

2. Strengthening basic institutional arrangements on the securities market

First, the IPO system has been reformed and improved. The China Securities Regulatory Commission (CSRC) issued the *Guiding Opinions on Further Reforming and Improving the IPO System*, identifying measures to advance the price enquiry 询价 and subscription mechanism, optimizing the online offering system, paying more attention to retail investors' participation intentions, strengthening risk warnings, and urging market participants to shoulder their due responsibilities.

Second, supervision over securities companies has been strengthened. In 2009 the CSRC released *Provisions on Classified Supervision over Securities Companies* and the *Provisions on Strengthening Supervision over Listed Securities Companies*, to promote the sustainable and standardized development of securities companies and to improve their corporate governance.

Third, standardized operation of mutual funds has been promoted. In November 2009, the CSRC issued the *Provisional Administrative Measures on Performance Evaluation of Securities Investment Funds* to standardize operations, guide investors to conduct long-term investments, and protect investors' legitimate rights and interests. The *Rules on Dealers' Commissions for Open-ended Securities Investment Funds* were issued in December to maintain an orderly market for sales of funds and to improve the structure and level of the dealers' commissions so as to advance the healthy development of mutual funds.

Fourth, institutional arrangements on the futures market have been improved. In September 2009, the *Provisions on Classified Supervision of Futures Companies (Trial)* were implemented, playing a positive role in strengthening awareness of compliance among futures companies and thus promoting the stable and healthy development of the futures industry.

Moreover, the Growth Enterprise Market (GEM) was launched on October 30, 2009. A pilot for short selling and margin trading and stock index futures has been approved in principle.

3. Improvements in the management of insurance institutions' investments on the bond market and pressing ahead with the pilot project for commercial banks' equity investment in insurance companies.

In order to further strengthen management of insurance institutions' investment on the bond market, the China Insurance Regulatory Commission (CIRC) issued the *Notice on Issues concerning Bond Investment* in September 2009, adjusting the regulations on the share of insurance institutions' investment in enterprise (corporate) bonds and the qualifications for bond issuers. In addition, the CIRC permitted insurance institutions to purchase uncollateralized enterprise bonds issued on the inter-bank bond market and identified the conditions, credit ratings, means of issuance of such uncollateralized bonds, and the quota for the insurance companies' investment in this area.

Moreover, in order to promote the pilot program of mutual investment between commercial banks and insurance companies, the CBRC released the *Provisional Administrative Measures on Equity Investment in Insurance Companies by Commercial Banks*, covering various areas such as the access and risk management of commercial banks. It is stipulated that a commercial bank may invest in only one insurance company, which in principle should be the one in which the commercial bank already has investments. Providing guidance to the commercial banks' investments in equities of insurance companies, the *Measures* help prevent the risks of cross-sector contagion and deepen cooperation between the banking and insurance sectors.

Part 4 Macroeconomic Analysis

I. Global economic and financial developments

In 2009, affected by the large-scale economic stimuli, the global economy showed signs of stabilization and improving, but the underlying fundamentals for such a recovery need to be further consolidated. The United States, the euro area, and Japan saw a slow recovery and record high unemployment rates, while the emerging market economies, especially those in Asia, witnessed a more robust rebound. On January 26, the IMF released the world growth rate for 2009 -- at –0.8 percent, 3.8 percentage points lower than that for 2008. Presently, the major risks to the world economy include the high debt level and the unsustainable fiscal position in some countries, the rapid capital inflows into the emerging market economies and the resulting asset price hike, the withering demand from the developed economies, and the rising trade protectionism. Looking forward to 2010, the global economy will continue to recover, but probably with ups and downs caused by foreseeable adjustments of the economic stimuli, rising risks of sovereign defaults, and upward inflationary pressures in some countries or regions.

1. Economic developments in the major economies

The U.S. economy showed signs of recovery but endogenous forces for such a recovery were insufficiently strong and the unemployment situation did not improve. The growth rate of GDP in 2009 posted -2.4 percent, compared with 0.4 percent in 2008. And the annualized GDP growth after the seasonal adjustment registered -6.4 percent, -0.7 percent, 2.2 percent, and 5.7 percent respectively for the four quarters, an accelerated increase through the year. The annual unemployment rate after the seasonal adjustment stood at 9.3 percent, and the figure for December was 10 percent, up 2.6 percentage points from the same period of the last year and a record high in 17 successive years. Both the total trade volume and the trade deficit shrank, with the accumulated trade volume registering US$3486.8 billion, accounting for 24.5 percent of GDP, down 5.6 percentage points compared with the last year; and the trade deficit was US$380.7 billion, accounting for 2.7 percent of GDP, down 2.1 percentage points year on year. Due to the economic slowdown and the extraordinary fiscal measures, the fiscal deficit of the federal government rocketed. For the fiscal year that ended on September 30, 2009, the total fiscal deficit reached US$1.42 trillion, a record high since World War II, and about 10 percent of GDP. Although the CPI moved up slightly, long-term expectations for inflation were stable. In 2009, the CPI grew by -0.4 percent, 4.2 percentage points lower than that in 2008. The year-on-year CPI for December was 2.7 percent and the seasonally adjusted annualized quarter-on-quarter CPI in 2009 registered 2.2 percent, 3.3 percent, 2.5 percent, and 3.3 percent respectively for the four quarters.

Recovery in the euro zone was sluggish. The annualized GDP growth after the seasonal adjustment for the first three quarters of 2009 posted -9.6 percent, -0.4 percent, and 1.7 percent respectively, moving back to positive territory after the third quarter. However, the employment situation deteriorated further, with the unemployment rate reaching 10 percent in December after the seasonal adjustment, up 1.8 percentage points year on year.. Foreign trade contracted notably, however, with imports dropping more than exports, turning the trade deficit into a surplus. From January to November, the total trade volume declined by 21.5 percent year on year and the trade surplus reached EUR186 billion, forming a contrast with the EUR531 billion deficit last year. Massive expenditures on the fiscal stimuli and bank rescues significantly weakened the public debt and the budgetary positions of many countries. In 2009 the ratio of the fiscal deficit to GDP in the euro zone reached 6.4 percent, 4.4 percentage points higher than in the last year. And several international rating agencies have already downgraded the sovereign ratings of Greece and Spain. Inflation edged up a little, but was still subdued. The HICP rose by 0.3 percent year on year, down 3 percentage points compared with the last year. After 1.1 percent growth at the beginning of the year, the HICP first dropped to –0.7 percent in July and then picked up gradually to 0.9 percent in December.

The Japanese economy remained weak and slid into a deflationary phase. The annualized quarter-on-quarter GDP growth after the seasonal adjustment posted –11.9 percent, 2.7 percent, and 1.3 percent respectively for the first three quarters of 2009. The employment situation continued to be pessimistic, with the unemployment rate standing at 5.7 percent after the seasonal adjustment, up 1.7 percentage points year on year. Foreign trade decreased dramatically, but exports rebounded strongly owing to the increasing external demand. Consequently, despite a 34 percent year-on-year decrease in total trade volume, the trade surplus for the year soared to 2.8 trillion yen, a growth of 36 percent year on year. The budget and debt level for the new fiscal year surged to a historical high and the fiscal position deteriorated further. Planned fiscal expenditures for the 2010 fiscal year registered 92 trillion yen, while tax revenue was expected to be only 37 trillion yen; therefore the outstanding public debt is estimated to be 973 trillion yen. Deflation recurred. The CPI decreased by 1.4 percent in 2009, down 2.8 percentage points compared with the last year. In particular, the CPI moved downward for 11 consecutive months after February and reached –1.7 percent in December.

The recovery of the emerging market economies showed a mixed picture. Due to favorable fiscal, international payment, and external debt positions, the Asian emerging market economies witnessed a more obvious rebound. But, due to economic structure constraints, recovery in the Mideast suffered a relapse. On November 25, the outbreak of Dubai's debt crisis shook world markets and spilled over to Greece, Spain, and the Baltic Sea areas. The economies in Latin America diverged, with Mexico's economy slowing down further whereas Brazil and Argentina crawled out of the shadow of the crisis and returned to growth. Several Eastern European countries, because of their heavy debt burdens, fragile financial systems, and fading attraction to foreign capital, underwent a slow recovery.

2. Global financial market developments

In 2009 the exchange rates of the major currencies fluctuated within broad bands. Generally, the US dollar weakened amidst fluctuations. Movement of the US dollar can be divided into three phases throughout 2009. At the beginning of the year, the US dollar continued the upward trend starting from the latter half of 2008 and continued to appreciate against the euro and the yen. Starting from March, with the effect of the crisis on the wane and the economy recovering, risk aversion in the international foreign exchange market lessened and gradually gave way to risk seeking. Meanwhile, the record-low US dollar interest rate facilitated the dollar carry trade, eventually setting off a depreciation of the US dollar against the euro and the yen. In December, concerns about the risks of sovereign defaults and the fiscal sustainability of some countries rose, allowing the US dollar to rebound from a weak level. By the end of the year, the exchange rate of the US dollar against the euro closed at US$1.4332 per euro, down 2.9 percent year on year. And the exchange rate of the yen against the US dollar closed at 93.08 yen per dollar, an appreciation of the US dollar by 2.5 percent year on year. The Trade Weighted US dollar Index, which is published by the Federal Reserve, declined cumulatively by 4.6 percent throughout the year.

Major market interest rates slid further from their already low levels. The US dollar Libor fluctuated downward. Against the backdrop of the historically low Federal Funds rate, the US dollar Libor tumbled way down. On December 31, the 1-year US dollar Libor hit 0.98 percent, a drop of 1.02 percentage points from the start of the year. The Euribor remained low. On December 31, the 1-year Euribor was 1.248

percent, down 1.801 percentage points compared with the beginning of the year.

The yields of government securities of the major countries fluctuated dramatically. In 2009 world financial markets were still in distress; as a result, the yields of government securities fell slightly after a surge. Lately, the yields have leveled out, due to the worldwide firm recovery and subdued inflation. At the end of 2009, the yields of 10-year treasury bonds of the United States, euro area, and Japan closed at 3.793 percent, 3.381 percent, and 1.291 percent; up 1.732, down 0.437, and down 0.123 percentage points respectively compared with the beginning of the year.

The major stock indices rallied. Since mid-February, market confidence was boosted by the aggressive unconventional measures and rescue plans frequently launched by the various governments, and stock indices all over the world rocketed. Though the stock indices were hit hard by the debt crisis in Dubai on November 25, the markets regained their upward momentum fairly quickly. At the end of the year, the Dow Jones Industrial Average, the NASDAQ, the STOXX50, and the Nikkei 225 closed at 10549, 2291, 2579, and 10638 respectively, up 16.7 percent, 40.0 percent, 20.8 percent, and 17.6 percent from the start of the year.

3. The development of the housing markets in the major economies

The U.S. housing market continued to fall, though at a moderate pace, and in 2009 the decline of the U.S. federal housing price index widened further, posting a 3.37 percent, 3.99 percent, and 4.08 percent decrease year on year for the first three quarters. The monthly average of the start of new home construction and new home sales registered 554,000 and 374,000 respectively, down 38.8 percent and 22.9 percent, reflecting a narrowing of the margin of the decline. Amid a slow economic recovery and strengthened investor confidence, housing prices in some cities edged up a bit in the fourth quarter.

The European housing market remained sluggish. The quarterly year-on-year growth of the housing commodity price index published by the ECB posted 2.0 percent, 2.1 percent, 2.0 percent, and 1.9 percent respectively. Housing prices in Britain climbed after hitting rock bottom, and the seasonally adjusted MoM Halifax Index, after plunging to a year low of –2.2 percent in February, went up into positive territory in July and reached 0.8 percent in December. In the first half of the year, the French housing market continued its bearish atmosphere of 2008. However, propped up by the economic stimulus measures, the housing market took a turn for the better later in the year, with new home sales and starts of new home construction rising from the second quarter. Housing prices in Spain, Ireland, and Germany also showed signs of leveling. But because the recovery of the EU is not firm and the unemployment rate remains high, the EU housing market will remain under stress for the short term.

The Japanese housing market saw no improvement. Since 2009, the dropping income of residents coupled with the economic deflation weighed heavily on Japan's housing market, reflected in a 12-month decrease of year-on-year starts of new home construction. In the fourth quarter of 2009, the land price index in the six largest cities tumbled by 10.8 percent, and the picture for the future was not rosy.

4. The monetary policies of the major economies

The central banks of the major economies maintained close-to-zero interest rates. Throughout 2009, the US Federal Reserve kept the federal funds target rate within the range of 0 to 0.25 percent. The Bank of Japan left the uncollateralized overnight call rate unchanged at 0.1 percent. The ECB slashed the minimum bid rate of the main refinancing operations by 50 basis points on January 21 and March 5 and by 25 basis points on April 2 and May 7 to a record low of 1 percent. On January 8, February 5, and March 5, the Bank of England cut its bank rate by 50 basis points on three occasions to 0.5 percent, the lowest level in the more than 300 years since record-keeping began.

In order to further loosen their monetary stance, the central banks of the major economies also adopted an unconventional monetary policy featuring an increase in money supply through a balance-sheet expansion. After the crisis intensified in September 2008, the US Federal Reserve created many new facilities to provide liquidity to different types of financial institutions. In addition, the US Federal Reserve also began to purchase agency-guaranteed mortgage-backed securities, agency debts, and treasury securities and maintained the amount of such purchases right into 2009. On March 18, the US Federal Reserve decided to expand its balance sheet by another trillion, including the purchase of US$300 billion treasury securities. By the end of 2009, outstanding credit of the US Federal Reserve boomed to US$2.22 trillion, up US$1.33 trillion compared with August 2008. As for the ECB, apart from extending the maturities of standing facilities and using fixed rates when providing liquidity to money markets, it also initiated a plan to buy up to EUR60 billion of covered bonds. The Bank of England enlarged the asset purchase facility from GBP75 billion to GBP175 billion as part of its quantitative easing. The Bank of Japan prolonged its financial support and unveiled a 10 trillion yen credit program as an additional stimulus to the market.

As the economic recovery took hold, the central banks of the major economies turned to the exit strategies for the accommodative monetary policies, and some countries with better performance started a gradual exit. On August 25, the Bank of Israel raised the benchmark interest rate by a quarter of a percentage point to 0.75 percent, the first central bank to lift rates since the signs of an easing of the crisis. The Reserve Bank of Australia raised the key cash rate by a total of 75 basis points to 3.75 percent on October 6, November 3, and December 1, becoming the first G20 country to "substantively" exit from the stimulus. On October 27, the Reserve Bank of India announced the termination of some liquidity support measures, required reserves for the issuance of collateralized borrowing and lending obligations by commercial banks, and increased the commercial banks' statutory liquidity ratio from 24 percent to 25 percent. On October 28, the Norges Bank decided to lift its key policy rate by 25 basis points to 1.5 percent. The US Federal Reserve also set about to unwind its unconventional monetary policy. It announced a reduction of the offered amount under the TAF and TSLF on September 24, purchased US$175 billion of agency debt on November 4, somewhat less than the previously announced US$200 billion, and tried to withdraw liquidity by a small scale reverse repo. But in principle, the central banks of the major economies, including the US Federal Reserve, ECB, the Bank of Japan, and the Bank of England, were very cautious about a policy exit, stressing the unsoundness of the global economic recovery and on many occasions warning against a premature unwinding.

5. The global economic outlook

Judging from the major economic indices, especially those of the capital market, the global economy showed clear signals of bottoming out. According to the projections of the IMF, following the deepest global downturn in recent history, economic growth had solidified but the recovery was proceeding at different speeds in various regions. In 2010, world output was expected to rise by 4 percent, representing an upward revision of 0.75 percentage points from the October 2009 estimation. Growth in the United States, the euro area, Japan, and the emerging market economies was expected to be 2.7 percent, 1.0 percent, 1.7 percent, and 6.0 percent respectively, up by 5.2, 4.9, 7, and 3.9 percentage points compared with their real growth in 2009. The IMF also pointed out that because of the still low levels of capacity utilization and the stable inflation expectations, inflation pressures would be contained in 2010. In the advanced economies, overall inflation was expected to pick up from zero in 2009 to 1.25 percent in 2010, as rebounding energy prices more than offset the slowing labor costs. In the emerging and developing economies, inflation was expected to edge up to 6.25 percent as some of these economies may face upward pressures due to more limited economic slack and increased capital flows.

High unemployment rates worldwide, the still fragile financial sector, the severe fiscal deficit of some economies, and the influence of the exit from the stimulus policy are all factors that might hamper the recovery. In the process of the global recovery, the international community should strengthen communication and coordination, fight against trade, investment, and financial protectionism, and continue economic globalization.

Box 3: Development of Unconventional Policies during the Financial Crisis

Since the outbreak of the financial crisis, the economic stimulus policies launched by the various governments have facilitated an economic recovery on the one hand, but also have brought about some negative impacts on the other hand, including boosting asset bubbles, increasing inflationary pressures, and adding to some countries' sovereign default risks. Therefore, a major challenge facing the major economies is how to adjust the current economic stimulus policies.

The unconventional policies played an important role in the bailout. In 2008 the subprime crisis spilled over from the United States to the entire world and caused enormous damage. The developed economies, as the place of origin of the crisis, were most severely stricken and thus experienced a sharp economic slowdown. To resist the crisis and provide an impetus to the economy, the involved countries launched unprecedented and large-scale economic stimulus packages. The major central banks slashed interest rates and injected a large amount of liquidity into financial markets; meanwhile, governments expanded their fiscal expenditures to support financial institutions and enterprises in difficulty. Driven by these unconventional policies, the global economy has shown signs of bottoming out since 2009 and some emerging market economies have started to recover.

Although contributing to an economic recovery, the unconventional policies have also created new risks. First, the unconventional policies caused upward pressures on inflation. Although inflation remained subdued in most of the economies, inflation expectations are increasing. Since November 2009, inflation in most developed countries has turned positive and some emerging market economies have been witnessing rising prices. International commodity prices have surged, with the CRB growing by 23.5 percent in 2009 and the crude oil price rising from US$47 per barrel to US$77 per barrel, up 63.8 percent from the beginning of the year. Second, the unconventional policies increased global liquidity, which led to asset price hikes in the emerging markets. Since 2009 the BOVESPA index of Brazil, the RIS index of Russia, and the SENSEX index of India have increased by 140 percent, 129 percent, and 80 percent respectively, as is the case with the Asian housing market. Last but not least, the unconventional policies weighed on the fiscal conditions of some economies. Governments of various economies mobilized tremendous fiscal resources to provide crisis relief and an economic stimulus, thus transforming many private losses into public debt. Therefore, the debt burdens have been too heavy for some economies to bear. Presently, Greece, Spain, Italy, Portugal, and Ireland are distressed by a sovereign debt problem. It will be a real challenge for many economies to ease the debt burden in a timely manner.

There is an international consensus that most unconventional policies implemented during the crisis will eventually come to an end. If the close-to-zero interest rate is maintained for too long, the consequent economic toll will be even higher than that caused by the recent financial crisis. A number of countries have already started to unwind their unconventional monetary or fiscal measures. The United States, the European Union, and Mexico have gradually terminated some unconventional measures, which were already mature or no longer needed. At end-2009, the United States ended the capital purchase program, the capital assistance program, and the targeted investment program, which were part of the Troubled Asset Relief Program.

On December 31, the Bank of England suspended the credit insurance arrangement according to a pre-set agreement. And on December 3, the ECB decided to wind down the 6-month low-rate refinancing program. Many others will terminate the temporary deposit insurance right after the pre-decided maturity date.

Out of worries about the potential negative external impact inflicted by a disorderly exit, international organizations represented by the IMF and the FSB emphasize the flexibility, transparency, and credibility of the exit strategies and the indispensable role of market mechanisms and international cooperation. The IMF and FSB recommend the utilization of basic market mechanisms such as price leveraging to elevate the cost for market participants to receive public support, so that when market conditions normalize, those participants will choose to be less dependent on public support, contributing to an orderly and spontaneous exit. Since the exit strategy of one country might have a spillover effect on other economies, an uncoordinated exit of a single country or a certain policy measure might incur arbitrage activities in the market. Therefore, when making and implementing exist strategies it is necessary to carry out international coordination and cross-border cooperation. This will be conducive to the recovery and growth of the respective economic systems. But this does not mean that all the economies should unwind their policies at the same time.

Compared with the emerging market economies, the policy adjustments of the developed economies have a more obvious impact on the global economy because of their relatively large economic aggregates. Consequently, more attention should be paid to the exit strategies of the major developed economies. Before a complete exit of the major developed countries, global liquidity will continue to be sufficient, pushing up asset prices further. Once the unwinding begins in the major developed economies, the direction of capital flows might reverse, leading to fluctuations in asset prices, especially in the emerging market economies.

II. Analysis of China's macroeconomic performance

In 2009 China's economy withstood the severe challenges posed by the international financial crisis. Facing extremely complicated circumstances both at home and abroad, China continued a proactive fiscal policy and relatively loose monetary policy and implemented a stimulus package with timely adjustments. Due to such efforts, China was among the first to achieve a recovery and upturn in 2009. China's GDP rose 8.7 percent year on year to 33.5 trillion yuan, a deceleration of 0.9 percentage points, and economic growth accelerated quarter by quarter. Final consumption, capital formation, and net exports of goods and services contributed 52.5 percent, 92.3 percent, and –44.8 percent respectively to GDP growth. The CPI decreased 0.7 percent year on year, 6.6 percentage points lower compared with that in the previous year. The trade surplus registered US$196.1 billion, down US$102 billion over 2008.

1. Domestic demand increased steadily and external demand turned for the

better

Urban and rural household income increased. Consumption in real terms grew steadily and the willingness of households to consume recovered stably. In 2009 the per capita disposable income of urban households registered 17,175 yuan, representing a nominal increase of 8.8 percent and real growth of 9.8 percent, an acceleration of 1.4 percentage points over 2008. The per capita net income of farmers stood at 5,153 yuan, amounting to a nominal increase of 8.2 percent and real growth of 8.5 percent, an acceleration of 0.5 percentage points compared with the previous year. The income gain and consumption promotion measures, such as home electric appliances to the countryside and cash for old appliances and automobiles, played an active role in expanding household consumption. The willingness of households to consume rebounded steadily. According to the urban depositors' survey of the PBC, in Q4, 38.0 percent of households reported a quarter-on-quarter increase in consumption, marking stable growth for a third consecutive quarter. In 2009 total retail sales rose 15.5 percent nominally and 16.9 percent in real terms, an acceleration of 2.1 percentage points over 2008. Retail sales in urban areas posted 8.5 trillion yuan, up 15.5 percent nominally and 17.0 percent in real terms year on year, an acceleration of 1.3 percentage points, whereas retail sales in counties, townships, and villages and below registered 4.0 trillion yuan, up 15.7 percent in nominal terms and 16.9 percent in real terms, an acceleration of 3.8 percentage points.

Investment rose rapidly. Driven by the stimulus package, the growth of fixed-asset investment rebounded in a rapid manner. In 2009 total fixed-asset investment registered 22.5 trillion yuan, up 30.1 percent year on year nominally, an acceleration of 4.6 percentage points, and up 35.2 percent in real terms, an acceleration of 17.1 percentage points. Fixed-asset investment in urban areas registered 19.4 trillion yuan, up 30.5 percent year on year, and that in rural areas stood at 3.1 trillion yuan, an increase of 27.5 percent over 2008. At present, the willingness of enterprises to invest has further recovered. The PBC survey of 5,000 enterprises showed that index of enterprise investment in fixed assets, equipment, and construction registered 51.2 percent, 50.5 percent, and 48.1 percent respectively in Q4, representing a recovery of 0.8 percentage points, 0.7 percentage points, and 0.4 percentage points respectively over the previous quarter.

Exports and imports recovered moderately and the trade surplus declined. Export growth turned positive in December 2009, registering year-on-year growth of 17.7 percent. Year-on-year import growth posted 26.7 percent in November 2009, putting an end to a 12-month decrease. In December, the number climbed to 55.9 percent, displaying strong growth in domestic demand. In 2009 exports and imports totaled US$2.2 trillion, down 13.9 percent compared with 2008. This decline was 9.6 percentage points smaller than that in the first half of 2009 and 31.7 percentage points lower than the year-on-year growth of exports and imports in 2008. Specifically, exports stood at US$1.2 trillion, down 16.0 percent year on year, 5.8 percentage points lower than in the first half of 2009 and 33.2 percentage points lower than the year-on-year export growth in 2008; imports registered US$1.0 trillion, a decrease of 11.2 percent over 2008, 14.2 percentage points lower than that in the first half of 2009 and 29.7 percentage points lower than the year-on-year import growth in 2008. The trade surplus posted US$196.1 billion, down US$102 billion compared with the previous year. Actually utilized foreign direct investment totaled US$90 billion, down 2.8 percent year on year, a deceleration of 20.8 percent.

2. Development of the agricultural sector remained stable and industrial production rebounded quarter by quarter

In 2009 the added value of the primary, secondary, and tertiary industries reached 3.5 trillion yuan, 15.7 trillion yuan, and 14.3 trillion yuan respectively, up 4.2 percent, 9.5 percent, and 8.9 percent year on year.

Development of the agricultural sector was stable and grain production continued to increase. In 2009 grain production totaled 530 million tons, up 0.4 percent year on year, marking a year-on-year increase for the sixth consecutive year. Meat production maintained stable growth and reached 76.42 million tons, an increase of 5.0 percent.

Industrial production rebounded quarter by quarter and profits of industrial enterprises turned positive. The growth of industrial added value rose steadily from the trough of 5.1 percent in Q1 2009 to 9.1 percent in Q2, 12.4 percent in Q3, and 18 percent in Q4. From January through November of 2009 the profits of statistically large industrial enterprises registered a year-on-year increase of 7.8 percent, ending the negative growth for 10 consecutive months and representing an acceleration of 18.4 percentage points from the first 8 months and 2.9 percentage points from the same period of 2008. According to the survey of 5,000 enterprises conducted by the PBC, the corporate profitability index stood at 55.6 percent in Q4, up 1.9 percentage points over Q1, representing a recovery for the third consecutive quarter.

3. Major price indices declined most of the time in 2009 and picked up at year-end

In 2009 prices in China decreased and then rebounded. After September 2008, the major price indices in China fell significantly due to the impact of the international financial crisis. Year-on-year growth of the CPI and PPI turned negative in February 2009 and December 2008 respectively, reaching a trough in July 2009. Since then, due to a more established domestic economic stabilization and recovery, the continued increase in commodities prices on the international market, and the lessened impacts of a negative tailing effect, major price indices began to recover. The CPI rose 0.6 percent in November 2009, ending a nine-month decline. The PPI grew 1.7 percent year on year in December 2009, ceasing the negative year-on-year growth for 12 months.

Consumer prices decreased continuously, but showed an upturn at the end of the year. In 2009 the CPI declined 0.7 percent year on year, 6.6 percentage points lower compared with 2008. From Q1 through Q4, the year-on-year CPI growth stood at –0.6 percent, -1.5 percent, -1.3 percent, and 0.7 percent respectively. Food prices rose 0.8 percent, a deceleration of 13.8 percentage points over 2008; non-food prices declined 1.4 percent, 2.9 percentage points lower compared with the previous year. The price of consumer goods dropped 0.6 percent, 8.0 percentage points lower than in the previous year, and the price of services fell 1.1 percent, 2.4 percentage points lower compared with 2008.

The price of industrial products decreased at an accelerated pace in early 2009, but recovered quite rapidly in the remainder of the year. In 2009 the PPI declined 5.4 percent year on year, 12.3 percentage points lower compared with 2008. From Q1 through Q4, the PPI decrease posted 4.6 percent, 7.2 percent, 7.7 percent, and 2.1 percent respectively. The purchase price of raw materials, fuels, and power dropped 7.9 percent year on year, 18.4 percentage points lower compared with 2008, and the decrease registered 7.1 percent, 10.4 percent, 11.1 percent, and 3.0 percent respectively from Q1 through Q4.

Producer prices of agricultural products increased in Q4, and their decrease in 2009 was slightly smaller than the decrease in the price of agricultural capital goods. The producer prices of agricultural products (referring to the price at which producers of agricultural produces directly sell their products) declined 2.4 percent in 2009, 16.5 percentage points lower than that in 2008. The price dropped by 5.9 percent, 6.6 percent, and 2.7 percent respectively in Q1 through Q3, and rose 3.2 percent in Q4. The price of agricultural capital goods decreased by 2.5 percent in 2009, 22.8 percentage points lower compared with the previous year. In particular, the price of agricultural capital goods registered a year-on-year growth of 5.9 percent in Q1 and decreased by 3.7 percent, 7.3 percent, and 4.0 percent respectively in the later quarters.

The decrease in import prices was greater than the decrease in export prices. In 2009 import prices declined 13.3 percent year on year, 28.1 percentage points lower compared with the previous year. The year-on-year decrease of import prices registered 15.6 percent, 18.6 percent, 17.5 percent, and 1.7 percent respectively from Q1 through Q4. Export prices dropped 6.0 percent year on year, 14.7 percentage points lower than in the previous year. The year-on-year drop in export prices stood at 1.9 percent, 7.0 percent, 8.5 percent, and 6.6 percent respectively. The rapid moderation of the year-on-year import price decrease was attributable to the continued price hike of international commodities since Q2. In 2009 the average crude oil futures on the New York Mercantile Exchange registered a quarter-on-quarter growth of 38.1 percent, 14.1 percent, and 11.6 percent respectively from Q2 through Q4, amounting to a cumulative hike of 75.8 percent. The average spot price of copper on the London Metal Exchange registered a quarter-on-quarter increase of 35.8 percent, 25.2 percent, and 13.7 percent respectively, accumulating to a surge of 93.3 percent. The average spot price of aluminum on the London Metal Exchange witnessed a quarter-on-quarter increase of 9.3 percent, 21.6 percent, and 10.8 percent respectively, amounting to a cumulative upswing of 47.3 percent.

Labor income continued to grow. In the first three quarters, the average monthly salary of urban employees was 2,475 yuan, up 12.9 percent year on year. In particular, the average monthly salary in state-owned entities was up 14.2 percent to 2,662 yuan, that in collectively-owned entities was up 15.8 percent to 1,543 yuan, and that in other categories of entities was up 10.4 percent to 2,353 yuan.

The GDP deflator declined by a smaller margin. In 2009 the GDP was up 8.7 percent to 33.5 trillion yuan. The rate of change in the GDP deflator (as a ratio of nominal GDP to real GDP) was -1.8 percent,[2] down 13.1 percentage points from the last year and down 1.0 percentage point from the first three quarters of 2009.

Further progress has been made in the reform of resource prices. Since 2009 the National Development and Reform Commission (NDRC) has adjusted the price of oil products on 9 occasions based on the improved pricing mechanism with reference to the oil price on the international market. In July, the NDRC and the Ministry of Housing and Urban-Rural Development established general principles for a water price adjustment, that is, to establish a pricing mechanism that allocates water resources efficiently and enhances water use to promote water conservation and the sustainability of water resources. In November 2009, the central government launched a plan for an adjustment in the price of electricity, hiking it by an average of 2.8 cents per kilowatt-hour nationwide. An appropriate adjustment in resource prices helps improve resource supplies and curbs unreasonable demand, restructures the economy, and transforms the growth pattern. In the future, on the basis of giving full consideration to the acceptability of all involved parties, the reform of resource prices will be advanced in an active and stable manner so that the market mechanism plays a more fundamental role in resource allocation.

4. Fiscal revenues grew month by month and fiscal expenditures increased rapidly

In 2009 fiscal expenditure growth remained high. As fiscal revenue growth recovered with the recovery of economic growth, the fiscal pressures that mounted at the

[2] The data on the GDP in 2008 have been adjusted according to the results of the second National Economic Census conducted by the National Bureau of Statistics.

beginning of the year gradually eased.

Since the beginning of 2009, with the Chinese economy taking a turn for the better, year-on-year growth of fiscal revenues recovered from –17.1 percent in January to 55.8 percent in December. According to preliminary statistics, fiscal revenues totaled 6847.7 billion yuan, representing growth of 11.7 percent, including central government revenues of 3589.6 billion yuan (representing growth of 9.8 percent), and local government revenues of 3258.1 billion yuan (representing growth of 13.7 percent). Tax revenues grew 9.8 percent to 5951.5 billion yuan and non-tax revenues increased 26.1 percent to 896.2 billion yuan.

Throughout the year, the growth of fiscal expenditures remained high. In particular, in the first three months when the economy was sluggish, year-on-year expenditure growth was 32.5 percent, 42 percent, and 31.4 percent respectively. Later, due to the improvement in economic performance and the high expenditures in the base period in 2008, year-on-year growth of expenditures moderated but remained fairly high. According to preliminary statistics, total expenditures grew 21.2 percent to 7587.4 billion yuan, representing a deceleration of 4.5 percentage points from 2008. Among the total, central government expenditures grew 14.5 percent year on year to 1528.0 billion yuan, representing a deceleration of 2.1 percentage points from 2008 and accounting for 20.1 percent in total expenditures; local government spending grew 23 percent year on year to 6059.4 billion yuan, representing a deceleration of 5.4 percentage points from 2008 and accounting for 79.9 percent of total expenditures.

5. The balance of payments registered a twin surplus

Since the outbreak of the international financial crisis and affected by the fundamental changes at home and abroad, the balance of payments fluctuated. In general, the current account and the capital and financial account were both in surplus. According to preliminary statistics released by the State Administration of Foreign Exchange, in 2009 the current account surplus was down 35 percent year on year to US$284.1 billion whereas the capital and financial account surplus (including errors and omissions) was US$109.1 billion. At end-2009, foreign exchange reserves increased US$453.1 billion year on year to US$2399.2 billion.

The size of the external debt shrank. At end-September 2009, the outstanding external debt decreased 12.5 percent year on year to US$386.8 billion. In particular, the registered external debt was US$254.3 billion, accounting for 65.7 percent of the total and representing a year-on-year decrease of 11.8 percent; the short-term external debt was US$222 billion, accounting for 57.4 percent of the total and representing a year-on-year decline of 20.7 percent.

6. Sectoral analysis

In 2009 industrial output increased quarter by quarter and profits improved since the beginning of Q2. Among the 39 sectors, 38 sectors reported a year-on-year growth of profits or a slower decline of profits in the first eleven months. The restructuring made further progress. Implementation of the Restructuring and Revitalization Program of the Ten Key Industries produced good results, as the auto, iron and steel, ship-making, petrochemical, light industry, textile, non-ferrous metal, equipment manufacturing, and electronic information industries reversed a sharp decline in output. Output and sales in the auto industry were both up by over 40 percent; the value added of petrochemical, equipment manufacturing, and light industries increased more than 10 percent year on year; the added value of the textile industry and electronic information industry was up 9. 5 percent and 5.3 percent year on year respectively. The output of coal and electricity and transportation volume continued to recover while the supply of crude oil was basically stable. In 2009 the output of raw coal, power generation, and freight volume was 2.96 billion tons, 3650.6 billion kilowatt per hour, and 27.44 billion tons respectively, up 12.7 percent, 7.0 percent, and 7.5 percent; the output of crude oil declined 0.4 percent year on year to 190 million tons.

Box 4: Redouble Efforts in Energy Conservation and Emission Reductions and Promoting Industrial Restructuring

In recent years, in particular after the 11th Five-Year Plan established binding objectives for energy conservation and emission reductions, energy consumption per unit of GDP and emissions have declined as a result of strenuous efforts, including measures to restrict the highly energy consuming and highly polluting industries and resource industries, encouraging the development of the tertiary and high-tech industries, and phasing out outdated capacities. From 2006 to 2008, energy consumption per unit of GDP declined 1.79 percent, 4.04 percent, 4.59 percent annually or by a total of 10.67 percent. Emissions of sulfur dioxide and the demand for chemical oxygen declined 8.95 percent and 6.61 percent respectively. In the first half of 2009, energy consumption per unit of GDP declined further by 3.35 percent, whereas emissions of sulfur dioxide were down 5.4 percent and chemical oxygen demand down 2.46 percent. In the structure of the supply of energy, the share of renewable energy in the total use of primary energy reached 9 percent in 2008. Wind and solar power accounted for 32.3 percent of the total installed power generation capacity in 2009, 5 percentage points higher than during the previous year. At end-2009, more obsolete capacities in raw material and energy sectors were phased out, the closure of 60 million kilowatts of small thermal power generators and the number of coal mines reducing to 15,000. This has effectively reduced energy consumption in these sectors. In the first half of 2009, energy consumption per unit of added value in the coal mining, iron and steel, construction material, and power generation sectors was down 3.83 percent, 8.43 percent, 9.03 percent, and 9.51 percent respectively.

Despite this progress, the absolute level of energy consumption and emission per unit of GDP remained fairly high. Energy, resources, and the environment still caused a bottleneck for economic and social development. On the one hand, rapid urbanization and industrialization exert even greater pressures on energy demands and emissions. On the other hand, with the economy heavily depending on the external sector, increased imports of energy and resources and excessive price hikes on the international market will push up domestic manufacturing costs. There will be stronger international pressures calling for stricter energy consumption and emission standards for Chinese manufactured goods.

It was emphasized both at the 2009 Central Economic Work Conference and by President Hu Jintao in his speech at the CPC Central Committee Party School that transformation of the growth pattern is imperative and the impact of the international financial crisis in essence has been on the growth pattern, although it appears as an impact on the growth rate. Based on a comprehensive consideration of the global and domestic economic situations, the need for a transformation of the growth pattern cannot be overstated.

The transformation will be a systemic engineering with far-reaching impacts. Restructuring the economy and industrial structure is the strategic focus of the transformation, and promoting energy conservation and emission reduction is an important part of the restructuring. Through the establishment of an external constraint mechanism, the pricing mechanism and the market transaction mechanism that support energy conservation and emission reductions, rational energy and resource prices and environment costs will help limit the development of highly polluting and energy consuming industries, raise the share of tertiary and high-tech industries in the economy, and optimize the structure of the manufacturing industry. For the objective of an optimum economic structure, expansion of the tertiary industry will help boost service consumption, and a better structure of the manufacturing industry will help slash imports of primary goods and raise the added value of exports, contributing to a balanced growth pattern and better growth efficiency.

The key to a faster pace of energy conservation and emission reductions lies in establishing an effective mechanism combining external constraints and market-based transactions. First, standards of energy conservation and emission reductions should be formulated and implemented and external constraints intensified. Second, a reform of energy and resource prices and an environment fee charge should be promoted, enabling prices to play a fundamental role in the adjustment of supply and demand of energy and resources and emission costs. Third, increase the input of public finance and other public resources and use tax leverage to promote energy conservation and emission reductions. Fourth, efforts to build a market for energy, resources, and emission rights transactions should be accelerated by drawing on the transaction mechanism and instruments of financial markets to more rationally price the costs of energy, resources, and the environment and providing an effective market-based energy conservation and emission reduction financing channel.

(1) Real Estate Sector

In 2009, to address the international financial crisis, the authorities adopted a series of policies to promote the healthy development of the real estate market. These policies played an important role in boosting confidence, revitalizing the market, improving the availability of housing for low-income households, and encouraging housing consumption and investment. In 2009, the sold floor area of commercial real estate continued to increase, and year-on-year growth of housing prices moved up every month after June. In some cities, the surge in sold floor area and prices was more obvious. Due to market changes, real estate credit also expanded quickly.

Real estate development investment recovered steadily. In 2009 realized investment totaled 3.62 trillion yuan, up 16.1 percent year on year. Growth of monthly real estate development investment accelerated but remained at a nine-year low. Among the total, commercial real estate development investment was up 14.2 percent year on year to 2.56 trillion yuan, accounting for 70.7 percent of the total. During the year, the floor area of real estate projects under construction was up 12.8 percent year on year to 3,196 million square meters; the floor area of newly started projects was up 12.5 percent to 1,154 million square meters; the completed floor area totaled 702 million square meters, up 5.5 percent, including 577 million square meters in floor area of residential projects (representing growth of 6.2 percent). In 2009 real estate development enterprises purchased a total of 319 million square meters of land, down 18.9 percent year on year.

Sales of commercial real estate quickly rebounded. In 2009 the total floor area of sold commercial real estate was up 42.1 percent to 937 million square meters. In particular, the area of sold commercial housing units was up 43.9 percent and the sales volume of sold commercial real estate was up 75.5 percent year on year to 4.40 trillion yuan, with the volume of sold commercial housing units up 80.0 percent. The boom in commercial real estate transactions was due to many factors, including external factors, such as the economic stimulus package, as well as the housing price decline and potential buyers’ intentions to postpone purchases in 2008. Because real estate sales in 2008 (the base period) declined year on year, year-on-year growth in 2009 was remarking.

The year-on-year movement of housing prices turned positive in June 2009 and continued growing thereafter. In December, housing prices in the 70 large and medium cities grew 7.8 percent year on year and 1.5 percent month on month, with the latter representing an acceleration of 0.3 percentage points from November. The price of new homes was up 9.1 percent year on year and 1.9 percent month on month, whereas the price of pre-owned homes was up 6.8 percent year on year and 1.0 percent month on month. Among the 70 large- and medium-sized cities, housing prices moved up more than 10 percent year on year in several cities, including Shenzhen (up 18.9 percent), Wenzhou (up 14.5 percent), Jinhua (up 12.0 percent), Hangzhou (up 11.5 percent), Zhanjiang (up 11.0 percent), and Nanjing (up 10.4 percent). In Q4 2009, rent in the 70 large- and medium-sized cities was flat compared with Q4 2008; land prices were up 13.8 percent, and prices of land designated for housing projects were up 19.4 percent.

Outstanding commercial real estate loans ballooned, but with a different growth structure. At end-2009, outstanding commercial real estate loans of major financial institutions were up 38.1 percent year on year to 7.33 trillion yuan, representing an acceleration of 27.7 percentage points and higher than the average loan growth rate by 6.7 percentage points. In particular, land development loans grew 104.1 percent year on year to 667.8 billion yuan, representing an acceleration of 98.4 percentage points year on year; housing development loans recovered relatively slowly, by 15.8 percent year on year to 1.86 trillion yuan, representing an acceleration of 4.6 percentage points. Mortgage loans continued to grow and accelerated in the second half of the year. At end-2009, outstanding mortgage loans were up 43.1 percent year on year to 4.76 trillion yuan, representing an acceleration of 33.3 percentage points from the previous year. Mortgage loans for new homes and pre-owned homes grew 40 percent and 79 percent respectively. At end-2009, outstanding real estate loans accounted for 19.2 percent of the total outstanding loans, one percentage point higher than in the previous year.

In 2009 new real estate loans posted 2 trillion yuan and accounted for 21.9 percent in the total new loans, 11.1 percentage points higher or 1.5 trillion yuan more than in the previous year. In particular, new mortgage loans reached 1.4 trillion yuan, about five times that in 2008 and 2 times that in 2007. The ratio of loans for new real estate projects to the sales volume of new homes was 26.3 percent in 2009, an increase of 16 percentage points and 4 percentage points from 2008 and 2007 respectively.

(2) Coal Mining Industry

Coal is the most important energy and manufacturing raw material in China. With the upturn in the domestic economy and the global recovery, output and price of coal both went up. Surging demand from downstream industries such as thermal power and iron and steel established a basis for further recovery of the coal mining industry and required a more efficient energy transportation system.

Coal output stabilized and increased and the coal price hiked. Since February 2009, driven by an acceleration of output growth in the western provinces, coal output rose month by month. In 2009, output totaled 29.6 trillion tons, an increase of 12.7 percent year on year. In the first three quarters, coal prices remained generally stable; in Q4, as a result of stronger economic growth, the price hike in the international market and higher freight costs, and an unusually cold winter in many areas, coal inventories in major ports declined and domestic coal prices rose by a large margin. At end-2009, coal stock in the port of Qinhuangdao and in power plants receiving a direct supply posted 5.36 million tons and 21.47 million tons respectively, down 380,000 tons and 21.85 million tons year on year; the prices of various kinds of coal power in the port of Qinhuangdao was up about 30 percent from end-September, and up between 31 percent and 40 percent from the beginning of the year. Due to the higher domestic price over international prices, coal was sold more to the domestic than to the international market. In 2009, coal exports declined 50.7 percent year on year to 22.40 million tons, whereas coal imports increased 211.9 percent year on year to 125.83 million tons. China became a net importer of coal for the first time.

The efforts to transform the growth pattern produced visible results in the coal mining industry. During the 11th Five-Year Plan period, the focus is on the consolidation of the coal-mining industry, supplemented by the establishment of new plants. As a result of promoting the development of a large-scale coal-mining base, merger and restructuring of coal-mining enterprises were accelerated and concentration of the industry was enhanced. The consolidation of coal resources has been completed in Shanxi province. At end-2009, a total of 82.54 million tons of obsolete mining capacity was phased out, 2.54 million tons more than the planned amount in the 11th Five-Year Plan.

Straightening out the thermal power pricing mechanism is the key to improving the supply and demand of coal power and easing coal and power shortages. In December, with the release of the *Guidelines on Connecting the Production, Transportation, and Demand of Coal Mines* by the National Development and Reform Commission, the government pulled out from the coal power negotiations. This marked an important step in the coal market reform. After the elimination of the coal ordering system, a modern coal trading system based on the National Coal Trading Center, supplemented by regional markets and supported by network technology, will be established to enable market players to trade independently and to support government efforts for macroeconomic management; a coal power index will be formulated and improved to provide reference for quotations and negotiations and to guide the production and consumption of coal.

China’s energy structure is expected to depend on coal for quite a long time and thus it will be an arduous task to reach the goal of reducing emissions of carbon dioxide per unit of GDP set for 2020 and the goal of increasing the share of non-fossil 15 percent of total primary energy consumption. It is necessary to beef up the restructuring efforts, develop modern coal chemical projects, limit overcapacity and duplicate construction in certain industries, focus more on energy conservation and consumption reduction, introduce energy efficient technology and products, and create an energy conservation assessment system.

Part 5 Future Monetary Policy Stance

I. Macroeconomic outlook

With a number of favorable factors, the Chinese economy is expected to continue its sound and relatively rapid growth in 2010. On the one hand, since the worst of the global financial crisis is over, the world economy is beginning to recover slowly and, despite some uncertainties, the external environment for China has generally improved. Many institutions, including the World Bank, believe that China’s net exports in 2010 will again contribute positively to GDP growth. A business survey conducted by the PBC also shows that the export order index stood at 49.2 percent in the fourth quarter, a rise of 1.8 percentage points quarter on quarter and up 8.1

percentage points from the trough in the first quarter. On the other hand, business activities and confidence at home are growing stronger, and local governments are eager to speed up development and expand investment. In 2009, total planned investment for projects under construction rose 32.3 percent year on year, an acceleration of 12.4 percentage points, whereas total planned investment for newly started projects saw year-on-year growth of 67.2 percent, which represents a dramatic acceleration of 61.8 percentage points. Urbanization and upgrading of the consumption structure are expected to provide a stronger push for growth. The urbanization process, which still has large room for development in the future, will drive the continued development of a series of related industries. In terms of consumption, while urban consumption is undergoing a structural upgrading, rural consumption will expand as income grows. In particular, higher social security level, continued medical and healthcare reforms, increased agricultural subsidies, policies and measures aimed at boosting consumption as well as improving the economy, corporate profits, and the employment situation will lead to higher household income and a propensity for consumption and will contribute to consumption growth. The PBC urban depositors' survey shows that sentiment about future income in the fourth quarter had strengthened for two consecutive quarters, and 39.3 percent of the respondents expected to consume more in the next quarter, up 7.9 percentage points from the third quarter. The employment sentiment, which had been improving since the beginning of 2009, also saw a quarter-on-quarter rise. The business survey in the fourth quarter suggests macroeconomic expectations jumped 2.4 percentage points quarter on quarter, and demand, sales, and profits all improved. The survey of bankers also points to an increase of 4.0 percentage points from the previous quarter in terms of the bankers' expectations regarding the macro economy.

Nevertheless, it should be noted that there are many difficulties and domestic and international challenges. At the global level, despite the improved performance of the world economy, new sources of growth are not yet clear and major economies have limited space to further expand stimulus policies. Moreover, rising trade frictions, the exit from the stimulus policies, and other uncertainties will also affect the international economy and the external environment for China's development. With regard to the domestic situation, though there has been a rebound in demand, it is not established on a balanced foundation and the role of private investment and the contribution of domestic demand to growth need to be strengthened. Boosting household consumption and improving the economic structure remain demanding tasks, and efforts are needed to watch price movements and look out for financial risks. In an effort to accelerate the shift in the growth model it is important to create favorable conditions for long-term development while ensuring sound and rapid growth for the short term.

Future price movements are uncertain. While external demand remains weak, continued harvests and strong industrial capacity will help to stabilize prices. But against the backdrop of a loose monetary condition around the world, prices are likely to go upward as the economy improves and market confidence strengthens. In addition, movements of the dollar and commodities prices, as well as adjustments of resources price at home, will add to the uncertainty over future price movements. In general, price stability faces heightened potential risks. As the PBC urban depositors' survey in the fourth quarter shows, the price expectation index, which had been on the rise since the beginning of 2009, stood at 73.4 percent, up 6.6 percentage points from the third quarter.

II. Policy stance for the next stage

Going forward, in line with the overall arrangements of the State Council, the PBC will work to enhance the momentum for an economic improvement and upturn through a combination of market-based mechanisms and macroeconomic management and by striking a balance between supporting sound and rapid economic growth, restructuring the economy, and managing inflation expectations. While continuing the relatively loose monetary policy, properly managing the intensity, pace, and focus of policy implementation, and maintaining policy consistency and stability, policies will be better targeted and more flexible in response to new developments so as to enhance the sustainability of financial support to growth and to maintain the healthy and stable performance of the financial system. Broad money M2 is expected to grow by around 17 percent in 2010.

First, the PBC will strengthen liquidity management and guide money and credit aggregates to grow properly. In line with economic and financial developments and changes in foreign exchange flows, the PBC will use a variety of monetary policy tools, carefully arrange the mix and term of the policy tools, and manage the intensity of monetary policy operations. It will work to ensure that liquidity in the banking system remains at a reasonable level and will promote proper money and credit growth through enhanced liquidity management. It will guide financial institutions to properly pace their loan extensions in line with the needs of economic development so that loans are balanced throughout the year without sharp fluctuations across quarters and months.

Second, the PBC will step up financial support to help the shift in the growth pattern and economic restructuring. On the one hand, it will continue to implement differentiated credit policies and to improve the credit structure. In this regard, the PBC will enhance credit policies to support weak links in the economy, employment programs, emerging strategic industries, and industrial relocation. It will work to address financing problems facing agriculture and small enterprises and will ensure that loans to key projects are granted in a timely manner. On the other hand, it will rein in lending to highly energy consuming and polluting industries, industries with excess capacity, and newly started projects. Risk warnings to financial institutions will be improved. Drawing on the regulatory reform approaches proposed by the Financial Stability Board (FSB) and other institutions, and taking into consideration China's circumstances, the PBC will build a macro-prudential management framework and leverage on its countercyclical role to maintain the soundness of the financial system and improve the sustainability of financial support to economic development.

Third, the PBC will steadily advance the market-based interest rate reform and improve the RMB exchange rate mechanism. Continued efforts will be made to foster a benchmark interest rate system on the money market to improve the pricing mechanism and make interest rates a more effective channel for policy transmission. The RMB exchange rate mechanism will be improved in a self-initiated, controllable, and gradual manner to keep the RMB exchange rate basically stable at an adaptive and equilibrium level. The PBC will promote the development of the foreign exchange market and introduce more tools for managing exchange rate risks. It will deepen the reform of the foreign exchange administration system and steadily advance the pilot program for RMB settlement of cross-border trade transactions to further facilitate trade and investment.

Fourth, the PBC will speed up financial product innovation and promote sound development of the financial market. It will provide more direct financing channels for enterprises, allow a wider range of financial institutions to issue debts, including giving a broader scope of foreign institutions access to the domestic bond market. It will accelerate the development of the bond market and introduce more financial derivatives. While encouraging innovations in debt financing instruments for non-financial enterprises by drawing on existing debt financing instruments, the PBC will continue to expand the market. In particular, it will encourage SMEs to issue short-term financing bills and medium-term collective bonds, will explore the possibility of issuing convertible debt financing instruments by SMEs, and will study the issuance of asset-backed bills by enterprises.

Fifth, the PBC will deepen the reform of financial institutions to promote financial stability. Reform of the state-owned commercial banks that have been transformed into joint-stock banks will be continued, and measures will be taken to speed up the establishment of a modern financial institution system. Efforts will be made to encourage the Agricultural Bank of China to improve its corporate governance and risk control systems and to develop the agro-related services division, and to support the China Development Bank in its efforts to improve the organization of financial services. Guidance will be given to the Export-Import Bank of China and the China Export and Credit Insurance Corporation to implement reform plans. Internal reform in the Agricultural Development Bank of China will be continued so as to improve its operations and management, and reform of the rural credit cooperatives in major areas will be advanced.

Moreover, it will be necessary to strengthen the coordination and cooperation between fiscal and monetary policy to ensure proper investment growth and a greater role of fiscal policy in optimizing the economic structure and improving the people's livelihood. It is important to accelerate the economic restructuring and reforms in key areas, enhancing the vitality of private businesses, ensuring that the market mechanism plays a greater role in resource allocation, enhancing the growth potential, and building new endogenous economic drivers by shifting the growth pattern and restructuring the economy.