Economic and Financial Development & Prospects of Financial Sector in China

Mr. FENG Runxiang

Director General

International Department

The People's Bank of China, Shanghai Head Office

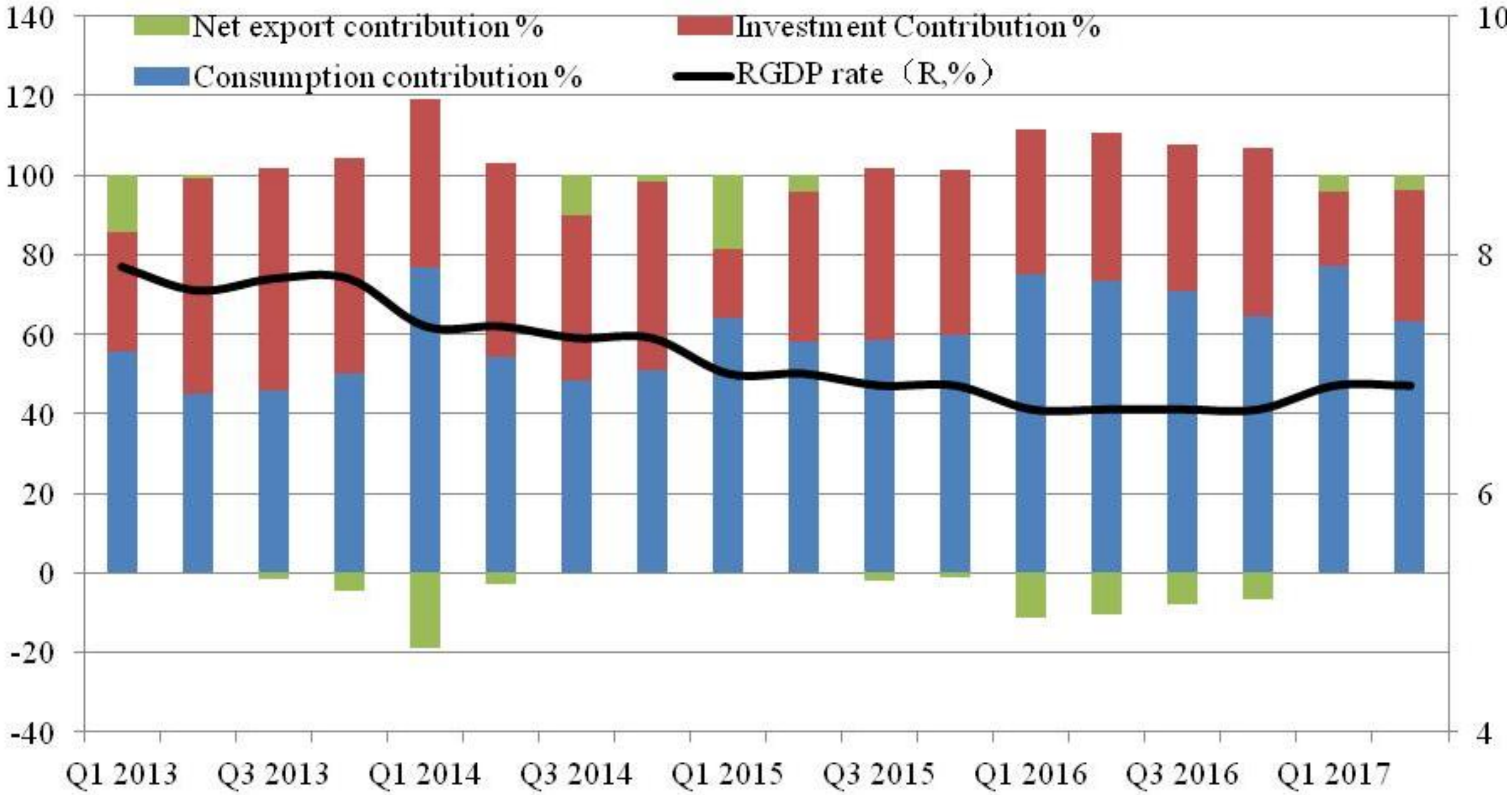
中国人民银行
THE PEOPLE'S BANK OF CHINA

Outline

- 1.The economy had a stable performance in the first half of 2017.
- 2. The development of financial sector in the future
  - In July, China held its fifth National Financial Working Conference
    - Financial sector should fulfill its duty of supporting the real economy
    - Preventing systemic financial risks
    - Deepening financial reforms
    - Further opening up its financial sector

1. In H1 2017, China economy performed stably

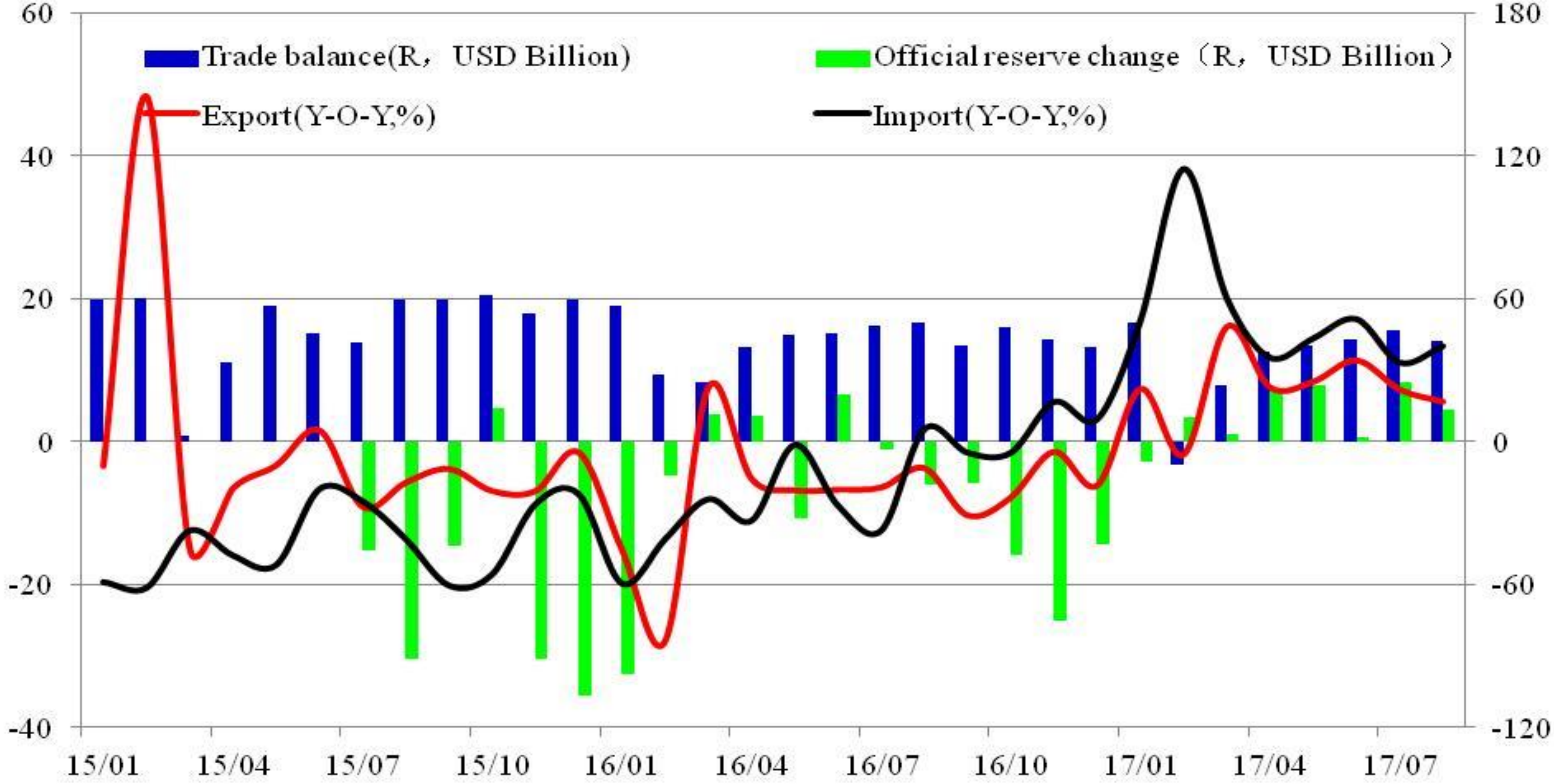
- 1.1 Real GDP increased 6.9%.



1.2 Consumption contributed more than 60 percent of China’s economic growth.

- In recent years, consumption played an increasingly important role of driving economic growth, while the role of investment and export decreased.
- In H1 2017, nominal GDP reached 38.15 trillion yuan. Consumption contributed 63 percent of China’s economic growth; the contribution of net export was 4 percent, changing from negative to positive; investment’s contribution was 33 percent.

1.3 Trade balance decreased, and official reserve rallied.

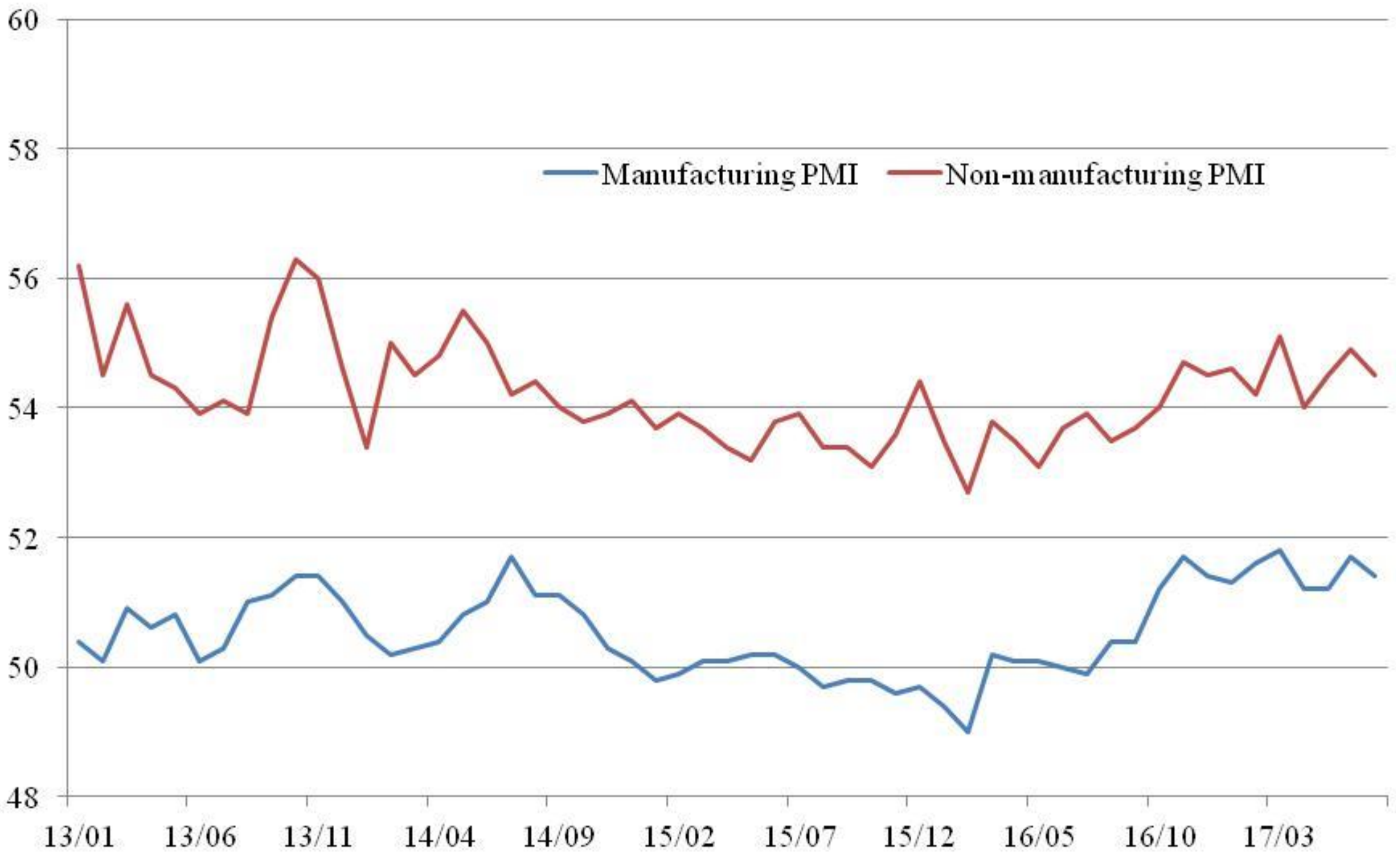


中国人民银行
THE PEOPLE'S BANK OF CHINA

1.3 Trade balance decreased, and official reserves rallied.

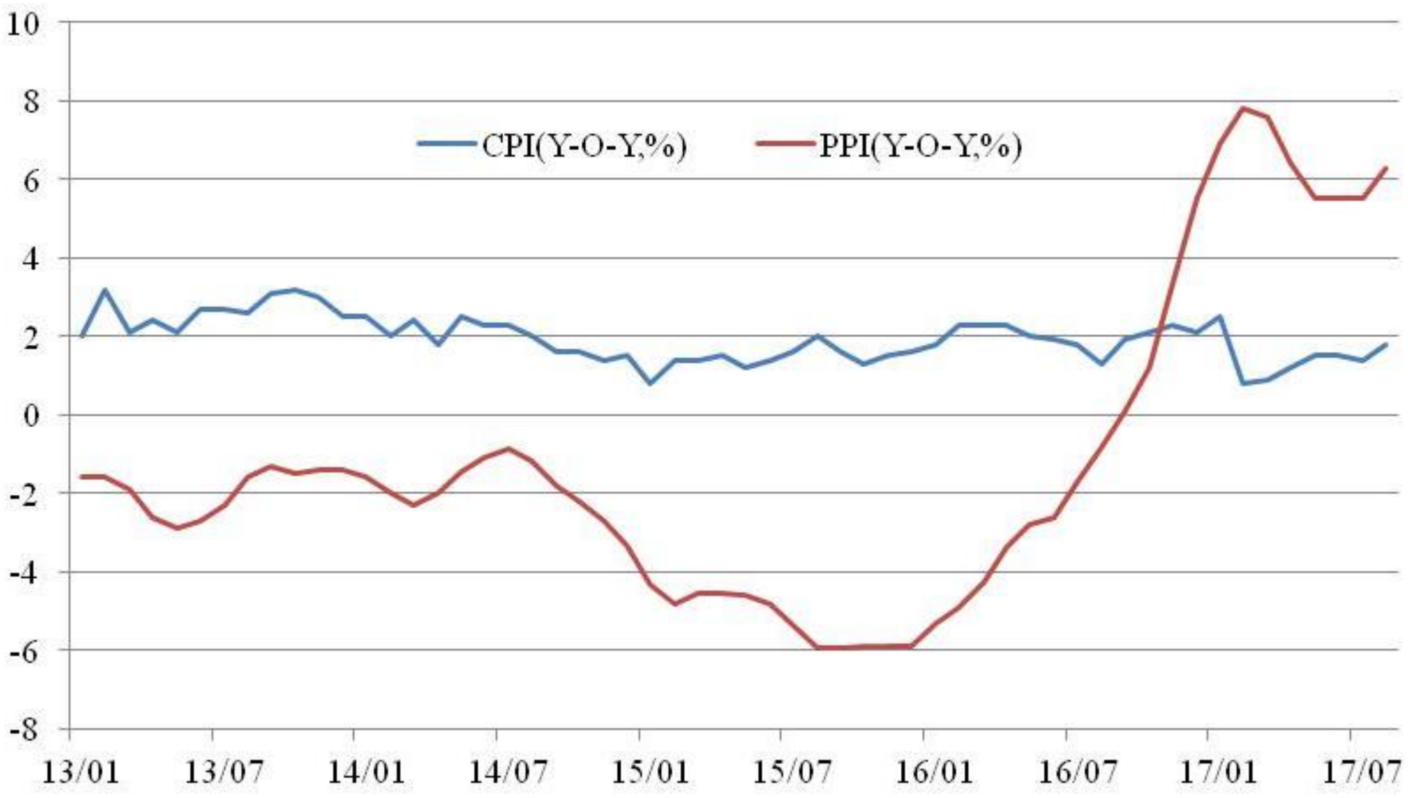
- From January to August 2017, export was 1.44 trillion US dollars, grew 7.9% y-o-y; import 1.17 trillion US dollars, grew 17% y-o-y; trade balance 274 billion US dollars, fell 19% y-o-y.
- Due to economic growth, the appreciation of RMB exchange rate and the reduction of capital outflow, the official reserves rallied. In the first 8 months of 2017, official reserves reached 3.19 trillion US dollars, an increase of 90.7 billion US dollars.

1.4 PMI obviously improved.



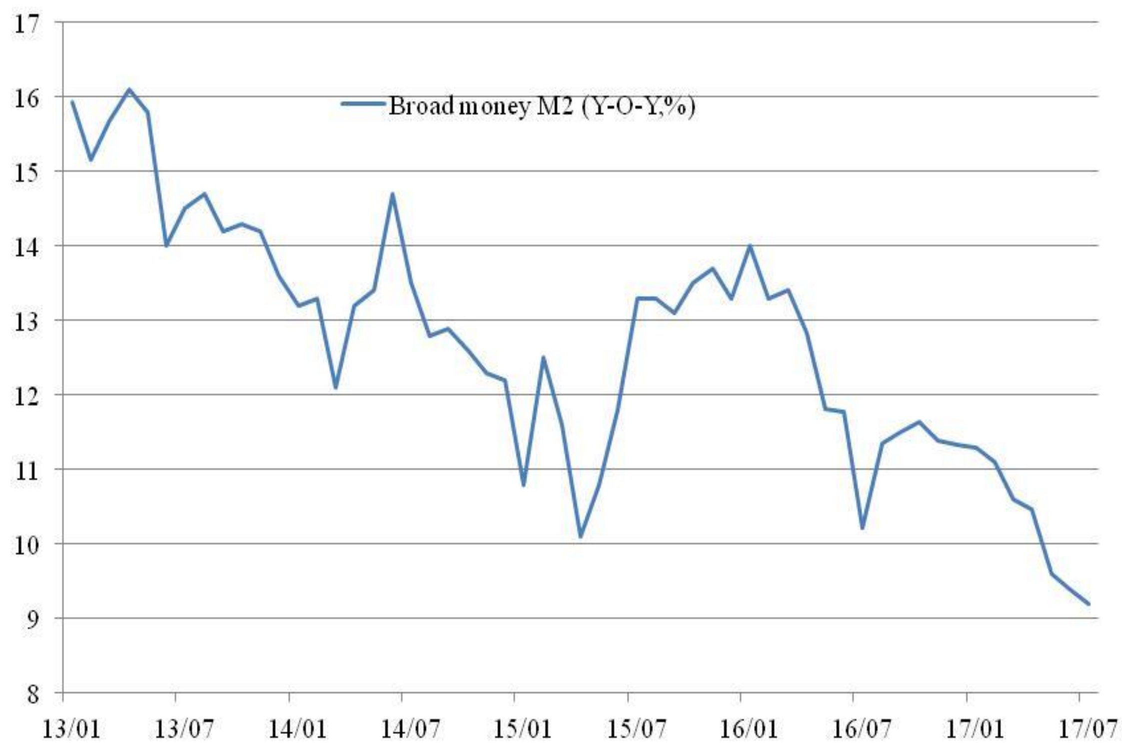
1.5 Inflation rate was below 2%.

- Although PPI grew over 6% y-o-y, the inflation rate was below 2%.



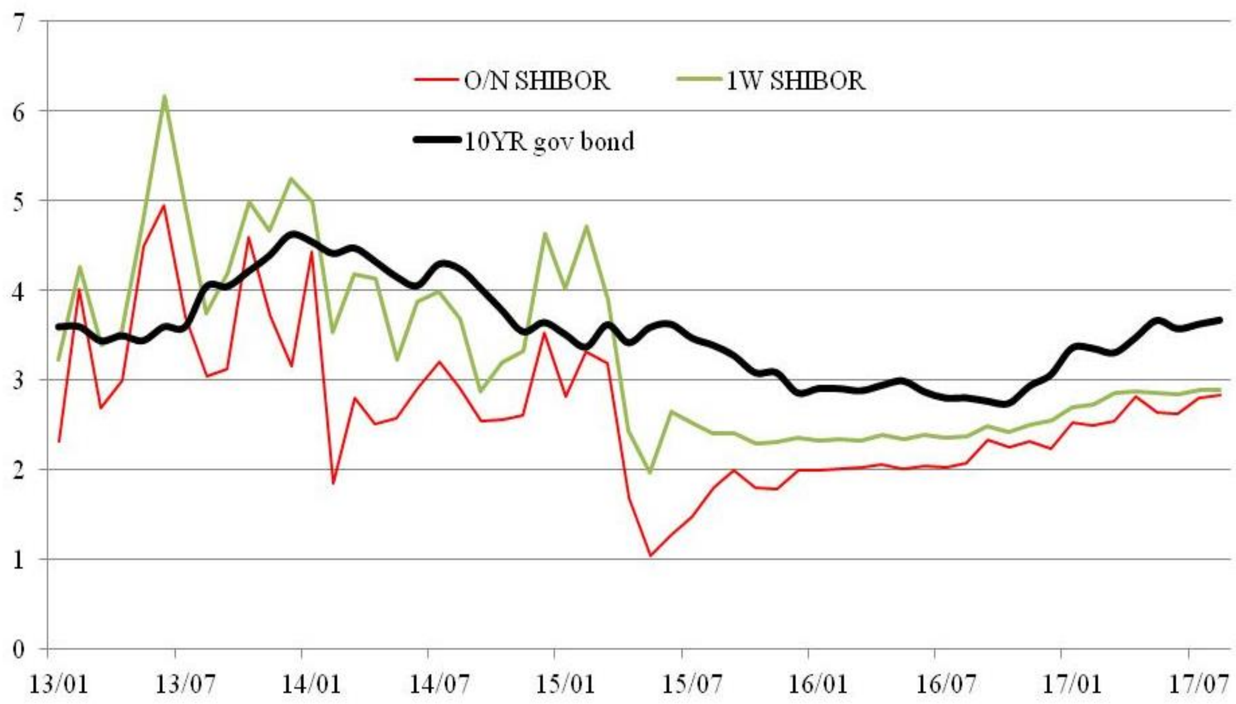
1.6 The growth rate of M2 continued to fall.

- The growth rate of broad money M2 fell to 9.2% from 13% in the beginning of last year.
  - The reform of housing monetarization was basically completed, and money demand fell.
  - In the past years, interbank business, WMP, etc. developed quickly. However, from this year, with the strengthening of financial regulation, related business shrank in scale, and so did the M2.



1.7 Market interest rate was stable, but also faced upward pressure.

- In 2016, the overnight and one-week SHIBOR, 10-year government bond yield were stable.
- Since 2017, as the Fed raised interest rates and China economy showed a good momentum for growth, the interest rates have tended to rise.
- In April 2017, the interest rates rose against the background of increased regulation and tight funds.

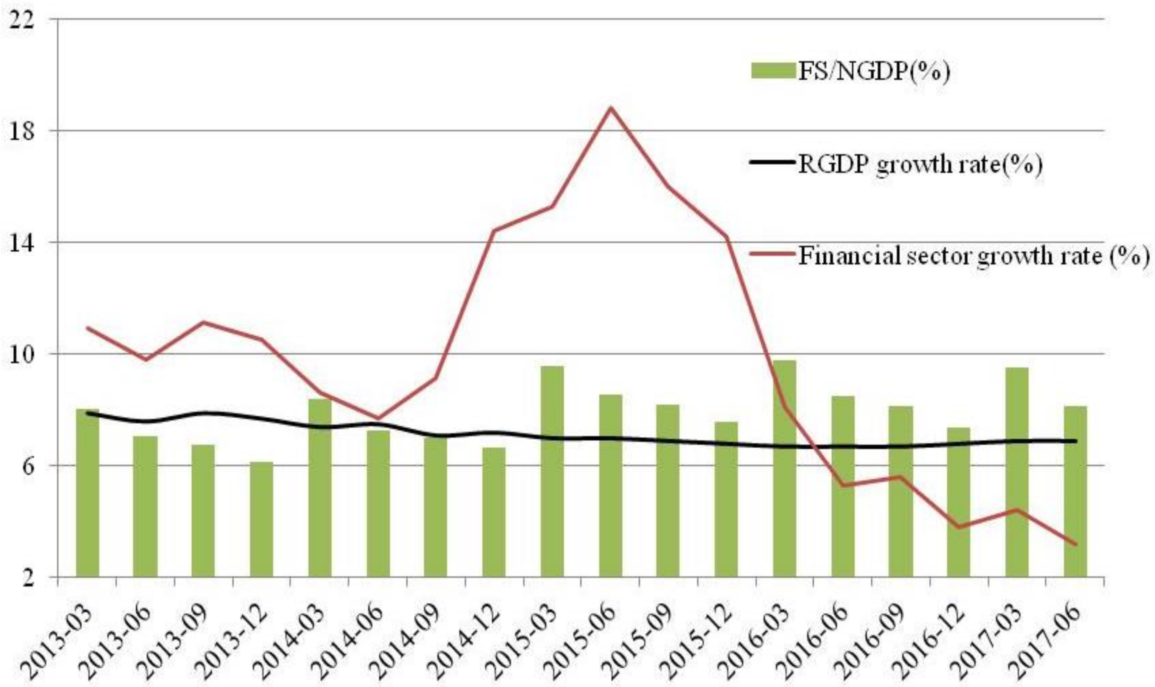


2. Financial industry should improve its ability to serve real economy.

- From 2012 to 2016, the added value of financial industry rose from 6.5% to 8.4% of GDP, which surpassed some developed countries, such as the United States and Japan. The scale of China’s financial market was far bigger than that of real economy, so there was self- circling and inflation to some extent. For example, during the same period, banking asset rose from 247% to 312% of GDP.
- Since 2017, supervision has been strengthened remarkably so as to prevent financial risks. In the future, more emphasis will be laid on the ability of China’s financial industry to serve the real economy, and more attention will be focused on sound performance of financial institutions rather over-expansion of asset scales.

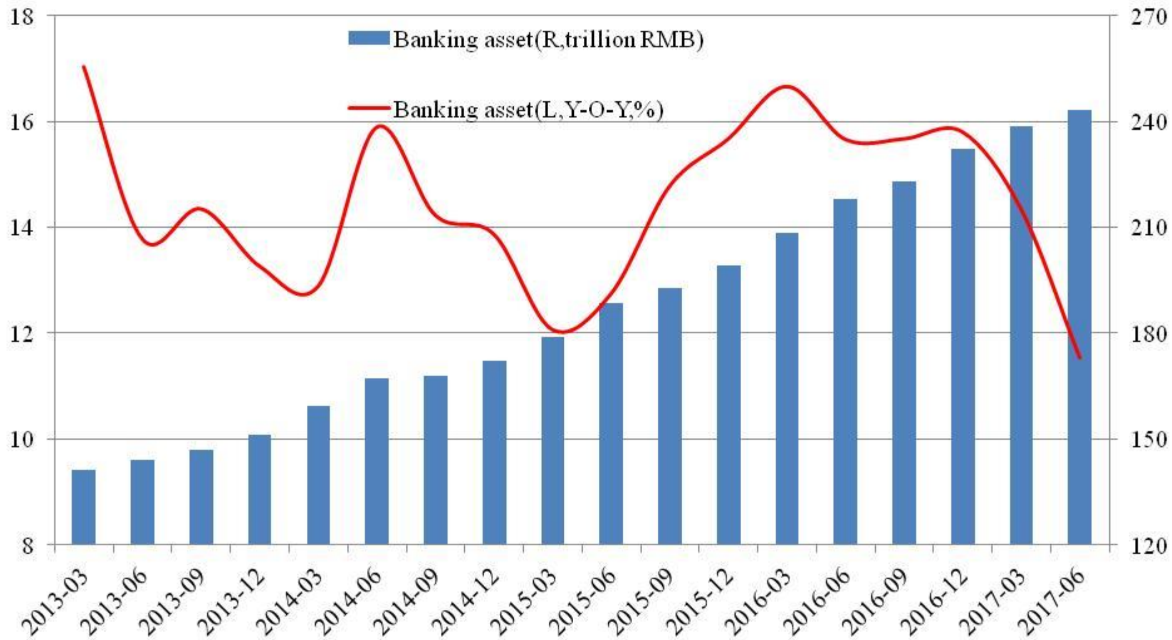
2.1 The added value growth of financial sector slowed down.

- In Q2 2015, due to the overheated stock market, the financial sector hit 18.8% in added value growth, which now has dropped back to 3.2%.
- Although still taking a high percent of GDP, the added value of financial sector has signs to go down. In H1 2017, the added value of financial sector accounted for 8.8% of GDP, lower than 9.1% in H1 2016.



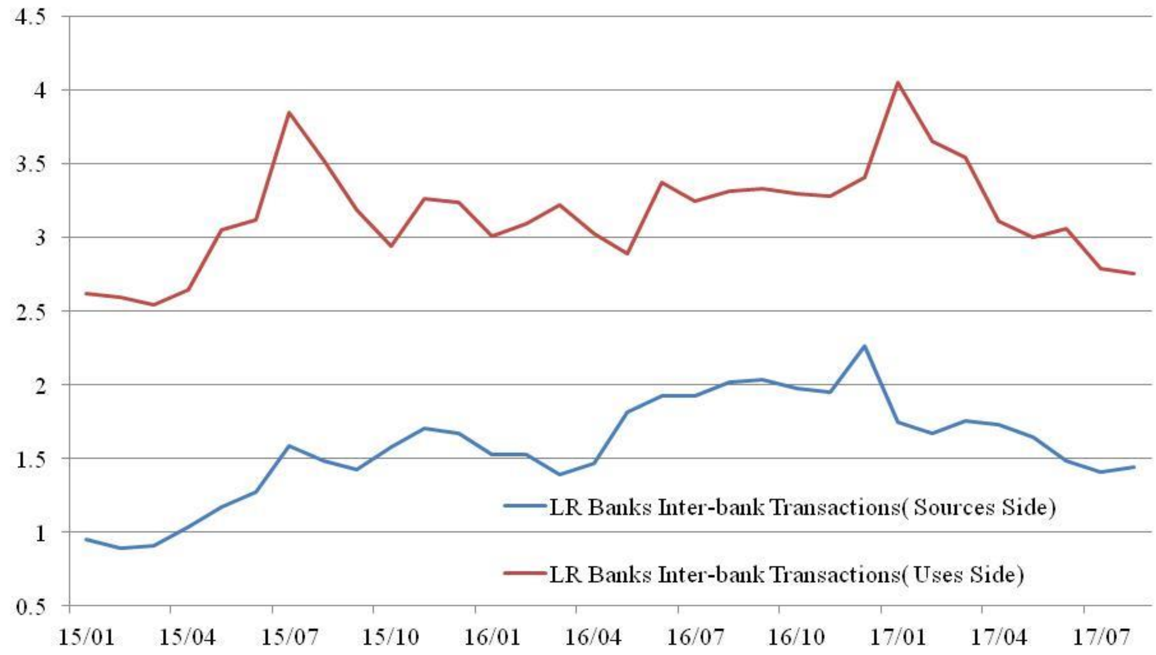
2.2 Banking asset size growth also slowdown.

- From 2013 to the end of Q2 2017, the banking asset size growth also declined from 17% to 11.5%.
- By the end of Q2 2017, the banking asset size reached 243 trillion yuan.



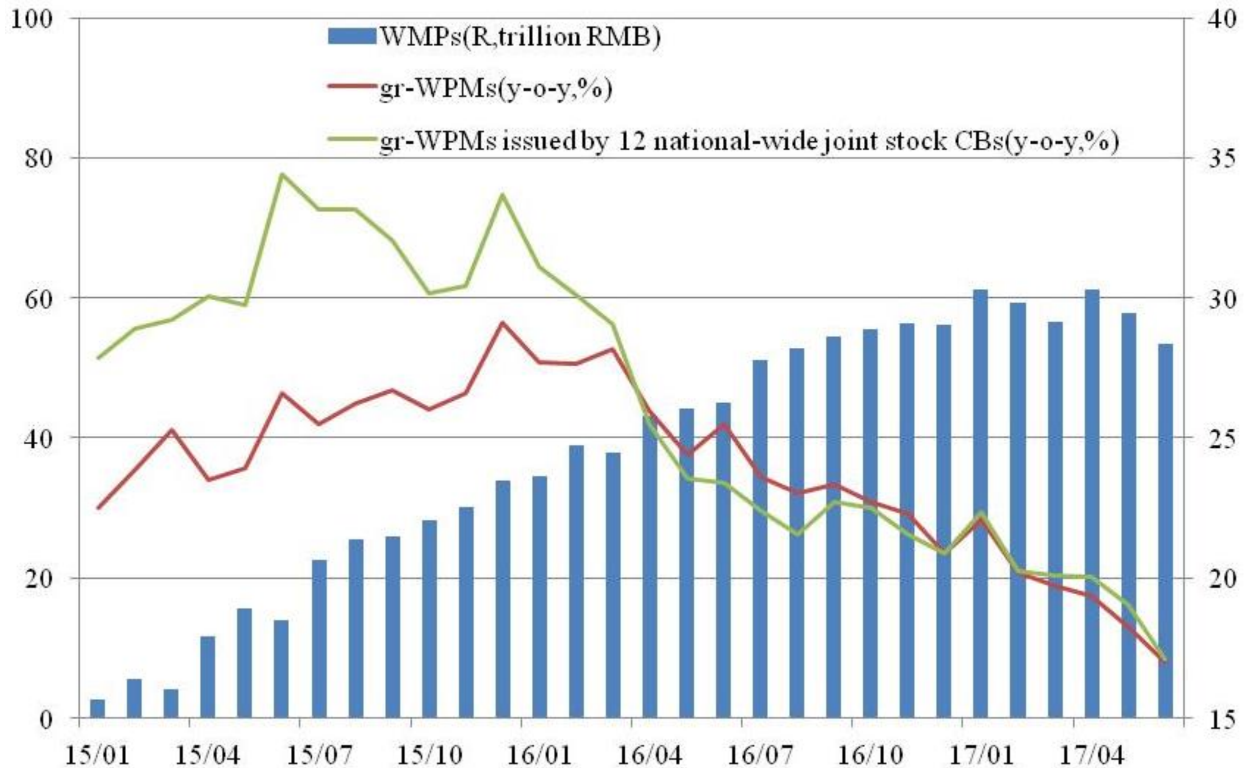
2.3 Inter-bank business of large banks declined remarkably.

- In Aug. 2017, 1.4 trillion yuan of large banks' funds was from inter-bank business, declining obviously compared with 2 trillion yuan in the same period of last year.
- There was 2.8 trillion yuan used for inter-bank financing from large banks, which was also obviously lower than the amount of 4 trillion yuan at the beginning of this year.



2.4 WMPs decelerate

- The outstanding balance of WMPs as of June 2017 reached 28.4 trillion yuan, indicating 8% y-o-y growth, much slower than the 23.6% in 2016 and 56.5% in 2015.
- The outstanding balance of WMPs issued by 12 national-wide joint-stock commercial banks decreased even larger.



2.5 Some perspectives

- Financial asset size growth will decelerate apparently, and money supply growth will also slow down.
- China will pay more attention to the development of direct financing, especially equity financing.
  - From 2013 to 2016, net bond financing rose from 1.8 trillion yuan to 3 trillion yuan, and financing by non-financial enterprises on the domestic stock market rose from 220 billion yuan to 1.24 trillion yuan. Loan still played a dominant role, which rose from 8.9 trillion yuan in 2013 to 12.4 trillion yuan in 2016.
- In order to enhance market competition and better serve small and medium-sized enterprises (SMEs), China will further improve indirect financing market and encourage the growth of small and medium-sized banks as well as private financial institutions.

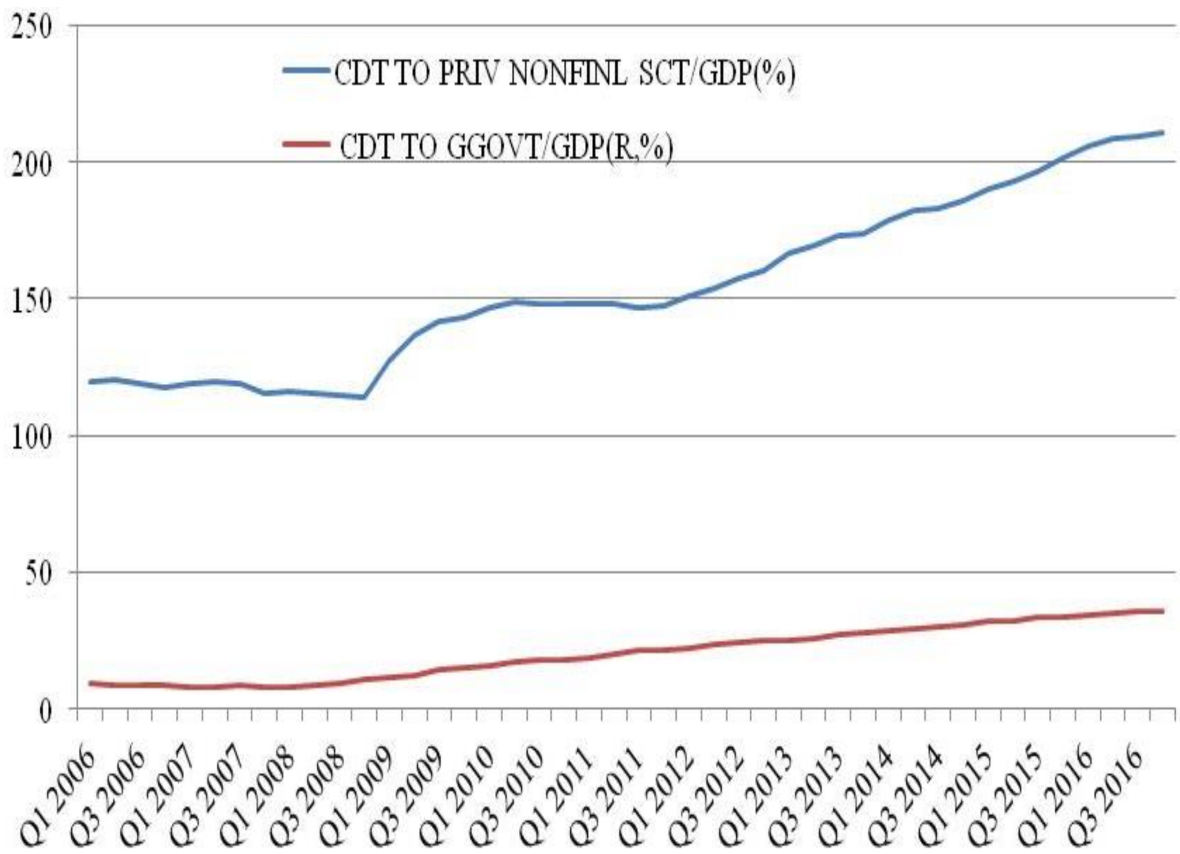
3. Preventing and mitigating financial risks

3.1 High corporate leverage ratio

- Under the relatively high corporate leverage ratio and mounting downward pressure on the economy, enterprises' disability of paying matured debts will cause NPLs within the banking system.
- In 2009, China took an economic stimulus plan to minimize impact of the global financial crisis, which caused a large increase of debts in the private non-financial sector. In the second half of 2012, with China's economy entering a "new normal" status, the private non-financial sector leverage ratio began a new round of rapid growth.
- By the end of 2016, the leverage ratio of private non-financial sector reached 211%. The leverage ratio of household was low at 40%-50%, but that of enterprises was relatively high, at about 170%, and in particular, state-owned enterprises had a higher ratio.

3.1 High corporate leverage ratio

- According to the latest statistics, the leverage ratio of China's economy is 257%. The debt risk is controllable on the whole.
  - In fact, part of corporate debts are government debts.
  - China's government debt level is relatively low.
  - China's saving rate is high and household leverage ratio is relatively low.



3.2 Efforts have been made to strengthen regulation and standardize inter-bank business.

- The financial regulatory authorities are formulating unified regulatory standards for asset management industries.
- The People's Bank of China (PBC) is also continuously improving its Macro Prudential Assessment (MPA) system.
  - Off balance sheet WMPs was incorporated into the scope of generalized credit, whose growth has dropped from a high level afterwards.
  - From 2018, CDs within 1 year issued by commercial banks with assets more than 500 billion yuan will be covered by MPA system.
- The regulatory authorities will strengthen regulation and supervision over the entities they are responsible for.
- Efforts will be made to jointly regulate internet finance, fight financial fraud and illegal fund-raising activities, etc..

4. Reform of financial regulatory system

- A new committee was set up to strengthen regulatory coordination—Financial Stability and Development Committee under the State Council.
  - The constraint force of previous inter-departmental meetings organized by the PBC, CBRC, CSRC, and CIRC was relatively small.
  - The new Committee will help curb the regulatory arbitrage of financial institutions by closing loopholes and reducing regulatory competition. The Secretary Office of the Committee will be set up at PBC, which will claim responsibility for weak supervision.
  - This committee may take responsibility of formulating development plan for financial industries, which may help the regulators to avoid the dilemma of both supervision and development, so interest conflicts will be reduced.
- The responsibility of the PBC will be strengthened in macro prudential management and systematic risk prevention.
  - Clear definition of its duties in macro prudential management and systemic risk prevention helps to build the authority and independence of the PBC.
- Requiring the regulators to focus on regulation duties rather than development is convenient for government to claim responsibility to them.

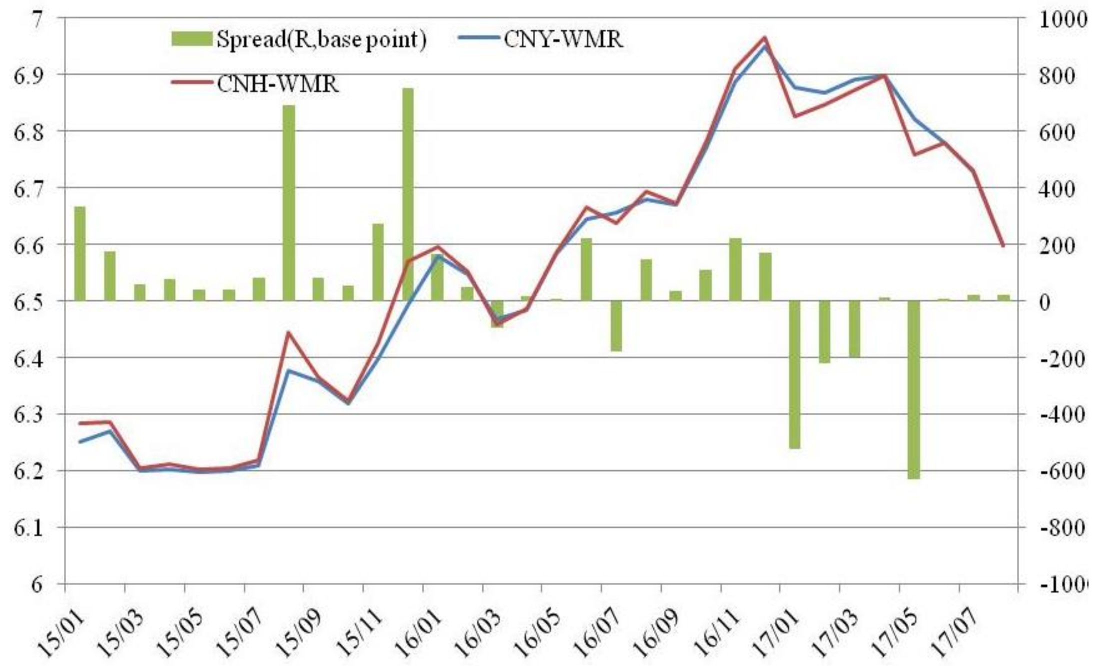
5. Firmly further opening up financial industries

5.1 Speeding up financial market opening-up

- From July 2017, with the launch of "bond connect", overseas investors can invest on the mainland inter-bank bond market through Hong Kong financial market.
- At present, domestic investors can issue RMB bond and stock overseas, and overseas investors can issue "panda bond" in mainland. Overseas investors can basically participate in China's capital market, especially the bond market, through QFII/RQFII, QDII/RQDII, "Shanghai-Hong Kong stock connect", , "Shenzhen-Hong Kong stock connect", "bond connect", and the international board of gold market.
- China will study to further open up its financial market, including loosen or cancel limitations for overseas investors to establish or invest financial institutions in China.
- By the end of July 2017, inter-bank bond market had brought in 514 foreign agencies with holding RMB bond hitting about 886 billion yuan, which was 1.3% of the total volume of the inter-bank bond market under custody.

5.2 A more market-oriented RMB exchange rate

- Mid 2015 to 2016 witnessed an apparent depreciation of RMB exchange rate.
- From the beginning of 2017, RMB appreciated nearly 6% .
- RMB off-shore and on-shore exchange rates basically had the same trace.
- The off-shore exchange rate was obviously more volatile than on-shore rate, which implies that the managed floating exchange rate mechanism by the PBC could stabilize market expectation while strengthening the elasticity of exchange rate.



5.3 Reinforcing financial cooperation with the Belt and Road countries

- Efforts will be made to cooperate with the Belt and Road countries to expand reciprocal establishment of financial institutions, synergize financial services, connect capital markets and financial infrastructures, strengthen cooperation and communication between monetary agencies and regulators.
- In the process of finance supporting the Belt and Road projects, the usage of RMB will be promoted.
- Fund support has been enhanced. In December 2014, China established the Silk Road Fund by investing 40 billion US dollars, and then in May 2017, Chinese President Xi Jinping announced to provide replenishment of 100 billion yuan. China also encourages financial institutions to conduct Overseas Fund Business in RMB with the estimated amount of about 300 billion yuan, providing financing support for the Belt and Road related projects.

Thank You!