

China Monetary Policy Report, Quarter Four, 2012

(February 6, 2013)

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

Executive Summary

In 2012, the Chinese economy registered steady growth and made progress. The consumer demand was stable, fixed asset investment grew steadily, agricultural sector was in good shape and the output of industrial sector stabilized after deceleration. Growth of price level declined, the employment situation remained generally stable, and the balance of payments improved further. The GDP posted 51.9 trillion yuan, up 7.8 percent year on year; the consumer price index was up 2.6 percent year on year; the current account surplus as a percentage of GDP declined to 2.6 percent.

The PBC has followed the overall arrangements of the State Council and continued to implement a sound monetary policy. In the first several months of the year, in view of the deceleration of economic growth and CPI growth, fine-tunings and preemptive adjustments were conducted in a forward-looking manner, including two cuts of reserve requirement ratio of 0.5 percentage points each, flexible open market operations in both directions, two cuts of benchmark lending and deposit rates, and the counter-cyclical adjustment through dynamic adjustment of differentiated reserve requirement, to promote reasonable growth of money and credit. In the second half of the year, reserve repo operations were conducted on a continual basis in response to the changes in supply and demand of liquidity to keep liquidity at reasonable volumes and market interest rate movement in a stable manner. Market-based interest rate reform advanced in strides. The ceiling of RMB deposit rates offered by financial institutions to their clients was adjusted to 1.1 times of the benchmark rates and the floor of the lending rates offered by financial institutions to their clients was adjusted to 0.7 times of the benchmark rates. The RMB exchange rate regime was further improved as the floating band of the US dollar to RMB exchange rate on inter-bank spot market was expanded from 0.5 percent to 1 percent. The cross-border use of RMB was expanded. Reform of the financial institutions was advanced and the financial markets developed further with increased innovation and better regulation.

The growth of money and credit was consistent with expectations. At end-2012, outstanding M2 totaled 97.4 trillion yuan, up 13.8 percent year on year; outstanding RMB-denominated loans was up 15.0 percent year on year, registering an increase of 8.2 trillion yuan from the beginning of 2012, 732 billion yuan more than that registered in 2011, and the credit structure improved further. The financing aggregate grew rapidly with all-system financing aggregate reaching 15.76 trillion yuan and the financing structure further diversified. The lending rates offered by financial institutions to their clients declined further. In December, the weighted average lending rate offered to non-financial enterprises and other sectors declined 1.23 percentage points from that at the beginning of the year to 6.78 percent, indicating lower financing cost. At the end of 2012, the central parity of RMB against the US dollar was 6.2855 yuan per dollar, appreciating 0.25 percent from the end of 2011, while the real effective exchange rate of RMB appreciated 2.22 percent. The market

supply and demand have played a stronger role in the RMB exchange rate mechanism.

Looking ahead, the drivers of Chinese economic growth will remain fairly strong and there are fresh positive factors to enhance domestic demand. With these factors supported by macroeconomic policies, the outlook for maintaining the fairly rapid and stable growth is positive. Nevertheless, it is worth noting that China faces complex domestic and external environment. With sluggish global recovery, the negative spillover of the loose monetary policies of major economies is on the increase. The basis for stable economic growth has not been sufficiently solid as there are both strong investment impulse in some sectors and a lack of endogenous drivers. The structural imbalances are still acute and the resource and environmental constraint has become stronger. At the moment, since prices are sensitive to demand expansion, special attention should be paid to the potential impact of expectation changes on prices. During the transition, the focus of monetary policy should always be reigning in inflation risks.

The PBC will follow the overall arrangements of the State Council, focus on the theme of scientific development and transformation of growth pattern and the pursuit of higher quality growth and efficiency, follow the principle of seeking progress amidst stability, continue to implement a prudent monetary policy, maintain the continuity and stability of policy, make policy measures more forward-looking, targeted and flexible, properly handle the relationship among stable and fairly rapid growth, structural adjustment, inflation control and risk prevention, and properly handle the focus, intensity and pace of policy measures. A variety of monetary policy tools will be used, including quantity-based and price instruments, and the macro-prudential policy framework will be improved to keep market liquidity at reasonable volumes and guide money, credit and all-system financing aggregate to grow in a stable and appropriate manner. Measures will be taken to optimize the allocation of credit resources and the adjustment of the credit asset in stock. Steady steps will be taken to advance market-based interest rate reform and RMB exchange rate regime reform, improve the allocation efficiency of the financial system, and improve the macro-economic management over the financial sector. Furthermore, efforts will be made to deepen the ongoing reform in financial institutions. The market orientation will continue to promote sound development of the financial markets, effectively prevent systemic financial risks, and preserve stability of the financial system.

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Part 1 Monetary and Credit Performanc

In 2012, the liquidity in banking sector was appropriate, monetary and credit growth developed as expected, growth in aggregate financing saw relatively fast growth, and the credit structure improved further.

I. Money supply registered relatively fast growth

At the end of 2012, outstanding M2 stood at 97.4 trillion yuan, up 13.8 percent year on year, accelerating 0.2 percentage points from that at the end of the last year. Outstanding M1 stood at 30.9 trillion yuan, up 6.5 percent year on year. Currency in circulation M0 totaled 5.5 trillion yuan, up 7.7 percent year on year. Net cash put into circulation in 2012 totaled 391 billion yuan, 225.1 billion yuan less than that in 2011.

With the adoption of monetary policy measures aimed at preserving economic growth, higher growth in M2 and M1 provided a favorable monetary environment to stabilize economic growth. From the perspective of money creation channels, bond investment of banks and interbank market have a greater impact on money supply in addition to bank lending, while RMB counterpart of foreign exchange reserves has diminished impact.

At the end of 2012, outstanding base money registered 25.2 trillion yuan, up 12.3 percent year on year and 2.8 trillion yuan more than that at the beginning of the year. The money multiplier stood at 3.86, which was 0.07 higher than that at the end of 2011. Liquidity in the banking sector was appropriate. The excess reserve ratio of financial institutions was 3.3 percent, 1.0 percentage point higher than that at the end of the last year, and that of rural credit cooperatives (RCCs) was 8.2 percent, 0.9 percentage points higher than that at the end of the last year.

II. Deposits at financial institutions saw seasonal fluctuations

At the end of 2012, outstanding deposits in domestic and foreign currencies of all

financial institutions (including foreign-funded financial institutions, the same hereinafter) reached 94.3 trillion yuan, up 14.1 percent year on year and accelerating 0.6 percentage points from the end of 2011. Outstanding deposits were 11.6 trillion yuan more than that at the beginning of the year, an acceleration of 1.8 trillion yuan year on year. Outstanding RMB deposits registered 91.7 trillion yuan, up 13.3 percent year on year, a deceleration of 0.2 percentage points than that at the end of 2011. This was 10.8 trillion yuan more than that at the beginning of 2012, an acceleration of 1.2 trillion yuan year on year. Influenced by factors such as the end-quarter performance evaluation and fast development of off-balance sheet wealth management, outstanding deposits showed a notable pattern of increasing substantially at the end of a season and dropping significantly at the beginning of the next season; there was an average increase of 2.3 trillion yuan in the last month of each quarter, and an average decrease of 511.5 billion yuan in the first month of a quarter. Outstanding deposits in foreign currencies posted USD406.5 billion, an increase of 47.8 percent year on year, or USD131.4 billion more than that at the beginning of 2012, which was USD82 billion more from that in the same period of the previous year.

Broken down by sectors, the growth of household deposits was stable and that of non-financial institutions accelerated. At the end of 2012, outstanding household deposits in financial institutions posted 40.6 trillion yuan, up 16.7 percent year on year, accelerating by 1.0 percentage points from end of last year; this was 5.7 trillion yuan more than that at the beginning of 2012 and represented an acceleration of 991.6 billion yuan year on year. Outstanding deposits of non-financial enterprises registered 32.7 trillion yuan, up 7.9 percent year on year, with a growth rate same as that at the end of September and 2.2 percentage points higher than that at end of June; this represented a rise of 2.7 trillion yuan compared with that at the beginning of year, and an acceleration of 180.3 billion yuan year on year. At the end of 2012, outstanding fiscal deposits registered 2.4 trillion yuan, down 197.4 billion yuan from the beginning of the year.

III. Lending in financial institutions grew steadily

At the end of 2012, outstanding loans in domestic and foreign currencies of all financial institutions registered 67.3 trillion yuan, up 15.6 percent year on year, a deceleration of 0.1 percentage points over the end of the last year. This was also 9.1

trillion yuan more than that at the beginning of the year, an acceleration of 1.2 trillion yuan year on year.

Growth of RMB loans was stable. At the end of 2012, outstanding RMB loans stood at 63.0 trillion yuan, up 15.0 percent year on year; the fluctuation of RMB lending growth in 2012 was notably lower than that of the previous two years; the outstanding RMB loans was 8.2 trillion yuan more than that at the beginning of 2012, an acceleration of 732 billion yuan year on year. In general, credit provision within the year was balanced under the guidance of macro-prudential policy instruments, and new loans in the four quarters as a percentage of new loans in 2012 was 30 percent, 30 percent, 20 percent, and 20 percent respectively.

Medium and long-term loans rose steadily, and the the growth of home mortgage loans rebounded. Broken down by the recipients of RMB loans, growth of household loans picked up with a year-on-year increase of 18.6 percent at the end of 2012, an acceleration 0.8 and 2.0 percentage points from end-September and end-June; the household loans was 2.5 trillion yuan more than that at the beginning of 2012, an acceleration of 107.1 billion yuan year on year. Loans to non-financial enterprises and other sectors continued to rise quickly. At the year end, the growth was 13.7 percent year on year, a deceleration of 0.2 percentage points from the end of 2011. Loans to non-financial enterprises grew 5.7 trillion yuan from that at the beginning of 2012 and represented an acceleration of 616.6 billion yuan year on year. Broken down by lenders, lending by Chinese-funded large-sized national banks, small-and medium-sized regional banks, rural cooperative financial institutions accelerated year on year by a fairly large margin. Broken down by maturities, the share of medium and long-term loans rebounded. Driven by investment recovery, loan support to on-going projects was gradually intensified. Medium and long-term loans were up 9 percent at the end of the year with its growth rate remaining at about 9 percent since April 2012. Medium and long-term loans registered an increase of 2.9 trillion yuan compared with that in the beginning of the year, and accounted for 35 percent in total loans, 2.7 percentage points higher than the lowest percentage in the year. The growth rate of home mortgage loans rebounded with a year on year growth rate of 12.9 percent at the end of the year, rising for seven consecutive months, and 2.6 percentage points higher than the lowest level at the end of May. The home mortgage loans posted an increase

of 841.9 billion yuan over the beginning of 2012, an acceleration of 9.8 billion yuan from a year ago. Short-term loans including bill financing increased by 5.1 trillion yuan from the beginning of the year, accelerating 1.3 trillion yuan year on year. In particular, bill financing increased by 530.9 billion yuan over the beginning of the year, an acceleration of 519.7 billion yuan from a year ago; which was due to greater increase in the first eight months, and bill financing decreased consecutively starting from September 2012. Enterprises and banks tended to make short-term fund arrangements due to complex economic situations in 2012.

Table 1 RMB Loans of Financial Institutions in 2012

Unit: 100 million yuan

	2012		2011	
	New Loans	Acceleration	New Loans	Acceleration
Chinese-funded large-sized national banks ^①	38,784	1,323	37,461	-3,361
Chinese-funded small- and medium-sized national banks	23,202	619	22,583	-873
Chinese-funded small- and medium-sized local banks ^③	13,214	5,884	7,329	2,039
Rural cooperative financial institutions ^④	11,544	1,532	10,012	357
Foreign-funded financial institutions	777	-3	779	-849

Notes: ① Chinese-funded large-sized banks operating nationwide refer to banks with assets denominated in domestic and foreign currencies equivalent to no less than 2 trillion yuan (according to the amount of total assets in both domestic and foreign currencies at end-2008).

② Chinese-funded small- and medium-sized banks operating nationwide refer to banks operating across different provinces with assets of less than 2 trillion yuan denominated in domestic and foreign currencies.

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

④ Rural cooperative financial institutions refer to rural commercial banks, rural cooperative banks, and rural credit cooperatives.

Source: People's Bank of China.

Foreign currency-denominated loans grew rapidly. At the end of 2012, outstanding foreign-currency loans of financial institutions reached USD683.6 billion, up 26.9 percent year on year. This was USD145.1 billion more than that at the beginning of 2012, an acceleration of USD56.9 billion year on year. In terms of loan structure, there was a greater loan support for trade financing and the *Going global* initiatives of enterprises. In particular, trade financing increased by USD92.4 billion, an acceleration of USD64.9 billion year on year, and overseas loans and domestic medium- and long-term loans climbed by USD51.7 billion, an acceleration of USD11.1 billion year on year.

IV. Diversified structure of aggregate financing

According to preliminary statistics, in the year of 2012 all-system financing aggregate reached an all-time high of 15.76 trillion yuan, an acceleration of 2.93 trillion yuan¹ from a year ago. Starting from May 2012, all-system financing aggregates exceeded 1 trillion yuan for eight consecutive months, and higher than that in the corresponding period of the last year. The main reason for the higher all-system financing aggregates in 2012 was active financing through trust loans, corporate and enterprise bonds, RMB loans and foreign currency denominated loans. The above-mentioned four means of financing amounted to 12.66 trillion yuan, an acceleration of 3.05 trillion yuan over that in 2011.

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

Unit:100 million yuan

	All-system	Of which:
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¹ Year-on-year growth data in the report was calculated by comparable data.

	Financing Aggregate ^①	RMB loans ^③	Foreign currency- Denominated Loans(RMB equivalent)	Entrusted loans	Trust loans	Undiscount ed Bankers' acceptances	Corporate Bonds	Financing by domestic non-financial institutions via the domestic stock market
2002	20,112	18,475	731	175	—	-695	367	628
2003	34,113	27,652	2,285	601	—	2,010	499	559
2004	28,629	22,673	1,381	3,118	—	-290	467	673
2005	30,008	23,544	1,415	1,961	—	24	2,010	339
2006	42,696	31,523	1,459	2,695	825	1,500	2,310	1,536
2007	59,663	36,323	3,864	3,371	1,702	6,701	2,284	4,333
2008	69,802	49,041	1,947	4,262	3,144	1,064	5,523	3,324
2009	139,104	95,942	9,265	6,780	4,364	4,606	12,367	3,350
2010	140,191	79,451	4,855	8,748	3,865	23,346	11,063	5,786
2011	128,286	74,715	5,712	12,962	2,034	10,271	13,658	4,377
2012	157,606	82,035	9,163	12,837	12,888	10,498	22,498	2,508

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

② Data for the current period are preliminary.

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

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

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

Looking at the financing structure, the means of financing was diversified and optimized. First, RMB loans increased by a large margin, but its share fell to a historic low. Second, the growth of foreign-currency denominated loans was more from that in

the last year. Third, bonds issuance was quite active, and the share of direct financing reached a historic high. Fourth, the growth of trust loans accelerated year on year. The growth of undiscounted bankers' acceptances and entrusted loans was roughly same as that in 2011. In 2012, compensation payments from insurance companies, loans from micro-credit companies and credit companies increased 513.6 billion in total, 74.5 billion yuan more from that in the last year.

Box 1 International Experience of Urbanization Financing

In the urbanization and industrialization process, rural population move to seek employments in non-agricultural industries, towns and cities. From the perspective of public service equalization, there will be enormous demand for infrastructure and other public services during the urbanization process, and corresponding fund support is a key issue.

Based on the experience of many countries, financing for urbanization comes from three sources. First, traditional source of government tax revenue; second, proceeds of the project based on the principle of user fee; third, fund raising through financial market by the issuance of municipal bond or similar debt instruments. Government tax revenue, user fee and bonds are all supported by enhanced infrastructure service as a result of urbanization process and future land and property revenue.

I. The Revenue Basis of Urbanization Financing

Traditionally, urban infrastructure is regarded as public goods. As public goods are produced in a non-competitive way, and consumed in a non-exclusive way, they should be built by governments with tax revenue, and be available and free to urban residents as taxpayers. However, practices have shown that governments do not have a strong motivation of cost control when they provide public goods. Moreover, rapid development of urbanization increases demand pressure on public service, public finance fall short of meeting the demand on its own. Thus, various forms of public private partnership such as authorization, outsourcing, and subsidy are used to produce public goods. And user fee has been an important way of providing public goods, and becomes a basis for the future revenue of urbanization financing.

Another future revenue source of urbanization financing is tax revenue of local governments and transfer payment from central government. Compared with other tax

revenue, the property tax revenue based on land and property, has local tax source and is collected by local government. Among nations with fiscal federalism, property tax accounts for over 80 percent of tax revenue of local government below the state level in the U.S, i.e. municipal governments and county governments, and estate tax is almost the sole tax revenue for local government below the state level in Canada, accounting for over 40 percent of their fiscal revenue, and another 40 percent is non-tax revenue from user fee, the transfer payment is only about 17 percent in total revenue. Although the local tax system in a centralized country is relatively weak, the general trend is expanding local tax levy, in particular, through the property tax, land tax, urban development tax and local public facilities tax. Property value gain from the improved urban infrastructure is the basic tax source for local government, and the building of urban infrastructure is mainly the responsibility of local government too. The two are strongly consistent, and those taxes are usually levied and used by local government, giving them an incentive to improve public facilities and services.

II. Municipal bond is an important financing instrument for urbanization

With user fee and local taxes such as property tax as stable future revenue, a local government can use debt financing in its urbanization drive. One typical international practice is the issuance of municipal bond and similar debt instruments. The municipal bond can be divided into general obligation bond and revenue bond. The former is paid back by tax revenue of local government, while the latter is mainly paid back by project revenue. But the two of them are not strictly differentiated in practice, use of the combination bond secured by project revenue and government credit is relatively common. The municipal bond is tax-free in general. Its proceeds are strictly used for public welfare project and infrastructure construction, and must not be used to cover running expenses of governments, and it is usually issued with a long maturity.

Historically, municipal bond is closely related to urbanization. From the end of Civil War to the end of World War I, the issuance of municipal bonds exceeded those of federal government securities in the U.S, this was also a period of accelerated urbanization in USA. In the Post-war period of 1950s to 1970s, fast economic growth greatly promoted urbanization in Japan, and local bonds were issued on large scale at that time. In South America, although Brazil, Mexico, Argentina and some other

countries experienced some setbacks in municipal bond, it still played an important role in supporting urbanization. In 1990s, Poland, Russia and Hungary and other countries in transition all issued large amount of municipal bonds to support urban infrastructure construction. Currently, municipal bond or similar local bond is widely used for urban infrastructure construction among major economies whether they are fiscal federalism nations or fiscal centralized nations.

The wide use of municipal bond has its reasons. Compared with bank loan, municipal bond is issued openly on the financial market, and is done after information disclosure and credit rating. The bond price reflects fiscal standing of a local government, so the issuer of a municipal bond is subject to market discipline. This is conducive to stimulating local governments to improve their credibility to reduce financing cost. Compared with corporate bond, municipal bond is issued by local governments and public institutions authorized by local governments who are subject to certain fiscal discipline. Besides, to issue municipal bond in some countries, public hearing and local parliament deliberation are required, so the issuer is also restrained by public opinion. That is why municipal bonds, despite setbacks in its development, has a default risk notably lower than that of corporate bond and bank loan in general. In particular, many countries promulgated bills to strengthen fiscal discipline and regulatory transparency in 1980s and 1990s to define the repayment responsibility, source of repayment and default resolution responsibility of local debts such as municipal bond, effectively stopping the spread of local debt risks to central government, reducing externality of risks. The default rate declined by a large margin (the default rate in U.S and Japan is no more than 1 percent).

Balanced development of urbanization is a major strategy for China's modernization, and contains enormous potential of domestic demand. The development of urbanization and accelerated urban and rural integration is to be supported by large investments. Such investment is massive; its recovery may take a long time due to the long construction cycle; a large portion of the investment produces social benefit instead of cash revenue. Therefore, it is necessary to encourage investment from the private sector, improve the taxation system and improve diversified financing mechanisms to provide sound, stable and sustainable fund support for urbanization investment.

V. The deposit and lending rates of financial institutions declined

In the first half of 2012, the lending rates of financial institutions steadily declined affected by factors such as abundant liquidity in banking sector, lower interest rates of market based product including discount and bond financing. In June and July, the PBC reduced benchmark deposit and lending rates for two times consecutively, and slightly expanded the range of rate floating. The lending rate of financial institutions declined further, and became stable towards the end of the year. In December, the weighted average lending rate was 6.78 percent, down 1.23 percentage points compared with that in the beginning of the year. In particular, the weighted average interest rate of loans registered 7.07 percent, 0.73 percentage points lower than that in the beginning of the year. The weighted average bill financing rate posted 5.64 percent, down 3.42 percentage points compared with that in the beginning of the year. The weighted average home mortgage loan rate declined steadily to 6.22 percent in December, down 1.4 percentage points compared with that in the beginning of the year.

The share of loans with lower interest rates increased. In December, the share of loans with interest rates lower than the benchmark was 14.16 percent, up 7.14 percentage points from that in the beginning of the year, and the share of loans with interest rates flat with or higher than the benchmark stood at 26.10 percent and 59.74 percent respectively, down 0.86 and 6.28 percentage points from those in the beginning of the year.

The deposit and lending rates of US dollars moved down among fluctuations due to interest rates movement on the international financial market and fund supply and demand changes in china. In December, the weighted average rates of large-value US dollar demand deposits and that of less than 3-month deposits were 0.17 percent and 0.51 percent respectively, down 0.14 percentage points and 2.78 percentage points from the beginning of the year. The weighted average rates for US dollar loans of less than 3 month, 3 (including 3-month) to 6 month posted 2.02 percent and 1.96 percent respectively, down 1.83 percentage points and 2.35 percentage points from those in the beginning of 2012.

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

Unit: %

Month	Lower than the benchmark	At the benchmark	Higher than the benchmark					
	[0.9, 1.0]	1.0	Sub-total	(1.0, 1.1]	(1.1, 1.3]	(1.3, 1.5]	(1.5, 2.0)	Over 2.0
January	4.79	26.22	69.00	22.33	25.51	8.76	9.22	3.17
February	5.53	27.59	66.88	23.12	23.76	7.98	8.61	3.40
March	4.62	24.95	70.43	21.12	26.99	9.48	9.41	3.43
April	5.03	23.06	71.91	20.76	28.92	10.10	8.98	3.16
May	5.35	24.08	70.57	20.51	28.90	9.73	8.31	3.12
June	7.92	25.08	66.99	19.94	27.87	8.90	7.66	2.63
July	9.51	24.38	66.11	19.74	26.78	9.13	7.61	2.85
August	11.61	22.66	65.73	19.64	26.45	8.30	8.33	3.01
September	11.31	24.57	64.12	20.16	25.18	8.13	7.67	2.98
October	10.88	26.80	62.32	20.15	24.30	7.28	7.53	3.06
November	11.70	25.74	62.56	19.43	24.52	7.64	7.71	3.26
December	14.16	26.10	59.74	18.41	22.87	7.58	7.84	3.04

Note: The downward floating band from August to December 2012 was [0.7, 1.0].

Source: People's Bank of China

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

Unit: %

Month	Large-value deposits						Loans				
	Demand Deposits	Within 3 months	3-6 months (including 3 months)	6-12 months (including 6 months)	1 year	Above 1 year	Within 3 months	3-6 months (including 3 months)	6-12 months (including 6 months)	1 year	Above 1 year
January	0.34	3.29	4.24	4.73	5.46	5.87	3.78	4.35	4.81	4.47	4.27

February	0.29	3.16	3.93	4.34	4.64	4.50	3.51	4.08	4.35	4.28	4.29
March	0.27	2.91	3.61	4.34	4.76	5.35	3.56	4.00	4.36	4.03	3.53
April	0.21	2.69	3.54	3.97	4.40	3.32	3.54	3.96	4.44	4.07	3.99
May	0.26	2.37	3.33	3.92	4.12	4.16	3.50	4.11	4.27	4.21	3.90
June	0.26	2.07	2.93	3.39	4.07	4.36	3.38	3.74	3.72	4.02	4.10
July	0.19	2.80	2.57	3.06	3.78	2.13	3.01	3.29	3.54	3.00	3.76
August	0.20	0.96	2.08	2.43	3.21	1.59	2.48	2.70	3.11	2.44	4.04
September	0.17	0.63	1.45	1.65	2.13	1.88	2.05	2.09	2.24	2.15	3.36
October	0.14	0.71	1.30	1.50	2.14	2.17	2.01	2.01	2.05	2.00	3.60
November	0.13	0.60	1.19	1.27	1.86	1.98	1.99	1.89	2.21	2.34	3.73
December	0.17	0.51	1.01	1.52	1.76	1.67	2.02	1.96	1.97	2.73	3.42

Source: People's Bank of China.

VI. The flexibility of the RMB exchange rate increased significantly

In 2012, the RMB exchange rate moved in both directions yet appreciated slightly, with much stronger flexibility and stable expectations. At the end of 2012, the central parity of the RMB against the US dollar was 6.2855 yuan per dollar, representing an appreciation of 154 basis points or 0.25 percent over end-2011. From the reform of the RMB exchange-rate regime in 2005 to end of 2012, the RMB appreciated a cumulative 31.68 percent against the US dollar. The BIS estimated that in 2012 the nominal effective exchange rate of the RMB appreciated 1.73 percent and the real effective exchange rate appreciated 2.22 percent; from the start of RMB exchange-rate regime reform in 2005 to end-December 2012 the nominal effective RMB exchange rate appreciated 23.25 percent and the real effective exchange rate appreciated 31.86 percent.

Part 2 Monetary Policy Operation

In 2012, following the overall arrangements of the State Council, the PBC continued to implement a prudent monetary policy. The policy measures were made more flexible, targeted, and forward-looking, and preemptive and fine tunings were conducted in a timely and appropriate manner.

I. Optimizing the instrument mix of open market operations and flexibly conducting open market operations

In 2012, as both the balance of payments and the RMB exchange rate moved towards equilibrium, and the European sovereign debt crisis caused turbulence on the international financial markets, the inflows of foreign exchange declined, subsequently the growth of RMB equivalent of official foreign exchange holdings decelerated by more than 2 trillion yuan compared with the previous year. Central bank liquidity management needed to factor in the significant changes in the supply of liquidity in the banking system.

The PBC strengthened the analysis and monitoring of domestic and external markets and supply and demand of liquidity in the banking system, properly managed the maturity, product mix, scale, and frequency of repo and reverse repo operations, and conducted open market operations in a flexible way. In the first half of the year, along with twice cuts in the reserve requirement ratio, the PBC conducted two-way open market operations using the repo as the main tool, supplemented by the reverse repo operations. In the latter half of the year, the reverse repo operation became the main channel to inject liquidity, and effectively smoothed out liquidity fluctuations resulting from a multiple of factors. In 2012, a total of 944 billion yuan of repo operations was conducted on a cumulative basis, while the volume of reverse repo transactions amounted to 6,038 billion yuan. At end-2012, outstanding reverse repos posted 498 billion yuan.

The flexibility of interest rates for open market operations was appropriately enhanced to effectively guide market expectations. Along with twice cuts in the benchmark deposit and loan interest rates, and in view of changes of market interest rates over time, the PBC appropriately increased the flexibility of interest rates for open market operations, which helped signal a sound monetary policy stance, effectively guide market expectations, and facilitate a modest drop in the interest rates on the money market. At end-2012, interest rates for 7-day, 14-day, and 28-day reverse repo operations were 3.35 percent, 3.45 percent, and 3.60 percent respectively.

The PBC conducted state treasury cash management in an appropriate manner. The business of making time deposits of state treasury funds in commercial banks advanced steadily, and in 2012 a total of 690 billion yuan of state treasury funds was deposited in commercial banks in 14 operations, with outstanding balance of 300 billion yuan at the end of the year. The frequency, turnover, and outstanding balance of such operation were all at their peak over the preceding years.

II. The reserve requirement ratio was cut twice, and the dynamic adjustment mechanism of differentiated reserve requirement played a role in counter-cyclical management

In 2012, in view of changes in supply and demand of liquidity, the PBC appropriately used the reserve requirement instrument to adjust liquidity. In addition to 0.5 percentage points cut of reserve requirement ratio on December 5, 2011, the PBC cut the reserve requirement ratio again on February 24 and May 18, 2012 each by 0.5 percentage points, to keep reasonable and ample liquidity in the banking system.

In 2012, in line with developments in domestic and international economic and financial situations, soundness of financial institutions and their records of implementing the credit policy, the PBC modulated the parameters of the differentiated reserve requirement dynamic adjustment mechanism to realize counter-cyclical adjustments, to guide the growth of credit at a stable and reasonable pace, and to improve resilience of financial institutions. In the beginning of the year, in response to slow-down of economic growth and decline of CPI growth, the PBC timely reduced the macroeconomic condition parameter. In addition, the PBC guided rural financial institutions to take full account of seasonal credit demand of agricultural cycle and to timely extend agricultural loans to support farming activities in the Spring season in an effort to meet credit demand of the agriculture, rural areas, and farmers. Starting from May, the PBC, in line with the requirement of preserving steady growth, strengthened preemptive and fine tunings and encouraged local financial institutions which had complied with the credit policy and had relatively abundant liquidity to increase credit extension.

III. Timely lowering benchmark deposit and lending rates and adjusting the floating band of deposit and lending rates

In light of changes in economic situations, the PBC cut the RMB benchmark deposit and loan interest rates of financial institutions on June 8 and July 6 respectively. As a result, the one-year RMB benchmark deposit rate was cut from 3.5 percent to 3 percent, with cumulative decline of 0.5 percentage points; the one-year benchmark loan rate was cut from 6.56 percent to 6 percent, with cumulative decline of 0.56 percentage points. In the meantime, to integrate the adjustment in the benchmark interest rate with market-based interest rate reform, the PBC adjusted the floating band of deposit and lending rates of financial institutions. The ceiling of the floating band for deposit interest rates of financial institutions was adjusted to 1.1 times the

benchmark deposit rates, and the floor of the floating band for loan interest rates was adjusted to 0.7 times the benchmark loans rates. The above measures helped guide the prices of funds to move downward, and create a more favorable policy environment for reducing the financing costs of enterprises. A larger scope for financial institutions to price their products will prompt financial institutions to participate in market competition through improved financial services. After the adjustments in the benchmark deposit and lending rates and the floating band, the average lending rates of financial institutions to the corporate sector decreased month by month. Nevertheless, the scope for utilizing the floating band of deposit rates was not exhausted by financial institutions, and instead the financial institutions adopted differentiated and refined pricing strategies.

IV. Strengthening window guidance and credit policy guidance

To support the financial sector to provide services to the real economy, the PBC brought into full play of the role of macro credit policies in transforming economic growth pattern and adjusting economic structure, while strengthening adjustments of aggregate money and credit. Financial institutions were encouraged to step up financial support for agriculture, rural areas, and farmers, small- and micro-sized enterprises, energy conservation and environmental protection, and the ongoing or follow-up key national projects that have significant impacts on the overall economy. The PBC, in line with requirements of regional development policy of the state, guided reasonable credit allocation to promote regional economic restructuring and optimization of industrial capacities. Financial support was strengthened for scientific and technological innovation, strategic emerging industries, tourism industry, cultural industries and other industries important for the overall social and economic development, as well as programs bearing on people's livelihood, including employment creation and poverty reduction. The PBC continued to support the development of affordable housing and ordinary commercial residential property with modest floor plans as well as the purchase of first-time home buyers.

Credit support to small and micro-sized enterprises and to the agriculture, rural areas, and farmers maintained strong momentum. At end-2012, outstanding RMB loans to small and micro-sized enterprises extended by major financial institutions, rural cooperative financial institutions, urban credit cooperatives, and foreign-funded banks registered a year-on-year growth of 16.6 percent, outpacing that of loans to large and medium enterprises by 8.0 percentage points and 1.0 percentage point respectively. In 2012, outstanding agro-linked loans in both the domestic and foreign currencies of major financial institutions, rural cooperative financial institutions, urban credit cooperatives, village and township banks, and finance companies grew 20.7 percent year on year, higher than the average loan growth by 5.7 percentage points.

V. Central bank loans and discounts played a role in guiding credit to the agricultural sector and small- and micro-sized enterprises

In 2012, the PBC used central bank loans and rediscounts to step up credit support to weak links of the economy, including agriculture, rural areas, and farmer, and small- and micro-sized enterprises. In the beginning of the year, the PBC improved the management of agro-linked central bank loans to support sustainable development of the rural economy. In August, the PBC conducted a pilot program of agro-linked central bank loans in Shanxi Province and Helongjiang Province, in which recipients eligible for agro-linked central bank loans were expanded from deposit-taking financial institutions with legal person status incorporated in the counties and townships such as rural commercial banks, rural cooperative banks, rural credit cooperatives, and village and township banks at the county and township levels, to the aforementioned four kinds of financial institutions incorporated in urban areas whose agro-linked loans accounted for no less than 70 percent of their total loans, so as to guide and support those institutions to ramp up agro-linked credit. At end-2012, outstanding central bank agro-linked loans posted 137.5 billion yuan, representing an increase of 28.1 billion yuan over the beginning of the year. In particular, both the quota and outstanding balance of central bank agro-linked loans to the west region and main grain production areas accounted for the more than 90 percent of their respective total. Outstanding central bank rediscounts nationwide registered 76 billion yuan, an increase of 31.4 billion yuan over the beginning of the year. Broken down by the use of loans, central bank discounts to the agricultural sector accounted for 32 percent, while those to the SMEs accounted for 87 percent.

In the meantime, in view of changes in demand and supply of liquidity, the PBC explored the use of central bank loans and discounts in injecting liquidity, complemented by other monetary policy tools, to ensure ample supply of liquidity to the banking system. At end-2012, outstanding central bank loans and discounts, that were meant to inject liquidity to the market, posted 236.7 billion yuan, representing an increase of 190.9 billion yuan over the end of the last year. Central bank loans and discounts had an improved structure and a larger role in liquidity injection.

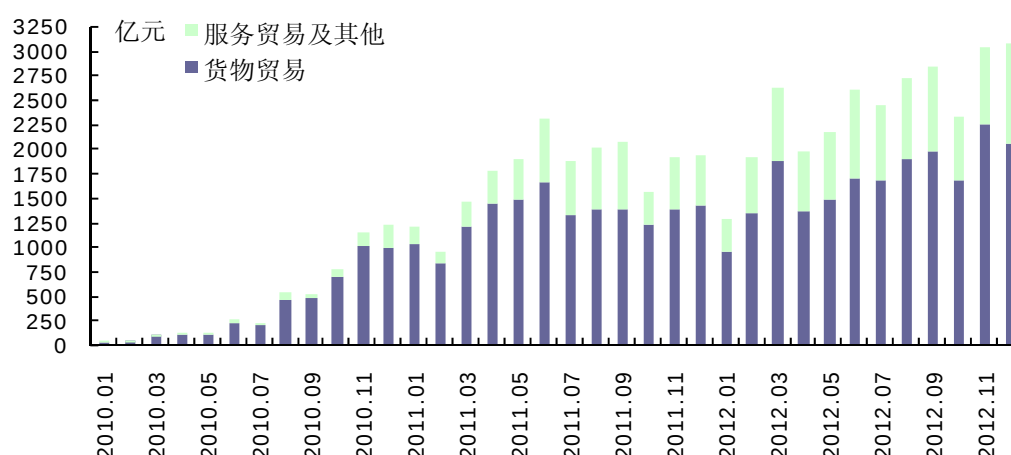
VI. Promoting development of the cross-border RMB business

In June 2012, the PBC, jointly with other five ministries and commissions, issued the focused-supervision list of enterprises in the RMB settlement for goods exports. The cross-border RMB settlement business was expanded to the whole country, and all enterprises that have export and import licenses can choose the RMB as the pricing,

settlement, and payment currency.

The volume of RMB settlement of cross-border trade increased steadily. In 2012, RMB settlement of cross-border trade by commercial banks 2.94 trillion yuan on a cumulative basis, representing a year-on-year growth of 41 percent. In particular, settlement of trade in goods registered 2.06 trillion yuan, and that of trade in services and other items under the current account registered 876.45 billion yuan. Actual RMB receipts and payments in 2012 registered 1.30 trillion yuan and 1.57 trillion yuan respectively, with net outflow of 269.17 billion yuan. The receipt-to-payment ratio reached 1:1.2, compared with 1:1.7 in 2011. Bank settlement of cross-border RMB direct investment in 2012 reached 284.02 billion yuan. In particular, outward direct investments settled in RMB totaled 30.44 billion yuan, and foreign direct investments settled in RMB totaled 253.58 billion yuan. By the end of 2012, domestic agent banks had opened 1,592 interbank RMB accounts for participating overseas banks, with a total outstanding balance of 285.20 billion yuan. Overseas enterprises had opened 6,197 RMB settlement accounts at domestic banks, with a total balance of 50.02 billion yuan.

Figure 1 RMB Settlement of Cross-border Trade



Source: The People's Bank of China.

Box 2 The Development of Overseas RMB Markets

I. RMB business in Hong Kong market developed in a stable and fairly fast manner

According to Outline of the "Twelfth Five-Year" Plan, efforts will be made to support Hong Kong to become an offshore RMB center and international asset management center, so as to consolidate and promote the status of Hong Kong as an international

financial hub. To develop Hong Kong's offshore RMB market is vital in the efforts to consolidate and promote Hong Kong's status as an international financial hub, and Hong Kong has been an important overseas RMB business center since 2009.

Participants in the Hong Kong offshore RMB market are diversified and the market provides a large variety of products, including bonds, fund products, insurance products, certificates of deposit, futures which are denominated in RMB, and "dual currencies and dual stocks" denominated in both RMB and Hong Kong dollar. According to statistics of the HKMA, at end-November 2012 outstanding RMB deposits in Hong Kong posted 571 billion yuan. The development of RMB market in Hong Kong has promoted closer economic and trade links and personnel exchanges between Hong Kong and the Chinese Mainland, and greatly facilitated trade and investment liberalization.

II. The circular use of RMB in overseas markets has been gradually expanding

With a larger role of RMB in cross-border trade and investment settlement, its acceptance has been on the rise in overseas markets. At end-2012, domestic enterprises had actual cross-border RMB receipts and payments with their counterparts in 206 countries and regions. RMB business gradually expanded in overseas markets such as Taiwan, London, and Singapore. In September 2011, China and British issued a joint statement, and said that both parties welcomed private sector's interest in the London offshore RMB market and latest market developments. To promote the development of RMB business, the City of London set up a working group comprising representatives from the private sector. In July 2012, the Chinese and Singapore governments exchanged letters; accordingly, in the framework of *China-Singapore Free Trade Agreement*, the Chinese side would select one Chinese-funded bank with a full bank license in Singapore as the clearing bank for RMB business in Singapore. In August 2012, the *Memorandum of Cooperation on Cross-Straits Currency Clearing* was signed by monetary authorities on both sides of the Taiwan Straits. In December, the PBC authorized the Taipei Branch of the Bank of

China to serve as the clearing bank of RMB business in Taiwan. Based on market demand, overseas enterprises and banks are showing interest in the RMB business and exploring the use of RMB in trade and investment activities in accordance with commercial principles. Cooperation in offshore RMB business development among various overseas markets helps promote the circular use of overseas RMB.

VII. Improvement in the RMB exchange rate regime

The PBC further improved the RMB exchange-rate regime reform in line with the principle of making it a self-initiated, controllable, and gradual process. Focusing on the role of market supply and demand and adjustments with reference to a basket of currencies, the PBC enhanced the flexibility of the RMB exchange rate and kept it basically stable at an adaptive and equilibrium level. Effective from April 16, 2012, the PBC widened the floating band of the RMB trading price against the US dollar on the interbank spot foreign exchange market from 0.5 percent to 1 percent. Furthermore, the PBC continued to promote direct trading between the RMB and other emerging market currencies, and opened the direct trading between the RMB and the yen on the interbank foreign exchange market.

In 2012, the central parity of the RMB against the US dollar peaked at 6.3495 yuan per dollar and reached a trough of 6.2670 yuan per dollar. In the 243 trading days, the RMB appreciated on interbank foreign exchange market in 122 days and depreciated in 121 days. The largest single-day appreciation in 2012 was 0.26 percent (or 162 points), whereas the largest depreciation was 0.33 percent (or 209 points). The RMB exchange rate moved in both directions against the euro, Japanese yen, and other major international currencies. At end-2012, the central parity of the RMB against the euro registered 8.3176 yuan per euro, a depreciation of 1.86 percent from end-2011, and the central parity of the RMB against the yen stood at 7.3049 yuan per 100 yen, an appreciation of 11.03 percent from end-2011. Beginning from the RMB exchange-rate regime reform in 2005 to end-2012, on a cumulative basis the RMB appreciated 20.40 percent and 0.01 percent against the euro and the Japanese yen respectively.

Table 5 Trading Volume of RMB against Other Currencies on the Spot Interbank Market in 2012

Unit: 100 million yuan

Currency	USD	Euro	Japanese Yen	HKD	GBP	Australia dollar	Canadian dollar	Rigit	Russian Ruble	Thailand Baht
Trading volume	201,767.3	968.4	7,593.2	1,361.5	37.3	66.0	4.3	10.9	47.3	18.2

Source: China Foreign Exchange Trade System.

VIII. Deepening reform of financial institutions

The “going global” strategy of large commercial banks made progress, and the reform of the Agricultural Bank of China (ABC) to build a multi-divisional structure for financial services for rural areas was pushed ahead. A number of overseas M&A activities by Chinese-funded banks got regulatory authorities’ approval in their host countries, such as the Industrial and Commercial Bank of China (ICBC)’s acquisition of Bank of East Asia (USA) and the establishment of a subsidiary in Brazil, the establishment of a branch office in New York by the ABC, and the establishment of a branch office in Chicago by the Bank of China (BoC). The cross-border operation of large commercial banks advanced. Earlier in the year, the PBC issued a new standard for differentiated reserve requirement of the Country Area Banking Division of the ABC to provide policy incentives. In the meantime, the PBC, through seasonal monitoring, annual assessment, examination and assessment, and special researches, has been monitoring, assessing, and guiding the implementation of reform package of the ABC. The reform of policy financial institutions advanced steadily. The China Export and Credit Insurance Corporation (Sinasure) continued to implement its reform plan, and its first Board meeting was convened in December 2012. The reform of other financial institutions also made progress. The China Cinda Asset Management Company successfully introduced domestic strategic investors in March 2012. The China Huarong Asset Management Co. Ltd. was established as a joint-stock company in October 2012, with the governance structure of a modern shareholding company. The China Life Insurance (Group) Corporation was listed on the Hong Kong market in December 2012.

Remarkable achievements were made in reforming rural credit cooperatives (RCCs). Financial support for RCCs was further implemented. At end-2012, a total of 169.9 billion yuan of central bank special bills was issued to RCCs in 2,408 counties (cities), among which a total of 169.4 billion yuan was redeemed from RCCs in 2,402 counties (cities), accounting for over 99 percent of all bills issued for this purpose. In addition, 1.7 billion yuan of central bank special loans were issued to 3 provinces (regions) including Xinjiang. Since the beginning of 2012, RCCs have improved their performance, financial standing, and risk-prevention capacity, and extension of agro-linked loans increased significantly. Based on the five-category loan classification, the NPL ratio of RCCs was 4.5 percent at end-2011, a decline of 1 percentage point from the end of the last year. Their capital adequacy ratio stood at 11.8 percent, up 1.1 percentage points from end-2011. Total profits of RCCs amounted to 159.3 billion yuan in 2012, representing an increase of 900 million yuan year on year. Outstanding agro-linked loans and lending to rural households by RCCs posted 5.3 trillion yuan and 2.6 trillion yuan at end-2012 respectively, representing year-on-year growth of 16 percent and 12.6 percent. Moreover, steady progress was made in property right reform and internal control. At the end of 2012, there were 1,804 RCCs, 337 rural commercial banks, and 147 rural cooperative banks with

legal-person status at the county (city) level. Some RCCs have explored ways to build multiple property right arrangements and organization forms, to improve the legal person governance and internal management with remarkable results.

IX. Deepening reform of foreign exchange administration

The reform of administration of foreign exchange for trade in goods was advanced on a comprehensive basis. On August 1, 2012, the reform of foreign exchange administration under goods trade was expanded to the whole country. The case-by-case procedure of foreign exchange verification was removed, the procedure of custom declaration were adjusted, and that of export tax rebates were simplified. As a result, costs of enterprises were cut significantly, the efficiency of foreign exchange payments and receipts by commercial banks for trade items improved notably, and the role of inter-ministerial supervisory cooperation was enhanced. The reform has achieved trade facilitation and promoted effective supervision.

RMB convertibility under the capital account made steady progress. The administration of foreign exchange for FDI was streamlined, and 35 of the 50 administrative approval items were abolished, and 14 items were simplified and consolidated. As a result, RMB convertibility under FDI items was basically realized. The Qualified Foreign Institutional Investor (QFII) scheme, the Qualified Domestic Institutional Investor (QDII) scheme, and the RMB Qualified Foreign Institutional Investor (RQFII) scheme were further improved. The allocation of investment quota under the QFII scheme was refined, and the management of outflows of QFII investment capital was regulated. In 2012, a total of 100 new QFIIs was approved, with investment quota of USD15.8 billion; 25 new QDIIs were approved, with investment quota of USD10.63 billion; and 28 new RQFIIs were approved, with investment quota of 56.3 billion yuan. Increases of investment quota for ongoing QFII and RQFII programs were USD50 billion and 250 billion yuan respectively.

Actions were taken to promote trade and investment facilitation. Policies were adjusted to make it easier for companies to repatriate receipts from outbound direct investments, for banks to lend in foreign currencies in overseas markets, and for individuals to make external guarantees. A new administrative mechanism was initiated for banks to manage their overall position of foreign exchange sales and purchases within a specified band. Access to the foreign exchange market was made easier, and non-financial institutions and enterprises were encouraged to participate in the market. Currency swaps were traded in a larger variety of forms, and the pilot program of chartered currency exchange shops was expanded. Efforts were made to promote retail foreign exchange sales and purchases via online banking.

Institutional arrangements were improved to address potential shocks of cross-border capital flows. Efforts were made to improve contingency policies against sharp volatilities in cross-border capital flows, in particular irregular capital outflows, by closely monitoring domestic and international economic and financial developments and changes in cross-border flows. Measures against irregular capital flows were maintained, and efforts were enhanced to crack down on major cases and underground banking activities.

Part 3 Financial Market Analysis

In 2012, China's financial market continued to perform in a sound manner. Transactions on the money market were brisk, while the interest rates declined slightly. Bond issuances grew significantly. Stock indices rebounded somewhat after hitting a bottom. Total assets in the insurance industry continued rapid growth. Transactions on the foreign exchange market were stable with swap transactions increasing rapidly.

I. Financial market analysis

1. Transactions on the money market were brisk, and interest rates declined slightly

Repo transactions and interbank borrowing on the money market were brisk, with the trading volume increasing rapidly. In 2012, the turnover of bond repos on the interbank bond market totaled 141.7 trillion yuan, with an average daily turnover of 569.1 billion yuan, up 43.1 percent year on year. The turnover of interbank borrowing reached 46.7 trillion yuan, with an average daily turnover of 187.6 billion yuan, an increase of 40.2 percent year on year. Overnight products still dominated bond repo and interbank borrowing transactions, accounting for 80.7 percent and 86.3 percent of their respective turnover, up 5.9 and 4.6 percentage points from the same period of the last year. The turnover of government securities repos on the stock exchanges soared 73.5 percent year on year to 34.6 trillion yuan.

In terms of financing entities, the flow of funds among financial institutions displayed the following characteristics: first, large banks acted as net fund providers on both the repo and interbank borrowing markets, and their amount of the net lending continued to increase. In particular, large banks became net lenders on the interbank borrowing market in 2012; in contrast, during the last year they were net borrowers. Second, small- and medium-sized banks, securities and fund management companies, and other financial institutions had an increasing demand for financing. In particular, small- and medium-sized banks and foreign-funded financial institutions

became net borrowers on the interbank borrowing market, as opposed to being net lenders during the last year.

Table 6 Fund Flows among Financial Institutions in 2012

Unit: 100 million yuan

	Repo		Interbank borrowing	
	2012	2011	2012	2011
Domestically-funded large banks ^①	-550,748	-289,596	-73,486	18,514
Domestically-funded small- and medium-sized banks ^②	242,558	118,134	5,112	-32,644
Securities and fund management companies	130,067	66,659	34,889	10,237
Insurance companies	53,270	24,926	-	-
Foreign-funded financial institutions	20,734	10,079	9,972	-9,571
Other financial institutions ^③	104,120	69,798	23,513	13,464

Notes: ① Domestically-funded large banks include the Industrial and Commercial Bank of China, the Agricultural Bank of China, the Bank of China, the China Construction Bank, the China Development Bank, the Bank of Communications, and the Postal Savings Bank of China. ② Domestically-funded small- and medium-sized banks include the China Merchants Bank and 16 other medium-sized banks, city commercial banks, rural commercial banks, rural cooperative banks, and village and township banks. ③ Other financial institutions include urban credit cooperatives, rural credit cooperatives, finance companies, trust and investment companies, financial leasing companies, asset management companies, social security funds, investment companies, corporate annuities, other investment vehicles, and so forth. ④ A negative sign indicates net lending and a positive sign indicates net borrowing.

Source: China Foreign Exchange Trade System.

In 2012, interest rates on the money market rose in the run-up to the Spring Festival and fell thereafter, but generally remained stable and lower than those in the previous year. In December, the weighted average interest rate of bond-pledged repo and interbank borrowing posted 2.62 percent and 2.61 percent respectively, down 75 and 72 basis points from the same period of the last year. At end-2012, the overnight and 7-day Shibor rates posted 3.87 percent and 4.58 percent respectively, down 113 and 175 basis points from end-2011, and the 3-month and one year Shibor rates were 3.90 percent and 4.40 percent respectively, down 157 and 84 basis points from end-2011.

Trading of RMB interest-rate swaps increased slightly while that of forward products decreased somewhat. In 2012, the total notional principal of RMB interest-rate swaps amounted to 2902.1 billion yuan, an increase of 8.45 percent year on year. In terms of the maturity structure, RMB interest-rate swaps with a maturity within one year traded most briskly, and their aggregate notional principal amounted to 2249.8 billion yuan, accounting for 77.5 percent of the total. In

terms of the base rate, the base rate of the floating end of the RMB interest-rate swaps mainly included 7-day fixing repo rate and the Shibor, and their nominal principal accounted for 45.33 percent and 50.01 percent of the total respectively.

Table 7 Transactions of Interest-rate Derivatives, 2006-2012

	Interest-rate swaps		Bond forwards		Forward-rate agreements	
	Number of deals	Amount of notional principal (100 million yuan)	Number of deals	Amount of notional principal (100 million yuan) ①	Number of deals	Amount of notional principal (100 million yuan)
2006	103	355.7	398	664.5	-	-
2007	1,978	2,186.9	1,238	2,518.1	14	10.5
2008	4,040	4,121.5	1,327	5,005.5	137	113.6
2009	4,044	4,616.4	1,599	6,556.4	27	60.0
2010	11,643	15,003.4	967	3,183.4	20	33.5
2011	20,202	26,759.6	436	1,030.1	3	3.0
2012	20,945	29,021.4	56	166.1	3	2.0

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

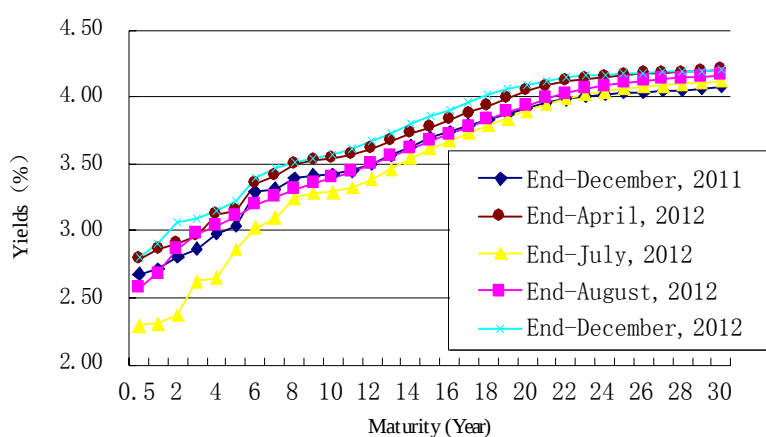
Source: China Foreign Exchange Trade System.

2. Bond transactions grew steadily and bond issuances increased significantly

The turnover of spot bond transactions on the interbank market grew steadily. In 2012, a total of 75.2 trillion yuan of bonds was traded, with a daily average of 302 billion yuan, up 18.6 percent year on year. In terms of trading entities, domestically-funded large banks and foreign-funded financial institutions were net bond buyers on the interbank bond market, with net purchase of 449.2 billion yuan and 141.7 billion yuan respectively; domestically-funded small- and medium-sized banks, securities and fund management companies were net bond sellers, with net sales of 511.3 billion yuan and 161.9 billion yuan respectively. A total of 88.6 billion yuan of spot government securities was traded on the stock exchanges in 2012, 36.7 billion yuan less than that in the previous year.

In 2012, the China Bond Composite Index (net price) declined from 101.23 points at the beginning of the year to 100.75 points at year-end, or down 0.47 percent, while the China Bond Composite Index (full price) rose from 111.28 points at the beginning of the year to 111.66 points at year-end, or up 0.34 percent. The government securities index on the stock exchanges rose 3.31 percent, from 131.44 points early in the year to 135.79 points at year-end.

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



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

In 2012 the yield curve of government securities on the interbank market in general showed a flattening and upward trend, and their movements could be divided into the following three phases. In the first four months, affected by factors such as relatively higher CPI level, the yield curve of government securities showed a flattening and upward trend. In the second phase from May to July, affected by several factors such as the second cut in reserve requirement ratio, two cuts in benchmark deposit and lending interest rates, and widening of floating band of interest rates by the PBC, yields of government securities of all maturities declined notably, while the yield curve of government securities became steeper and moved downward. In the third phase from August to December, as the Chinese economy stabilized and rebounded, the yields of government securities moved up amidst fluctuations and the yield curve of government securities displayed a flattening and upward trend.

Bond issuances grew significantly. In 2012, a total of 7.97 trillion yuan of bonds (excluding central bank bills) was issued, 1.56 trillion yuan more than that in the previous year, or up 24.3 percent. In particular, the issuance of financial bonds, corporate debenture bonds such as enterprise bonds, super short-term commercial paper, and privately-placed debt financing instruments saw a larger increase compared with that in 2011. At end-2012, a total of 23.8 trillion yuan of bonds was deposited with the China Government Securities Depository Trust and Clearing Co., Ltd., an increase of 11.2 percent year on year.

Table 8 Issuance of Major Bonds in 2012

Types of bonds	Issuance (100 million yuan)	Year-on-year growth (100 million yuan)
Government securities	16,154	-946
Of which: Municipal bonds	2,500	500
Financial bonds ^①	26,202	2,711
Of which: Policy financial bonds issued by the China Development Bank and other policy banks	21,415	1,442

Bank ordinary bonds	1,680	1,330
Bank subordinate bonds and hybrid bonds	2,254	-915
Corporate debenture bonds ^②	37,365	13,817
Of which: Enterprise bonds	7,999	4,526
Short-term financing bonds	8,370	338
Super short-term commercial paper	5,822	3,732
Medium-term notes	8,453	1,184
Privately placed debt-financing instruments	3,759	2,840
Corporate bonds	2,550	1,298

Notes: ① Including policy financial bonds issued by the China Development Bank and other policy banks, bank ordinary bonds, bank subordinate bonds, hybrid bonds, asset-backed securities, bonds issued by securities companies, short-term financing bills issued by securities companies, and so forth. ② Including enterprise bonds, short-term financing bills, super short-term commercial paper, medium-term notes, collective bills issued by SMEs, privately placed debt financing instruments, asset-backed bills, corporate bonds, convertible bonds, bonds with detachable warrants, privately placed SMEs debt, and so forth.

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

Government securities issuance rates were generally stable. The interest rate of 10-year government bonds issued in December 2012 was 3.55 percent, down 2 basis points from those of the same maturity issued in December 2011. In 2012, 483 fixed-rate enterprise bonds issued on the primary bond market were all based on the Shibor, with a gross volume of 649 billion yuan. In addition, a total of 388.8 billion yuan of short-term financing bills based on the Shibor was issued, accounting for 46 percent of the total issuance of short-term fixed-rate financing bills, up 15 percentage points from 2011.

3. The volume of bill financing increased slightly

The bill acceptance business grew steadily but decelerated in the fourth quarter. In 2012, commercial bills issued by enterprises totaled 17.9 trillion yuan, representing year-on-year growth of 18.8 percent; the total volume of outstanding commercial bills at end-2012 posted 8.3 trillion yuan, representing year-on-year growth of 25.4 percent. In the first three quarters, the total volume of discounted outstanding commercial bills grew steadily and reached 8.4 trillion yuan at end-September, a historical high. In the fourth quarter, the growth of bill acceptance business slowed down with small fluctuations in the outstanding balance. At end-2012, outstanding bankers' discounted bills had increased 1.7 trillion yuan from the beginning of the year. In terms of issuing entities, outstanding bankers' acceptance bills were mainly issued by enterprises in the

manufacturing, wholesale and retail industries. In particular, small- and medium-sized enterprises issued about two thirds of the total bankers' acceptance bills. The steady growth of bill acceptance business provided greater support to the real sector, in particular to the small- and medium-sized enterprises.

The volume of bill financing increased amid fluctuations, and interest rates on the bill market in general declined. In 2012, the cumulative amount of discounts by financial institutions posted 31.6 trillion yuan, representing year-on-year growth of 26.4 percent; the outstanding balance of discounted commercial bills at end-2012 increased 35.1 percent year on year to 2.0 trillion yuan. In the first three quarters, the outstanding balance of discounted commercial bills grew steadily and reached 2.6 trillion yuan at end-August, a yearly high, and gradually declined thereafter. The outstanding balance of bill financing at end-2012 increased by 500 billion yuan from the beginning of the year, and accounted for 3.2 percent of all categories of loans, up 0.5 percentage points from the beginning of the year. Due to a number of factors such as money-market interest rate movements and changes in supply and demand for bills, interest rates on the bill market in 2012 witnessed a declining trend.

4. Stock indices rebounded somewhat after hitting a bottom, and both the trading volume and equity financing on the stock market declined

Stock indices showed a declining trend amidst fluctuations, and rebounded somewhat after hitting a bottom in November. At end-2012, the Shanghai Stock Exchange Composite Index and the Shenzhen Component Index closed at 2,269 points and 9,116 points respectively, gaining 70 points and 198 points from the end of the last year. The Growth Enterprise Board (GEB) (Chinext Price Index) of the Shenzhen Stock Exchange closed at 714 points, shedding 16 points from the end of the last year. The weighted average P/E ratio on the A-share market of the Shanghai Stock Exchange and the Shenzhen Stock Exchange declined from 13.4 times and 23.5 times at the end of the last year to 12.3 times and 22.2 times respectively.

Trading volume on the stock markets declined. In 2012, the turnover on the Shanghai and Shenzhen stock exchanges totaled 31.5 trillion yuan, down 25.4 percent year on year, and the daily turnover averaged 129.1 billion yuan, down 25.4 percent year on year. Among the total, the volume of transactions on the GEM Board amounted to 2.33 trillion yuan, representing an increase of 23.4 percent year on year. At end-2012, the combined market capitalization of the Shanghai and Shenzhen exchanges posted 18.2 trillion yuan, up 10.1 percent year on year. The market capitalization on the GEM Board amounted to 333.5 billion yuan, up 33.2 percent from the end of the last year.

The amount of equity financing on the stock market declined. In 2012, a total of 386.2

billion yuan was raised by enterprises and financial institutions on the domestic and overseas stock markets by way of IPOs, additional offering, and rights issuance, representing a year-on-year decrease of 33.4 percent. Among this total, 312.8 billion yuan was raised on the A-share market and 73.4 billion yuan was raised on the H-share market.

5. Total assets in the insurance industry continued rapid growth

In 2012, total premium income in the insurance industry amounted to 1.5 trillion yuan, representing year-on-year growth of 8.0 percent, and total claim and benefit payments amounted to 471.6 billion yuan, representing year-on-year growth of 20.0 percent. Specifically, total claim and benefit payments in the property insurance sector increased 28.8 percent, while those in the life insurance sector increased 9.0 percent.

Total assets of the insurance industry continued rapid growth. At end-2012, total assets of the insurance industry posted 7.4 trillion yuan, an increase of 22.3 percent year on year. Among this total, bank deposits increased 32.2 percent while investment-linked assets increased 19.5 percent.

Table 9 Use of Insurance Funds at End-2012

	Outstanding balance (100 million yuan)		As a share of total assets (%)	
	End-2012	End-2011	End-2012	End-2011
Total assets	73,546	60,138	100.0	100.0
Of which: Bank deposits	23,446	17,737	31.9	29.5
Investment	45,097	37,737	61.3	62.8

Source: China Insurance Regulatory Commission.

6. Trading on the foreign exchange market was stable with swap transactions increasing rapidly

In 2012, the turnover of spot RMB/foreign exchange transactions totaled USD3.36 trillion, representing a decline of 5.6 percent year on year. The turnover of RMB/foreign exchange swap transactions totaled USD2.52 trillion, representing an increase of 42.2 percent year on year; among this total, overnight RMB/USD swap transactions amounted to USD1.4 trillion, accounting for 55.6 percent. The turnover on the RMB/foreign exchange forward market totaled USD86.6 billion, a decrease of 59.6 percent year on year. The turnover of foreign currency pair transactions amounted to USD85.7 billion, a decrease of 9.5 percent year on year. In particular, USD/HKD transactions accounted for the bulk, or 41.6 percent, down 3.6 percentage points from the previous year.

The number of participants on the foreign exchange market expanded further. At end-2012, there were 353 members on the foreign exchange spot market, 79 members on the foreign exchange forward and swap markets, and 31 members on the foreign exchange options market.

7. The gold market performed in a stable manner

The price of gold fluctuated. In 2012, the price of gold on the international market reached a peak of USD1791.75 per ounce and a trough of USD1540 per ounce, and closed at USD1664 per ounce at end-2012, up 5.68 percent from the end of the last year. The movement of domestic gold price kept pace with that on the international market. During the year, the highest price on the Shanghai Gold Exchange (Au9995) was 362.5 yuan per gram, and the price closed at 334.34 yuan per gram, up 4.55 percent from the end of the last year. The weighted average price of gold was 339.81 yuan per gram, up 3.75 percent from the previous year.

The volume of transactions on the Shanghai Gold Exchange saw a slight decline. In 2012, the trading volume of gold was 6350.20 tons, a decrease of 14.63 percent year on year, and the turnover posted 2.15 trillion yuan, a decrease of 13.18 percent year on year; the trading volume of silver was 208,900 tons, a decrease of 15.42 percent year on year, and the turnover posted 1.36 trillion yuan, a decrease of 29.99 percent year on year; the trading volume of platinum was 63.91 tons, a decrease of 1.72 percent year on year, and the turnover posted 21.043 billion yuan, a decrease of 12.26 percent year on year.

II. Institutional building in the financial market

1. Promoting innovation and sound development of the bond market

In 2012, the PBC took the lead in establishing the Corporate Debenture Bonds Inter-Ministerial Coordination Mechanism, a mechanism to promote the sound development of the bond market. Securities companies and the Securities Finance Company were encouraged to issue short-term financing bills, the pilot program of credit assets securitization was expanded, and the asset-backed bills were launched. Under the guidance of the PBC, the National Association of Financial Market Institutional Investors (NAFMII) released the *Master Agreement on Bond Repo on the Interbank Market*, to improve market efficiency and strengthen resilience.

2. Promoting the sound development of the gold market

First, the gold price enquiry business was launched. On December 3, 2012, the gold price enquiry business on the interbank market was put into operation, which helped

improve the trading mechanism on the gold market, increase market liquidity, and deepen market functions. Second, the business filing, monitoring and statistical system for the gold market was put in place to promote the sound development of gold business of banking institutions. Third, the PBC, jointly with other ministries and commissions, launched a campaign against illegal gold trading markets in a prudent way, and strengthened education of gold investors, to safeguard market order.

3. Exploring ways to promote financial regulatory cooperation

In December 2012, to strengthen regulatory cooperation and preserve financial stability, the PBC and the CSRC signed the *Memorandum on Strengthening Securities and Futures Regulatory Cooperation to Jointly Safeguard Financial Stability*. The purpose of the *Memorandum* is to take advantage of the wide coverage of the PBC branch offices at municipal and county levels where the CSRC system has inadequate staffing, so as to improve the efficacy of financial regulation and supervision. In the same month, approved by the State Council, the PBC, the CBRC, and the CSRC further expanded the pilot program of allowing commercial banks to set up fund management companies, to broaden ways for bank deposits to be channeled into the capital market in an orderly manner and support the stable development of the capital market.

4. Improving institutional arrangements on the securities market

The reform of new stock issue system was deepened. Measures were taken to strengthen the authenticity and accuracy of information disclosure, properly adjust the price enquiry range and the placement ratio, increase free-floats of newly listed companies, and strengthen supervision on IPO pricing and speculation on new stocks, in an effort to advance the building of an information disclosure-based stock issue system, to promote balanced and healthy development of the primary and secondary markets, and to protect the legitimate rights and interests of investors.

The construction of a multi-tiered capital market made steady progress. Measures were taken to specify the positioning of regional equity markets and the participation of securities companies in relevant business of that market, and to regulate the establishment approval, day-to-day supervision and monitoring of regional equity trading markets, investor suitability management, and responsibilities of market intermediaries. The scope of non-listed public companies was specified, and the application procedures for open transfer, private transfer, and private placements of non-listed public companies were clarified, thus officially bringing regulation and supervision of non-listed public companies into the legal system.

Regulation and supervision of securities companies was strengthened. Sponsors were required to establish an accountability system for sponsor representatives and

members of the sponsorship team, improve the mechanism to keep continuous track of the sponsored project, and achieve effective internal control throughout the sponsoring process. Corporate governance and internal control system of subsidiaries of fund management companies were strengthened, and the fund management companies were required to establish and improve the identification, reporting, handling, and accountability system to prevent internal trading.

5. Improving institutional arrangements on the insurance market

The reform of insurance regulatory system was deepened. First, the CIRC released the *Plan for Establishment of China's Solvency II System*, to build a new solvency supervisory regime that suits the specificities of China's insurance market. Second, starting from July 2012, the CIRC continued to deepen reform of the supervisory regime regarding the use of insurance funds, and released ten new regulations on asset allocation, entrusted investment management, bond investment, equity and real estate investment, and etc, incorporating breakthroughs in the scope of insurance fund investment and institutions of entrusted investment, and expanding the scope of insurance company investment. Third, measures were taken to reform the insurance clauses and premium rates management system, improve the principles, methods and procedures of commercial car insurance clause formulation and premium rate calculation and approval, and regulation over insurance clauses and premium rates of life insurance companies was strengthened. Fourth, the *Regulation on Compulsory Traffic Accident Liability Insurance for Motor Vehicles* was amended to allow foreign insurance companies access to compulsory traffic accident liability insurance business.

Comprehensive measures were taken to deal with misleading behaviors in selling life insurance products and complaints of slow and difficult motor vehicle claim payments. A working mechanism was established to objectively assess misleading behaviors in selling insurance products, misleading sale behaviors and penalty for misconduct were defined, and an accountability system was put in place. A guideline for the management of motor vehicle insurance claim was formulated to introduce a standard motor vehicle claim process and auto insurance claim service standards.

The capacity of the insurance industry to serve the real economy and the household sector was upgraded. In November 2012, the State Council issued the *Regulation on Agricultural Insurance*, which covers agro-linked insurance providers and their business operation principles and models, policy support, regulation and supervision over agricultural insurance business, and etc, specifies the legal status of agriculture insurance, providing a legal and regulatory basis for agro-linked insurance business. In August 2012, six ministries and commissions jointly issued the *Guidelines for the Development of Major Illness Insurance Business for Urban and Rural Residents*, to launch the major illness insurance business, which is led by the government and

operated by commercial insurance agencies, in full swing.

Part 4 Macroeconomic Analysis

I. Global economic and financial developments

A deep global economic correction was underway in 2012. The U.S. recovered moderately with a slow progress in fiscal consolidation. Conditions in Europe turned for the better but the sovereign debt crisis was increasingly taking its toll on the real economy. Weak external demand and insufficient domestic consumer demand led to a downturn in Japan. The growth momentum in a majority of emerging economies moderated due to increased uncertainties.

1. Economic developments in the major economies

In the U.S., a modest growth continued with stalled progress of fiscal consolidation, although the housing market turned for the better, and the process of financial sector deleveraging was almost complete. The energy and hi-tech sectors grew robustly, and inflationary pressures were lessened. The recovery was unstable as policy uncertainties from the stalled progress in fiscal consolidation dampened investment and consumption growth. According to the first estimate, the U.S. GDP shrank by 0.1 percent q-o-q at an annualized rate in Q4, due to government spending cut and the slip in export. The estimate for real GDP growth in 2012 was 2.2 percent. In the short-term, the U.S. economy remains vulnerable to policy uncertainties stemming from the negotiation on government expenditure reduction. Meanwhile, weak labor market would continue to drag the recovery of market confidence.

Box 3 The Fiscal Cliff in the U.S. and its Prospect

Fiscal cliff refers to the potential deep downturn in the U.S. fiscal deficit curve that would make it shape like a cliff due to a combination of expiring tax cuts and the adoption of deficit-reduction measures at the beginning of 2013. The fiscal cliff involves policy changes in four aspects: first, the expiration of Bush tax cuts; second, the expiration of Obama payroll tax cut; third, end of the temporary extension of unemployment benefit launched by the Obama Administration; and fourth, the activation of sequestration under the Budget Control Act of 2011.

Though mindful of the debt unsustainability and the inevitability of deficit reduction, the U.S. government and congress were only able to reach a radical deficit reduction deal as a result of increasing political polarization. This is the reason behind the fiscal cliff. According to CBO, should all policy changes materialize the deficit reduction would amount to 5.1 percent of GDP in 2013, entailing a real GDP contraction of 0.5 percent y-o-y in Q4 and pushing up unemployment rate to 9.1 percent. Both the IMF and the World Bank recognized the fiscal cliff in the U.S. as one of the major

uncertainties threatening global recovery.

Aware of the huge potential damage of fiscal cliff on U.S. economy, the Democrats and Republicans started negotiation on this issue immediately after the general election. The problem won't be solved unless the two parties concur on the deficit reduction plan for the next decade, which was very difficult given their divergent ideas on the paths to deficit cuts. The Democrats advocated increasing revenues by canceling tax cuts for the rich; while the Republicans relied on government spending cut, especially cuts in entitlement, and insisted that tax advantages should benefit the rich. After rounds of difficult negotiations, the Democrats and Republicans came to a "two-step" solution on the brink of the cliff at the end of 2012. The package raised the tax rate for families with an annual income of more than USD450,000, and extending tax advantages and unemployment benefits for the low-income. Meanwhile, the activation of spending cut sequestration was postponed by two months.

According to the CBO, the solution would increase the U.S. deficit by USD4 trillion compared with the fiscal cliff scenario (excluding USD600 billion of additional debt interest payments). Therefore, deficit reduction remained a severe challenge in the U.S. Though avoided at the last minute, the unsustainable trajectory of the U.S. fiscal status was not reversed. The government debt limit was reached at end-2012; however, measures were taken by the Treasury Department as a temporary solution. In late-January 2013, the U.S. congress passed the bill to delay the implementation of the debt ceiling, allowing the government to borrow to meet principal and interest payment obligations, which was not to be more than the minimum amount needed. Given the political polarization in the U.S., the debate between the two parties on expenditure reduction and raising debt ceiling would go on, and would produce policy uncertainties that might undermine financial market stability in the U.S. and beyond.

Development of the European sovereign debt crisis was full of twists and turns, and had increasing adverse impact on the real economy. Hit by the crisis, economies in euro area suffered zero or negative growth in the first three quarters in 2012. The launch of Outright Monetary Transaction (OMT) on September 6th by ECB calmed the financial conditions, though the real economy was still weak in the euro area. The December PMI in euro area declined to 47.2, below the threshold level of 50 for 11 consecutive months. The unemployment rate rose to 11.8 percent in November, the record high since the creation of euro area. The HICP fell to 2.2 percent. In December, the ECB estimated that real GDP growth would decline by 0.4-0.6 percent in 2012.

There was a downturn in the Japanese economy due to weak external demand. The Japanese economy declined sharply after a robust but brief rebound in the first quarter. Fading effects of reconstruction efforts after the earthquake and tsunami in 2011, and falling household consumer confidence index pointed to insufficient domestic demand in the Japanese economy. Meanwhile, contracting external demand and higher energy demand led to large trade deficit. Moreover, there remained uncertainties in the implementation of the Consumption Tax Reform Act under the new

administration, and the accumulation of government debt could heighten fiscal risks. According to the IMF projection, total debt outstanding of the Japanese government would register 1122.6 trillion yen at end-2012, accounting for 236.6 percent of its GDP.

Table 10 Macroeconomic and Financial Indices of the Major Economies

country	Index	2011Q4			2012Q1			2012Q2			2012Q3			2012Q4		
		Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.
United States	Real GDP Growth Rate (annualized quarterly rate, %)	4.1			2.0			1.3			3.1			-0.1(first estimate)		
	Unemployment Rate (%)	8.9	8.6	8.5	8.3	8.3	8.2	8.1	8.2	8.2	8.2	8.1	7.8	7.9	7.8	7.8
	CPI (YOY, %)	3.5	3.4	3.0	2.9	2.9	2.7	2.3	1.7	1.7	1.4	1.7	2.0	2.2	1.8	1.7
	DJ Industrial Average (closing number)	11955	12045	12218	12633	12952	13212	13214	12393	12880	13009	13091	13486	13096	13025	13104
	NASDAQ (closing number)	2684	2620	2605	2814	2967	3092	3046	2827	2935	2940	3067	3116	2977	3010	3019
Euro Area	Real GDP Growth Rate (quarterly YOY, %)	-0.3			0.0			-0.2			-0.1					
	Unemployment Rate (%)	10.5	10.6	10.7	10.8	10.9	11.0	11.2	11.3	11.4	11.4	11.5	11.6	11.7	11.7	11.7
	HICP (YOY, %)	3.0	3.0	2.7	2.7	2.7	2.7	2.6	2.4	2.4	2.4	2.6	2.6	2.5	2.2	2.2
	EURO STOXX 50 (closing number)	2318	2299	2370	2422	2477	2459	2423	2257	2381	2479	2509	2518	2525	2551	2569
Japan	Real GDP Growth Rate (annualized quarterly rate, %)	0.3			5.7			-0.1			-3.5					
	Unemployment Rate (%)	4.4	4.5	4.5	4.6	4.5	4.5	4.6	4.4	4.3	4.3	4.2	4.2	4.2	4.1	4.2
	Core CPI (YOY, %)	-0.1	-0.2	-0.1	-0.1	0.1	0.2	0.2	-0.1	-0.2	-0.3	-0.3	-0.1	0.0	-0.1	-0.2
	NIKKEI225 (closing number)	8700	8988	8435	8455	8803	9723	10084	9521	8543	9007	8695	8840	8928	9446	10332

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

The majority of the emerging markets faced slower growth, more volatile cross-border capital flows and higher inflationary pressures. Since the beginning of 2012, growth of BRICS countries slowed down due to declining external demand and cyclical factors. In December, the Central Bank of Brazil revised its projection of growth in the 2012 down from 1.27 percent to 1.03 percent, a significant decline compared to the 2.7 percent in 2011. Some of the emerging market economies, such as India and Russia, were facing inflationary pressures. Advanced economies' quantitative easing policy impacted cross-border capital flow of some emerging markets. It may further push up commodity prices, grain prices in particular, which

would heighten inflationary pressures and complicate the making of macroeconomic policy for emerging market countries.

2. Global financial market development

In 2012, the global financial market was volatile amid slow global recovery, changeful evolution of the European sovereign debt crisis, quantitative easing measures of advanced economies, and geopolitical shocks.

Capital flowed back and forth between major advanced economies and emerging markets along with changes in the economic conditions, and the exchange rates of major currencies fluctuated substantially. In the first two months, most major currencies appreciated against the dollar based on the improved conditions in Europe. March through June, capital moved away from Europe and emerging markets to the U.S. and Japan driven by risk aversion. As a result, the U.S. dollar and yen appreciated against euro and emerging market currencies. After July, with progress in addressing the European sovereign debt crisis and the launch of a new round of QE by major economies, capital flowed from the U.S. back to the emerging markets, and many currencies appreciated against the U.S. dollar. In Q4, as a result of expansion of asset purchasing program by the Bank of Japan and market expectation of exchange rate policy to be adopted by the new administration, yen depreciated substantially against the U.S. dollar. By end-2012, the exchange rates of euro and yen against the U.S. dollar were 1.3194 dollar per euro and 86.74 yen per dollar, appreciating 1.92 percent and depreciating 11.3 percent respectively y-o-y. Developments of emerging market currencies diverged: the Korean won, Chilean peso and Mexican peso appreciated more than 8 percent against the U.S. dollar in 2012, while the Argentinean peso and Brazilian real depreciated more than 9 percent.

Box 4 Spillover of Further Quantitative Easing on Capital Flows

In 2012, central banks in advanced economies, such as the ECB, the Fed and the Bank of Japan unleashed more quantitative easing. On September 15, the Fed announced the decision to increase policy accommodation by purchasing additional agency mortgage-backed securities at a pace of USD40 billion per month, known as QE3. On December 12th, the Fed released the FOMC statement to expand the purchase of long-term Treasury bonds at a pace of USD 45 billion per month after the Operation Twist was completed at the end of 2012. The Fed also announced that the extremely low target range of federal funds rate would be appropriate as long as unemployment rate was above 6.5 percent, inflation between one and two years ahead is projected to be no more than 0.5 percentage points above the 2 percent longer-run goal. Different from QE1 and QE2, the QE3 was open-ended, without a total size and duration. It was designed to avoid investors' withdrawal of acting along with the Fed, or ever operating reversely as the Fed intended, which would undermine the effectiveness of QE approaching the date of completion. Second, in addition to unconventional monetary policy measures such as LTROs and SMP, the ECB launched the OMT, where the ECB could purchase government-issued bonds that mature one to three years on the secondary market provided the bond issuing countries meet ECB

conditionality and has submitted the application for assistance. Though not used, the commitment to buy an unlimited amount signals the ECB's determination to fill the financing gap for heavily-indebted euro area sovereigns. Third, the Bank of Japan further eased monetary policy on five occasions in 2012, expanding the asset purchase program from 55 trillion yen at the beginning of 2012 to 101 trillion yen (an equivalent of USD1.15 trillion) at the end of 2012. Given frequent expansion of asset purchase program and pressure from the new administration to ease further, the QE in Japan was likely to be almost unlimited.

Advanced economies' QE went from close-ended to open-ended in 2012, greatly lessening investors' risks that may be triggered by a policy exit. Assuming that the Fed continued an extremely loose monetary policy in 2013, a total of USD1.02 trillion of assets would be purchased. Moreover, since the money multiplier was on a rise in the U.S., money creation function would further enhance dollar supply. Against this background, the market expected that there would be an unlimited supply of low-cost funds, and investors' risk premium was substantially reduced. A huge amount of low-cost capital flowed to the emerging markets in pursuit of higher returns. According to EPFR Global, by 2 January 2013, equity funds in emerging markets received net capital inflow for 17 consecutive weeks by a total of USD90 billion. The amount of net capital inflow into emerging bond markets registered USD55.6 billion in 2012, hitting a record high, and much larger than the USD15.9 in 2011. Sustained capital inflow led to significant appreciation and higher asset prices in emerging markets, in particular in Asia. In 2012, the Korean won, Singapore dollar and NT dollar appreciated 8.3 percent, 6.1 percent and 4.3 percent respectively, and the stock market in HK and Singapore grew by 8.7 percent and 3.5 percent respectively.

Despite the recovery in export in Q4 2012, emerging market economies were facing the common headache of slower growth. In Q3 2012, the GDP of ROK grew 1.8 percent, half as much as that in 2011; the GDP growth of Singapore and HK posted 0.3 percent and 1.3 percent respectively, much lower than 4.9 percent and 5 percent in 2011, reflecting the negative effect of local currency appreciation on economic recovery. Meanwhile, the majority of emerging markets saw a decline in inflation due to stable commodity price and sluggish domestic demand. Therefore, curbing inflationary pressure by way of revaluing domestic currency was not a policy priority. Therefore, in order to stabilize export and ensure growth, some emerging markets, especially the export-oriented ones, were forced into actions such as central bank intervention in order to rein in local currency appreciation. The ROK and the Philippines publicly voiced concerns over rapid appreciation, and central bank and monetary authorities of some economies intervened in the market to curb local currency appreciation. In Q4 2012, the HKMA injected a total of 107.18 billion HK dollar on 28 occasions to fulfill the strong-side convertibility undertaking. Among advanced economies, the Swiss National Bank guarded the exchange rate ceiling of 1 euro against 1.2 CHF, while the Reserve Bank of Australia signaled readiness to curb appreciation when necessary, which was a rare case for RBA. IMF economists held

that, exchange market intervention could be counted as a policy option amidst volatile capital flows, reflecting subtle change in IMF's attitude toward foreign exchange intervention by monetary authorities.

Yields of traditional safe haven treasury bonds remained subdued, while those of heavily-indebted sovereigns were on a decline. The lackluster global recovery fanned up risk aversion, and the T-bond yields in the U.S., Germany and Japan were subdued. Yield of major safe haven treasury bonds rallied due to a series of uncertainties including the fiscal cliff negotiation in the U.S.. Affected by regional banking crisis, yield of the ten-year government securities of Spain hit a high of over 7.5 percent. In 2012, the easing of European sovereign debt crisis caused the yield of government securities of highly indebted sovereigns to go down. The dollar Libor continued to decline in 2012, Euribor decreased to a historical low due to the ECB rate cut and further easing of monetary policy stance. On December 31, one-year Libor was 0.8435 percent, a reduction of 0.285 percentage points from a year ago; the one-year Euribor was 0.5420 percent, a reduction of 1.405 percentage points.

Major stock indices went up. In Q1, with adoption of rescue measures in Europe, stock indices rallied in the U.S., European and Japanese market. In April and May, due to the worsening of the banking crisis in Spain and the Greek situation, stock indices declined around the globe. Since July, with the fiscal cliff looming in U.S., uncertainties in negotiation of Greek rescue plan and the change of government in Japan, global stock market fluctuated wildly. With stronger expectation of further easing of monetary policies in the advanced economies, the stock market in the U.S., Europe and Japan rebounded, and the U.S. stock market had even restored the pre-crisis level.

The price of crude oil rose after a period of decline, while the price of gold fluctuated at an elevated level. At end-2012, the price of Brent oil futures remained flat with that at beginning-2012, while the price of gold closed at USD1674 per ounce, up 7 percent compared with the beginning of 2012. Throughout the year, the price of international industrial metals fell affected by global economic performance, and the price of agricultural produces surged as a result of extreme weather conditions.

3. Monetary policies of the major economies

In 2012, major advanced economies further eased their monetary policy. The Fed kept the federal funds rate at the target range of 0-0.25 percent, and announced on June 20 to extend Operation Twist to end-2012 and increase the total amount of asset purchase by USD267 billion. On September 13, the Fed announced the decision to purchase MBS open-endedly at a pace USD40 billion per month, known as QE3. On December 12, the Fed decided to enhance the size of long-term Treasury bond purchase by USD45 billion per month, and broke the ground to link interest rate policy with specific economic indicators including unemployment rate. It is expected that the Fed

would keep the interest rate at an extremely low level as long as unemployment rate was to be above 6.5 percent, interest rate would not exceed 2.5 percent and long-term inflationary expectation was well-anchored. The ECB continued to reinforce its easy monetary policy. On June 20, the ECB further lowered the standard of collateral against which banks in euro area could acquire liquidity from the ECB. On July 5, the ECB announced to cut major refinancing rates by 25 basis points to the record low of 0.75 percent. Moreover, the ECB launched the OMT program by which the ECB would purchase government issued bonds with a maturity of no longer than 3 years on the secondary market, with the purpose of curbing financing cost of member countries. In their meeting on December 13, the EU Finance Ministers reached an agreement to give the ECB a new mandate of regulating all banks in the euro area beginning March 1st 2014. The Bank of England kept the benchmark interest rate unchanged at the record low of 0.5 percent. The Bank announced on June 14 to launch the auctions under Extended Collateral Term Repo Facility. On July 5, the Bank announced to further increase the size of asset purchase by 50 billion pound to 375 billion pound. The Bank of Japan kept the zero-interest rate policy, and expanded the size of available fund for asset purchase on several occasions. On January 22, 2013, the Bank of Japan announced to set the price stability target at 2 percent in terms of the y-o-y rage of change in the CPI, and decided to introduce a method of purchasing a certain amount of financial asset every month without setting any termination date starting from January 2014.

Amidst increased uncertainties in external environment and the slowdown of domestic growth, the majority of emerging markets adopted an easier monetary policy stance. In 2012, the Central Bank of Brazil cut benchmark interest rates on seven occasions to 7.5 percent. The Reserve Bank of India lowered the repurchasing rate by 50 basis points to 8 percent on April 17, and announced to decrease the statutory liquidity ratio from 24 percent to 23 percent on July 31. On September 17, it reduced the cash reserve ratio by 25 basis points to 2.75 percent. Besides, the benchmark interest rates were lowered as well in South Africa, the Philippines, Vietnam, Kazakhstan and Hungary.

4. World economic outlook and major risks

Global growth would be slow in 2013 with major uncertainties in the outlook. In the updated *World Economic Outlook* in January, the IMF revised its projection of global growth rate downward to 3.5 percent. Specifically, the projection of growth in the U.S., the euro area, Japan and emerging markets were lowered to 2.0 percent, -0.2 percent, 1.2 percent and 5.5 percent respectively.

Going forward, major risks in the global economy include: First, sovereign debt crisis remained the most prominent risk threatening global recovery. Despite the temporary

easing in the European sovereign debt situation, risks still remained. Spain may have to accept a comprehensive assistance package. The indebtedness and poor economic growth in France are potential risks which may aggravate the European sovereign debt crisis. Moreover, the potential fiscal risks in the U.S. and Japan are not to be overlooked.

Second, uncertainties regarding US fiscal policy might continue to pose risks for US and global growth. Though the U.S. government and congress had come to a preliminary agreement to avoid the fiscal cliff, the issue of government expenditure reduction was pending in the future months. If not handled properly and in time, it may still adversely impact the U.S. and global economy.

Third, the impact of a fresh round of accommodative monetary policy adopted by advanced economies on the global economy is not clear. Since the second half of 2012, major advanced economies further reinforced their quantitative easing (QE), with spillovers to global economy. Such open-ended QEs entail huge uncertainties on domestic and global economy, and might add to volatility in cross-border capital flows, push up commodity prices, and have larger spillovers to the emerging market economies.

Fourth, trade and investment protectionism might come to the fore. With gloomy growth outlook, high unemployment rate and stronger financial sector regulation in the advanced economies, trade frictions might occur more frequently and investment faces stronger risks. The WTO revised the estimation of global trade growth in 2012 from 3.7 percent to 2.5 percent, much lower than the average of 5.7 percent in the past 30 years. The WTO had also revised the projection of global trade growth in 2013 down from 5.6 percent to 4.5 percent.

Fifth, geopolitical risks were on a rise. In recent years, political polarization became more acute in some advanced economies. Such a trend, together with the deterioration in Middle East political situation and greater tension in geopolitics in East Asia, might affect bilateral economic and trade ties and regional economic cooperation.

II. Analysis of China's Macroeconomic Performance

In 2012, the Chinese economy registered steady growth and made progress. Consumer demand was stable, and fixed asset investment grew fairly fast. The outlook of agricultural sector was good, and output growth of industrial sector moderated and stabilized. The margin of price levels generally fell, and employment situation was basically stable. The BOP accounts became more balanced, and the financial and capital account had its first deficit since the Asian financial crisis. In 2012, the Gross Domestic Product (GDP) registered 51.9 trillion yuan, up 7.8 percent year on year in terms of comparable prices, and 1.5 percentage points lower than the

growth of the last year. The Consumer Price Index (CPI) was up 2.6 percent year on year, down 2.8 percentage points from the last year. In 2012, the trade surplus posted USD231.1 billion.

1. Consumption demand rebounded, investment grew in a stable and fairly fast manner, whereas exports slowed down

Supported by fairly fast household income gains, the consumption demand rebounded. In 2012, the per capita disposable income of urban households posted 25,000 yuan, representing a year-on-year growth of 12.6 percent and price-adjusted real growth of 9.6 percent. The per capita net income of rural households registered 7,917 yuan, up 13.5 percent in nominal term and 10.7 percent in real term. The PBC survey of urban depositors in the fourth quarter shows that the household income index rebounded by 1.6 percentage points from the previous quarter to 51.8 percent. Households had fairly strong inclination to consume, and the proportion of those who preferred more consumption was 19.4 percent, up 1.9 percentage points from the beginning of the year. In 2012, retail sales of consumer goods totaled 20.7 trillion yuan, representing a year-on-year growth of 14.3 percent, or 12.1 percent in real terms. Retail sales in urban areas registered 17.9 trillion yuan, up 14.3 percent year on year, while retail sales in the rural areas grew 14.5 percent year on year to 2.8 trillion yuan.

Fixed-asset investments grew in a stable and fairly rapid way. In 2012, fixed-asset investment (excluding investment by rural households) totaled 36.5 trillion yuan, up 20.6 percent year on year, or 19.3 percent in real terms. In terms of regional distribution, growth of fixed-asset investment in the central and western regions outpaced that in the east, and growth in the east, central and western regions registered 17.8 percent, 25.8 percent and 24.2 percent respectively. In terms of sector distribution, fixed-asset investment in the primary, secondary, and tertiary industries grew 32.2 percent, 20.2 percent, and 20.6 percent respectively. Total planned investment in new projects grew 28.6 percent year on year to 30.9 trillion yuan, and total planned investment in projects under construction grew 18.1 percent year on year to 74.2 trillion yuan.

Due to sluggish external demand, the growth of exports declined. In 2012, total imports and exports posted USD3.9 trillion, up 6.2 percent year on year. In particular, exports registered USD2.0 trillion, up 7.9 percent year on year, and a deceleration of 12.4 percentage points from 2011; imports posted USD1.8 trillion, up 4.3 percent year on year. The trade surplus was USD231.1 billion. The U.S. replaced the EU as China's largest export market. Exports to the U.S. registered USD351.8 billion in 2012, up 8.4 percent year on year, while exports to the EU reached USD333.99 billion, down 6.2 percent year on year. Trade with the emerging market economies had fairly rapid growth. In 2012, exports to the ASEAN countries, Russia, and South Africa

surged 20.1 percent, 13.2 percent, and 14.7 percent respectively, an acceleration of 12.2 percentage points, 5.3 percentage points, and 6.8 percentage points. The growth of exports by private enterprises picked up, and in 2012 exports by private enterprises grew 21.1 percent year on year. In the export structure, exports of mechanical and electronic products, and labor-intensive products grew steadily. In particular, exports of mechanical and electronic products grew 8.7 percent year on year, and exports of seven categories of labor-intensive products such as clothing, texture, and footwear grew 8.6 percent year on year. In 2012, actually utilized foreign direct investment reached USD111.7 billion; Domestic entities made direct investments in 4,425 overseas businesses in 141 countries and regions, with cumulative direct investments by non-financial institutions reaching USD77.22 billion.

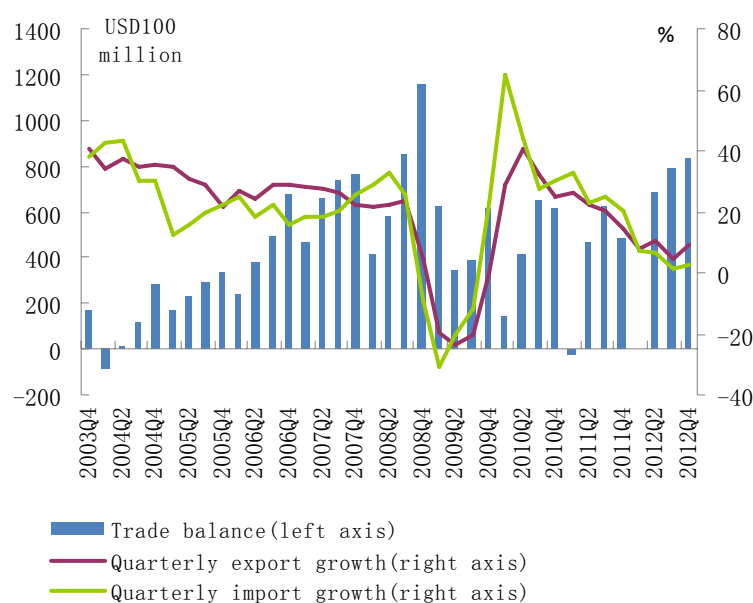


Figure 3 Imports and Exports Growth and the Trade Balance

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

2. Outlook of agricultural sector was good and performance of the industrial sector slowed

In 2012, the value-added of the primary, secondary, and tertiary industries were 5.2 trillion yuan, 23.5 trillion yuan, and 23.2 trillion yuan respectively, up 4.5 percent, 8.1 percent, and 8.1 percent. The shares of the three industries in GDP were 10.1 percent, 45.3 percent, and 44.6 percent respectively.

The outlook of agricultural production was positive, and grain output reported growth for nine consecutive years. Grain output in 2012 posted 589.57 million tons, up 3.2 percent from the previous year. The total output of meat (including pork, beef, mutton, and poultry) posted 82.21 million tons, up 5.4 percent year on year. Among this total, the pork output totaled 53.35 million tons, up 5.6 percent year on year.

The growth of industrial output picked up. In 2012 the value-added of statistically large enterprises grew 10.0 percent year on year, representing a deceleration of 3.9 percentage points. The year-on-year growth of value-added gradually rebounded since August, from 8.9 percent in August to 10.3 percent in December. Profits of statistically large enterprises posted 5.6 trillion yuan, up 5.3 percent year on year. Profitability of statistically large enterprises from their main business posted 6.07 percent, while 98.0 percent of all industrial products were sold. The survey of 5,000 industrial enterprises conducted by the PBC in the fourth quarter reveals that the business index rebounded, and profitability of industrial enterprises improved. In the fourth quarter, the business index posted 61.8 percent, up 0.7 percentage points from the previous quarter, and the profitability index posted 53.1 percent, up 1.7 percentage points from the previous quarter.

Box 5 Performance of Industrial Enterprises

As market demand rebounded, enterprises were doing better. According to the statistics of PBC survey of 5,000 industrial enterprises, in the fourth quarter of 2012, the equipment utilization index posted 40 percent, up 0.2 percentage points from the previous quarter; the general business condition index and entrepreneur confidence index posted 61.8 percent and 60.4 percent respectively, up 0.8 percentage points and 1.2 percentage points from the previous quarter. Looking at their financial data, although the total realized profits declined from the same period of the last year, the margin of decline narrowed for three months in a row. In the first eleven months, 5,850 enterprises realized a total of 881.09 billion yuan of profits, representing a year-on-year decrease of 14.3 percent, down 4.7 percentage points from that in the first ten months. As market demand recovered, the inventory level saw a decline. In the fourth quarter of 2012, the market demand index posted 51 percent, up 0.8 percentage points from the previous quarter, while the inventory level index posted 54.5 percent, down 1.5 percentage points from the previous quarter. Specifically, 17 percent of enterprises thought their inventory level as high, down 2.5 percentage points from the previous quarter.

We have selected ten indices which can capture the production and performance of enterprises. The inventory index and the overseas order level index declined from the last quarter, the fixed investment index was flat with that of the previous quarter, and the other seven indices all picked up from the previous quarter, indicating better performances of enterprises.

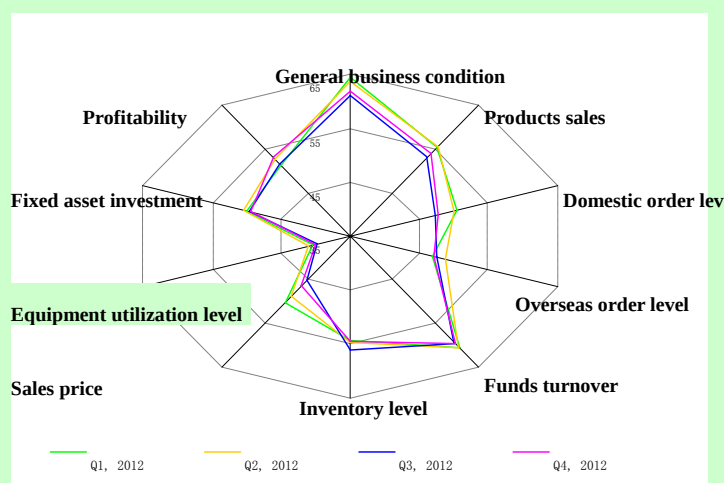


Exhibit: Changes of Major Performance Indices of 5000 Industrial Enterprises Survey (%)

Source: Financial Survey and Statistics Dept. of the PBC

However, industrial enterprises still faced some challenges including rising labor costs, and were cautious in making new investments. According to the survey data of export-oriented enterprises, 53.3 percent of export-oriented enterprises regarded “rising labor cost and difficulty in hiring” as the most prominent issue in the fourth quarter of 2012. In terms of regional distribution, not only those eastern provinces that attract large amount of labors from other parts of the country reported difficulties in hiring workers, an increasingly larger proportion of enterprises in other large labor-exporting provinces such as Henan, Jiangxi, and Hubei also had the same problem. In addition, enterprises became more cautious in making investment. The fixed asset investment index, the equipment investment index, and the building project investment expectation index posted 46.9 percent, 46.4 percent, and 44

percent respectively in the fourth quarter of 2012, down 2.3 percentage points, 2.6 percentage points and 3.1 percentage points from the same period of the last year.

Going forward, efforts should be made to continuously improve the corporate financing environment, and improve financial services to the real economy. A variety of monetary policy tools will be used to guide money, credit, and all-system financing aggregates to grow in a stable and appropriate manner. The allocation of financial resources should be optimized to effectively tackle the structural problems in the supply and demand for credit, to prevent financial risks, to allow direct financing to play a greater role, and to meet diverse investment and financing demands. Furthermore, efforts should be made to improve the financial services system for small and micro-sized enterprises, to improve financial services for small and micro-sized enterprises, to accelerate the development of small- and medium-sized financial institutions, and to build the small and micro-sized enterprises financing guarantee system and credit evaluation system.

3. Inflation was effectively contained and CPI fell into the target range

In 2012, as the economic growth moderated and the impacts of sound monetary policy gradually unfolded, major price indices continued a slowdown trend. From September to December, as the momentum of growth moderation and stabilization continued, major price indices picked up again slightly.

The hike in the CPI in 2012 was smaller than that in the previous year, and picked up towards the year end. In 2012, the CPI grew 3.8 percent, 2.9 percent, 1.9 percent and 2.1 percent year on year in the four quarters respectively, averaging 2.6 percent, and decelerating by 2.8 percentage points from a year earlier. In terms of food and non-food items, food prices gained 4.8 percent, a deceleration of 7.0 percentage points from the previous year, and prices of non-food items increased 1.6 percent, a deceleration of 1.1 percentage points from the previous year. In terms of consumer goods and services, prices of consumer goods grew 2.9 percent year on year, down 3.3 percentage points from the previous year, and prices of services were up 2.0 percent, representing a deceleration of 1.5 percentage points from the previous year.

The quarter-on-quarter decrease in producer prices narrowed. In 2012, the ex-factory prices of industrial products grew 0.1 percent year on year in the first quarter, and

declined 1.4 percent, 3.3 percent and 2.3 percent respectively from the second to fourth quarter, averaging a decline of 1.7 percent for the whole year. Producer purchasing prices grew 1.0 percent in the first quarter, and fell 1.6 percent, 3.9 percent and 2.8 percent respectively from the second to fourth quarter, averaging an annual decline of 1.8 percent. In 2012, the Corporate Goods Price Index (CGPI) declined 1.6 percent year on year; the index rebounded year on year from September to December after declining for 13 months in a row. Growth of the prices of agricultural capital goods outpaced that of producer prices of agricultural products. In 2012, the producer prices of agricultural products increased 2.7 percent, a deceleration of 13.8 percentage points, whereas the prices of agricultural capital goods gained 5.6 percent, down 5.7 percentage points from 2011.

Due to factors such as the overall declines of commodity prices on the international market, import prices fell. In 2012, the average price of crude oil futures on the New York Merchantile Exchange was up 9.5 percent, down 9.4 percent, down 1.2 percent, and down 4.3 percent respectively in the four quarters, a cumulative decline of 6.2 percent year on year. Import prices fell 0.5 percent year on year, down 14.5 percentage points from the previous year. Specifically, import prices rose 4.1 percent in the first quarter, and fell 0.7 percent, 3.2 percent and 2.3 percent respectively in the next three quarters. Export prices increased 4.7 percent, 3.5 percent, 0.5 percent, and 0.2 percent respectively in the four quarters, averaging 2.2 percent in 2012 and decelerating 7.8 percentage points from the previous year.

The GDP deflator (the ratio of the nominal GDP versus the real GDP) decelerated significantly. GDP registered 51.9 trillion yuan in 2012, up 7.8 percent year on year. Movement of the GDP deflator was 1.8 percent, down 6.0 percentage points from the previous year.

The resource products pricing reform made new progress. First, the National Development and Reform Commission on December 18 decided to abolish the temporary intervention measures on price of power generation coal effective January 1, 2013, and to abrogate the relevant provisions that set the ceilings for the price of power generation coal acquired through contract and on the open market, so that the price will be determined by sellers and buyers through negotiation. Second, after several hearings were held in many places on revising and perfecting the implementation plan of a progressive electricity pricing system for household users, the new system was finally brought into operation on July 1, 2012.

4. Growth of fiscal revenue slowed down, and the structure of fiscal expenditures continued to improve

In 2012, fiscal revenue grew 12.8 percent year on year to 11.7 trillion yuan, representing a deceleration of 12.2 percentage points from the last year, whereas fiscal expenditures registered 12.6 trillion yuan, up 15.1 percent year on year, representing a deceleration of 6.5 percentage points from the last year. As a result, revenue was 850.2 billion yuan less than expenditures.

As for the structure of fiscal revenue, tax revenue posted 10.1 trillion yuan in 2012, up 12.1 percent year on year and representing a deceleration of 10.5 percentage points from the last year. The deceleration of tax income was mainly due to slowing economic growth, decline in corporate profits, structural tax reduction policies, and etc. In particular, the domestic VAT, consumption tax, business tax, corporate income tax, and the VAT and excise tax on imported products, were up 8.9 percent, 13.5 percent, 15.1 percent, 17.2 percent, and 9.1 percent respectively, whereas personal income tax was down 3.9 percent from the previous year. Revenue from these six tax items accounted for 77.0 percent of total national fiscal revenue.

As for the structure of fiscal expenditures in 2012, spending for education, agriculture, forestry and water conservancy, cultural, sports and media, urban and rural community affairs, and government-subsidized housing projects registered fairly rapid growth of 28.3 percent, 19.8 percent, 18.9 percent, 18.4 percent, and 16.4 percent respectively year on year. In the expenditure basket, three largest items, namely education, social security and employment, and agriculture, forestry and water conservancy, accounted for 16.8 percent, 10.0 percent, and 9.5 percent of total expenditures, respectively.

5. The employment situation was generally stable

In 2012, 767.04 million people were on the payroll, 2.84 million more than that at the end of the last year, among which there were 371.02 million urban employees, 11.88 million more than that at the end of the last year.

A statistical analysis conducted by the China Human Resources Market Information Monitoring Center in the fourth quarter on public employment service agencies in 103 cities shows that labor supply fell slightly short of demand in Q4, and the ratio of job seekers to job vacancies had exceeded 1 for ten consecutive months. However, job openings grew while job seekers fell compared with the previous year. Broken down by region, the degree of insufficient job openings in the western region was higher than those in the eastern and central regions. Broken by industry, job openings were mainly concentrated in the second and tertiary industries, in particular, demand for labor rose slightly in construction, domestic services and other service sectors, and construction sectors. In the labor market, there was a shortage of talent with a

medium-to-high level in the category of skills, and the ratio of job vacancies to job seekers of technicians, senior technicians, and senior engineers was relatively high.

6. The balance of payment further improved

In 2012, the balance of payments (BOP) remained basically balanced, and the capital and financial account posted a net outflow. According to the preliminary statistics of the SAFE, current account surplus increased 6 percent from a year earlier to USD213.8 billion in 2012, which accounted for 2.6 percent of GDP and was 0.2 percentage points less than that in 2011. Although the surplus of trade in goods grew slightly, the deficit of trade in services and revenue items widened further, while the surplus of current transfer declined. There was a deficit of USD117.3 billion under the capital and financial account (including error and omissions), whereas there was a surplus of USD186.1 billion in the previous year. The growth of foreign exchange reserves moderated. The stock of foreign exchange reserves in the BOP statistics (excluding impacts of non-trading valuation changes such as exchange rates and prices) only grew USD98.7 billion, representing a deceleration of 74 percent year on year.

The growth of outstanding external debt moderated, and the share of short-term external debt continued to increase. As of end-September, the stock of China's external debt stood at USD770.8 billion, up 10.6 percent year on year. Among this total, the stock of registered external debt posted USD471.3 billion, up 7 percent year on year; short-term external debt posted USD572.8 billion, a year-on-year growth of 12.8 percent and accounting for 72.8 percent of the total, which represented an acceleration of 1.5 percentage points year on year.

7. Sector analysis

In 2012, 29 out of 41 industrial sectors reported year-on-year growth in profits, 11 sectors experienced a year-on-year decline in profits, and one sector saw profits as opposed to losses during the same period of the last year. In terms of industry, profits of the electricity, heat generation and distribution industry and the agricultural products processing industry grew 69.1 percent and 20.6 percent respectively year on year. Adjustment of industrial structure has made new progress. The growth of value-added of high-tech industries outpaced the average level of statistically large enterprises by 2.2 percentage points, and the energy consumption per value-added of statistically large industrial enterprises declined more than expected.

(1) The real estate sector

In 2012, the sales of commercial housing nationwide grew slightly, though the growth was lower than that of the last year. The number of cities seeing a month-on-month housing price increase grew slightly since November, growth of investment in the real estate sector remained low, the floor areas of newly built housing declined from a year earlier, and growth of real-estate loans rebounded somewhat.

Sales of commercial real estate grew slightly, and the growth was lower than that in the previous year. The sold floor areas of commercial real estate nationwide declined compared with the same period last year for the first ten months, but started to rise in November, and posted 1.113 billion square meters for the whole year, up 1.8 percent year on year, a deceleration of 2.6 percentage points from the previous year. Sales value of commercial real estate was up 10 percent year on year to 6.4 trillion yuan, representing a deceleration of 1.1 percentage points from 2011. In particular, the sold areas and turnover of commercial residential housing accounted for 88.5 percent and 83 percent respectively of the total sold areas and turnover of commercial housing. Growth of sales of office buildings considerably outpaced that of commercial residential housing.

The number of cities where housing prices registered a year-on-year growth gradually declined from January to December, but grew slightly since November. In December, prices of newly built commercial residential housing increased from a year earlier in 40 of 70 cities, representing a decrease of 13 compared with that in January, but an increase of 28 compared with that in October; prices of pre-owned residential housing gained year on year in 25 cities, which was 5 cities less than that in January but 10 cities more than that in October.

Growth of investment in real-estate development remained sluggish. The year-on-year growth of real-estate development investment declined on a gradual basis, and started to rebound slightly in November. Investment in real estate development in 2012 totaled 7.2 trillion yuan, up 16.2 percent year on year, representing a deceleration of 11.9 percentage points from the previous year, among the lower levels registered since 2010. In particular, investment in residential housing was up 11.4 percent year on year to 4.9 trillion yuan, representing a deceleration of 18.8 percentage points from the last year and accounting for 68.8 percent of the total. The floor area of newly built housing fell 7.3 percent year on year to 1.77 billion square meters, whereas that of 2011 grew 16.2 percent. The floor areas of housing under construction grew 13.2 percent year on year to 5.73 billion square meters, representing an deceleration of 12.1 percentage points from the previous year. The floor areas of completed housing stood at 990 million square meters, up 7.3 percent and representing a deceleration of 6 percentage points from 2011.

Growth of real estate loans picked up. As of end-2012, the real estate loans of major financial institutions (including foreign-funded financial institutions) posted 12.1 trillion yuan, an increase of 12.8 percent year on year. Although the real estate loans began to rebound in May, the overall growth was still 1.1 percentage points lower than that of 2011. Outstanding real estate loans accounted for 19.8 percent of total outstanding loans, down 0.3 percentage points from the end the last year. Among this total, outstanding mortgage loans rose 12.9 percent year on year to 7.5 trillion yuan, representing a deceleration of 1.9 percentage points from the end of the last year; outstanding real estate development loans gained 10.7 percent year on year to 3.0 trillion yuan, representing a deceleration of 6.4 percentage points from the end of the last year; outstanding land development loans gained 12.4 percent year on year to 863 billion yuan, compared with a decline of 7.9 percent year on year at end 2011. New real estate loans grew 89.7 billion yuan from a year earlier to 1,346.5 billion yuan. New loans in the real estate sector accounted for 17.4 percent of total new loans, down 0.1 percentage points from 2011.

Credit support for welfare housing was gradually reinforced. As of end-2012, outstanding loans for welfare housing reached 571.1 billion yuan, accounting for 25.1 percent of the total real estate development loans. Among this total, new loans in 2012 posted 179.6 billion yuan, accounting for 89.3 percent of the total new real estate development loans. Moreover, the pilot program of using housing provident fund loans to support the construction of affordable housing was advanced steadily. As of end-2012, a total of 42.09 billion yuan of such loans was disbursed to 162 projects in 40 cities under the affordable housing program based on their construction progress, and a total of 5.81 billion yuan of loan principal has been recovered.

(2) E-commerce

E-commerce emerged as a result of information technology development, and is an effective means to reduce costs, improve efficiency, cultivate markets, and innovate business models. It helps meet and upgrade consumer demand and create new economic growth points. During the “Eleventh Five-Year” period, e-commerce maintained sustainable and rapid growth, and the volume of transactions grew by approximately 2.5 times. Specifically, the value of e-commerce transactions reached approximately 4.5 trillion yuan and 6 trillion yuan respectively in 2010 and 2011. During the first eleven months of 2012, the value of e-commerce transactions exceeded 7 trillion yuan. Large-scale and diversified consumption demand, ongoing consumption structure upgrading, decline in transaction costs, and the easy access to internet are all factors to drive the rapid growth of e-commerce.

E-commerce, in turn, drives the rapid development of other emerging industries such as e-commerce platform services, credit services, electronic payment, modern

logistics, and electronic authentication, and is a new growth point in modern services industry. The third-party e-commerce platform service platform aims to serve a vast population of enterprises, especially SMEs, and has been developing in a specialized and integrated direction. Novel payment means, such as online payment, mobile payment, and telephone payment, have developed rapidly. The release of the *Administrative Measures on Payment Services of Non-financial Institutions* and the issuances of third-party payment licenses have created conditions for the sound development of the payment service markets. The modern logistics industry has developed very rapidly. In 2012, the volume of courier services provided by statistically large enterprises nationwide amounted to 5.69 billion, up 54.8 percent year on year, and business incomes amounted to 105.53 billion yuan, up 39.2 percent year on year. As of end-2012, the amount of valid electronic authentication certificate holdings amounted to approximately 87.31 million.

The government has played a positive role in the development of e-commerce by introducing a series of policies, regulations and standards. However, The e-commerce business is still in initial stage, the business model is not yet mature, the service capacity had yet to be enhanced, the development of modern logistics industry is yet to catch up that of e-commerce, the institutional environment for e-commerce development should be further improved, legislation should be accelerated, the service regulatory system, the credit information system, the statistical monitoring system, and the e-commerce industry investment and financing mechanism should be strengthened, while efforts should be made to facilitate on-line transaction dispute settlements.

The “Twelfth Five-Year” period provides strategic opportunities to accelerate the development of e-commerce. Measures should be adopted to strengthen organization and security, establish a supportive e-commerce culture based on good faith, upgrade public services and market surveillance, improve rights and interests protection mechanism, enact laws, regulation and standards, build diverse investment and financing mechanisms, so as to promote the wide application of e-commerce in various fields, accelerate the popularization of mobile e-commerce applications, vigorously promote the balanced development of supporting mechanisms such as logistics, payment, credit, financing, insurance, testing and certification, to further improve the security and technical capabilities of the e-commerce.

Part 5 Monetary Policy Stance for the Next Stage

I. Outlook for the Chinese economy

Looking ahead, the drivers of Chinese economic growth will remain fairly strong.

Supported by macro-economic policies, the outlook for maintaining stable and fairly rapid growth is positive. Looking at the global economy, despite many uncertain factors, slow recovery is likely to continue. With de-leveraging already going on for a while in the U.S., its drag on the economy is waning; the liquidity support program of ECB has helped stabilize the markets; overall, the external environment is generally weak but fairly stable. Within China, there are fresh positive factors to promote domestic consumption expansion. In 2012, the real growth of per capita disposable income of urban dwellers and per capita net income of rural residents both exceeded that of GDP. With stronger policy measures to encourage consumption and the progress of income distribution reform, household income is likely to increase fairly rapidly and its structure will gradually improve. Consumption will have a bigger role to play in economic growth. According to the quarterly depositors' survey conducted by the PBC in Q4 2012, the future income confidence index was up 2.5 percentage points from the previous quarter, indicating that a larger share of respondents tend to increase consumption and pointing to a stronger willingness to consume. The localities are keen to seek development, especially the middle and western regions have a strong incentive to take later mover advantage and achieve balanced regional development. In the process of urbanization, informatization, industrialization and modernization of the agricultural sector, the investment demand will be strong, especially investment for infrastructure, industry and technology upgrading. These are important factors supporting stable economic growth. In addition, since de-stocking has been going on for a while, the industries are more sensitive to demand recovery and expectation changes. This is another positive factor for economic growth. The effect of fine-tunings and preemptive measures are gradually unfolding. With macro-economic management experiences building up, there will be proper management of the intensity and pace of policy measures, which will be conducive to a good policy environment.

Yet, we should be aware that the domestic and external environment remains complicated. With tepid global recovery and some economies heavily indebted, the combination of a tight fiscal policy and a loose monetary policy may become a long-term policy choice of major developed economies. In addition, emerging economies face trade and financial sector challenges due to resurgence of trade and investment protectionism. On the domestic front, the recent investment recovery is driven mainly by state-owned investment and entities with the state holding the controlling shares, and thus the basis for stable performance is not sufficiently solid. There are both a strong investment impulse in some sectors and a lack of endogenous drivers in the wider economy. With acute structural imbalances and stronger resource and environmental constraint, the task of adjusting economic structure and building ecological civilization remains arduous.

The price situation is relatively stable. However, uncertain factors are on the rise. In the short run, prices are subject to supply shock but in the long run are affected by aggregate demand, output gap and structural changes. Stable growth, grain output

gain for nine years in a row, sufficient output and supply capacity are all positive factors in support of stable prices. Yet, there are factors that give upward pressures. First of all, with growth of working-age population decelerating year after year, prices of agricultural produce and services which are labor-intensive and almost non-tradable may go up. The pricing of resource products is yet to be straightened out. The impact of this factor has a lot to do with aggregate demand. Secondly, due to a multiple of factors, supply curve may become steeper, and prices will become more sensitive to demand expansion. Judging from what has happened since the outbreak of the global financial crisis, ultra-loose monetary environment may alter the interaction between global growth and inflation, resulting in relative low output and relatively higher price gain. Empirical evidence shows that the elasticity of China's CPI to changes in output gap has increased after the outbreak of financial crisis. As such, economic recovery and expansion of demand may soon be transmitted to CPI. Thirdly, the global monetary environment will remain ultra-loose for a period to come. The major economies are increasing the strength of quantitative easing and the potential imported inflationary pressure should be watched. According to the quarterly depositors' survey conducted by the People's Bank of China in Q4 2012, 41.7 percent of the surveyed expected higher prices in the coming quarter, 4.7 percentage points higher than in Q3 2012. It is necessary to pay special attention to the potential impact of expectation changes on future prices. When the economy is in transition, monetary policy will always focus on preventing inflation risks.

II. Monetary policy for the next stage

Going forward, the PBC will follow the overall arrangements of the State Council, implement the decisions adopted at the Central Economic Work Conference, take sustainable development as the central theme and acceleration in the shift of the growth pattern as the core of its policy conduct, place high priority on higher quality growth and efficiency, follow the principle of making progress while maintaining stability, continue to implement a prudent monetary policy, preserve the continuity and stability of policy, make the policy measures more forward-looking, targeted and flexible, properly handle the relationship among preserving fairly fast and stable growth, structural readjustment, and managing inflation expectation, strengthen policy coordination, preserve a stable monetary environment, improve financial services to the real sector, maintain fairly stable price levels, create conditions for the economy to readjust and the inherent stability mechanism to function, and promote the sustained sound development of the economy.

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

Second, credit resource allocations will be optimized and structural adjustment of the credit asset in stock will be enhanced to support economic structural adjustment and to better serve the real sector. The financial institutions will be guided to enhance credit support to the ongoing and follow-up national key projects, the agriculture, rural areas and farmers, small- and micro-sized enterprises, modern service sector, and emerging industries, continue to improve financial services to welfare projects such as job creation, poverty reduction and student loans to improve people's welfare, support the regional economic development policy and continue to provide financial support and services for balanced regional development. Control will remain tough to restrict lending to highly polluting industries and those with excess capacity. Differentiated housing mortgage policies will continue to support the construction of welfare housing and common commercial housing projects with apartments of modest floor plans and purchase by a first-time home buyer of common commercial housing for his/her own use, and to contain speculative purchase and purchase for investment purpose.

Third, the market-based interest rate reform and RMB exchange rate regime reform will be advanced to improve efficiency of credit resource allocation, and improve the monetary policy framework. The development of benchmark market interest rate system will be facilitated to guide financial institutions to strengthen pricing capability, properly use their discretion in offering rates within a floating band of the benchmark interest rates, strengthen non-deposit liability management and cost restraint, properly assess interest rate risks, improve pricing mechanism, and maintain pricing order. Measures will be adopted to improve the ability of the central bank in guiding market interest rates, strengthen price-based transmission and adjustment mechanism, and promote balanced growth of the real and financial sectors. The RMB exchange rate regime will be improved to enhance the two-way flexibility of the RMB exchange rate, to enable market demand and supply to play a larger role, and keep the exchange rate basically stable at an adaptive and equilibrium level. The

development of the foreign exchange market will be accelerated to facilitate innovation in exchange rate risk management. Measures will be taken to support the use of RMB in cross-border trade and investment and the channels for inflows and outflows of RMB funds will be broadened. The direct trading of RMB against emerging market currencies will be promoted in the inter-bank market to provide the better services for the RMB settlement of cross-border trade. The impact of changing international situation on capital flow will be closely watched and effective monitoring of cross-border capital movement will be strengthened.

Fourth, market-orientation will be followed to promote sound development of the financial market. Efforts will be made to encourage financial market innovation, enhance risk awareness and prevention, allow market mechanisms to fully function, continue to build and strengthen market infrastructure, and enhance monitoring and regulation to promote sound development of the financial markets. To broaden financial channels of small- and micro-sized enterprises, qualified SMEs will be encouraged to secure financing through various channels including SMEs collective bills and qualified commercial banks will be allowed to issue financial bonds earmarked to support micro and small enterprises.

Fifth, reform of financial institutions will be deepened. Reform of large commercial banks will be deepened to gradually improve modern financial enterprise system, improve internal governance and risk management, speed up the transformation of growth pattern, build innovation capability and international competitiveness. Rural credit cooperative (RCCs) reform will be deepened and the Rural Financial Business Division of the Agricultural Bank of China will be advanced to improve the rural financial service system through reform. The development of policy financial institutions will be considered comprehensively; the market-based reform of the China Development Bank will be deepened while the reform of the Export-Import Bank of China and the Agricultural Development Bank of China will be advanced based on the principle of one set of specific policies for each bank and providing specific guidance. Work will continue to promote market-based transformation of asset management companies. The pilot reform of cross-sector operation will be implemented on a prudent and progressive basis. Development of financial institutions established with private capital will be supported and the pilot program of local financial sector reform will be advanced to promote sound development of private finance.

Sixth, effective measures will be adopted to mitigate systemic financial risks and to preserve stability of the financial system. Macro-prudential regulation will be enhanced to guide financial institutions to operate on a sound basis. Financial institutions will be urged to strengthen internal control and risk management, and to better monitor the risks in innovation and business development. The framework for systemic financial risks assessment and early warning will be improved, and monitoring and assessment of cross-sector, cross-market and cross-border financial

risks will be strengthened to prevent the spread to financial system of risks associated with real economy in some regions, industries and enterprises and those arising from financing activities outside of the formal financial system. It is necessary to build a crisis management and risk disposal framework and to further the efforts of building a deposit insurance scheme. A variety of measures will be taken to safeguard the bottom line of preventing systemic risks and regional financial risks.