**China Monetary Policy Report**

**Quarter One, 2018**

(May 11, 2018)

**Monetary Policy Analysis Group of**

**the People’s Bank of China**

**Executive Summary**

During the first quarter of 2018 the economy maintained stable growth, with steadily progressing transformation and upgrading, an increasing role of domestic demand as a driving force, greater contributions by the service industry to economic growth, and fairly good quality and efficiency of growth. The Gross Domestic Product (GDP) grew 6.8 percent year on year, and the Consumer Price Index (CPI) was up 2.1 percent year on year.

From the beginning of 2018, the PBC continued to implement a sound and neutral monetary policy. In a timely manner it adjusted and improved the macro-prudential policy, emphasized carefully calibrating the pace, strength, and mix of monetary-policy instruments, and strengthened preemptive adjustments, fine-tunings, and management of expectations. First, the volume and structure of liquidity were well managed and the role of price leveraging was given full play. A combination of monetary-policy instruments were used in a flexible way, including repos, the Medium-term Lending Facility (MLF) and the Standing Lending Facility (SLF), to provide liquidity of different maturities. The Contingency Reserve Arrangement (CRA) helped smooth the temporary liquidity volatilities caused by the large injection of cash before the Spring Festival. Targeted cuts were made to the reserve requirement ratios (RRR) of selected financial institutions to replace the MLF, thus stabilizing the provision of liquidity in the banking system and optimizing the structure of liquidity. The bidding interest rates of open market operations edged up in line with market conditions. Second, targeted RRR cuts for inclusive financing were implemented. Credit policies were adopted to support the use of tools such as central-bank lending, central-bank discounts, and Pledged Supplementary Lending (PSL) to guide financial institutions in beefing up support for priority areas and for weak links in the economy. Third, the macro-prudential policy framework was further improved. Since the first quarter of 2018, inter-bank certificates of deposit were included in the calculation of the inter-bank liability ratio for macro-prudential assessments (MPA). Against the backdrop of basically balanced cross-border capital flows and foreign-exchange supply and demand, the counter-cyclical macro-prudential policies for capital flows that were announced earlier all returned to a neutral stance.

In general, the sound and neutral monetary policy produced fairly good results. Liquidity in the banking system remained reasonable and stable. Money, credit, and all-system financing aggregates grew at an appropriate pace, interest rates remained basically stable, and efforts to control internal leveraging of the financial system made progress. All of these played a vital role in serving the real economy and in mitigating financial risks. At end-March 2018, outstanding M2 was growing by 8.2 percent year on year. The outstanding volume of RMB loans was up 12.8 percent year on year, representing an increase of RMB 4.9 trillion from the beginning of the year, and representing an acceleration of RMB 633.9 billion from the previous year. The stock of all-system financing aggregates was growing by 10.5 percent year on year. In March, the weighted average interest rate of loans to non-financial enterprises and other sectors was 5.96 percent. At end-March, the CFETS RMB exchange-rate index was 96.73, and the central parity of the RMB against the US dollar was RMB 6.2881.

At the current juncture, the global political and economic environments have become more complicated. On the one hand, the global economic recovery has continuously gained momentum. On the other hand, trade frictions and geopolitical factors have brought about significant uncertainties. Although positive changes have taken place in the structural adjustment of the domestic economy and the financial system, some underlying problems remain unresolved. The essential characteristic that the Chinese economy has shifted from a phase of rapid growth to a phase of high-quality development must be borne in mind. Emphasis should be placed on improving the quality and efficiency of the supply-side system through structural reforms. Strenuous efforts are needed to promote reform and opening-up and to achieve better quality, higher efficiency, and more robust drivers of economic growth based on the reforms.

Going forward, the PBC will continue to follow the overall arrangements of the CPC Central Committee, the State Council, and Xi Jinping’s Thought on Socialism with Chinese Characteristics for a New Era, focus on the three tasks of serving the real economy, guarding against financial risks, and deepening financial reform, adopt innovative approaches to improve financial macro controls, maintain policy consistency and stability, implement a sound and neutral monetary policy, attach importance to management of expectations, and create a neutral and appropriate monetary and financial environment for supply-side structural reforms and high-quality development. The PBC will improve the two-pillar framework underpinned by the monetary and macro-prudential policies, deepen the market-based interest rates and reforms of the exchange-rate regime, enhance the conduct of monetary policy through interest-rate instruments, enhance the role of the market in determining the exchange rate, and keep the RMB exchange rate basically stable at a reasonable and equilibrium level. The PBC will steadily promote the reform and opening-up of the financial sector, vigorously develop inclusive financing, play a greater role in serving the real economy, support entrepreneurship and innovation, and foster new drivers of growth. Efforts will be made to win the uphill battle of preventing and resolving major financial risks, strengthen macro-prudential management and coordinated financial regulation, and safeguard the bottom line of preventing systemic financial risks.

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**Part 1. Money and Credit Analysis**

During Q1 of 2018, liquidity in the banking sector was stable at an appropriate level. Money, credit, and all-system financing aggregates grew moderately. Lending structures continued to improve, interest rates were generally stable, and RMB exchange rates were becoming more flexible.

**I. Monetary aggregates grew steadily**

**The growth of M2 was generally stable.** At end-March, outstanding M2 stood at RMB 174.0 trillion, up 8.2 percent year on year and representing an acceleration of 0.1 percentage point from end-2017. Outstanding M1 stood at RMB 52.4 trillion, up 7.1 percent year on year and representing a deceleration of 4.7 percentage points from end-2017. Outstanding M0 reached RMB 7.3 trillion, up 6.0 percent year on year. On a net basis, during Q1 the PBC injected RMB 204.7 billion of cash into the system, an increase of RMB 174.6 billion year on year.

**Due to the coordinated and effective implementation of a prudent and neutral monetary policy and financial-regulation policy, M2 growth has stabilized.** This will help control leverage within the financial system, reduce funds that circulate within the financial system through embedded structures, and stabilize leverage in the overall economy, supporting the battle to prevent and mitigate major risks. With the deepening of financial markets and development of financial innovations, the money supply will be subject to increasingly complicated factors. As a result, the measurability and controllability of M2 and its relevance to the real economy have all been weakening. Revising the scope of the M2 indicator does not fundamentally resolve the declining effectiveness of the quantitative indicators. In light of the requirement for high-quality development, it is necessary to follow the laws of economic and financial development and to transform the method of macroeconomic management by gradually shifting from quantity-based indicators to interest rates and other price-based indicators.

At end-March, base money stood at RMB 32.1 trillion, representing a decrease of RMB 52.1 billion from the beginning of the year and a decline of RMB 607.1 billion year on year. The money multiplier was 5.41. The overall excess reserve ratio of financial institutions was 1.3 percent and the overall excess reserve ratio of rural credit cooperatives was 9.4 percent.

**Figure 1. Growth of money supply**



Source: People’s Bank of China.

**II. The share of RMB term deposits in financial institutions increased**

**The growth of deposits slowed down slightly.** At end-March, outstanding deposits in domestic and foreign currencies in all financial institutions posted RMB 174.4 trillion, up 8.4 percent year on year and representing a deceleration of 0.4 percentage point from end-2017. This marked an increase of RMB 5.2 trillion from the beginning of the year, which was RMB 279.9 billion less year on year. Outstanding RMB deposits registered RMB 169.2 trillion, up 8.7 percent year on year and a deceleration of 0.3 percentage point from end-2017. This represented an increase of RMB 5.1 trillion from the beginning of the year, which was RMB 7.7 billion more year on year. Outstanding deposits in foreign currencies stood at USD 836.8 billion, an increase of USD 45.9 billion from the beginning of the year, which was USD 13.3 billion less year on year.

**The share of term deposits increased.** In Q1 of 2018, term deposits accounted for 122.8 percent of new deposits by households and non-financial enterprises, up 40.1 percentage points year on year. Broken down by sectors, deposits by households and non-banking financial institutions registered a year-on-year acceleration of RMB 310.9 billion and RMB 1.4 trillion, respectively, whereas deposits by non-financial enterprises recorded a year-on-year deceleration of RMB 1.4 trillion.

**Table 1. Structure of RMB Deposits in Q1 of 2018**

RMB 100 million

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 　 | Deposits at end-March | Year-on-year growth | Increase from the beginning of the year | Change in the increase from the same period of the last year |
| RMB deposits | 1,691,816 | 8.7% | 50,640 | 77 |
| Households  | 686,804 | 7.8% | 42,735 | 3,109 |
| Non-financial enterprises | 529,321 | 5.1% | –12,071 | –14,338 |
| Government | 310,348 | 11.8% | 5,328 |  –1,568 |
| Non-banking financialinstitutions | 155,163 | 20.8% | 14,934 | 13,781 |
| Overseas | 10,180 | 9.3% | -287 |  -907 |

Source: People’s Bank of China.

**III. Lending by financial institutions grew rapidly**

**Lending grew rapidly, providing strong support for the real economy.** At end-March, outstanding loans in domestic and foreign currencies of all financial institutions posted RMB 130.5 trillion, up by 11.9 percent year on year and a deceleration of 0.2 percentage point from end-2017. This marked an increase of RMB 4.9 trillion from the beginning of the year and represented a year-on-year acceleration of RMB 309.7 billion. At end-March, outstanding RMB loans registered RMB 125.0 trillion, up 12.8 percent year on year and an acceleration of 0.1 percentage point from end-2017. This marked an increase of RMB 4.9 trillion from the beginning of the year, which represented a year-on-year acceleration of RMB 633.9 billion. Due to a strong demand for loans as well as a change from quasi-credits to loans, compared with the same period of the last year more loans were extended this year.

**The share of new medium- and long-term RMB loans declined.** Compared with the beginning of the year, medium- and long-term RMB loans increased by RMB 3.7 trillion, representing a deceleration of RMB 389.2 billion year on year and accounting for 77.0 percent of the total new loans, down 20.8 percentage points year on year. Medium- and long-term loans to industries with excessive capacity continued to slow down. Broken down by sectors, growth of RMB loans to the household sector had declined to 20.0 percent by end-March, which was 1.4 percentage points lower than that at end-2017. In particular, growth of mortgage loans continued to moderate. At end-March, outstanding mortgage loans were growing by 20.0 percent year on year, marking a decline for the thirteenth consecutive month. Compared with the beginning of the year, mortgage loans increased by RMB 994.4 billion, representing a deceleration of RMB 173.0 billion year on year and accounting for 20.5 percent of the total new loans, down 7.2 percentage points year on year. Other loans to the household sector increased by RMB 758.7 billion compared with the beginning of the year, representing an acceleration of RMB 79.1 billion year on year. Loans to non-financial enterprises and government departments and organizations increased by RMB 3.1 trillion from the beginning of the year, representing an acceleration of RMB 437.6 billion year on year. Broken down by type of institution, domestic small- and medium-sized banks registered stronger lending growth year on year.

**Table 2. Structure of RMB Loans in Q1 of 2018**

RMB 100 million

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 　 | Outstanding amount at end-March | Year-on-year growth | Increase from the beginning of the year | Change in the increase from the same period of the last year |
| RMB loans to | 1,249,814 | 12.8% | 48,552 | 6,339 |
| Households | 422,733 | 20.0% | 17,531 | -939 |
| Non-financial enterprises,government departments, and organizations | 816,154 | 9.6% | 30,947 | 4,376 |
| Non-banking financialinstitutions | 6,217 | -7.6% | -141 | 2,672 |
| Overseas | 4,710 | 8.1% | 216 | 232 |

Source: People’s Bank of China.

**Table 3. New RMB Loans by Financial Institutions in Q1 of 2018**

RMB 100 million

|  |  |  |
| --- | --- | --- |
|  | New loans | Year-on-year acceleration  |
| Chinese-funded large-sized banks 1 | 19,447 | 2,872 |
| Chinese-funded small- andmedium-sized banks2 | 26,808 | 3,727 |
| Small-sized rural financial institutions3 | 6,696 | 324 |
| Foreign-funded financial institutions  | 726 |  173 |

Notes: 1. Chinese-funded large-sized banks refer to banks with assets (both in domestic and foreign currencies) of RMB 2 trillion or more (according to the amount of total assets in both domestic and foreign currencies at end-2008).

2. Chinese-funded small- and medium-sized banks refer to banks with total assets (both in domestic and foreign currencies) of less than RMB 2 trillion (according to the amount of total assets in both domestic and foreign currencies at end-2008).

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

Source: People’s Bank of China.

**Growth of loans in foreign currencies slowed down.** At end-March, outstanding foreign-currency loans of all financial institutions stood at USD 870.4 billion, up 4.0 percent year on year and decelerating by 2.6 percentage points since end-2017. This represented an increase of USD 32.4 billion from the beginning of the year and a deceleration of USD 18.6 billion year on year. In terms of loan use, short-term loans to non-financial enterprises and government departments and organizations increased by USD 7.7 billion from the beginning of the year, a deceleration of USD 3.9 billion year on year; external loans increased by USD 25.1 billion from the beginning of the year, a deceleration of USD 14.6 billion year on year.

**IV. All-system Financing Aggregates Grew at a Reasonable Pace**

**All-system financing aggregates grew at a reasonable pace, and some off-balance-sheet financing returned to the balance sheet due to stricter regulations.** According to preliminary statistics, outstanding all-system financing aggregates reached RMB 179.93 trillion at end-March, up 10.5 percent year on year and exceeding nominal GDP growth. In Q1, incremental all-system financing aggregates reached RMB 5.58 trillion, down RMB 1.33 trillion year on year. Incremental all-system financing aggregates were characterized by the following: First, growth of RMB loans to the real economy registered a year-on-year acceleration. In Q1, RMB loans by financial institutions to the real economy increased by RMB 4.85 trillion, an acceleration of RMB 343.8 billion compared to the same period of the last year and accounting for 86.9 percent of the incremental all-system financing aggregates. Second, growth of trust loans and undiscounted bankers’ acceptance bills registered a year-on-year deceleration, whereas growth of entrusted loans registered a considerable year-on-year acceleration. In Q1, trust loans increased by RMB 75.8 billion, representing a deceleration of RMB 659.1 billion year on year; undiscounted bankers’ acceptance bills increased by RMB 122.1 billion, representing a deceleration of RMB 558.1 billion; and entrusted loans decreased by RMB 331.4 billion, representing a deceleration of RMB 966.1 billion. Third, corporate debt financing registered a year-on-year acceleration and equity financing registered a year-on-year deceleration. In Q1, corporate debt financing registered RMB 537.1 billion, a year-on-year increase of RMB 2.55 trillion, and equity financing by non-financial enterprises recorded RMB 128.3 billion, a year-on-year decrease of RMB 131.3 billion.

**Table 4. Stocks of All-System Financing Aggregates at end-March 2018**

Unit: RMB trillion, %

|  |  |  |
| --- | --- | --- |
|  | All-system financing aggregates① | Of which: |
| RMB loans  | Foreign- currency denominated (RMB equivalent) | Entrusted loans | Trust loans  | Undiscounted bankers’ acceptances  | Enterprise bonds | Financing by domestic institutions via the domestic stock markets |
| End-March 2018② | 179.93 | 123.86 | 2.46 | 13.63 | 8.62 | 4.56 | 18.86 | 6.78 |
| Year-on-year change | 10.5 | 12.9 | –8.6 | –1.4 | 22.9 | –0.4 | 5.7 | 12.3 |

Notes: 1.) Stocks of all-system financing aggregates refer to the total outstanding volume of financing provided by the financial system to the real economy (the non-financial corporate sectors and the household sectors in the domestic market) at the end of a certain period of time. 2.) Data for the current period are preliminary. Stocks are based on the book value or the face value. The year-on-year change is annualized and based on comparable data.

Sources: People’s Bank of China, National Development and Reform Commission, China Securities Regulatory Commission, China Insurance Regulatory Commission, China Central Depository and Clearing Co., Ltd., and National Association of Financial Market Institutional Investors.

**Table 5. Increments of All-system Financing Aggregates in Q1 2018**

Unit: RMB 100 million

|  |  |  |
| --- | --- | --- |
|  | Incremental all-system financing aggregates① | Of which: |
| RMB loans  | Foreign- currencydenominated (RMB equivalent) | Entrusted loans | Trust loans  | Undiscounted bankers’ acceptances  | Enterprise bonds | Financing by domestic institutions via the domestic stock markets |
|  Q1, 2018 ② | 55765 | 48474 | 492 | –3314 | 758 | 1221 | 5371 | 1283 |
| Year-on-year change | –13299 | 3438 | –290 | –9661 | –6591 | –5581 | 6877 | –1313 |

Notes: 1.) An increment in the all-system financing aggregates refers to the total volume of financing provided by the financial system to the real economy (the non-financial corporate sector and the household sector of the domestic market) during a certain period of time. 2.) Data for the current period are preliminary.

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

**V. Interest rates on loans offered by financial institutions stabilized and rose moderately**

**Due to the stable and positive economic performance and strong demand for credit, the interest rates on loans offered by financial institutions stabilized and rose moderately, with interest rates on loans to enterprises rising by a smaller margin.** In March, the weighted average interest rate on loans offered to non-financial enterprises and other sectors was 5.96 percent, an increase of 0.22 percentage point compared with that in December 2017. In particular, the weighted average interest rate on ordinary loans posted 6.01 percent, up 0.21 percentage point from December 2017; the weighted average bill financing rate posted 5.58 percent, up 0.35 percentage point from December 2017. Interest rates on mortgage loans edged up, with the weighted average interest rate posting 5.42 percent in March, up 0.16 percentage point from December 2017.

**Broken down by floating range, the share of loans with interest rates above the benchmark rate increased moderately, whereas the share of loans with interest rates below or at the benchmark rate decreased moderately.** In March, the share of loans with interest rates higher than the benchmark rate was 74.35 percent, up 9.94 percentage points from December 2017; the share of loans with interest rates at the benchmark rate was 16.04 percent, down 5.27 percentage points from December 2017; and the share of loans with interest rates lower than the benchmark rate was 9.61 percent, down by 4.67 percentage points from December 2017.

**Table 6. Shares of Loans with Rates Below, At, or Above the Benchmark Rate, January through March 2018**

|  |
| --- |
| Unit: % |
| Month | Lower than the benchmark | At the benchmark  | Higher than the benchmark |
| Sub-total | (1，1.1］ | (1.1，1.3］ | （1.3，1.5] | （1.5，2.0] | Higher than 2.0 |
| January | 11.89 | 20.31 | 67.80 | 16.45 | 19.67 | 12.32 | 12.11 | 7.26 |
| February | 12.50 | 18.83 | 68.67 | 15.98 | 18.66 | 12.88 | 12.65 | 8.50 |
| March | 9.61 | 16.04 | 74.35 | 15.86 | 21.29 | 14.00 | 14.53 | 8.68 |

Source: People’s Bank of China.

**Against the background of interest-rate fluctuations in international financial markets and changes in the supply and demand of foreign currencies in the domestic market, the interest rates for foreign-currency deposits and loans went up.** In March, the weighted average interest rates for large-value USD demand deposits and deposits with maturities within 3 months registered 0.30 percent and 1.92 percent, respectively, up 0.10 and 0.22 percentage point from December 2017. The weighted average interest rates for USD loans with maturities within 3 months and with maturities between 3 months (including 3 months) and 6 months posted 3.17 percent and 3.42 percent, respectively, up 0.50 percentage point and 0.43 percentage point, respectively, from December 2017.

**Table 7. Average Interest Rates for Large-Value Deposits and Loans in USD, January through March 2018**

|  |
| --- |
| Unit：% |
| Month  | Large-value deposits | Loans |
| 3–6 months (including 3 months) | 6–12 months(including 6 months) | 3–6 months (including 3 months) | 6–12 months(including 6 months) | 3–6 months (including 3 months) | 6–12 months(including 6 months) | 3–6 months (including 3 months) | 6–12 months(including 6 months) | 3–6 months (including 3 months) | 6–12 months(including 6 months) | 3–6 months (including 3 months) |
| January | 0.19 | 1.79 | 2.37 | 2.61 | 2.77 | 2.87 | 2.72 | 3.10 | 2.84 | 3.04 | 4.48 |
| February | 0.18 | 1.82 | 2.39 | 2.70 | 2.97 | 2.81 | 2.79 | 3.28 | 2.95 | 3.21 | 4.11 |
| March | 0.30 | 1.92 | 2.70 | 3.09 | 3.28 | 3.33 | 3.17 | 3.42 | 3.21 | 3.73 | 4.23 |

Source: People’s Bank of China.

**VI. The RMB exchange rate was more flexible in terms of two-way fluctuations.**

**The flexibility of the RMB exchange rate against the USD strengthened further and with stronger two-way fluctuations. Exchange-rate expectations remained well anchored.** In Q1, as the USD weakened most of the major currencies appreciated against the USD, and the RMB exchange rate strengthened against the USD while remaining stable against a basket of currencies. At end-March 2018, the CFETS RMB exchange-rate index closed at 96.73, up 1.98 percent from end-2017; the RMB exchange-rate index, based on the Bank for International Settlements (BIS) basket and the SDR basket, closed at 97.79 and 99.31, respectively. According to calculations by the BIS, the NEER and REER of the RMB depreciated by 3.54 percent and 3.45 percent, respectively, in Q1. At end-March 2018, the central parity of the RMB against the USD was 6.2881, an appreciation of 3.91 percent from the end of 2017. Since April, the RMB has weakened. As of May 11, the central parity of the RMB against the USD posted 6.3524, a depreciation of 1.01 percent from end-March and an appreciation of 2.86 percent from the end of 2017. In Q1, the volatility rate of the central parity of the RMB against the USD was 4.05 percent, close to the level of some Asian currencies. Due to greater flexibility in the RMB exchange rate, market expectations differed and the exchange rate played an automatic stabilizer role.

**VII. Cross-border RMB businesses saw stable development**

In Q1, cross-border receipts and payments in RMB totaled RMB 3.15 trillion, up 87.1 percent year on year. In particular, RMB receipts registered RMB 1.65 trillion, up 113 percent year on year; RMB payments registered RMB 1.5 trillion, up 65.4 percent year on year. RMB cross-border receipts and payments under the current account posted RMB 1.06 trillion, up 6.5 percent year on year. In particular, settlements of trade in goods registered RMB 797.05 billion, whereas settlements of trade in services and other items registered RMB 261.93 billion. RMB cross-border receipts and payments under the capital account posted RMB 2.09 trillion, up 203 percent year on year.

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**Figure 2. Monthly RMB Payments and Receipts under the Current Account**



 Source: People’s Bank of China.

**Box 1. New Developments in RMB Internationalization**

According to the decisions and arrangements of the Central Committee of the Communist Party of China (CPC) and the State Council, on the basis of market decisions, since 2009 the People’s Bank of China (PBC), together with other relevant ministries, has established and improved a policy framework and infrastructure for cross-border and international use of the RMB, with a focus on facilitating and liberalizing trade and investment. International use of the RMB has expanded steadily. On October 1, 2016, the RMB was officially included in the SDR basket of the International Monetary Fund (IMF), representing a milestone in the process of RMB internationalization. Since the beginning of 2018, RMB internationalization has made new progress, supported by further improvements in policies and infrastructure for RMB cross-border use.

**1. International use of the RMB has risen steadily**

**The role of the RMB as a payment currency has continuously strengthened.** According to SWIFT statistics, by the end of January 2018 the RMB ranked as the fifth largest payment currency in the world, with a market share of 1.66 percent. By the end of March 2018, over 349,000 companies and 386 banks had conducted RMB cross-border businesses and foreign banks from 137 countries and regions had opened 5,028 current accounts in China.

**The role of the RMB as an investment and financing currency continued to deepen.** By the end of February 2018, 652 foreign institutions had gained access to China’s inter-bank bond market, with a total registered investment of RMB 2.09 trillion; the outstanding domestic RMB financial assets, including stocks, bonds, and loans and deposits held by foreign entities, had reached RMB 4.47 trillion, an increase of 39.6 percent year on year. By the end of March, the total registered or approved amount of panda bonds had reached RMB 624.01 billion and their total issuance reached RMB 245.7 billion.

**The role of the as a reserve currency is emerging.** For the first time, the IMF released information on RMB reserves. In Q4 of 2017, RMB reserves held by reporting countries to the currency composition of official foreign-exchange reserves (COFER) stood at USD 112.8 billion, up 4.5 percent quarter on quarter. According to incomplete statistics, over 60 foreign banks and monetary authorities have included the RMB in their official foreign-exchange reserves.

**2. Policies on the cross-border use of the RMB have improved continuously.**

**Policies have been introduced to facilitate trade and investment.** In January 2018, the PBC issued the *Notice on Further Improving RMB Cross-border Business Policies to Facilitate Trade and Investment* (PBC Document [2018] No. 3), stipulating that enterprises can use the RMB to settle cross-border transactions that can be settled in foreign exchange according to the law. The *Notice* allows RMB settlements by individuals for other items under the current account, facilitates direct investments in RMB by foreign investors, introduces RMB cross-border settlements of transactions for carbon-emission rights, and makes it easier for enterprises to transfer home RMB funds raised by issuing stocks and bonds abroad. Implementation of the *Notice* will further facilitate trade and investment, enhance the capacity of financial institutions to serve the real economy and the Belt and Road Initiative, and bring the opening-up to a new level.

**Crude oil futures denominated and settled in RMB were officially launched.** The *Announcement on Issues Related to the Management of Cross-border RMB Settlements for Domestic Transactions of Crude Oil Futures* (PBC Announcement [2015], No. 19) was issued in July 2015. On March 26, 2018, crude oil futures denominated and settled in RMB were officially listed or the Shanghai International Energy Exchange. This will promote the RMB’s role as an account unit and a settlement currency for commodities and will facilitate use of the RMB in international trade.

**3. The underlying infrastructure continued to improve**

**Efforts have been made to improve overseas RMB clearing arrangements.** In January 2018, the PBC and the Taibei Branch of the Bank of China renewed the *Agreement on the Clearing of RMB Businesses*. In February, the PBC designated JP Morgan Chase Bank as the second RMB clearing bank in the U.S. By the end of March 2018, the PBC had established RMB clearing arrangements in 23 countries and regions, including Asia, Europe, America, Oceania, and Africa. This will better tap into the role of RMB clearing banks and make it easier for foreign entities to hold and use RMB.

**Phase 2 of the RMB Cross-border Inter-bank Payment System (CIPS) was officially launched.** On March 26, 2018, Phase 2 of the RMB CIPS was launched for trial operation, and ten Chinese and foreign banks (direct participants) simultaneously came online On May 2, the Phase 2 of the CIPS was fully launched. The operating hours of the Phase 2 of the CIPS have been further extended, basically covering all time zones and providing support for RMB payments and financial-market businesses. By the end of March 2018, there were 31 direct participants and 695 indirect participants.

Going forward, guided by the principle of market-driven development and the goal of serving the real economy and facilitating trade and investment, the PBC will continue to improve the policy framework for RMB cross-border businesses and will enhance the necessary infrastructure in response to the growing international use of the RMB.

**Part 2. Monetary Policy Operations**

In Q1 of 2018 the Chinese economy set the stage for a good start as its economic structure continued to be optimized. Under the leadership of the Central Committee of the Communist Party of China (CPC) and the State Council, the PBC is committed to implementing a new development philosophy and to strongly promoting high-quality development in response to the principal contradictions in Chinese society and the changes in its economic development. In particular, in fostering an appropriate monetary and financial environment for supply-side structural reforms and high-quality development, the PBC continued to implement a prudent and neutral monetary policy, balanced economic growth and structural adjustments, improved the transmission mechanism for monetary policy, maintained a reasonable and stable level of liquidity, improved the regulatory framework underpinned by monetary and macro-prudential policies, promoted the opening-up and reform of the financial sector, and took steady and systematic steps to defuse all kinds of risks in the financial sector.

## I. Conducting Open Market Operations (OMOs) in a Flexible Manner

As a number of interwoven temporary and seasonal factors affected liquidity in the banking system in Q1, the PBC enhanced pre-emptive adjustments and fine-tunings and conducted OMOs with a combination of tools and maturities in line with the requirements for a prudent and neutral monetary policy, which helped to keep liquidity in the banking system at a reasonable and stable level and to keep money-market interest rates stable.

**A new tool was introduced to smooth seasonal liquidity fluctuations.** The PBC appropriately injected liquidity into the market ahead of the Spring Festival as necessary via a new tool, called the Contingent Reserve Allowance (CRA), as well as via various other policy tools, such as the Targeted Reserve Requirement Ratio (RRR) cuts for inclusive financing, the Medium-term Lending Facility (MLF), and repos. These moves smoothed out liquidity volatility caused by factors such as the heavy demand for cash by households and firms before the Spring Festival, while meeting the various liquidity needs of financial institutions. After the Spring Festival, given the fact that the maturities of the CRA and the repos were largely in line with the pace of cash returning to the banking system, aggregate liquidity remained at a neutral and appropriate level. Meanwhile, in coping with short-term liquidity fluctuations due to factors such as regulatory reviews and policy expectations, the PBC conducted MLF and repo operations whenever appropriate to raise the proportion of cross-seasonal funding, which helped to stabilize money-market interest rates during the quarter-end dates.

**Price levers were used in a timely and appropriate manner.** On March 22, the bid rate for 7-day repos rose by 5 basis points in line with market conditions, and subsequently rates for repos with other maturities and MLFs also went up by a similar margin. The modest OMO rate increase, which was widely expected by the market, reflected changes in funding supply and demand and was a normal market response to the Fed’s further rate hike on March 21. Money-market rates have been higher than OMO rates since 2017, and although the spread has narrowed since 2018, the interest- rate differential is still noteworthy. Therefore, the increase in the OMO rates might further help to narrow the spread and enhance the transmission of the OMO rates to the money-market rates. It may also guide market entities to form rational interest-rate expectations, curb irrational financing activities, and play a role in stabilizing the macro-economic leverage ratio.

**Box 2 Eligible Counterparties of Central Banks**

Eligible counterparties of a central bank are market institutions that are selected and appointed by a central bank according to certain criteria and that can directly trade with a central bank in its monetary-policy operations.

In light of international experience, the selection criteria for eligible counterparties vary substantially from country to country. In the U.S., primary dealers in OMOs serve as major counterparties of the Fed. The selection criteria are relatively stringent, including requirements on the institutions’ activity levels, market performance, financial condition, regulatory compliance, operational capacity, internal controls, and ability to provide market information and to conduct policy evaluations. As a result, there are currently only 23 primary dealers, which are either a commercial bank or a securities institution. In contrast, the counterparties of the Eurosystem (including the ECB and the national central banks) encompass a broad range of institutions because all institutions in the euro area meeting the minimum reserve requirements are eligible to participate in Eurosystem OMOs based on standard tenders. Nonetheless, in conducting fine-tuning operations and transactions, such as foreign-exchange swaps, the ECB or each national central bank will narrow down the range of counterparties by making additional requirements as necessary. In general, the selection criteria for eligible counterparties applied by central banks are tailored to country circumstances, are intended to support the formulation and implementation of monetary policy, and are flexibly adjusted based on the goals of macro regulation at different development stages.

The PBC established the primary-dealer system in OMOs in 1998, when only a few selective financial institutions in good standing, referred to as “primary dealers in open market operations,” became eligible counterparties of the PBC to participate in OMOs and to support the transmission of monetary policy. In 2004, the PBC established an appraisal system for primary dealers, by which it launched an index system to annually evaluate primary dealers based on “survival of the fittest” characteristics, requiring them to demonstrate their ability and intention to carry out their duties. Since then, the number of primary dealers has stabilized at around 50. Currently, the number stands at 48, but the list includes development financial institutions, policy banks, large state-owned commercial banks, joint-stock commercial banks, city commercial banks, rural commercial banks, foreign-funded commercial banks, and securities firms. Although small in number, primary dealers have a generally good reputation and standing among their own type of institution, while they play a significant role in the transmission of monetary policy as they are the most active market participants in trading and financing activities.

As eligible counterparties of the PBC, primary dealers in OMOs may participate in a wide range of central-bank daily operations, such as (reverse) repos, subscriptions for the issuance of central-bank bills, and spot bond trading. Meanwhile, as the PBC has in recent years introduced new operational tools, it has also strengthened unified management for eligible counterparties by selecting a subset of the above-mentioned primary dealers in OMOs, subject to certain criteria based on the instrument’s features and functions, to participate in related operations. For instance, when introducing the MLF to inject medium and long-term (from 3 months to 1 year) liquidity into the banking system in 2014, the PBC restricted the eligibility of counterparties in MLF operations to commercial banks among the primary dealers in OMOs that did better in macro-prudential assessments (MPA). In sum, the PBC first determines the range of eligible counterparties based on common standards and then selects a subset that best fits the requirements with respect to specific types of operations in light of the macro regulations. This is easy for the market to understand and for the PBC to operate, and doing so also helps keep technical and market adjustment costs comparatively low, thereby ensuring fair, effective, and safe monetary-policy operations.

Given the changes in the market environment and money supply, the current requirements for primary dealers in OMOs are quite different from those in 2004 when the appraisal system was established. In March 2018, the PBC introduced a new index system for the appraisal system, which includes 32 indicators in seven categories at three levels. Specifically, indicators regarding their *transmission of monetary policy* mainly evaluate the primary-dealers’ participation in OMOs and their ability to ease structural liquidity shortages; indicators regarding their *role as stabilizers for the market* primarily evaluate the consistency, stability, and pricing ability in their financing activities on the money market; indicators regarding their *levels of market activity and influence* assess the primary-dealers’ activities, such as subscriptions, transactions, and market-making on the money and bond markets; indicators regarding their *prudent operations in accordance with the laws and regulations* take into account their performance in the MPA and other regulatory and supervisory assessments; indicators regarding their *liquidity management ability* look into the liquidity gap of the primary dealers and their reliance on central-bank funding; finally, indicators regarding their *relevant work on* *operations and support to the OMO Division* evaluate whether the primary dealers participate in OMOs with integrity and in a safe and standard manner.

Compared with the original indicators, the coverage of the new appraisal index system is substantially broader, which is beneficial to evaluate the ability and performance of the financial institutions to comprehensively and accurately fulfill their roles as primary dealers in OMOs. Additionally, it reflects the new requirements put forth by the PBC for primary dealers in respects such as the macro prudential assessment, providing liquidity across the market, improving the interest-rate transmission mechanism, and smoothing out market fluctuations. Moreover, the change is an upgrade and improvement to the primary-dealer system, whereby the PBC applies the principle of “high standards, fewer but better” to the selection of primary dealers. This should help motivate the primary dealers to carry out their duties and to promote the achievement of the monetary-policy goals.

In conclusion, the effective selection and management of primary dealers are key steps in the central-banks’ monetary-policy operations. Given this, the PBC will continue to improve the relevant management system based on China's own situation and draw on international experiences, thereby ensuring the effective implementation and transmission of monetary policy.

## II. Conducting Standing Lending Facility (SLF) and MLF Operations

In Q1, the PBC employed a combination of monetary-policy instruments, such as the MLF and the SLF, to enhance the flexibility and effectiveness of liquidity management and to maintain liquidity at a proper and stable level.

**SLFs were conducted promptly.** To promote smooth operations of the money market, the PBC injected short-term liquidity to locally-incorporated financial institutions through SLFs to fully meet their demands, while using the SLF rates as the ceiling of the interest-rate corridor. In Q1, the PBC conducted a total of RMB 106.9 billion SLF operations, with outstanding SLFs of RMB 48.2 billion at end-March. Additionally, the PBC raised the SLF rates by 5 basis points for monetary-policy implementation, bringing the overnight, 7-day, and 1-month SLF interest rates to 3.40 percent, 3.55 percent, and 3.90 percent, respectively.

**MLFs were conducted on a monthly basis as necessary.** In Q1, the PBC conducted a total of RMB 1223.5 billion MLF operations, all with maturities of 1 year. The outstanding volume of MLFs posted RMB 4917.0 billion at end-March, an increase of RMB 395.5 billion from the beginning of the year. The bid rate remained unchanged from the end of the last quarter, with the 1-year rate in the final operation at 3.25 percent.

## III. Using Tools for Managing Reserves in a Flexible Manner

**Targeted RRR cuts for inclusive financing and the CRA were employed.** Targeted RRR cuts for inclusive financing, which became effective on January 25, 2018, released RMB 450 billion in liquidity and covered all of the large and medium-sized commercial banks, nearly 80 percent of the city commercial banks, and 90 percent of the non-county rural commercial banks. In addition, since mid-January 2018 national commercial banks have been allowed to use the CRA for a period of 30 days; at its peak a total of nearly RMB 2 trillion in temporary liquidity was released. The move effectively satisfied the demand for cash ahead of the Spring Festival and therefore liquidity in the banking system remained at a reasonable and stable level.

**RRRs were lowered for some financial institutions to replace the MLF loans, which helped ease the problem of small and micro businesses finding it difficult and expensive to access financing.** The PBC reduced the RRRs of large commercial banks, joint stock commercial banks, city commercial banks, non-county rural commercial banks, and foreign-funded commercial banks by one percentage point on April 25, 2018. Banks with outstanding MLF loans could then use the newly-released funds to repay on the same day their respective MLF loans on a “first borrow, first repay” basis. As a result, about RMB 900 billion of MLF loans was repaid on that day, and an additional RMB 400 billion was released, most of which went to city commercial banks and non-county rural commercial banks. In general, the reduction of RRRs to replace the outstanding MLFs has further reinforced fund stability in the banking system and has optimized the liquidity structure, while releasing an appropriate amount of additional funds. Moreover, it has helped guide financial institutions to strengthen support for small and micro businesses. The PBC will assess implementation by the relevant financial institutions in the macro-prudential assessment (MPA) for the remaining three quarters of 2018. Nonetheless, as most of the released funds were used to repay MLF loans as a substitution for the two liquidity adjustment instruments and part of the remaining mitigated the liquidity impact of the corporate tax payment in the latter half of April, aggregate liquidity in the banking system has largely remained unchanged and the monetary-policy position is still prudent and neutral.

## IV. Further Improving the Framework for Macro-Prudential Policies

**The MPA was further improved in view of the need for macro regulation.** Starting from Q1 2018, the PBC began to include inter-bank certificates of deposit issued by commercial banks with assets above RMB 500 billion in the MPA indicator of the inter-bank liability ratio and its assessment, while monitoring the inter-bank certificates of deposit issued by commercial banks with assets below RMB 500 billion. Since the MPA was officially implemented in early 2016, the PBC has actively conducted assessment work, guided financial institutions to strengthen self-restraint and self-discipline, promoted the healthy operation of financial institutions and the sustainability of financial services to the real economy, and it has forestalled systemic financial risks.

## V. Stronger Credit Support to Key Areas and Weak Sectors in the Economy

**Credit policy was used to enhance the effectiveness of central-bank lending, central-bank discounts, Pledged Supplementary Lending (PSL), and other policy instruments to guide financial institutions to increase support for key fields and weak links in the economy, such as small and micro businesses, agriculture, rural areas and rural households, poverty alleviation, renovation of shanty towns, and hydraulic projects.** The PBC expanded nationwide the pilot program for credit-asset pledges and central-bank internal ratings in order to effectively address the problem of insufficient eligible collateral for local small and medium-sized financial institutions when using central-bank lending. At end-March 2018, outstanding central-bank loans for agriculture, small businesses, and poverty alleviation posted RMB 241.0 billion, RMB 92.8 billion, and RMB 147.6 billion, respectively, and outstanding central-bank discounts stood at RMB 189.4 billion. The PSLs provided to policy and development banks in Q1 posted RMB 303.8 billion, while the amount outstanding registered RMB 2991.4 billion at end-March.

## VI. Window Guidance and Credit Policies for Structural Guidance

In implementing the overall arrangements of the CPC Central Committee and the State Council, the PBC combined promotion of supply-side structural reforms and structural adjustments of credit policies to promote optimization of the economic structure and the upgrading of the industrial structure, transformation of the energy mix, financial inclusiveness, and the people's livelihood, and to guide financial resources to key fields for economic and social development, priority areas, and weak links so as to meet the effective financing needs of the real economy.

**First, financial services for industrial supply-side structural reforms were enhanced.** In promoting industrial restructuring and upgrading, the PBC encouraged banking institutions to improve their financial services for advanced and hi-tech manufacturing industries and to strengthen the interactions between finance and industry. The PBC also guided financial institutions to cut loans to industries suffering from overcapacity, such as iron, steel and coal, and to deal with corporate debt issues properly by using approaches consistent with market principles and rule of law. **Second, efforts were made to improve financial services for modern services.** The PBC strengthened financial support for elderly care, health, and other new forms of consumption, while continuing to provide financial services to key areas and industries, such as infrastructure construction and projects to rebuild rundown urban areas, underground utility tunnels, railways, logistics, and energy. It also established and improved the green financial system while vigorously developing green lending. **Third, efforts were made to promote coordinated regional development** through financial support for major national strategic areas, such as the coordinated development of Beijing, Tianjin, and Hebei, the Belt and Road Initiative, development of the Yangtze Economic Belt, and the Western China Development Drive. **Fourth, financial services for the maritime economy were improved** to help shift the growth model of the maritime economy to one that emphasizes quality and efficiency. **Fifth, intensive efforts were made to provide financial support for targeted poverty reduction and alleviation.** The PBC promoted financial support for poverty alleviation in deeply impoverished areas and encouraged financial institutions to provide funds and services to these areas. It also strengthened fund-raising, related transfer payments, and management for the relocation of residents in poverty-stricken areas so as to ensure smooth implementation of the relocations. In addition, the PBC took comprehensive measures, including information-sharing, statistical surveillance, and policy evaluations of financial measures for targeted poverty reduction, as well as targeted measures against official misconduct in the field of poverty alleviation, to improve the precision and efficiency of targeted poverty alleviation. **Sixth, consistent efforts were made to improve rural financial services.** The PBC conducted research on a rural revitalization strategy to explore innovative financial products and services for the rural areas. Meanwhile, it supported financial institutions to make further progress in the pilot program of collateralized loans with operational rights for contracted farming land and rural housing property, while improving the supporting mechanisms. **Seventh, financial support was enhanced for the development of small and micro businesses.** The PBC intensified efforts to improve the financing environment for small and micro businesses and to broaden their financing channels in ways such as expanding the role of the bond market. **Eighth, efforts were strengthened to promote implementation of guaranteed loans for start-ups** by broadening the scope of loan borrowers, relaxing the application criteria, lowering the requirements for collateral and interest subsidies, and providing support to people having difficulty in starting a business or finding a job. **Ninth, efforts were made to raise the professional level of financial services for culture.** The PBC improved the supporting mechanisms for intellectual property pledged financing and continued to improve the bond market, while also encouraging cultural enterprises to expand their financing channels via non-financial corporate debt financing instruments. **Tenth, full support was given to improve financial services for weak links and vulnerable groups, such as students from impoverished families, migrant workers, and ethnic minority regions.** Furthermore, efforts were made to improve the credit-asset securitization program for the development of the asset-securitization market.

## VII. Improving the Market-based RMB Exchange-Rate Regime

**Since 2018, with cross-border capital flows and demand and supply on the foreign-exchange market basically balanced and exchange-rate expectations stable, the counter-cyclical macro-prudential management policies of capital flows introduced earlier all returned to neutral levels.** The RMB exchange rate experienced two-way fluctuations based on market supply and demand with greater flexibility and it continued to be generally stable at an adaptive and equilibrium level. In Q1, the highest and lowest central parities of the RMB against the USD were RMB 6.2785 and RMB 6.5207 per dollar, respectively. During the 59 trading days, the RMB appreciated on 39 days and depreciated on 20 days. The biggest intra-day appreciation and depreciation were 0.60 percent (377 bps) and 0.59 percent (372 bps), respectively. Meanwhile, the movement of the RMB against the euro, the Japanese yen, and other major currencies diverged. At end-March, the central parities of the RMB against the euro and the Japanese yen stood at RMB 7.7378 per euro and RMB 5.9066 per 100 yen, representing an appreciation of 0.83 percent and a depreciation of 2.00 percent from the end of 2017, respectively. During the period between 2005, when the RMB exchange-rate regime reform was unveiled, and end-March 2018, the RMB appreciated by a cumulative 29.42 percent against the euro and 23.69 percent against the yen.

In Q1, direct RMB trading was buoyant on the inter-bank foreign-exchange market, with an obvious increase in liquidity, which lowered the conversion costs for market participants and facilitated bilateral trade and investment.

**Table 8. Trading Volume of the RMB Against Other Currencies in the Inter-bank Foreign-Exchange Spot Market in Q1 2018**

Unit：RMB 100 million

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Currency | USD | EUR | JPY | HKD | GBP | AUD | NZD | SGD | CHF | CAD | MYR | RUB | ZAR |
| Trading volume | 91895.67 | 1784.93 | 456.36 | 309.97 | 40.76 | 160.94 | 29.14 | 7.54 | 25.64 | 97.46 | 8.62 | 19.64 | 1.02 |
| Currency | KRW | AED | SAR | HUF | PLN | DKK | SEK | NOK | TRY | MXN | THB | MNT |  |
| Trading volume | 60.90 | 0.08 | 0.30 | 0.10 | 0.13 | 2.55 | 9.16 | 1.24 | 0.21 | 0 | 1.49 | 0.08 |  |

Source: China Foreign Exchange Trade System.

At end-March, under the bilateral currency swap agreements between the PBC and foreign monetary authorities, the latter utilized a total of RMB 22.072 billion and the former used the equivalent of USD 0.601 billion of foreign currency. These operations played a positive role in promoting bilateral trade and investment.

## VIII. Deepening the Reform of Financial Institutions

**The reform plan for development and policy financial institutions has been fully implemented.** The PBC, together with members of the reform working group, systematically advanced the reform through measures such as establishing and improving the role of the board of directors and the governance structure and clarifying the business scope of the relevant banks. In particular, new boards of directors for the CDB and for the China EximBank were established and have operated effectively.

**The deposit insurance scheme was improved.** Since implementation of the *Regulations on Deposit Insurance* of May 1, 2015, relevant work has proceeded smoothly. Deposits in financial institutions have grown steadily, while the structure of deposits in large, medium-sized, and small banks has remained stable. The insurance limit of RMB 500,000 covers 99.6 percent of all depositors and has remained stable. The PBC has continued to implement a risk-based differentiated premium-rate arrangement and has explored ways to improve risk insurance assessments and the premium-rate mechanism so that the differentiated premium-rate arrangement will provide positive incentives and will limit risks. Additionally, the PBC made efforts to monitor and identify risks by strengthening risk monitoring and reviewing of all types of insured institutions, thereby providing risk warnings and carrying out early corrections. The PBC also actively communicated and coordinated with local governments and supervisory bodies to promote risk resolution in accordance with the rules and regulations. Finally, the PBC enhanced public training about deposit insurance and continued regular premium collections and fund management.

## IX. Deepening Reform of the Foreign-Exchange Administration

**Improvements were made in foreign-exchange management to better serve the real economy.** First, efforts were made to better exercise law-based governance and to deepen reforms so as to streamline administration, delegate powers, and improve regulations and services. The PBC has consistently taken steps to streamline administration, modify or abolish outdated regulations, and improve the Internet Plus Government Services model as well as the quality and efficiency of foreign-exchange management. Second, efforts have been made to support new forms and models. of trade. The PBC supported the development of cross-border foreign-exchange payments by third-party payment institutions, comprehensive experimental zones for cross-border e-commerce, private-sector procurement, and enterprises that provide comprehensive foreign-trade services, while regulating their related activities. Third, efforts were made to advance the development of free trade zones. The PBC put forward a host of reform measures to simplify the review process for foreign-exchange purchases and settlements under the current account, which facilitated business for enterprises and contributed to standardizing management of the Bonded Logistics Centers.

**Reforms in key areas deepened.** First, reforms to the Qualified Domestic Institutional Investor (QDII) scheme were advanced steadily, as the PBC worked out specific arrangements in the QDII scheme that fit the different institutions based on their business type so as to better meet the demands of domestic investors to allocate their assets globally. Second, domestic derivatives markets, such as the commodity futures market, were further opened. In particular, the PBC put forward rules for foreign-exchange management of physical deliveries of crude oil futures, thereby facilitating the participation of overseas investors in these transactions.

**Efforts were made to maintain orderly development of the foreign-exchange market.** First, the foreign-exchange market self-disciplinary mechanism was improved. In particular, the PBC promulgated seven basic principles for banking businesses to promote the efficient and stable functioning of the foreign-exchange market. Second, the PBC took serious measures to combat illegal and criminal activities related to foreign exchange, such as "underground banks" and online foreign-currency speculation, while it cooperated with the relevant departments to crack down on foreign-exchange irregularities based on the laws and regulations.

**Part 3 Financial Market Analysis**

In Q1 2018, the financial market as a whole operated smoothly. Money-market interest rates declined modestly and transactions were active. Bond yields and issuance interest rates generally declined, but the volume of bond issuances increased year on year. Influenced by factors such as the government’s support for innovation-driven development, the Growth Enterprise Index experienced a large rally. The volume of trading on the stock market grew, while the amount of equity financing fell year on year. The premium income in the insurance industry fell year on year, and the growth of its assets slowed down.

## I. Financial market analysis

**1. Money-market interest rates declined, but market transactions were active.**

**Liquidity in the banking system was at a reasonable and stable level, market expectations stabilized, and money-market interest rates declined moderately.** In March, the weighted average interest rate of inter-bank lending and pledged repos posted 2.74 percent and 2.9 percent, respectively, down 17 basis points and 21 basis points, respectively, from December 2017. The weighted average interest rate of repos between deposit-taking institutions with rate securities as pledges posted 2.65 percent, down 9 basis points from December 2017. The Shibor rates generally moved down. At end-March, the overnight and 7-day Shibor posted 2.69 percent and 2.92 percent, respectively, down 15 basis points and 4 basis points from end-2017. The 3-month and 1-year Shibor posted 4.46 percent and 4.65 percent, respectively, down 45 basis points and 11 basis points from end-2017.

**The volume of repo transactions and lending on the inter-bank market surged year on year, with Chinese-funded large banks as major net lenders.** In Q1, the cumulative volume of bond repos reached RMB 164.7 trillion on the inter-bank market, representing a daily average of RMB 2.7 trillion and an increase of 30.8 percent year on year. The cumulative volume of inter-bank lending reached RMB 30.6 trillion, with a daily average of RMB 501.3 billion and an increase of 47.3 percent year on year. In terms of the maturity structure, overnight repos and overnight lending accounted for 78.4 percent and 88.7 percent, respectively, of the turnover in bond repos and inter-bank lending. The volume of bond repos on the stock exchanges decreased 0.5 percent year on year to RMB 58.4 trillion. In terms of financing among financial institutions, the flow of funds displayed the following characteristics. First, Chinese-funded large banks and fund providers saw a large increase in their net funding. In Q1, net lending by Chinese-funded large banks totaled RMB 70.5 trillion through repos and inter-bank lending, up 45.8 percent year on year. Second, insurance firms changed from net lenders in the corresponding period of last year to net borrowers in the period of this year, with their net borrowing amounting to RMB 946 billion in Q1. Third, there was a large increase in the net borrowing of other financial institutions, vehicles, and securities companies. In particular, net borrowing by other financial institutions and vehicles totaled RMB 32.1 trillion, up 88.2 percent year on year. Net borrowing by securities institutions posted RMB 17.6 trillion, up 64.8 percent year on year.

**Table 9. Fund Flows among Financial Institutions, Q1 2018**

|  |
| --- |
| **Unit: RMB 100 million**  |
| 　 | Repos | Inter-bank lending |
| Q1 2018 | Q1 2017 | Q1 2018 | Q1 2017 |
| Chinese-funded large banks① | –386,504 | –310,592 | –65,814 | –35,155 |
| Chinese-funded medium-sized banks② | –215,385 | –107,624 | –37,281 | –30,119 |
| Chinese-funded small-sized banks③ | 132,983 | 179,656 | 45,250 | 24,994 |
| Securities institutions④ | 134,676 | 78,088 | 41,874 | 28,985 |
| Insurance institutions⑤ | 9,377 | -14,083 | 82 | 9 |
| Foreign-funded banks | 18,860 | 13,255 | 579 | 1,779 |
| Other financial institutions and vehicles⑥ | 305,994 | 161,299 | 15,399 | 9,507 |

Notes：① Chinese-funded large banks include the Industrial and Commercial Bank of China, the Agricultural Bank of China, the Bank of China, the China Construction Bank, the China Development Bank, the Bank of Communications, and the Postal Savings Bank of China.

② Chinese-funded medium-sized banks refer to the policy banks, the China Merchants Bank and other eight joint-equity commercial banks, the Bank of Beijing, the Bank of Shanghai, and the Bank of Jiangsu.

③ Chinese-funded small-sized banks refer to Hengfeng Bank, China Zheshang Bank, China Bohai Bank, other city commercial banks, rural commercial banks, rural cooperative banks, and village and township banks.

④Securities institutions include securities firms and fund-management and futures companies.

⑤Insurance institutions include insurance firms and corporate annuities.

⑥Other financial institutions and vehicles include urban credit cooperatives, rural credit cooperatives, finance companies, trust and investment companies, financial leasing companies, asset-management companies, social-security funds, mutual funds, wealth management products, trust plans, and other investment vehicles. Some of these financial institutions and vehicles do not participate in the inter-bank lending market.

⑦A negative sign indicates net lending and a positive sign indicates net borrowing.

Source: China Foreign Exchange Trade System.

The inter-bank CD and CD businesses saw orderly development. In Q1, a total of 6,055 inter-bank CDs were issued on the inter-bank market, raising RMB 5.24 trillion. The trading volume on the secondary market totaled RMB 32.5 trillion. Issuances and trading were all priced based on the Shibor. The correlation between the issuance interest rates and the medium- and long-end Shibor was further enhanced. In March 2018, the average weighted issuance interest rate of 3-month inter-bank CDs was 4.74 percent, 6 basis points higher than that of the 3-month Shibor. At end-March, a total of 6,700 CDs was issued by financial institutions, raising RMB 2.25 trillion, an increase of RMB 679.9 billion year on year. Orderly development of the CD businesses has helped further expand the scope of market-priced liability products, build the pricing capability of financial institutions, and improve the formation and transmission mechanisms for market-based interest rates.

**Interest-rate swap trading was brisk**. In Q1, 42,464 deals were reached on the RMB interest-rate swap market, an increase of 35.1 percent year on year, with the volume of the notional principal totaling RMB 5.29 trillion, an increase of 97.05 percent year on year. In terms of the maturity structure, contracts with maturities of up to one year traded most briskly and the volume of their aggregate notional principal posted RMB 4.41 trillion, accounting for 83.3 percent of the total. In terms of the reference rates, the 7-day fixed repo rate and the Shibor were the two major floating reference rates for RMB interest-rate swap transactions. The notional principal of the interest-rate swaps with the two reference rates as benchmarks accounted for 84.2 percent and 15.2 percent of the total, respectively.

**Table 10. Transactions of Interest-Rate Swaps, Q1 2018**

|  |  |  |
| --- | --- | --- |
|  | Transactions (lots) | Amount of the notional principal (RMB 100 million) |
| Q1 2018 | 42,464 | 52,905.55 |
| Q1 2017 | 31,443 | 26,848.23 |

Source: China Foreign Exchange Trade System.

**Box 3 Central-Bank Interest-Rate Adjustments and Transmission**

The 13th Five-Year Plan includes a plan to build a targeted interest rate and an interest-rate corridor mechanism, and to promote the shift from quantitative- to price-based adjustments. The 19th National Congress of the CPC stated that the market-based interest-rate and the exchange-rate regime reform should be deepened. In recent years, the market-based interest-rate reform has been steadily furthered, with the deposit and loan interest rates basically liberalized. The benchmark interest-rate system and the price-based adjustment mechanism have been improved.

**The market-based interest-rate regime has made notable progress.** First, efforts have been made to establish an interest-rate corridor mechanism and to tap the SLF as the ceiling of the interest-rate corridor. Second, the benchmark interest-rate system has been improved. The Shanghai Inter-bank Offered Rate (Shibor) and the government bond yield have become important reference rates in the pricing of financial products, forming a financial-market benchmark interest-rate system. Third, the PBC has increased its focus on price signals and their transmission in monetary-policy conduct and has explored price-based adjustments and expectation management. The PBC has established a regular mechanism of daily open-market operations and has diversified the operational products to implement more forward-looking and effective liquidity management, to release consistent policy signals, and to guide market expectations. Fourth, financial institutions have built their interest-rate pricing capability. In the past, the fund transfer price (FTP) within a commercial bank was mainly based on the benchmark loan interest rates released by the PBC, and the FTP of financial-market businesses was based on money- and bond-market interest rates. With advances in the market-based interest-rate reforms and more diversified and market-based bank liabilities, commercial banks are improving their unified internal FTP curves and offering deposit and loan interest rates that are more sensitive to market interest-rate movements.

**The transmission of interest rates has been more efficient.** Since the latter half of 2016, the transmission of the short-term money-market rate to the bond and loan interest rates have outperformed expectations, and market participants have become more sensitive to interest-rate movements. Since August 2016, money-market interest rates rose about 50 to 60 basis points, consistent with macro-economic trends and changes in market supply and demand; subsequently, the interest rates of loans and bonds rallied, with bond yields up 100 to 150 basis points and the weighted average loan interest rate up 50 to 60 basis points. This has established a better foundation for furthering the market-based interest-rate reform.

**Nevertheless, the market-based interest-rate reform has some “hard nuts to crack.”** The dual track of the benchmark and market-based interest rates, and the phenomenon of deposit “transfers” have, to some extent, shortened the maturity of bank liabilities, increased the share of inter-bank liability lending, reduced fund stability, and pushed up funding costs. In the future, further progress is needed to improve the market-based benchmark interest-rate system, the interest-rate adjustment system, and the pricing capability of financial institutions.

**The market-based interest-rate reform will continue.**  The PBC will promote a convergence of the “dual track” into a more market-based “one track” interest-rate system. Efforts will be made to improve the banks’ FTP mechanism. Based on the experience and lessons of the benchmark interest-rate reform in other countries, the PBC will further improve the benchmark interest-rate system, such as the Shibor and the market-based interest-rate adjustment and transmission mechanism. Meanwhile, it will strengthen regulation of wealth-management products and other types of shadow- banking activities. In terms of the principle of “substance over formality,” the PBC will unify regulatory standards, strengthen prudential requirements on capital, liquidity, and other factors, and eliminate pricing distortions.

**2. Bond yields and issuance rates generally declined, whereas the issuance volume increased year on year**

Government bond yields declined notably and the yield curve steepened. In Q1, due to the fairly good economic fundamentals and the decline in the money-market interest rate, government bond yields generally fell, with short-term bond yields declining more notably than long-term bond yields. At end-March, the yield of 1-year, 5-year, and 10-year government bonds posted 3.32 percent, 3.66 percent, and 3.74 percent, respectively, down 47 basis points, 18 basis points, and 14 basis points, respectively, from the end of 2017. The spread between 1-year and 10-year government bonds expanded by 33 basis points from that at end-2017 to reach 42 basis points. The bond indices rose slightly. The China Bond Composite Index (net price) rose from 97.97 points at the end of 2017 to 98.85 points at end-March 2018, an increase of 0.9 percent. The China Bond Composite Index (full price) rose from 113.37 points at the end of the previous year to 114.66 points at end-March, registering an increase of 1.13 percent. The Shanghai Securities Exchange T-Bond Index increased from 160.85 points at the end of the previous year to 162.96 points at end-March, an increase of 1.31 percent.

**Figure 3 .Yield Curve of Government Securities on the Inter-bank Market**

Source: China Central Depository & Clearing Co., Ltd.

**In general, the bond coupon rates declined somewhat.** The rate of 10-year government bonds issued in March was 3.85 percent, an increase of 3 basis points from those of the same maturity issued in December 2017. The rate of 7-year financial bonds issued by the China Development Bank was 4.66 percent, a fall of 28 basis points from those of the same maturity issued in December 2017. The average rate of 1-year short-term financing bills (rated A-1) issued by AAA-rated enterprises was 5.19 percent, 32 basis points lower than those of the same maturity issued in December 2017. The average coupon rate of 5-year medium-term notes was 5.98 percent, an increase of 25 basis points from December 2017. The Shibor continued to serve as an important benchmark rate for bond pricing. In Q1, a total of 19 floating-rate bonds and inter-bank certificates of deposit were issued based on the Shibor, with a gross issuance volume of RMB 5.77 billion. A total of 41 fixed-rate enterprise bonds were issued, with a gross issuance volume of RMB 32.2 billion all based on the Shibor. A total of RMB 92.75 billion of fixed-rate short-term financing bills were issued based on the Shibor, accounting for 83.7 percent of all fixed-rate short-term financing bills.

**Spot bond trading on the inter-bank market was active.** In Q1, the cumulative volume of spot bond trading posted RMB 24.4 trillion, representing a daily average of RMB 400.5 billion or an increase of 17.8 percent year on year. In terms of the trading entities, Chinese-funded small- and medium-sized banks and securities institutions were net bond sellers, with net sales totaling RMB 1.4 trillion; other financial institutions and vehicles were net bond buyers, with net purchases totaling RMB 1.6 trillion. With respect to the products, a total of RMB 3.1 trillion of spot government bonds were traded, accounting for 12.5 percent of the total spot transactions on the inter-bank market. The volume of spot trading of financial bonds and corporate debenture bonds was RMB 17.3 trillion and RMB 4 trillion, respectively, accounting for 71 percent and 16.4 percent, respectively. Separately, the volume of spot bond transactions on the stock exchanges totaled RMB 1.6 trillion, an increase of 33.3 percent year on year.

**The volume of bond issuances increased year on year.** In Q1, a total of RMB 8.9 trillion of bonds was issued, an increase of 6.1 percent year on year. This was mainly due to the large increase in the issuance of corporate debenture bonds compared with the corresponding period of the previous year. At end-March, the total volume of outstanding bonds posted RMB 76.3 trillion, an increase of 14.8 percent year on year.

**Table 11 Bond Issuances, Q1 2018**

|  |  |  |
| --- | --- | --- |
| Type of bond | Issuances (RMB 100 million) | Year-on-year change (RMB 100 million) |
| Government securities | 5,199 | 242 |
| Local government bonds | 2,195 | -2,550 |
| Central-bank bills  | 0  | 0 |
| Financial bonds① | 65,000 | 2,199 |
|  Of which: Financial bonds issued by the China Development Bank and policy financial bonds  Inter-bank certificates of deposits | 9,19352,423 | 8772,395 |
| Corporate debenture bonds② | 15,987 | 5,033 |
|  Of which: Debt-financing instruments of non-financial enterprises  | 12,846 | 4,644 |
|  Enterprise bonds | 1122 | 529 |
| Corporate bonds | 1,877 | -282 |
| Bonds issued by international institutions | 212 | 142 |
| Total  | 88,593 | 5,065 |

Notes: ① Including financial bonds issued by the China Development Bank, policy financial bonds, ordinary bonds, subordinated bonds and hybrid bonds issued by commercial banks, bonds issued by securities firms, inter-bank certificates of deposits, and so forth.

② Including debt-financing instruments issued by non-financial enterprises, enterprise bonds, corporate bonds, convertible bonds, bonds with detachable warrants, privately-placed SME bonds, and so forth.

Sources: People’s Bank of China, the National Development and Reform Commission, the China Securities Regulatory Commission, and the China Central Clearing Co., Ltd.

**3. The volume of bill acceptances and bill financing declined moderately and interest rates fluctuated.**

**The bill acceptance business contracted further**. In Q1, commercial bills issued by enterprises totaled RMB 4.0 trillion, a decrease of 27.4 percent year on year. At end-March, outstanding commercial bills posted RMB 8.5 trillion, a decline of 3.9 percent year on year. The outstanding volume of bill acceptances declined month after month, and at end-March their outstanding volume had fallen RMB 327.8 billion from the beginning of 2018. In terms of issuers, outstanding bankers’ acceptances were mainly issued by enterprises in the manufacturing, wholesale, and retail industries, with small- and medium-sized enterprises issuing about two-thirds of the total.

**The outstanding volume of bill financing declined, whereas bill market interest rates rose slightly.** In Q1, financial institutions discounted a total of RMB 7.1 trillion of commercial bills, a decline of 41.5 percent year on year. At end-March, the outstanding balance of bill discounts stood at RMB 3.8 trillion, down 12.7 percent year on year. The balance of outstanding bill financing fell moderately and by end-March the balance had decreased by RMB 56 billion from the beginning of 2018. The share of outstanding bill financing in total outstanding loans was 3.1 percent, a decrease of 0.9 percentage point year on year. In Q1, liquidity in the banking system was adequate and stable. Excluding the Spring Festival seasonal factor, as supply and demand of the bill market was fairly balanced, the bill market interest rates rose slightly.

**4. The stock indices fell, the trading volume increased, and the amount of equity financing declined year on year**

**Impacted by factors such as trade frictions and volatility in international stock markets, stock indices fluctuated moderately, and as a whole decreased.** At end-March, the Shanghai Stock Exchange Composite Index closed at 3,169 points, down 4.2 percent from end-2017. The Shenzhen Stock Exchange Component Index closed at 10,869 points, down 1.6 percent from end-2017. Buoyed by the government’s support for innovation-driven development, the Growth Enterprise Board (GEM Board) Index (Chinext Price Index) closed at 1,900 points, up 8.4 percent from end-2017. At end-March, the weighted average P/E ratio of A-shares on the Shanghai Stock Exchange fell from 18.2 times at end-2017 to 17.8 times, whereas that on the Shenzhen Stock Exchange decreased from 36.5 times at end-2017 to 33.2 times. Turnover on the stock markets increased. In Q1, the combined turnover of the Shanghai and Shenzhen Stock Exchanges reached RMB 28.3 trillion and the average daily turnover was RMB 479.0 billion, an increase of 6.9 percent year on year. Turnover on the GEM Board totaled RMB 4.3 trillion, an increase of 6.8 percent year on year. At end-March, the combined market capitalization of the Shanghai and Shenzhen Exchanges posted RMB 44.5 trillion, an increase of 7.4 percent year on year. The market capitalization of tradable shares on the GEM Board posted RMB 3.3 trillion, an increase of 4.3 percent year on year.

The amount of equity financing declined year on year. In Q1, domestic enterprises and financial institutions raised a total of RMB 202.2 billion by way of IPOs, additional offerings, rights issuances, and warrant exercises on the domestic and overseas stock markets, a decrease of 38.3 percent year on year. Among this total, RMB 181.2 billion was raised on the A-share market, down 41.7 percent year on year.

**5. Premium income in the insurance sector declined year on year and asset growth moderated**

Premium income declined year on year. In Q1, total premium income in the insurance sector amounted to RMB 1.4 trillion, a year-on-year decrease of 11.2 percent. Claim and benefit payments totaled RMB 326.8 billion, a year-on-year decline of 1.1 percent. Specifically, total property insurance claim and benefit payments increased 10.6 percent year on year, and total life-insurance claim and benefit payments decreased 7.2 percent.

Growth of insurance assets further moderated. At end-March, total assets in the insurance industry posted RMB 17.2 trillion, up 6.4 percent year on year and a deceleration of 4.4 percentage points from end-2017. Among this total, outstanding bank deposits decreased 14.5 percent year on year, whereas investment-linked assets increased 13.1 percent year on year.

**Table 12. Use of Insurance Funds, End-March 2018**

|  |  |  |
| --- | --- | --- |
|  | Outstanding balance (RMB 100 million) | As a share of total assets (%) |
|  | End-March 2018 | End-March 2017 | End-March 2018 | End-March 2017 |
| Total assets  | 172,242 | 161,815 | 100 | 100 |
| Of which: Bank deposits | 20,182 | 23,650 | 11.7 | 14.6 |
|  Investments  | 132,451 | 117,131 | 76.9 | 72.4 |

Source: China Insurance Regulatory Commission.

**6. Swap transactions on the** **foreign-exchange market witnessed fairly fast growth.**

**Trading on the foreign-exchange market was brisk.** In Q1, turnover of spot RMB/foreign-exchange transactions totaled USD 1.5 trillion, an increase of 13.7 percent year on year. Turnover of RMB/foreign-exchange swap transactions totaled USD 3.5 trillion, an increase of 34.5 percent year on year. Specifically, overnight RMB/USD swap transactions posted USD 2 trillion, accounting for 56.6 percent of the total swap turnovers. Turnovers on the RMB/foreign-exchange forward market totaled USD 19.4 billion, a decrease of 29.6 percent year on year. Turnovers of foreign-currency pair transactions totaled USD 32.4 billion, an increase of 30.4 percent year on year. In particular, the EUR/USD pair registered the largest trading volume, accounting for 40.6 percent of the total.

**Participants on the foreign-exchange market increased further**. At end-March, there were 654 members on the foreign-exchange spot market, 203 members on the foreign-exchange forward market, 199 members on the foreign-exchange swap market, 167 members on the currency-swap market, and 119 members on the foreign-exchange options market. There were 32 market-makers on the spot market and 27 market-makers on the forward and swap markets.

**7. Gold prices fluctuated and trading volume further expanded.**

**Gold prices fluctuated within a moderate range**. In Q1, international gold prices peaked at USD 1,354.95 per ounce and hit a trough of USD 1,307.75 per ounce, closing at USD 1,323.85 per ounce at end-March, representing an increase of 2.11 percent from end-2017. The peak and trough prices of gold (AU9999) on the Shanghai Gold Exchange were RMB 280.00 per gram and RMB 267.55 per gram, respectively. At end-March, the AU9999 on the Shanghai Gold Exchange closed at RMB 270.56 per gram, a decrease of 0.89 percent from end-2017.

The trading volume on the Shanghai Gold Exchange grew continuously. In Q1, the volume of gold trading on the Shanghai Gold Exchange was 13,000 tons, an increase of 14.07 percent year on year, and the turnover posted RMB 3.56 trillion, an increase of 14.45 percent year on year. The trading volume of silver was 207,400 tons, a fall of 23.51 percent year on year, and the turnover posted RMB 764.849 billion, a decrease of 30.83 percent year on year. The trading volume of platinum was 98,600 tons, an increase of 3.35 percent year on year, and the turnover posted RMB 2.11 billion, a decline of 4.98 percent year on year.

## II. Progress in Financial-Market Institutional Arrangements

1. **Developments in the inter-bank bond market**

**First, product innovations in the inter-bank bond market were promoted.** PBC Public Notice No. 3 [2018] was issued, which regulated the capital supplemental bond issuance of financial institutions, clarified the definition and classification of such bonds and the issuance application requirements, and allowed the issuance of capital supplemental bonds with no fixed maturity. It also encouraged the issuance of new types of bonds with innovative loss-absorbing capacity or with triggering conditions to effectively enhance the loss-absorbing capacity of banking institutions.

**Second, regulation of green bonds was improved.** The PBC issued *Notice on Strengthening Regulation throughout the Duration of Green Bonds.* It further strengthened supervision and inspection of the use of funds raised through the duration of green bonds, monitoring and assessment of information disclosures, and rectification of the existing problems, to enforce regulation throughout the duration of green bonds and to make sure the issuers will step up their support for green development.

**2. Unification of regulatory standards for the asset-management business was accelerated**

In order to implement the spirit of the 19th National Congress of the CPC and the arrangement to fight the uphill battle of preventing and resolving major risks, in collaboration with the relevant departments, the PBC accelerated promulgation of the *Guidelines on Regulating the Asset-Management Business of Financial Institutions* (hereafter referred to as the Guidelines). On March 28, 2018, the first meeting of the CPC Committee on Comprehensively Deepening Reforms deliberated on and endorsed the Guidelines. With the approval of the State Council, the PBC, together with the China Banking and Insurance Regulatory Commission (CBRIC), the China Securities Regulatory Commission (CSRC), and the State Administration of Foreign Exchange (SAFE), on April 27, 2018 issued the *Guidelines on Regulating the Asset-Management Business of Financial Institutions*. The Guidelines follow the principle of bottom-line thinking in strictly controlling risks, aim to achieve the fundamental objective of serving the real economy and implementing the regulatory philosophy of combining macro prudential management with micro prudential regulation, adopt an objective-driven problem-solving orientation and a basic approach of covering and regulating the asset-management business of all kinds of financial institutions with a uniform set of standards, and implement fair market access and supervision. They unify regulatory standards based on product types, classify asset-management products from the perspectives of the fund-raising mode and the investment nature, and provide for unified requirements on the investment scope, leverage constraints, and information disclosures for each type of product. They adhere to the principle of matching products with investors, strengthen the suitability investor management, and intensify the responsibility of financial institutions to perform their duties and to disclose information. They make it clear that financial institutions cannot promise to guarantee the principal and returns of asset-management businesses, adhere to the principle of fair value measurement, and effectively end the practice of implicit repayment guarantees. They impose strict investment requirements on nonstandard credit assets and ban fund-pooling to prevent shadow-banking and liquidity risks. They classify and unify the requirements on liability and leverage for the tranches, eliminate multi-layered nesting, and constrain the channel business. They step up regulatory coordination, macro-prudential management, and functional regulation. By establishing a reasonable transitional period, there is time for financial institutions to orderly rectify and transform the asset-management business of financial institutions to make sure that financial markets function smoothly.

**3. Strengthening the regulatory rules for securities and futures**

**Efforts were made to further improve the rules and regulations for securities supervision.** First, the CSRC released the *Decision on Revising the Procedural Rules for Implementing CSRC Administrative Licenses*, which aims to harmonize regulatory policies for different intermediary institutions by including securities companies, securities-services institutions, and their employees into the scope of applicability of the policies for suspending applications for CSRC administrative licenses and reviews of such applications when these parties are under investigation so as to reduce the impact of the linking policy on applications from parties that are not being investigated. Second, the CSRC released the amended *Administrative Rules on Regulation of Integrity in the Securities and Futures Markets*, which covers a wider range of institutions and a larger scope of information to be reviewed. It established mechanisms that require an integrity commitment by market participants when applying for market access, disclosure of failures by market participants to maintain integrity, and establishment of a mechanism of integrity scores for key institutions. It also enhanced self-discipline and ex post supervision to promote integrity in market transactions.

**More mutual fund products were provided.** In the *Interim* *Guidelines on Selected Securities Investment Funds with Pension Funds*, the CSRC established a new category of fund products that are specifically designed for pension investments, provides principles for the operation of such investment funds and the qualifications for the fund managers, which will promote market-based pension reforms and support sound long-term development of the public funds industry.

**Rules on the sale of shares of listed companies were further improved.** The CSRC issued the *Special Rules on Reducing Equity Holdings by Venture Investment Fund Shareholders in Listed Companies*, clarifying the differentiated lock-up periods for venture investment fund shareholders in IPO companies and the specific qualifications for such venture investment funds in an effort to provide policy support for market-based exits by venture investors who have focused on long-term investments and value investments.

**4. Improving fundamental institutional arrangements in the insurance market**

**The *Administrative Rules on Equity Management in Insurance Companies* were revised.** With thisrevision, the insurance regulator further standardized the behavior of shareholders in insurance companies, focusing on clarifying the regulations on qualifications of the shareholders of insurance companies, the ownership structure, the authenticity of capital, and the penetration of supervision. The revised document lowers the upper limit of the shareholding ratio of a single shareholder from 51 percent to one-third and it specifies that investments in insurance companies must be financed by the investors’ own funds that are from legitimate sources. In addition, changes in the actual controller of the shareholders of insurance companies must be recorded with regulators, focusing on solving the problems of concealed connections, hidden shareholders, illegal entrustment shareholding, and so forth.

**The *Administrative Rules on the Use of Insurance Funds* were released.** The insurance regulator further regulated the entrusted management of insurance funds by investment managers, banned channel businesses and re-entrustment of the trusted funds, strengthened supervision of overseas investments, and imposed conditions on overseas investments with insurance funds. Information disclosures on how insurance funds are used were also strengthened.

**Rules on supervising asset/liability management in insurance companies were released.** This asset liability supervision system is based on qualitative and quantitative assessments. First, in line with the need for asset/liability management, the insurance regulator has developed requirements for the purpose and methods, organizational structure, responsibilities of staff members, work flows, systems and models, as well as performance evaluations, so as to review insurance companies’ capacity to manage their assets and liabilities in a qualitative way. Second, a comprehensive and quantitative evaluation of how insurance companies match their assets with liabilities is required by looking into the maturity structure, cost efficiency, and cash flows.

**Part 4.  Macro-economic Overview**

## I. Global Economic and Financial Developments

Since the beginning of 2018, the global economy has continued its recovery with positive developments. The labor market continued to strengthen and inflation remained subdued. Growth remained strong in the U.S., the recovery moderated in the euro area and the UK, and the Japanese economy grew steadily. The emerging market economies grew relatively rapidly, but performance continued to diverge with some economies still facing economic restructuring and transformation pressures.

**1. Economic Developments in the Major Economies**

The major advanced economies continued their recovery, but some economic indicators underperformed slightly compared with Q4 2017 due to seasonal factors. The U.S. saw solid gains in its economic recovery, inflation went up somewhat, and the jobless rate remained at low levels. The annualized quarter-on-quarter GDP growth was 2.3 percent in Q1 2018. In March, the Purchasing Managers’ Index (PMI) generated by the Institute for Supply Management was 59.3, above 50 for 19 consecutive months; and the University of Michigan’s Consumer Sentiment Index was 101.4, a record high. Inflation went up slightly, as the core Consumer Price Index (CPI) rose 1.8 percent and 2.3 percent in February and March, respectively. The labor market continued to be tight, as the jobless rate remained at 4.1 percent since October 2017, the lowest level since 2001.

In the euro area, due to unexpectedly cold weather, the economic recovery moderated, but the job market continued to become stronger. In Q1, the euro area manufacturing PMI continued to fall, hitting a 12-month low in March. Inflation remained subdued, as year-on-year growth of the core Harmonized Index of Consumer Prices (HICP) was above 1 percent for three consecutive months, with the overall price level slightly higher than that in Q4 2017. The unemployment rate fell to 8.5 percent in February, the lowest level since December 2008

Growth in the UK moderated somewhat. GDP growth posted 1.7 percent in 2017, and the CPI rose 2.5 percent year on year in March of this year, consistently higher than the target set by the Bank of England (BOE). The UK has recently reached a Brexit transition deal with the European Union, but uncertainties still remain.

The Japanese economy continued its moderate recovery. As of Q4 2017, GDP had grown for eight consecutive quarters, the longest growth streak in nearly 30 years. Since the beginning of 2018, expansion on the production side has moderated slightly, inflation expectations have remained subdued, and employers have been reluctant to raise wages, causing inflation to remain at low levels.

**Overall growth in the emerging market economies was relatively rapid, though performance continued to diverge as some of the emerging market economies still faced restructuring and transformation pressures**. Brazil saw positive growth developments, as the year-on-year growth of GDP in Q4 2017 hit its highest growth since Q2 2014. Manufacturing continued to expand since the start of 2018, with the PMI in March hitting a new high since March 2011. Due to a rebound in the prices of commodities such as oil, Russia’s economy gradually stabilized and inflation declined after being controlled. The Indian economy remained generally stable. Sentiment in the manufacturing and service sectors weakened slightly, and inflationary pressures went up a bit, as the CPI grew 5.1 percent year on year in January, a record high since September 2016. Growth in South Africa remained anemic amid a stubbornly high unemployment rate, but lately South Africa has shown signs of recovery on the back of government policy commitment to improve investment and economic prospects. In late March, Moody’s, the credit-rating agency, affirmed South Africa’s investment-grade credit rating and revised its credit outlook from negative to stable. Against the backdrop of policy normalization in the advanced economies, a number of emerging market economies may face potential risks, such as volatile cross-border capital flows. Economic restructuring and transformation pressures continued.

Table 13. Macro-economic and Financial Indicators in the Major Advanced Economies

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Country | Indicator  | 2017Q1 | 2017Q2 | 2017Q3 | 2017Q4 | 2018Q1 |
| Jan. | Feb. | Mar. | Apr. | May | Jun. | Jul. | Aug. | Sept. | Oct. | Nov. | Dec. | Jan. | Feb. | Mar. |
| United States | Real GDP Growth (annualized quarterly rate, %) | 1.2 | 3.1 | 3.2 | 2.9 | 2.3 |
| Unemployment Rate (%) | 4.8 | 4.7 | 4.5 | 4.4 | 4.3 | 4.4 | 4.3 | 4.4 | 4.2 | 4.1 | 4.1 | 4.1 | 4.1 | 4.1 | 4.1 |
| CPI (year-on-year, %) | 2.5 | 2.7 | 2.4 | 2.2 | 1.9 | 1.6 | 1.7 | 1.9 | 2.2 | 2.0 | 2.2 | 2.1 | 2.1 | 2.2 | 2.4 |
| DJ Industrial Average (end of the period) | 19864 | 20812 | 20663 | 20941 | 21009 | 21350 | 21891 | 21948 | 22405 | 23377 | 24272 | 24719 | 26149 | 25029 | 24103 |
| Euro Area | Real GDP Growth (annualized quarterly rate, %) | 2.1 | 2.4 | 2.6 | 2.7 | … |
| Unemployment Rate (%) | 9.6 | 9.5 | 9.4 | 9.2 | 9.2 | 9.1 | 9.0 | 9.0 | 8.9 | 8.8 | 8.7 | 8.6 | 8.6 | 8.5 | 8.5 |
| HICP (year-on-year, %) | 1.8 | 2.0 | 1.5 | 1.9  | 1.4 | 1.3 | 1.3 | 1.5 | 1.5 | 1.4 | 1.5 | 1.4 | 1.3 | 1.1 | 1.4 |
| EURO STOXX 50 (end of the period) | 3231 | 3320 | 3501 | 3560 | 3555 | 3442 | 3449 | 3421 | 3595 | 3674 | 3570 | 3504 | 3609 | 3439 | 3361 |
| Japan | Real GDP Growth (annualized quarterly rate, %) | 1.5 | 2.9 | 2.5 | 1.6 | … |
| Unemployment Rate (%) | 3.0 | 2.8 | 2.8 | 2.9 | 3.1 | 2.8 | 2.8 | 2.8 | 2.8 | 2.7 | 2.6 | 2.6 | 2.4 | 2.5 | 2.5 |
| CPI (year-on-year, %) | 0.4 | 0.3 | 0.2 | 0.4 | 0.4 | 0.4 | 0.4 | 0.7 | 0.7 | 0.2 | 0.6 | 1.0 | 1.4 | 1.5 | 1.1 |
| NIKKEI 225 (end of the period) | 19041 | 19119 | 18909 | 19197 | 19651 | 20033 | 19925 | 19646 | 20356 | 22012 | 22725 | 22765 | 23098 | 22068 | 21454 |

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

**2. Developments in Global Financial Markets**

Volatility increased in global financial markets as compared with the last year. In Q1, the USD Index continued its losing streak, depreciating against the currencies of the major advanced economies and some emerging market economies to varying degrees. Uncertainties arising from trade policies triggered large swings in the U.S. stock market. Major global stock indices dropped amid fluctuations.

The USD Index continued to weaken, as the euro, the British pound, and the Japanese yen appreciated against the dollar, whereas exchange-rate movements in the emerging market economies were mixed. As of end-March, the USD Index closed at 89.98, losing 2.51 percent from end-2017. The Japanese yen was at 106.26 yen per USD, strengthening 6.03 percent from the end of the last year. The exchange rate of the euro against the USD closed at USD 1.2321 per euro, appreciating 2.71 percent compared with end-2017. The British pound stood at USD 1.4015 per pound, appreciating 3.72 percent compared with the end of the last year.

Among the emerging market currencies, compared with end-2017 the Russian ruble, the Brazilian real, and the Mexican peso appreciated by 0.94 percent, 0.23 percent, and 8.25 percent, respectively, against the USD, whereas the Indian rupee and the Turkish lira depreciated by 1.97 percent and 4.18 percent, respectively, against the USD. Since late April, as expectations of interest-rate hikes by the Fed were heightened, the yield of 10-year U.S. Treasuries went up, and the USD Index continued to rebound, exceeding 93 by May 8.

Global money-market rates continued to diverge. The USD Libor went up slightly, whereas the Euribor moved downwards. Due to interest-rate hikes by the Fed, the USD Libor rose slightly. As of March 29, the 1-year USD Libor was 2.6626 percent, an increase of 56 basis points (bps) compared to the end of the last year. The Euribor declined further, as the European Central Bank (ECB) continued its accommodative monetary policy. As of March 29, the 1-year Euribor registered –0.19 percent, a decrease of 0.4 bp from end-2017.

The yields of government bonds in the U.S. and the UK increased somewhat. As of end-March, the yields of 10-year U.S. Treasuries and UK and German government bonds closed at 2.744 percent, 1.351 percent, and 0.494 percent, up 33.3 bps, 16.3 bps, and 7 bps, respectively, compared with the end of 2017. The yields of 10-year Japanese and French government bonds closed at 0.046 percent and 0.729 percent, retreating 0.4 bp and 5.6 bps, respectively, from end-2017. Among the emerging market economies, the yields of 10-year Russian, Brazilian, and Mexican government bonds lost 54 bps, 81.5 bps, and 39 bps, respectively, compared with the end of the last year, whereas the yields of 10-year Indian and Turkish government bonds went up 7.2 bps and 76 bps, respectively.

Stock-market volatility increased in the major economies. As of end-March, the U.S. Dow Jones Industrial Average, the German DAX, the Japanese Nikkei 225, the euro area’s STOXX 50, and the UK FTSE 100 tumbled 2.49 percent, 6.35 percent, 5.76 percent, 4.07 percent, and 8.21 percent, respectively, over the end of 2017. Among the emerging market economies, the stock indices in Russia and Brazil gained 8.23 percent and 11.73 percent, while those in India, Turkey, and Mexico dropped 3.2 percent, 1.4 percent, and 6.54 percent, respectively.

International commodity prices saw a broad-based gain. In Q1, the average price of Brent crude oil futures on the Intercontinental Exchange jumped 23.2 percent year on year and 9.4 percent quarter on quarter. The average spot price of copper and aluminum on the London Metal Exchange added 19.2 percent and 16.3 percent, respectively, year on year, rising 2.0 percent and 2.4 percent quarter on quarter.

**3. Monetary Policies in the Major Economies**

The U.S. Fed continued its monetary-policy normalization, whereas the ECB, BOE, and BOJ maintained their monetary easing. On March 21, the Fed raised the federal funds rate by 25 bps to the 1.50–1.75 percent range, kept the median rate forecast at 2.1 percent for end-2018, but revised it up to 2.9 percent and 3.4 percent, respectively, for end-2019 and end-2020 as it continued to unwind. The decreasing cap for Treasury securities was increased from USD 12 billion in March to USD 18 billion in April, and that for agency debt and mortgage-backed securities (MBS) increased from USD 8 billion to USD 12 billion. At the interest-rate meeting on May 2, the Fed decided to keep the fed rate unchanged at between 1.5 percent and 1.75 percent

On January 25, March 8, and April 26, the ECB decided to keep the interest rates on the main refinancing operations (MROs), the marginal lending facility, and the deposit facility unchanged at 0.00 percent, 0.25 percent, and –0.40 percent. It will maintain its monthly asset-purchase program of EUR 30 billion until September 2018. In its March statement, the ECB deleted its previous language, which was should economic prospects worsen or if financial conditions cannot warrant continuous inflation adjustments, the ECB stands ready to scale up asset purchases and if necessary extend them, and it revised up the GDP growth forecast for 2018 to 2.4 percent, while keeping the forecasts for 2019 and 2020 unchanged at 1.9 percent and 1.7 percent, respectively.

On January 23, March 9, and April 27, the BOJ decided to continue with its negative interest rate, maintain the size of asset purchases, and keep the yield of 10-year government bonds near zero through yield curve controls.

On February 7, March 21, and May 9, the BOE decided to keep the benchmark rate on hold at 0.50 percent and to maintain the scale of sterling non-financial investment-grade corporate bond purchases at GBP 10 billion and that of UK government bond purchases at GBP 435 billion.

The emerging market economies continued to adopt different monetary-policy stances. Given the stabilizing and lower-than-target inflation and in an attempt to boost economic growth, the Central Bank of Brazil cut its policy rate twice, on February 8 and March 21, by a total of 50 bps to 6.5 percent, and the Central Bank of the Russian Federation lowered its key rate on February 9 and March 23, each time by 25 bps, to 7.25 percent. In view of the upbeat economic performance and with inflation anchored around the target of 4 percent, the Reserve Bank of India on February 6 and April 5 kept the repo rate on hold at 6 percent. To address the peso depreciation, capital outflows, and inflationary pressures, the Banco de Mexico raised the overnight interest-rate target on February 8 by 25 bps to 7.5 percent. As a countermeasure against the risks of a huge exchange-rate depreciation and capital outflows, the Central Bank of Argentina increased the policy interest rate on April 27, May 3, and May 4 by 300 bps, 300 bps, and 675 bps to 40 percent, along with capital flow management measures.

**4. The Global Economic Outlook and Key Risks**

In its updated April 2018 *World Economic Outlook*, the International Monetary Fund (IMF) maintained its January forecast for global economic growth, which is 3.9 percent for both 2018 and 2019. In particular, the 2018 growth forecast for the advanced economies was revised upwards, while that for the emerging market and developing economies remained unchanged. Looking ahead, despite broadly positive prospects for the global economy, a number of uncertainties and destabilizing factors still require attention.

First, protectionism, unilateralism, and de-globalization have escalated global trade frictions, becoming a major risk to global economic growth. As global industrial structures and financial systems have become interconnected under economic globalization, the escalation of trade frictions will take a toll on trade in goods and services in most parts of the world. This may constrain demand and push up inflation, which will weigh down on growth or even pose greater macroeconomic risks.

Second, uncertainties about the Fed’s monetary policies have grown, including the pace of the rate hikes. No consensus has been reached regarding the future development of inflation expectations in the U.S. Tax reforms, infrastructure development plans, and escalating trade frictions have all added to the uncertainties. Given that the U.S. is close to full employment, the massive fiscal stimulus may stoke inflation. Further escalations of trade frictions and unexpected inflation developments will both affect the pace of policy normalization by the Fed.

Third, risks from global financial-market volatility have heightened. The upbeat recovery in the major advanced economies and the eased liquidity conditions have pushed up asset prices to historical highs, along with increasing financial vulnerabilities. Once the tightening of global liquidity is faster than market expectations, this may cause swings in asset prices and trigger a contraction phase in the financial cycle. Since the start of 2018, bouts of stock-market swings in the U.S. have sent repercussions across global equity markets. This partly reflects the problem of asset valuation under the previous accommodative monetary policies and the interconnectedness of global financial markets.

Fourth, medium and long-term growth still faces a number of structural challenges. On the one hand, high leverage ratios and heavy debt burdens may put a drag on consumption and investment growth, aggravate income disparities, and add to potential economic and financial risks. On the other hand, medium and long-term structural problems persist, such as an aging population, slower productivity gains, and higher policy uncertainties, all of which may also constrain economic growth.

In addition, geopolitical tensions have occurred in numerous places, and risk factors and uncertainties have been growing at a rapid pace, exerting a greater impact on the global economy and financial markets. In addition, risks from new technologies such as Fintech should not be neglected as they may pose additional challenges to global financial regulation and supervision.

## II. Macro-economic Developments in China

In the first quarter of 2018, the Chinese economy registered a good start as aggregate supply and demand became more balanced due to support from steady progress in economic upgrading, stable overall industrial production, and further expansion in the share of value-added from tertiary industry. Consumption remained a strong growth driver and private-investment growth recovered while the trade surplus narrowed. Consumer prices rose at a moderate pace and employment was generally stable. Preliminary estimates showed that GDP recorded RMB 19.88 trillion in the first quarter, up 6.8 percent year on year in comparable terms. The CPI went up 2.1 percent year on year. The trade surplus was RMB 326.2 billion.

**1. Consumption growth was stable, investment growth moderated, while the trade surplus narrowed**

Consumption contributed more to economic growth as household income grew steadily and online consumption spending accelerated. In the first quarter, per capita disposable income registered RMB 7,815, up 8.8 percent on a year-on-year basis, or 6.6 percent in real terms. The per capita disposable income of rural residents grew 6.8 percent in real terms, outpacing that of urban residents by 1.1 percentage points. According to the Q1 Urban Depositors’ Survey conducted by the People’s Bank of China, willingness to consume was stable, with 24.8 percent of consumers inclined to consume more, which was 1.0 percentage point higher year on year. Final consumption expenditures contributed 77.8 percent to GDP growth in the first quarter, up by 0.6 percentage point year on year. Retail sales grew by 9.8 percent year on year to RMB 9.03 trillion. Online retail sales recorded a strong expansion of 35.4 percent in the first quarter, up by 3.3 percentage points over growth during the same period of the last year.

Fixed-asset investment growth slowed down notwithstanding a recovery in private- investment growth. In the first quarter, fixed-asset investments (excluding those by rural households) reached RMB 10.08 trillion, up 7.5 percent year on year, which was 1.7 percentage points lower than that during the same period of the last year. A number of the following patterns were evident. First, private-investment growth has recovered, with quarterly growth of 8.9 percent year on year, which is 1.2 percentage points higher than that during the same period of the last year. Second, investment in high-tech manufacturing continued its strong growth, expanding at 7.9 percent, leading overall investment growth by 0.4 percentage point. Third, infrastructure investment growth was weaker as quarterly growth moderated to 13.0 percent year on year, a deceleration of 10.5 percentage points from growth during the first quarter in 2017. Fourth, investment growth in the central and western regions strengthened, with the quarterly year-on-year rate at 10.2 percent and 9.4 percent, respectively, outpacing investment in the eastern region by 4.2 percentage points and 3.4 percentage points.

Imports and exports grew rapidly and the trade surplus narrowed as the external trade structure continued to improve. Quarterly imports and exports reached RMB 6.75 trillion, up 9.4 percent year on year. Among this, exports expanded 7.4 percent year on year to RMB 3.54 trillion, and imports grew 11.7 percent year on year to RMB 3.21 trillion, narrowing the trade surplus at RMB 326.2 billion, which was down 21.8 percent year on year. In USD terms, the first quarter saw year-on-year growth of 14.0 percent in exports and 18.9 percent in imports, with a trade surplus at USD 48.39 billion. The external trade structure was improved, supported by an expansion in general trade, trade in machinery and electronics, as well as in external trade by private companies. General trade contributed 58.3 percent to total exports and imports during the first quarter, an increase of 2.0 percentage points year on year. Exports of machinery and electronics went up by 1.3 percentage points as a share of total exports. Exports and imports by private companies constituted 38.3 percent of total exports and imports, representing a year-on-year increase of 1.7 percentage points. Imports from and exports to countries covered by the Belt and Road Initiative continued to grow at a strong pace. In particular, imports from and exports to Russia, Poland, and Kazakhstan grew 20.5 percent, 16.6 percent, and 16.2 percent, respectively.

**Figure 4. Import and Export Growth and the Trade Balance**

Source: General Administration of Customs.

Foreign direct investments (FDI) continued to flow into high-end industries, while outbound investments improved further in terms of the composition of the destination industries. During the first quarter, the number of newly established foreign-funded companies increased 124.7 percent year on year to 14,340, with actually utilized FDI rising 0.5 percent to RMB 227.54 billion. Broken down by industries, actually utilized FDI in high-tech manufacturing grew 66.0 percent to RMB 22.49 billion, and that in high-tech services recorded RMB 21.47 billion, including a year-on-year increase of 25.6 percent in R&D and design. In terms of key FDI sources, actually utilized FDI from the ASEAN countries grew 79.1 percent year on year, and that from countries covered by the Belt and Road Initiative expanded 76.0 percent. Non-financial outbound direct investments registered USD 25.5 billion in the first three months, up 24.1 percent year on year. Outbound direct investments to 52 countries covered by the Belt and Road Initiative grew 22.4 percent year on year to USD 3.61 billion, accounting for 14.2 percent of the total outbound direct investments in the first quarter. The sectoral structure of outbound investments was further optimized as irrational outward investment activities were effectively constrained, with outbound investments focusing on leasing/commercial services, mining, manufacturing, and information transfers/software/information technology services, accounting for 25.6 percent, 18.2 percent, 15.2 percent, and 7.3 percent of the total, respectively. There were no new outbound investments in overseas real estate, sports, or the entertainment industries.

**2. Services registered strong growth, agricultural production was sound, and industrial production was generally stable**

Tertiary industry continues to expand in terms of its share of value-added. During the first quarter, the value-added of the primary, secondary, and tertiary industries recorded RMB 0.8904 trillion, RMB 7.75 trillion, and RMB 11.24 trillion, respectively, up 3.2 percent, 6.3 percent, and 7.5 percent year on year. Their shares of GDP were 4.5 percent, 39.0 percent, and 56.6 percent as the share of tertiary industry further increased by 5.0 percentage points compared with that in 2017 and exceeded the share of secondary industry by 17.6 percentage points.

Agricultural production was sound with a good start for the spring agricultural activities. Farmland for growing quality wheat and other crops increased. Animal husbandry and aquaculture production expanded steadily, with the quarterly output of pork, beef, mutton, and poultry increasing 1.8 percent year on year to 23.16 million tons.

Industrial production was steady and corporate profits were relatively good. During the first three months, the value-added of statistically large industrial firms (SLIFs) increased by 6.8 percent year on year in real terms, which was the same as that during the same period of the last year. The value-added in high-tech manufacturing and equipment manufacturing expanded 11.9 percent and 8.8 percent, respectively. The sales-to-output ratio improved, leading to relatively good profits. For the SLIFs, the ratio reached 97.9 percent in the first quarter, up 0.3 percentage point year on year, and profits went up 11.6 percent year on year to RMB 1.55 trillion. The SLIFs also saw the profit margins for their main business lines improve to 6.18 percent, up 0.11 percentage point over that for the first quarter of 2017. According to the Q1 Entrepreneurs’ Survey of 5,000 Industrial Enterprises conducted by the People’s Bank of China, the Corporate Performance Index posted 56.7 percent, up 6.8 percentage points year on year, exceeding 50 percent for the fourth consecutive quarter.

**3. Consumer price growth edged up, whereas while producer price growth continued to decline**

Consumer prices rose at a stronger pace driven by higher food price inflation. In the first quarter, the CPI rose 2.1 percent year on year, up 0.3 percentage point from that in the previous quarter, with monthly CPI growth at 1.5 percent, 2.9 percent, and 2.1 percent. Food price inflation turn positive from its previous negative figures, although non-food price inflation moderated. Food prices went up by 2.0 percent year on year, compared to a decline of 0.6 percent in the fourth quarter of 2017. Non-food prices moved up by 2.2 percent year on year, which was 0.2 percentage point lower than that in the last quarter of 2017. The prices of consumer goods rose at a remarkably stronger pace, while price rises for services moderated. Prices of consumer goods were up 1.7 percent year on year, which was 0.7 percentage point higher than that in the previous quarter. Prices for services moved up by 2.9 percent, representing a quarter-on-quarter deceleration of 0.2 percentage point.

Growth of producer prices continued to moderate. The PPI rose 3.7 percent in the first quarter, representing a quarter-on-quarter deceleration of 2.1 percentage points, with monthly PPI growth at 4.3 percent, 3.7 percent, and 3.1 percent, respectively. In particular, the price of capital goods rose 4.9 percent, which was 2.7 percentage points lower than that in the previous quarter. The Purchasing Price Index for Industrial Products (PPIIP) went up 4.4 percent year on year, down by 2.7 percentage points from growth in the previous quarter. The Corporate Goods Price Index (CGPI) rose 3.3 percent year on year, which was lower than that in the fourth quarter of 2017 by 5.4 percentage points. The moderation was largely driven by a strong deceleration in price rises of primary goods and investment goods, which were down by 14.8 percentage points and 6.0 percentage points, respectively, from their growth in the previous quarter.

The GDP deflator increased at a slower pace. During the first quarter, the GDP deflator (as the ratio of GDP at current prices to GDP at constant prices) rose 3.1 percent year on year, which was 1.0 percentage point lower than that in the previous quarter.

**4. Fiscal revenue and expenditures grew rapidly**

Fiscal revenue grew steadily and tax revenue grew at an accelerated pace. In Q1 of 2018, total fiscal revenue reached RMB 5.05 trillion, up by 13.6 percent year on year, but 0.5 percentage point lower than growth during the same period of the last year. In terms of the revenue structure, tax revenue registered RMB 4.43 trillion, up 17.3 percent year on year and an acceleration of 2.6 percentage points from the same period of the last year; non-tax revenue declined by 7.5 percent year on year to RMB 621.4 billion. In particular, the domestic value-added tax, domestic consumption tax, corporate income tax, personal income tax, and import value-added and consumption tax were all up by 20.1 percent, 28 percent, 11.7 percent, 20.7 percent, and 15.9 percent year on year, respectively.

Fiscal expenditures were relatively stable, and the tax- and fee-reduction measures will stimulate corporate production and investment. In Q1 of 2018, fiscal expenditures increased by 10.9 percent year on year to reach RMB 5.10 trillion. The fiscal deficit registered RMB 45.1 billion, down by RMB 110.1 billion year on year. In terms of the expenditure structure, expenditures on transportation, agriculture/forestry/water conservancy, and culture/sports/media were the major items experiencing rapid growth, up 28.4 percent, 24.9 percent, and 20.5 percent, respectively, year on year. Recently, the State Council has issued many tax-reduction measures, such as a further value-added tax reform. It is estimated that the tax-reduction measures will save market participants over RMB 400 billion in 2018, which is more than that during last year. The tax-reduction measures will encourage firms to produce and invest.

**5. Employment was generally stable**

The surveyed unemployment rate declined and the employment market was generally firm. In the first three months of 2018, the surveyed unemployment rates in urban areas were 5.0 percent, 5.0 percent, and 5.1 percent, respectively, down 0.2, 0.4, and 0.1 percentage point year on year. According to the PBC’s Urban Depositors’ Survey, the Employment Experience Index registered 45.8 percent during Q1 of 2018, up by 1 percentage point quarter on quarter, marking the seventh consecutive increase quarter on quarter.

Labor demand increased. According to statistical analyses by the China Human Resources Market Information Monitoring Center, in Q1 of 2018 labor demand slightly exceeded supply and the ratio of job vacancies to job seekers was 1.23, which was 0.1 higher year on year and 0.01 higher quarter on quarter. Compared with the same period of the last year, labor demand during Q1 of 2018 increased, whereas job seekers declined. Broken down by industries, leasing and commercial services, the scientific research, technological services, and geologic exploration industries, real estate, and the information transmission, computer services, and software industries recorded large increases in labor demand. Demand for labor with technical or professional skills exceeded supply. Demand for labor with advanced skills, basic skills, and medium professional skills all increased.

**6. The balance of payments was generally balanced**

The current account registered a deficit and the external debt increased rapidly. According to preliminary statistics, in Q1 of 2018 the current account deficit reached USD 28.2 billion, mainly due to seasonal factors and the rapid growth of imports of good. The non-reserve financial account registered a surplus of USD 54.5 billion, continuing the trend of capital inflows since Q2 of 2017. At end-March, total foreign-exchange reserves stood at USD 3.1428 trillion. As of end-2017, the total outstanding external debt in both domestic and foreign currencies registered USD 1.7106 trillion, up by USD 289.9 billion from the end of the previous year. Among this, the outstanding short-term external debt registered USD 1.099 trillion, accounting for 64 percent of the total external debt.

**7. Analysis by sectors**

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

In Q1 of 2018, the growth of housing sales continued to slow down. Both the month-on-month and year-on-year increases in housing prices in 70 large and medium-sized cities declined. The growth of real-estate investments accelerated, whereas the growth of real-estate loans continued to decline.

The appreciation of housing prices moderated. In March, the prices of newly-built housing recorded month-on-month growth in 55 out of 70 large and medium-sized cities, 2 cities fewer than that in December 2017, and average growth was down by 0.1 percentage point from December 2017; the prices of newly-built residential housing rose year on year in 60 cities, 1 city less compared with that in December 2017, and the average growth was 0.3 percentage point lower than December 2017. The price of second-hand residential housing increased month on month in 59 cities, 12 cities more than in December 2017; the price of second-hand residential housing increased year on year in 63 cities, 2 cities fewer than that in December 2017.

Growth of housing sales continue to slow down. In Q1, the total floor area of sold units posted 300 million square meters, up by 3.6 percent year on year, which was 4.1 percentage points lower than the growth in 2017. Housing sales reached RMB 2.6 trillion, up by 10.4 percent year on year, which was 3.3 percentage points lower than the growth in 2017. In particular, residential housing accounted for 86.8 percent of the total sold floor area and 84.4 percent of total housing sales.

Growth of real-estate investments picked up. In Q1, real-estate investments throughout the country registered RMB 2.1 trillion, up 10.4 percent year on year, which was 3.4 percentage points more than their growth in 2017. Specifically, investments in residential housing, which accounted for 69.1 percent of real-estate investments, reached RMB 1.5 trillion, up 13.3 percent year on year and representing an acceleration of 3.9 percentage points from 2017. The floor area of newly-started real-estate projects gained 9.7 percent year on year to reach 350 million square meters, which was 2.7 percentage points higher than that in 2017. The floor area of real-estate projects under construction grew by 1.5 percent year on year to reach 6.47 billion square meters, a deceleration of 1.5 percentage points from 2017. The floor area of completed real-estate projects declined by 10.1 percent year on year to 210 million square meters, dropping 5.7 percentage points more than the decline in 2017.

Growth of real-estate loans continued to slow down. At end-March, outstanding real-estate lending by major financial institutions (including foreign financial institutions) stood at RMB 34.1 trillion, up 20.3 percent year on year and a deceleration of 0.6 percentage point from end-2017. Outstanding real-estate loans accounted for 27.3 percent of total lending. Among this, outstanding personal mortgages rose by 20 percent year on year to RMB 22.9 trillion, which was 2.2 percentage points lower than the growth at end-2017; outstanding housing-development loans increased by 31.2 percent year on year to RMB 6.2 trillion, an acceleration of 4.4 percentage points from end-2017; outstanding land-development loans registered RMB 1.4 trillion, up 2.2 percent year on year as compared with the year-on-year decline of 8.0 percent at end-2017.

Loans for welfare housing continued to grow rapidly. At end-March, outstanding loans for the development of welfare housing stood at RMB 3.8 trillion, up 37.9 percent year on year and an acceleration of 5.3 percentage points from end-2017. In Q1, loans for the development of welfare housing grew by RMB 447.89 billion, accounting for 64.7 percent of the total new real-estate development loans, which was 2.9 percentage points higher than that in 2017. In addition, the pilot lending program financed by housing provident funds to support the construction of welfare housing proceeded steadily. By end-March, loans for 373 welfare-housing projects in 85 cities had been approved, RMB 87.21 billion had been disbursed based on the progress of the project, and RMB 79.31 billion in the loan principal had been repaid.

**(2) Modern agriculture**

The modernization of agriculture is the foundation and pillar for the modernization of China. Population growth, urbanization, and upgrading of consumption demand by urban residents require not only safe and quality agricultural products but also a low-carbon, recyclable, and green agricultural-production model. The pursuit of high-quality and sustainable green development has raised new requirements for modern agriculture.

In recent years, with increasing policy support for the benefit of farmers, the modernization of agriculture and the development of green agriculture have made remarkable achievements. The supply-side structural reforms in agriculture have made new progress, and the capacity of grain production has been enhanced. In 2017, grain production totaled 617.9 billion kilograms. The capacity to translate agricultural science and technology into production has improved continuously as technical equipment has reached a new level. In 2017, the contribution ratio of scientific and technological progress to agriculture was 57.5 percent. New industries and business models have thrived in the rural areas, bringing structural changes to the agricultural sector. In 2017, the key business revenue of agricultural processing firms over a certain threshold size amounted to RMB 19.4 trillion, up 6.5 percent year on year. New business models such as e-commerce have boomed, and eco-friendly agriculture has gradually become a public favorite. Personal income in the rural areas has made new breakthroughs. By 2017, growth of per capita disposable income in rural areas had exceeded the income growth of urban citizens as well as GDP growth for eight consecutive years. Financial support to modern agriculture has continued to strengthen. With a more comprehensive rural financial system and steady improvement in financial infrastructure, the coverage and quality of rural financial services have improved notably. At end-2017, total outstanding loans of all financial institutions to rural areas (at or below the county level) stood at RMB 25.1 trillion, up by 9.3 percent year on year; loans to rural households reached RMB 8.1 trillion, up by 14.4 percent; and loans to agricultural firms increased 5.7 percent to reach RMB 3.9 trillion.

Nonetheless, China still faces many challenges to promote modern agriculture. First, in pursuit of better quality and higher efficiency, agriculture suffers from a dual squeeze from the “floor” of production costs and the “ceiling” generated by international agricultural prices. Its profits, technology inputs, and sustainable development are all affected by the above factors. On the one hand, due to the increasingly tight constraints of environmental protection, it is difficult to develop and use agricultural resources. Per capita arable land and fresh water in China are only one-third and one-fourth, respectively, of the world’s average. Meanwhile, the amount of fertilizers and pesticides applied per unit area is much higher than the world’s average, and the effective utilization rate is low. On the other hand, first, the prices abroad of some agricultural products are lower than the prices at home. Second, it is difficult to translate scientific and technological progress into agricultural production or to spread their applications. The aging population and the rural hollowing out have dragged down the educational level of the labor force in the rural areas. Such factors, combined with poor rural infrastructure, inferior physical equipment, and a weak independent R&D capacity, have hampered the application and spread of scientific and technological progress in agriculture. In light of the requirements for high-quality and green development, it is a huge task to strike the right balance between sound and green development of modern agriculture for the medium- and long-term in China.

For the next step, China should increase its technology inputs in agriculture, improve the distribution of technological resources in rural regions, and enhance the incentive mechanism for technological innovations to focus on the green development of agriculture. Meanwhile, China should continue to promote agricultural structural adjustments, encourage the integrated development of the primary, secondary, and tertiary industries in the rural regions, and cultivate entities to serve the green development of agriculture. With enhanced policy support to green agriculture under the international framework such as the WTO, China will accelerate the construction of a sustainable financial-service system to promote green agriculture.

**Part 5. Monetary-Policy Stance to be Adopted during the Next Stage**

**I. Outlook for the Chinese Economy**

**During the next period, several favorable factors will support sustained and sound growth of the Chinese economy.** The global economic recovery will continue. The Chinese economy is experiencing a cyclical upturn, with favorable long-term momentum in the fundamentals remaining unchanged. The economy has a huge growth potential, with much room for development in new urbanization, services, advanced manufacturing, and consumption upgrading. There is also fairly large room for policy maneuvers. Reform of the economic system has been furthered, and the supply-side structural reforms have been deepened. The removal of excess capacity has continued, utilization of industrial capacity has rebounded, and aggregate supply and demand have become more balanced. New industries have expanded rapidly, traditional industries have made strong progress in upgrading, and the economic structure has improved further. Growth of the macro leverage ratio has decelerated. The financial system has made notable progress in controlling internal leveraging. The reasonable growth of money, credit, and all-system financing aggregates has provided a proper monetary and financial environment for supply-side structural reforms and high-quality development. Supported by numerous factors, the economy continued its sound development momentum in Q1 of 2018, with steadily advancing transformation and upgrading, strengthened economic resilience, better quality, and higher efficiency. The PBC’s Quarterly Survey of Entrepreneurs and Bankers in Q1 of 2018 reveals that the macro-economic indicator, confidence indicator, and other indicators rose both quarter on quarter and year on year. TheSurvey of Urban Depositors shows that employment expectations of households have also improved.

**Nevertheless, it is worth noting that structural and deep-rooted problems that weigh on sustained economic growth remain acute, the structural adjustments and reforms still have a long way to go, and the task of preventing and resolving major financial risks is still arduous.** Externally, the global economic and political situation is even more complicated, and there are uncertainties regarding fiscal policies, trade policies, and monetary policies in some advanced economies, which might cause shock waves on the global economy and on capital flows. Meanwhile, with geopolitical risks remaining elevated, volatilities in international financial markets might increase. On the domestic front, the recent upturn is, to a certain extent, driven by the boom in the external environment as a result of the global recovery, but bottlenecks in certain weak-point areas remain, overall leveraging is still elevated, and the debt burden of enterprises, especially state-owned enterprises, remains heavy. It is a must to be ready to protect against risks, focus on problem-solving, and address the most acute problems. It is necessary to understand that the economy has essentially moved from a high-growth phase to a period of high-quality development, and thus efforts must be made to advance supply-side structural reforms, improve the quality and efficiency of the supply system, continue measures designed to remove excess capacity in a market-oriented and law-biding manner, reduce inventories, leveraging, and costs, shore up weak points, and win the three difficult battles of resolving major risks, implementing targeted poverty reduction, and furthering pollution prevention and treatment. Efforts are needed to maintain overall stability, promote high-quality development, improve total factor productivity, and advance the reform and opening-up in a more proactive manner.

**Prices are generally stable.** The pace of price hikes is determined by the fundamentals and the relative changes in supply and demand. Globally, inflation in the major economies has gone up slightly, albeit still at a subdued level. Domestically, the steadily growing economy and the increased production of some agricultural products will help keep price levels stable. Nevertheless, due to various factors such as the removal of excess capacity, environmental protection inspections, the rebounding of commodity prices, and slightly greater tail effects in 2018, some price indices might grow, but in general inflationary pressures will remain well anchored. According to the Q1 Urban Depositors’ Survey conducted by the PBC, the Future Price Expectation Index dropped by 4.7 percentage points from the previous quarter. It is necessary to continue to monitor potential uncertainties in the future.

**Box 4 Latest Developments in China’s Macro Leverage Ratio**

The macro leverage ratio is usually measured by the ratio of the combined outstanding debt of the non-financial corporate sector (the corporate sector), the government sector, and the household sector to the gross domestic product (GDP). The debt of the three sectors is usually incurred through financial markets or financial institutions. Specifically, corporate debt includes domestic borrowing denominated in domestic and foreign currencies, bonds publicly placed on onshore markets, entrusted and trust loans, undiscounted bankers’ acceptances, and external borrowing; government debt is the combined borrowing of the central and local governments, with the latter including local government bonds and the stock of non-bond local government debt at end-2014 identified as a result of sorting; household debt includes loans and entrusted loans (mainly housing provident fund loans) from financial institutions, and margin financing from securities companies. In the measurements of debt, the amount of cross-holding debt should be removed to avoid repeated inclusion. For example, in some cases, policy financial bonds and external borrowing in the financial sector were included in the outstanding debt of the non-financial sector while in other cases, shadow-banking, which was already repeatedly included in various sectors’ borrowing, was treated in aggregate as debt. There were also cases where government-sponsored bonds and borrowing by local government financing platforms were simultaneously included in both government and corporate debt. All these would affect the accuracy of the measurement of the macro leverage ratio.

**The macro leverage ratio stabilized in 2017.** Before 2017, the macro leverage ratio experienced a period of rapid growth, up an average of 13.5 percentage points between 2012 and 2016. With the deepening of the supply-side structural reforms, the stable and strong momentum of macroeconomic performance, and the effective implementation of a sound and neutral monetary policy, the growth of the macro leverage ratio moderated notably in 2017, up 2.7 percentage points to 250.3 percent. In particular, the leverage ratio of the corporate sector was 159 percent, down 0.7 percentage point year on year, the first reduction since 2011, after increasing an average of 8.3 percentage points annually between 2012 and 2016. The leverage ratio of the government sector was 36.2 percent, down 0.5 percentage point year on year, in contrast to the average annual 1.1 percentage-point growth between 2012 and 2016. The leverage ratio of the household sector was 55.1 percent, up 4 percentage points year on year, an decrease of 0.1 percentage point from the average annual growth between 2012 and 2016.

**A number of important factors contributed to the stabilization of the macro leverage ratio.** The first is the notable progress in the supply-side structural reforms. Moreover, with the fairly strong growth of the world economy, China’s performance was strengthening, leading to relatively rapid increases in corporate profits, fiscal revenue, and household income, which helped stabilize the leverage ratio. In 2017, statistically large enterprises reported year-on-year growth in profits at 21 percent, an acceleration of 12.5 percentage points from last year; fiscal revenue increased 7.4 percent year on year, an acceleration of 2.9 percentage points from the last year; per capita disposable income was up 7.3 percent, an acceleration of 1 percentage point and outperforming GDP growth by 1 percentage point. The second factor is the effect of the sound and neutral monetary policy and the structural credit policy, and the subsequent reasonable growth of money and credit overall. Affected by the efforts to contain internal leveraging in the financial system, growth of broad money M2 increased by 8.1 percent year on year, decelerating from the previous year, creating a proper monetary and financial environment for stabilizing the leverage ratio while supporting steady economic growth. Moreover, the PBC adopted effective measures to optimize the credit structure. In 2017, the outstanding medium- to long-term loans in sectors with excess capacity were down 1.7 percent year on year, the inefficient financing demand were contained; outstanding real-estate loans were up 20.9 percent year on year, a deceleration of 6.1 percentage points from the previous year; specifically, outstanding home mortgage loans were up 22.2 percent year on year, a deceleration of 14.5 percentage points. Against the background of financial deleveraging and enhanced financial regulation, growth of trust loans, off-balance-sheet financing and other businesses decelerated significantly. A third factor is that the conduct of local government financing guarantees faced stricter regulation, borrowing by local government financing platforms and other entities with soft financial constraints were suppressed, and the growth of SOE debts moderated. In 2017, the combined SOE debt and outstanding bonds to GDP ratio was up 2.3 percentage points year on year, decelerating 1.5 percentage points from the average annual growth between 2012 and 2016.

**The rapid growth of the macro leverage ratio during the previous period can be attributed to structural features and the stage of development of the Chinese economy.** The first feature is the high savings ratio, the mismatch between those who saved and those who invested, and the underdevelopment of equity financing, which led to a surge in debt during the process of savings being turned into investments. Against this background, a lack of efficiency in debt use would inevitably push up the leverage ratio. The second feature is the rapid monetization leading to a period of rapid leverage expansion, especially in light of the progress in the market economy, the massive urbanization, the development of the real-estate market, and the higher growth of the export-oriented economy. The third feature is shadow-banking pushing up leveraging in the context of the deepening of rapid financing and the slow catch-up in financial regulation. The fourth feature is SOE and local government financing platforms undertaking some government functions, thus rapidly pushing up leveraging in the corporate sector.

**The above-mentioned factors contributing to a higher leverage have begun to change as the Chinese economy has entered a new stage.** First, stable growth can be expected in the period to come. The shift from a high growth rate to high-quality development will be supported by higher efficiency in the use of debt-financed funds and this will help to bring down the leverage ratio. Second, monetization in goods and factors markets is already quite high. With aging of the population picking up pace, the subsequent slowdown in the monetization process will be reflected in the leverage ratio. Third, as a result of stricter regulation and financial-market improvements, shadow-banking driving up the leverage ratio will be curbed. Fourth, constraints on local government debt are being strengthened and government financing guarantee behavior is being regulated. Fifth, further progress in the supply-side structural reforms and implementation of a market-based, rule-based debt-equity swap will contribute to the stabilization and reduction of the macro leverage ratio. With the above factors working together, the macro leverage ratio is expected to further stabilize and gradual structural deleveraging will be realized.

**II. Monetary Policy during the Next Stage**

Going forward, the PBC will act in accordance with the decisions and overall arrangements of the CPC Central Committee and the State Council, follow the guidance of Xi Jinping’s Thought on Socialism with Chinese Characteristics for a New Era and the overall requirements for the five-sphere integrated plan, continue to adhere to the guiding principles of seeking progress while maintaining stability and to the new vision for development, fully grasp the evolution of the principal contradiction in the economy and society, focus on the three tasks of serving the real economy, guarding against financial risks, and deepening the financial reforms, adopt innovative approaches to and improve financial macro-management, maintain policy consistency and stability, implement a sound and neutral monetary policy, attach importance to expectation management, enhance policy coordination, accelerate the building of a modern economy, and build a neutral and proper monetary and financial environment for supply-side structural reforms and high-quality development. The PBC will improve the two-pillar framework underpinned by the monetary and macro-prudential policies and will deepen the market-based interest-rate and exchange-rate regime reforms. The battle of forestalling and defusing major financial risks will be fought and won. Measures will be taken to promote financial-sector reforms and opening-up and to improve financial services for the real economy.

**First, the sound and neutral monetary policy will continue, and money supply will be properly managed.** A combination of price- and quantity-based instruments and macro-prudential policies will be adopted to enhance preemptive adjustments and fine-tunings to keep the growth of money, credit, and total financing within a reasonable range and to strike a balance between stable growth, deleveraging, and risk prevention. On the one hand, liquidity will be properly managed to facilitate deleveraging and financial risks management. On the other hand, with full consideration of changes in economic performance, measures will be taken to step up policy coordination. A variety of monetary-policy instruments will be flexibly used through well-paced operations to maintain stable liquidity at a reasonable volume. Macro-prudential assessments will be improved, and beginning from Q1 of 2019 inter-bank certificates of deposit issued by financial institutions whose assets are less than RMB 500 billion will be included in the MPA evaluations.

**Second, measures will be adopted to facilitate structural optimization to support economic structural adjustments, transformation, and upgrading.** In a bid to provide more efficient financial services to the supply-side structural reforms, continued efforts will be made to optimize the direction and structure of liquidity and to reinforce the role of credit policy in providing guidance. Financial services will be provided to support the transformation and upgrading of priority industries, such as the manufacturing sector, infrastructure, and railways. The role of the financial sector will be tapped to provide stronger support for newly-emerging consumption sectors, such as elderly care, education, and healthcare, as well as key sectors in the national economy, including entrepreneurship and innovation, science and technology, the cultural industry, the maritime economy, and the emerging strategic industries. Financial services will be improved for the coordinated development of Beijing, Tianjin, and Hebei, the Belt and Road Initiative, and development of the western regions. The focus of agro-linked financial services will be to support the strategy of rural rejuvenation, the integrated development of the primary, secondary, and tertiary industries, and to improve efficiency. The financial-sector mechanism for targeted poverty alleviation will be improved and financial services for seriously impoverished areas will be reinforced. Efforts will be made to evaluate the outcome of credit policies and to guide financial institutions to increase credit support to weak links in the economy. Innovations in financial products and services will be encouraged. Ad hoc campaigns to provide financing against accounts receivables of micro and small enterprises will be carried out. Efforts will be made to promote financing pledged with intellectual property rights.

**Third, the market-based interest-rate reform and the RMB exchange-rate regime reform will be furthered to improve the efficiency of financial resource allocations and to improve the financial management system.** Financial institutions will be urged to strengthen their internal control systems and to improve their capability for independent and rational pricing and risk management. In order to deepen the financial market, measures will continue to be adopted to develop market-based benchmark rates, to improve the yield curves of government securities, and to continuously improve the market-based interest-rate pricing mechanism. The PBC will explore the interest-rate corridor mechanism, enhance the central-bank’s capacity to make interest-rate adjustments and to further improve the transmission of central-bank policy rates to the financial market and the real economy. Oversight of the irrational pricing behavior of financial institutions will be strengthened. The important role of the market interest-rate self-disciplinary mechanism will be tapped. Effective approaches will be adopted to regulate interest-rate pricing, while industry self-discipline and risk prevention will be reinforced to maintain order for fair pricing. The market-based RMB exchange-rate regime will be deepened to improve the managed floating exchange-rate regime based on market supply and demand and with reference to a basket of currencies, to allow the market to play a greater role in determining the exchange rate, to enhance two-way flexibility in the RMB exchange rate, and to keep the RMB exchange rate basically stable at an adaptive and equilibrium level. Development of the foreign-exchange market will be accelerated to provide exchange-rate risk management services based on actual needs in accordance with the principle that finance should serve the real economy. Measures will be adopted to support the use of RMB in cross-border trade and investments. The PBC will closely monitor the impact of international developments on capital flows and will improve macro-prudential management of cross-border capital flows.

**Fourth, the financial-market system will be improved to enhance the role of the financial market in stabilizing economic growth, facilitating structural adjustments, promoting reforms, and preventing risks.** In accordance with the principle that the financial sector must serve the real economy, product innovations will be facilitated to deepen and broaden the bond market, supervision over green financing bonds will be strengthened throughout their duration, and the mechanism to prevent and resolve default risks will be improved. Fully tapping the role of financial markets, green financing will be in a better position to support the economic transformation. A two-way opening of the bond market will be facilitated by encouraging various overseas institutions to issue bonds on the onshore RMB market and for domestic institutions to place bonds in offshore markets, and to promote overseas institutions to invest in the onshore bond market. Development of the secondary bond market will be facilitated through improvements in the market-maker assessment system and in the institutional arrangements for trading, clearing, and settlement, in order to have a more liquid bond market. Supporting policies on accounting, audits, and taxes will be improved to create a more friendly and convenient investment environment. Further coordination is needed to promote securitization and the well-regulated development of the securitization market. A coordinated management framework of the financial-market infrastructure will be established to improve market infrastructure and to provide the institutional underpinning for the efficient functioning and overall stability of the financial market as the opening-up deepens further.

**Fifth, the reform of financial institutions will be deepened and financial services will be improved by increasing supply and enhancing competition.** Reform of large commercial banks and other large financial institutions will be further deepened by improving corporate governance, regulating the relationship among the shareholders’ meeting, the board of directors, the board of supervisors, and management, improving the operation authorization system, establishing an effective system for decision making, execution, and checks and balances, and improving the quality of operations and management and risk-control capacity. Further reforms of the management and operational mechanisms of the Agricultural and Rural Financial Service Division of the Agricultural Bank of China will be promoted, and effective measures will be taken to revitalize the County Service Division to improve its capacity to serve the real economy at the county level. The reform program for development and policy financial institutions will be implemented in a comprehensive manner. Efforts will be made to rapidly complete the follow-up tasks for improving the governance structure, specifying the scope of businesses, improving risk compensation mechanisms, and deepening the reforms in order to nurture development and policy financial institutions with Chinese characteristics that provide services for economic development and operate on a sustainable basis.

**Sixth, measures will be taken to strengthen risk prevention and management in key fields.** Thinking about the worst-case scenario and with a view to seeking progress amidst stability, the PBC will grasp the principal contradictions, follow the leadership of the Financial Stability and Development Committee under the State Council, earnestly fulfill its role in the committee’s office, and work together with the relevant departments to work out a timeline and roadmap to prioritize issues that might impact economic and social stability and trigger systemic risks. Efforts will made to overcome regulatory shortcomings, effectively control the macro leverage ratio and risks in key areas, address risks stemming from shadow-banking, and earnestly handle risks pertaining to various financial institutions. The PBC will also continue to pursue comprehensive policy measures to defend the bottom line in preventing systemic financial risks and to win the battle of preventing and mitigating major financial risks.