

Speech at the 18th International Conference on Banking Supervisors

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People's Bank of China

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Your Excellency Chairman Stefan Ingves,
Your Excellency Mayor Huang Xingguo,
Distinguished Guests,
Ladies and Gentlemen,

Good morning! At the outset, let me express, on behalf of Mr. Zhou Xiaochuan, the Governor of the People's Bank of China, warm congratulations on the opening of the conference in China.

The two themes of this conference, i.e. the post Basel-III international regulatory reform, and finance promoting economic growth, are of great significance to today's world. Six years have passed since the outbreak of the global financial crisis. The world economy is slowly recovering, and the countries and regions worst affected by the financial crisis have gradually got over the financial crisis. The banking sector is back on track again. Learning the lessons from the crisis, the FSB, BCBS and other international organizations have worked continuously to improve regulatory rules and enhanced banking sector soundness. How to further push ahead with regulatory reform and enable the financial sector to promote economic growth, is a common task for us all. I am very glad to take this opportunity to share with you the Chinese experience and lessons in financial sector development in recent years.

China's economy has maintained stable and fairly rapid growth, which is a very notable achievement. The financial system has played a significant role in promoting economic growth. In particular, given the dominance of indirect finance in the financing structure, the banking sector in China has a major role to play in contributing to real sector growth. Therefore, it is of vital importance to have a sound banking sector well-equipped to support the real sector. To this end, the Chinese Government has implemented a series of major financial reforms, including the restructuring and listing of large commercial banks. By establishing and improving sound corporate governance, strengthening internal control and risk management, the financial sector has built their capacity to provide service to the real sector, become more competitive in the global market and more resilient against risks. They have provided strong support to economic growth in the country. In our view, efforts must be made to maintain the soundness of the banking sector and the entire financial system as it is the foundation to provide sustainable financial resources and services to the real economy.

We have observed a common phenomenon in our study of the history. That is, in periods when the banking sector has expanded particularly fast, with the asset, profit

and other indicators going up rapidly, even exceeding the economic growth rate, usually financial risks ensue. We should be on alert against the potential crisis that may build up in a rapidly expanding banking sector. While recognizing that banks are for-profit enterprises that are constantly making innovations, we should also acknowledge that banks have characteristics that are different from ordinary enterprises. They provide quasi public goods in a competitive field, as their financial products are basic and necessary services required by enterprises, industries and individuals in the economy. Therefore, the banking sector should not thrive in isolation of the real sector. If banks have created many sophisticated products that are beyond the ken to most people, with demand coming from only within the financial system, and when such products have become the major sources of bank profits, we should assess the potential risks and its impact on the economy in the future.

In judging whether the banking sector is sound and on a sustainable growth path, we should not only look at conventional indicators on a bank's soundness such as adequate capital, safe asset, and sizable earning, but also assess from a macro-perspective whether the development of the banking sector is properly aligned with the real economy, i.e., whether the banking sector can effectively promote the continuous, healthy, and stable economic growth.

The supervisory authority should strike a balance among various targets of banking business development, risk prevention, profitability and social responsibility. The shadow banking is a case in point and the outcome of regulatory circumvention and business competition. Its rapid growth is driven by regulatory arbitrage in many instances. However, we should not say no to shadow banking just based on its behaviors in regulatory arbitrage. Rather, we ought to conduct comprehensive analysis and form a judgment before taking reasonable and effective regulatory measures. The first is to analyze rationality of the shadow banking business, in particular the relationship between the specific business and the real economy. Does it derive from the actual demand of the real economy, or is it just pure business transfer among financial institutions? The second is to make judgment on the actual risks. Using the US sub-prime crisis as an example, as the sub-prime mortgages exceeded the repayment capacity of borrowers and were very risky even though the sub-prime mortgages were transferred off balance sheet through asset securitization, the actual risks were still there. In some cases, the securitized sub-prime mortgages were re-securitized. Consequently, the risks were further concealed. The third is the applicability and consistency of regulatory rules. Differences in regulatory standards and supervisory rules have led to high costs in some businesses, and become an important reason in regulatory arbitrage. Therefore, as we unify the regulatory standards, we should also assess the impacts of higher costs from regulatory requirements on the financial system and the real sector. I wish to emphasize that as the international regulatory policies have in general become stricter, particular attention should be paid to the impacts of regulatory policy orientation. We should aim to strengthen, rather than weaken banking sector support for weak links in the

economy and small enterprises, and the supervisory authority should have special consideration in this regard.

In China, the shadow banking business has experienced rapid development in recent years. This has become a subject of much debate. Overall speaking, the use of funds by China's shadow banking sector is not sophisticated and quite similar to traditional banking business. Credit creation based on financial derivatives is rare. More importantly, most of shadow banking funds is used in the business operation of the corporate sector, which ultimately serves the real economy. The dominance of indirect financing, reliance on bank credit, and stricter regulatory requirements are important factors in the growth of shadow banking. Consequently, banks look for other financial intermediaries to share their financing burden. Therefore, we should look at the shadow banking issue in an objective manner. On one hand, it has problems such as irregularities in operation and regulatory arbitrage; on the other hand, it has met the multi-tier credit needs against the background of diverse economic development. Therefore, in the regulatory treatment of the shadow banking, we should guide our action according to the circumstances. While strengthening regulation, efforts should be made to guide the shadow banking sector to provide funding for the corporate sector in a proper and orderly manner.

In recent years, the People's Bank of China has placed special emphasis on integrating the conduct of monetary policy with maintenance of financial system stability, and made productive explorations.

First of all, the PBC has made monetary policy more forward-looking and flexible, and facilitated balanced development of banking industry and the real sector. Economic stability is the foundation of financial stability. In view of the complex situation at home and abroad, the PBC strengthened macro-prudential regulation, used a variety of policy instruments, both quantitative-based and price tools, adjusted money supply and credit input in a counter-cyclical manner, maintained the aggregate liquidity at adequate levels, and guided money, credit, and all-system financing aggregate to grow at reasonable rates.

Secondly, while adjusting the aggregates, we have also worked to optimize credit structure. Through the use of central bank lending, and the targeted reduction of required reserve ratio, we have encouraged and guided banks to allocate more credit resources to the agricultural sector, rural areas, farmers, micro and small enterprises, strategic new industries and other key industries and weak links in the economy. The application of differentiated mortgage loan policy has guided the steady and healthy growth of real estate market.

Thirdly, regulatory cooperation has been enhanced to improve regulatory effect. Last year, the inter-ministerial joint conference on financial regulatory coordination was established, with the PBC as the lead organizer, for the purpose of enhancing

coordination between monetary policy and financial regulatory policy, between regulation policy and laws and regulations, facilitating coordination of maintenance of financial stability with prevention and resolution of systemic and local financial risks, stepping up coordination in cross-sector financial product and inter-market financial innovations, improving information sharing and comprehensive financial statistics. Now, the inter-ministerial joint conference has reached consensus on and coordinated policy for regulating inter-bank businesses, promoting capital market development and guiding the sound development of cross-sector financing activities initiated on the internet.

Fourthly, reform of key financial industries and crucial links in the financial sector has made progress. Important financial institutions have deepened their reforms, the equity structure of state holding financial institutions has been optimized, and their corporate governance has improved. The reform of policy financial institutions was accelerated to strengthen and define their policy function. A lot of preparatory works have been completed for the creation of a deposit insurance scheme, and the market-based exit mechanism has been established step by step for financial institutions. The market-based interest rate and exchange rate reform have been furthered. On the basis of full liberalization of lending interest rates, the PBC will strengthen the benchmark interest rate system of financial market and the central bank policy rate system, and lift controls on deposit interest rates in a progressive and orderly manner. The market-based RMB exchange rate regime was improved to strengthen the flexibility of RMB exchange rate in both directions. RMB convertibility under the capital account has been promoted in an active and orderly manner. Measures have been taken to promote capital market development.

Ladies and gentlemen,

The sound development of real economy and smooth functioning of financial system is complementary to each other. As the central bank of China, we will follow the fundamental principle of having the financial sector serve the real economy, actively take part in international regulatory reforms, and enhance cooperation in international financial regulation, so as to make greater contribution to sustainable economic development and financial stability.

Thank you!