China Monetary Policy Report
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Monetary Policy Analysis Group of

the People's Bank of China

Executive Summary

As a result of the package of stimulus policies in response to the global financial crisis, efforts to support economic growth, restructure the economy, promote reform, and improve the people's livelihood achieved positive results in the third quarter of 2009. Economic growth accelerated, investment grew rapidly, consumption demand expanded, and the demand structure improved notably, with domestic demand playing a larger role in driving economic growth. Agricultural production remained stable, industrial output grew at a faster pace, and the momentum for an economic upturn was enhanced. In the first three quarters, China's Gross Domestic Product (GDP) registered 21.8 trillion yuan, a year-on-year increase of 7.7 percent, and the Consumer Price Index (CPI) dropped 1.1 percent year on year. In the third quarter, GDP rose 8.9 percent and the CPI declined 1.3 percent from the same period of last year.

In line with the overall arrangements of the State Council, the People's Bank of China (PBC) implemented an appropriately accommodative monetary policy and guided financial institutions to properly handle the pace of credit supply to ensure that monetary policy would play an active role in supporting sound and relatively rapid economic development. The PBC conducted open market operations to ensure that liquidity in the banking system would remain at a reasonably adequate level. Efforts were made to improve the credit structure and prevent credit risks, to ensure that loans to eligible projects with central government investment were extended in a timely manner and to step up credit support to agriculture, farmers, and rural areas, small and medium enterprises (SMEs), employment programs, students, post-disaster reconstruction projects, and other programs aimed to improve the people's livelihood. The PBC also enhanced coordination between monetary policy, fiscal policy, and industrial policy to create a favorable monetary and financial environment for economic development.

Rapid money and credit supply supported economic stabilization and an economic upturn. Aggregate money supply continued its rapid growth, with M1 accounting for a larger share, indicating more dynamic economic activities. At end-September 2009, broad money supply M2 posted 58.5 trillion yuan, a year-on-year rise of 29.3 percent and an acceleration of 14.1 percentage points from the growth during the same period of last year. Narrow money supply M1 registered 20.2 trillion yuan, an increase of 29.5 percent from the same period of last year, which is 20.1 percentage points higher in year-on-year terms. Deposits increased at a rapid pace, and demand deposits accounted for a larger share, whereas loans expanded rapidly. At end-September, RMB loans stood at 39.0 trillion yuan, a rise of 34.2 percent year on year and an acceleration of 19.6 percentage points. This also represents an increase of 8.7 trillion yuan from the beginning of the year, which is 5.2 trillion yuan more than the increase during the same period of last year. Lending rates offered by financial institutions remained stable. In September, the weighted average RMB lending rate for non-financial institutions and other sectors was 5.05 percent. The RMB exchange rate remained basically stable at an adaptive and equilibrium level. At end-September, the central parity of the RMB against the US dollar posted 6.8290 yuan per dollar.

China's economic and social development is now at a key juncture of stabilization and an upturn, but there are many difficulties and problems. With regard to the external environment, the global economic recovery is likely to be slow, and external demand will remain weak, having a lasting impact on the Chinese economy. Back at home, the foundation for an economic upturn is not firmly established, and is unstable and uneven. Some deeply rooted problems, structural problems in particular, are still acute. Domestic demand needs to contribute more to drive economic growth, and the willingness for private investment needs to increase. The excess capacity issue is becoming worse and industrial restructuring faces increasing pressures and difficulties. The credit structure needs to be improved and liquidity management is more difficult.

During the next stage, in line with the overall arrangements of the State Council, the PBC will continue to implement a moderately loose monetary policy. It will properly balance relations between supporting sound and rapid economic development, economic restructuring and inflation management, improving risk prevention and resolution, and enhancing the sustainability of financial support to economic development. It will ensure that liquidity remain at a reasonable level, guide financial institutions to improve the credit structure, and enhance the sustainability of lending growth so as to safeguard financial stability. It will vigorously develop financial markets and promote private investment. It will continue the market-based reform of interest rates, improve the RMB exchange rate mechanism, and enhance foreign exchange administration.

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Part 1 Monetary and Credit Performance

In the third quarter of 2009 China's economy saw a strengthened momentum for stabilization and recovery. Money and credit continued their rapid growth, with M1 accounting for a greater share and medium- and long-term loans increasing by a large margin.

I. Money supply grew rapidly

At end-September, the outstanding balance of broad money M2 grew 29.3 percent year on year to 58.5 trillion yuan, an acceleration of 14.1 and 0.9 percentage points from the same period of 2008 and the end of the second quarter respectively. The outstanding balance of narrow money M1 reached 20.2 trillion yuan, an increase of 29.5 percent year on year, representing an acceleration of 20.1 percentage points from the same period of 2008 and an acceleration of 4.7 percentage points from the second quarter. Cash in circulation M0 grew 16.0 percent year on year to 3.7 trillion yuan, an acceleration of 6.7 percentage points from the same period of 2008. Net cash injections in the first three quarters of 2009 totaled 314.7 billion yuan, 160.3 billion yuan more than that recorded during the same period of 2008.

In the first three quarters of 2009, growth of M2 and M1 accelerated quarter by quarter. In particular, at end-September M1 accelerated more markedly and grew faster than M2 for the first time since May 2008, which may be attributed to the level in the previous year and reflect more vibrant economic activities. In general, money aggregates continued to expand at a rapid pace and the share of M1 increased.

II. Deposits of financial institutions grew rapidly and the growth of corporate demand deposits accelerated

At end-September, the outstanding balance of deposits of all financial institutions (throughout this Report, "all financial institutions" includes foreign-funded financial institutions) denominated in RMB and foreign currencies increased by 27.8 percent year on year to 59.8 trillion yuan, an acceleration of 9.6 percentage points from the same period of 2008, representing an increase of 11.8 trillion yuan from the beginning of the year and an acceleration of 5.1 trillion yuan year on year. In particular, the outstanding balance of RMB deposits rose 28.4 percent year on year to 58.4 trillion yuan, an acceleration of 9.6 percentage points from the same period of 2008, representing an increase of 11.7 trillion yuan from the beginning of the year and an acceleration of 5.2 trillion yuan year on year. The outstanding balance of foreign currency deposits rose 7.8 percent year on year to US$203.2 billion, a deceleration of

1.5 percentage points from the previous year, representing an increase of US$10.5 billion from the beginning of the year and a deceleration of US$17.2 billion year on year.

Broken down by sectors and maturities of local currency deposits, the growth of household deposits slowed down, deposits by non-financial companies continued to grow rapidly, and the growth of corporate demand deposits accelerated. At end-September, the outstanding balance of household RMB deposits increased by 25.0 percent year on year to 26.0 trillion yuan, an acceleration of 3.9 percentage points from the same period of 2008 but a deceleration of 3.3 percentage points from the second quarter of 2009, representing an increase of 3.8 trillion yuan from the beginning of the year and an acceleration of 574.5 billion yuan year on year. Recent relatively brisk real estate market and stock market activities diverted household deposits. The outstanding balance of non-financial corporate RMB deposits stood at 28.3 trillion yuan, an increase of 34.7 percent year on year, 19.6 percentage points higher than the growth during the same period of 2008 and 0.1 percentage points lower than that recorded in the second quarter, representing an increase of 6.6 trillion yuan from the beginning of the year and an acceleration of 4.4 trillion yuan year on year. Corporate deposits accelerated and increased by 5.6 trillion yuan in the first three quarters of 2009, an acceleration of 3.8 trillion yuan year on year, indicating adequate funds and strong payment capability in the corporate sector. Specifically, the growth of corporate demand deposits accelerated by 2.5 trillion yuan year on year, suggesting relatively sufficient enterprise working capital. At end-September, the outstanding balance of fiscal deposits rose 1.9 percent year on year to 2.8 trillion yuan, representing an increase of 1.0 trillion yuan from the beginning of the year and an acceleration of 26.3 billion yuan year on year.

III. RMB loans issued by financial institutions continued their rapid growth, with medium- and long-term loans increasing by a large margin

At end-September, the outstanding balance of loans issued by all financial institutions in RMB and foreign currencies stood at 41.4 trillion yuan, a growth of 33.8 percent year on year, 19.0 and 1.1 percentage points higher than the growth during the same period of 2008 and the second quarter of 2009 respectively, representing an increase of 9.3 trillion yuan from the beginning of the year and an acceleration of 5.6 trillion yuan year on year. RMB loans increased rapidly, with the outstanding balance growing 34.2 percent year on year to 39.0 trillion yuan at end-September, 19.6 percentage points higher than the growth during the same period of 2008 but 0.3 percentage points lower than the growth in the second quarter of 2009, representing an increase of 8.7 trillion yuan from the beginning of the year and an acceleration of 5.2 trillion yuan year on year. Broken down by institutions, the share of small- and medium-sized financial institutions in the aggregate credit increased in the third quarter. In the third quarter, the shares of city commercial banks and rural cooperative financial institutions in the new loans of all financial institutions increased by 6.1 and 5.8 percentage points respectively from the first half of 2009, whereas the shares of state-owned commercial banks and joint-stock commercial banks declined by 10.1 and 19.4 percentage points respectively. At end-September, the outstanding balance of foreign currency loans stood at US$343.3 billion, representing an increase of 28.3 percent year on year, down 2.5 percentage points from the growth during the same period of the previous year but up 20.3 percentage points from the second quarter, indicating a relatively rapid rebound. Foreign currency loans increased by US$99.7 billion from the beginning of the year, an acceleration of US$50.5 billion year on year. In the third quarter, foreign currency loans saw substantial growth of US$47.9 billion, nearly 50 percent of which went to trade financing, indicating intensified credit support to external trade.

Table 1: RMB loans by financial institutions

Unit: 100 million yuan

	The first three quarters of 2009		The first three quarters of 2008	
	New loans	Acceleration year on year	New loans	Acceleration year on year
Policy banks①	7 895	4 104	3 792	437
State-owned commercial banks②	36 974	24 364	12 610	-47
Joint-stock commercial banks	21 249	13 766	7 483	813
City commercial banks	7 131	4 203	2 929	180
Rural cooperative financial institutions③	9 523	4 093	5 430	-251
Foreign-funded financial institutions	-65	-915	850	-264

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

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

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

Source: The People's Bank of China.

In terms of loan destinations, the growth of household loans accelerated notably, whereas lending to non-financial institutions and other sectors continued their relatively rapid growth. At end-September, the outstanding balance of household loans grew 34.0 percent year on year, 19.0 and 10.2 percentage points higher than the growth during the same period of 2008 and the growth in the second quarter respectively, representing an increase of 1.8 trillion yuan from the beginning of the year and an acceleration of 1.2 trillion yuan year on year. The outstanding balance of consumer loans grew 1.2 trillion yuan from the beginning of the year, representing an acceleration of 880.9 billion yuan year on year and a momentum of rapid growth. In particular, due to brisk transactions in the real estate market, individual housing loans increased by 952 billion yuan from the beginning of the year, an acceleration of 708.9 billion yuan. Household business-oriented loans grew 587.2 billion yuan from the beginning of the year, an acceleration of 333.3 billion yuan year on year. Supported by the rapid growth of medium- and long-term loans, loans to non-financial companies and other sectors grew 34.2 percent year on year, an acceleration of 19.8 percentage points from the same period of 2008, representing an increase of 6.8 trillion yuan from the beginning of the year and an acceleration of 4.0 trillion yuan year on year. Specifically, medium- and long-term loans accelerated by 2.7 trillion yuan year on year, effectively satisfying the need for funds for important infrastructure projects. Paper financing accelerated by 720.2 billion yuan year on year. However, with the large number of bills issued at the beginning of the year coming due, and affected by other factors such as the rebounding of the bill discount rate, declining bill issuances, and the reduction in paper financing by financial institutions to provide more medium- and long-term loans, paper financing decreased by 826.2 billion yuan on a net basis in the third quarter. RMB loans to small- and medium-sized enterprises grew at a rapid pace. According to statistics jointly released by the PBC and the China Banking Regulatory Commission (CBRC), at end-September, the outstanding balance of RMB loans from Chinese banking institutions issued to SMEs totaled 14.1 trillion yuan (among which 910.2 billion yuan consisted of paper financing), an increase of 3.08 trillion yuan or 28 percent from the beginning of the year.

The bulk of RMB medium- and long-term loans went to the infrastructure sector, the leasing and business services sector, the real estate sector, and the manufacturing sector. In the first three quarters of 2009, new medium- and long-term loans of major financial institutions (including state-owned commercial banks, policy banks, joint-stock commercial banks, and city commercial banks) in RMB and foreign currencies totaled 2.1 trillion yuan to the infrastructure sector (transportation and communication, warehousing and postal services, electricity, gas, water production and supply, water conservancy, environmental protection, and public facility management), 591 billion yuan to leasing and business services, 481.2 billion yuan to the real estate sector, and 431 billion yuan to manufacturing respectively, accounting for 50.5 percent, 14.0 percent, 11.4 percent, and 10.2 percent of all new medium- and long-term loans respectively.

IV. Liquidity in the banking system was sufficient

By end-September, the outstanding balance of base money had increased 13.7 percent year on year to 13.3 trillion yuan, an increase of 418.5 billion yuan from the beginning of the year. The money multiplier at end-September was 4.39, representing growth of 0.53 from the same period of 2008 and thus representing a stronger capacity for money creation. At end-September, the excess reserve ratio of financial institutions registered 2.06 percent. In particular, the excess reserve ratios of the four state-owned commercial banks, joint-stock commercial banks, and rural credit cooperatives were 1.80 percent, 2.00 percent, and 3.96 percent respectively.

V. The lending rates of financial institutions remained stable

In the third quarter, liquidity in the banking system was abundant and the RMB lending rates of financial institutions remained stable. In September, the weighted average lending rate to non-financial companies and other sectors stood at 5.05 percent, flat with that recorded in June. In particular, the weighted average lending rate of loans and the weighted average paper financing rate stood at 5.74 percent and 2.48 percent respectively. The lending rate of individual housing loans remained broadly stable, with the weighted average interest rate for individual housing loans standing at 4.38 percent in September.

Compared with the benchmark interest rate, the share of loans with an interest rate lower or higher than the benchmark interest rate increased. In September, the share of loans to non-financial companies and other sectors with an upward or downward adjusted interest rate registered 31.82 percent and 37.57 percent respectively, up 1.35 and 1.74 percentage points from June; the share of loans with an interest rate at the benchmark accounted for 30.61 percent, down 3.09 percentage points from June.

Table 2: Shares of RMB loans with rates adjusting at various ranges in the first three quarters of 2009

Unit：Percent

	Adjusted downward	At benchmark	Adjusted upward					
	[0.9，1)	1	Sum	(1，1.1)	(1.1，1.3]	（1.3，1.5）	(1.5，2]	Above 2.0
January	23.51	34.27	42.21	14.62	12.79	4.97	6.98	2.86
February	28.82	33.56	37.62	12.29	10.36	4.82	6.98	3.18
March	28.38	35.18	36.43	12.21	10.46	4.37	6.64	2.75
April	26.72	33.48	39.8	12.18	11.07	5.46	7.97	3.12
May	27.34	32.4	40.26	13.03	11.46	5.18	7.49	3.1

June	30.47	33.7	35.83	12.66	10.24	4.7	5.82	2.41
July	32.76	32.18	35.06	11.89	9.16	4.52	6.55	2.94
August	30.91	30.79	38.31	13.34	10.68	5.03	6.45	2.81
September	31.82	30.61	37.57	12.55	10.81	5.07	6.41	2.73

Source: The People's Bank of China.

Affected by the decline in interest rates in international financial markets, the interest rates of domestic foreign currency loans declined. In September, the domestic US dollar lending rate for loans with a maturity of within 3 months and loans with a maturity of 3-6 months stood at 1.33 and 1.37 percent respectively, down 0.16 and 0.11 percentage points respectively from June. The domestic US dollar deposit rate remained stable. In September, US dollar demand deposits and large-value US dollar deposits with a 3-month maturity stood at 0.13 and 0.37 percent respectively, up 0.02 and 0.05 percentage points from June. From the end of 2008 to June 2009, some financial institutions on several occasions cut their interest rates for small-value foreign currency deposits, with the one-year rates of small-value US dollar deposits decreasing from 3 percent to 0.8 percent, down 2.2 percentage points. In an effort to expand the sources of foreign currency funds, some financial institutions slightly increased the interest rate for their small-value foreign currency deposits in September, with the one-year US dollar deposit rate reaching 1 percent.

Table 3: The average interest rate for large-value deposits and loans denominated in US dollar in the first three quarters of 2009

unit：%

	Large-value deposits						Loans				
	Demand Deposits	Within 3 months	3-6 months	6-12 months	one-year	Above one-year	Within 3 months	3-6 months	6-12 months	one-year	Above one-yea r
January	0.34	0.55	1.36	1.26	1.91	1.46	2.89	3.33	3.48	3.04	3.62
February	0.16	0.48	1.46	1.79	1.95	5.01	2.18	2.87	3.13	2.61	2.74
March	0.15	0.55	1.32	1.77	2.2	1.3	2.23	2.44	3.05	2.51	3.39
April	0.1	0.36	1.13	1.39	1.58	3.73	1.98	2.26	2.37	2.14	3.59
May	0.11	0.36	0.9	1.17	1.49	5	1.59	1.86	1.79	1.49	2.63
June	0.11	0.32	0.76	1.05	1.68	1.12	1.49	1.48	1.52	1.44	3.53
July	0.1	0.32	0.65	1.08	1.52	1.98	1.51	1.47	1.51	1.36	2.61
August	0.1	0.35	0.67	0.93	1.89	1.66	1.41	1.37	1.42	1.53	2.71
September	0.13	0.37	0.61	0.74	1.82	2.33	1.33	1.37	1.51	1.59	2.59

Source: The People's Bank of China.

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

and equilibrium level

Since the beginning of 2009, to cope with the global financial crisis the RMB exchange rate remained broadly stable at an adaptive and equilibrium level. At end-September the central parity of the RMB against the US dollar was 6.8290 yuan per US dollar, an appreciation of 56 bps, or 0.08 percent, from the end of 2008; the central parity of the RMB against the euro and the Japanese yen was 9.9659 yuan per euro and 7.5747 yuan per 100 yen, a depreciation of 3.08 and 0.13 percent respectively from the end of 2008. Beginning from the exchange rate regime reform in July 2007 to end-September 2009, the RMB cumulatively appreciated 21.20 percent against the US dollar, and depreciated 0.48 percent against the euro and 3.55 percent against the Japanese yen.

Since the beginning of 2009, the peak and trough central parities of the RMB against the US dollar were 6.8201 yuan per US dollar and 6.8399 yuan per US dollar respectively. The largest appreciation of the RMB central parity against the US dollar in a single business day was 0.07 percent (50 basis points) and the largest depreciation in a single business day was 0.07 percent (50 basis points). Among the 184 trading days, the RMB appreciated on 99 days and depreciated on 85 days against the US dollar on the inter-bank market. The RMB/dollar exchange rate was relatively stable, basically in a range between 6.81 yuan per US dollar and 6.85 yuan per US dollar, leading to relatively stable expectations for the RMB exchange rate.

Part 2 Monetary Policy Conduct

In the third quarter of 2009, due to the effects of the policy package adopted to cope with the global financial crisis, the trend of a national economic recovery was strengthened. The PBC continued to carry out a relatively easy monetary policy, adjusted the focus, strength, and pace of policy operations to keep reasonably sufficient liquidity in the banking system, and guided financial institutions to optimize the credit structure and prevent credit risks, in order to create a good monetary and credit environment for economic development and to enable monetary policy to play an active role in supporting economic growth.

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

In Q3, the PBC conducted open market operations flexibly in line with the external and internal economic and financial situations and the changes in banking liquidity. First, the PBC managed the pace and strength of open market operations to maintain reasonably sufficient liquidity in the banking system along with a flexible supplement of hedging operations through central bank bills and short-term repo transactions. In Q3, 1.3 trillion yuan of central bank bills were issued, and 870 billion yuan of repo operations were conducted. At end-September, the volume of outstanding central bank bills was 3.9 trillion yuan. Second, hedging instruments were further expanded with the resumption of the issuance of one-year central bank bills at the beginning of July to optimize the maturity structure of operations and promote stable growth of money and credit. Third, the flexibility of interest rate operations was enhanced to effectively guide market expectations. When interest rate volatility in the money market intensified and interest rates increased with the resumption of IPOs in the stock market, open market operation rates gradually stabilized after moderate increases in the third quarter so that market expectations were effectively guided and the market interest rate played a role in adjusting the demand and supply of funds. At end-September, the interest rates of 28-day repo and 3-month central bank bills were stabilized at 1.18 percent and 1.33 percent respectively, up 28 and 36 basis points from the beginning of the year. The issuance rate of one-year central bank bills stood steadily at 1.76 percent, up almost 26 basis points since the resumption of the issuance of central bank bills. Fourth, state treasury cash management was carried out in a timely manner. In order to further strengthen coordination between fiscal policy and monetary policy, time deposit business with commercial banks for state treasury cash management was carried out on three occasions in the third quarter at a volume of 30 billion yuan each time; this helped increase the return on treasury cash and maintained continuity in operations, and also helped satisfy the funding requirements of some small- and medium-sized financial institutions in a timely manner.

II. Window guidance and credit policy guidance were enhanced

Financial institutions were guided to control the pace of credit extensions, improve the credit structure, and prevent credit risks. Efforts were made to strengthen macro-credit policy guidance and financial support for the restructuring and revitalization of ten key industries. Efforts were also made to strengthen credit support to SMEs, the agricultural sector, the countryside, and farmers, employment creation, students in need, out-sourcing of services, post-disaster reconstruction, and other projects to improve the people's well-being. Consumer credit development and implementation of a housing credit policy were encouraged. Funding support to economic restructuring, independent innovation, M&As, industry relocation, and concerted economic development in ethnic regions was strengthened. Credit to weak enterprises in high energy consuming, heavily polluting industries with excessive production capacity was strictly limited. Financial institutions were also guided and urged to strengthen internal risk controls, to manage the structure, pace, and progress of loan disbursements, and to prevent new credit risks.

III. The pilot RMB settlement of cross-border trade transactions was steadily promoted

To meet the requirements of domestic and overseas markets and enterprises, to support the development of trade between China and its neighboring countries and regions, and to provide more conveniences for enterprises, on April 8, 2009, the State Council decided to conduct pilot RMB settlement of cross-border trade transactions in Shanghai, and Guangzhou, Shenzhen, Zhuhai, and Dongguan of Guangdong province. In July 2009, the *Administrative Rules for the Pilot RMB Settlement of Cross-border Trade Transactions* and the *Regulation for Implementing the Administrative Rules on the Pilot Program for RMB Settlement of Cross-border Trade Transactions* were released to regulate RMB settlement of trade transactions.

Box 1 Steadily promote the pilot RMB settlement of cross-border trade transactions to enhance facilitation of trade and investment

Affected by the global financial crisis, major international settlement currencies such as the US dollar and the euro experienced large exchange-rate volatility and trade financing decreased, posing substantial risks for Chinese enterprises and enterprises in neighboring countries and regions when settling trade transactions in a third currency. Some enterprises, both in China and other countries, hoped to use the RMB as a payment instrument. At the same time, China had realized the convertibility of the RMB under the current account since 1996 and had accumulated experience in personal RMB business in Hong Kong and Macau and RMB settlement of border trade. Against such a background, the 56th regular meeting of the State Council decided to launch a pilot program for RMB settlement of cross-border trade transactions in Shanghai and Guangzhou, Shenzhen, Zhuhai, and Dongguan of Guangdong province to provide conveniences for enterprises. On July 1, 2009, the

PBC, jointly with the Ministry of Finance, the Ministry of Commerce, the General Administration of Customs, the State Administration of Taxation, and the China Banking Regulatory Commission, issued the *Administrative Rules on the Pilot Program for RMB Settlement of Cross-border Trade Transactions*. On July 3, the PBC released the *Regulation for Implementing the Administrative Rules on the Pilot Program for RMB Settlement of Cross-border Trade Transactions*. Thereafter, the State Administration of Taxation and the General Administration of Customs issued supporting policies on export tax rebates and customs declarations for RMB settlements in order to standardize RMB settlements for cross-border trade transactions and to steadily carry out the pilot program.

The general principle for RMB settlement of cross-border trade transactions is to facilitate trade activities while ensuring that risks remain controllable. Under this principle, the above-mentioned administrative rules and supporting policies stress, on the one hand, the importance of effective supervision over the pilot RMB settlement of cross-border trade transactions through strengthening the institutional arrangements in selecting the pilot enterprises, verification of trade authenticity, and statistical monitoring of RMB payments and receipt information and establishing an information-sharing and management system, and, on the other hand, to provide conveniences to enterprises by stipulating that RMB settlements of cross-border trade transactions need not go through the foreign exchange verification procedures, that exports settled with RMB are eligible for the export tax rebate (exemption) in line with the relevant rules, and that enterprises can deposit RMB revenue from export transactions overseas to meet their business needs.

Generally, the pilot program for RMB settlement of cross-border trade transactions progressed smoothly and the fund-clearing channel was safe and efficient. According to statistics of the Cross-border RMB Receipt and Payment Information Management System (RCPMIS), as of September 30, 2009, the total amount of RMB settlement of cross-border trade transactions was over 100 million yuan, and financing under RMB accounts, trade financing, and other related businesses were conducted successfully. The export tax rebate (exemption) claim and customs declaration for RMB settled transactions were gradually streamlined.

In the changing global economic and financial environment, the launch of RMB settlement of cross-border trade transactions will help enterprises manage foreign exchange rate risks and reduce foreign exchange losses, will be important to promote economic and trade development between China and its neighboring countries and regions, and will support stable foreign trade development. The PBC, together with the relevant departments, will build on the experiences of the pilot program and actively study the feasibility and implementation procedures for expanding the pilot program in an effort to promote facilitation of trade and investment.

IV. Reform of financial enterprises was advanced

Reform of the listed large state-owned commercial banks was further deepened and there was improved performance. The Industrial and Commercial Bank of China, the Bank of China, the China Construction Bank, and the Bank of Communications continued to improve governance, advance decision-making mechanisms, strengthen internal controls and risk prevention mechanisms to prevent a rebounding of the NPL ratio and a decline in profits, while earnestly implementing the state macro-adjustment policy and increasing credit support for economic growth. At the end of Q3, the capital adequacy ratio of the Industrial and Commercial Bank of China, the Bank of China, the China Construction Bank, and the Bank of Communications registered 12.6 percent, 11.6 percent, 12.1 percent, and 12.5 percent respectively, the NPL ratio was 1.7 percent, 1.6 percent, 1.6 percent, and 1.4 percent respectively, and pre-tax profits were 128.87 billion yuan, 84.76 billion yuan, 11.16 billion yuan, and 29.26 billion yuan respectively.

The joint stock reform of the Agricultural Bank of China and the China Development Bank made good progress. The Agricultural Bank of China steadily advanced the reform of its multi-divisional structure system, formulated a special credit policy for the agricultural economy, established a positive incentive mechanism to serve the agricultural economy, strengthened risk management and control in sectors serving the agricultural economy, increased credit extensions to the agricultural economy and key fields at the county level, and improved financial services for farmers. At end-September, the Agricultural Bank of China issued 29.67 million bankcards to farmers and issued micro credits to 2.16 million farmers through bankcards, with an outstanding balance of 56.8 billion yuan. The China Development Bank (CDB) continued exploring the establishment of an operational mechanism and mode suitable for medium- and long-term credit-lending banks. At end-August, the CDB established its PE-focus unit to develop the equity investment business.

The reform of policy financial institutions advanced steadily. The reform working group established by the PBC and relevant departments continued to improve the reform plan and articles of association of the Export-Import Bank of China and the China Export Credit Insurance Corporation. The nature of these two institutions will remain as policy financial institutions, with their business classified into policy business and commercial business and with a focus on policy business. They will enhance their service capacity for foreign trade and “going abroad” enterprises by injecting capital, improving corporate governance, strengthening internal controls and external constraints, and other reform measures.

The reform of the rural credit cooperatives (RCCs) advanced smoothly and the bulk of the financial support was disbursed. At end-September, a total of 160.1 billion yuan of special bills was redeemed for rural credit cooperatives in 2,321 counties and cities, accounting for more than 95 percent of all the bills issued for this purpose; and 1.5 billion yuan of earmarked loans were disbursed. The smooth implementation of the financial support policy served as a positive incentive to promote the rural credit cooperative reform. The asset quality of the rural credit cooperatives was significantly improved. At end-September, based on the four categories of loan classifications, the total volume and ratio of NPLs in the rural credit cooperatives was 361.7 billion yuan and 7.7 percent respectively, representing a reduction of 153 billion yuan and 29 percentage points from end-2002. Their lending ability increased by a fairly large margin. At end-September, total deposits and outstanding loans of the rural credit cooperatives posted 6.7 trillion and 4.7 trillion yuan respectively, the latter accounting for 11.9 percent of the outstanding loans of all financial institutions, 1.4 percentage points higher than that at end-2002. The RCCs have further enhanced support to the agricultural sector. At end-September, outstanding agricultural loans issued by the RCCs stood at 2.1 trillion yuan, accounting for 44 percent and 96 percent of the RCCs' total credits and the total agricultural credit of all financial institutions respectively, up 4 percentage points and 15 percentage points from end-2002. The reform of the property rights system continued. By end-September, 29 rural commercial banks, 181 rural cooperative banks, and 2,055 institutions with legal person status at the county level had been established.

V. Foreign exchange administration reform was deepened

The reform of the foreign exchange administration system was further deepened and foreign exchange services were improved. First, foreign exchange receipts and sales by export enterprises were made more convenient. The network verification and examination system for foreign exchange receipts and sales from export transactions was improved. Based on increasing the basic ratio of advanced sales revenue, deferred payments, and supplied processing materials, the basic ratio of advance payments was raised to 30 percent, and advance payment writing-off procedures were streamlined to further facilitate the foreign trade operations of enterprises. Second, measures were taken to actively support the development of the out-sourcing services industry. Foreign exchange receipt and payment approval procedures were streamlined for enterprises in the out-sourcing services business and off-shore out-sourcing services business was encouraged to use RMB as the denomination for settlement currency. RMB denominated instruments were developed to provide enterprises in outsourcing services with more tools to manage exchange-rate risks. Third, investment facilitation was promoted. Ex-post record disclosure-based registering replaced ex-ante approval and verification in the treatment of fund sources of outward investments. In terms of the administration of capital remittances, a filing system replaced the approval system. Fourth, balanced administration and risk prevention of cross-border capital were strengthened. Qualified domestic Chinese commercial banks and foreign-capital-funded banks were allowed to open foreign exchange accounts for overseas institutions and these foreign exchange accounts were included in the relevant information system. Efforts were made to crack down on the underground money shops, Internet-based foreign exchange trading, and other illegal activities. Fifth, efforts were made to safeguard the safety of foreign exchange reserve assets, by strengthening examination of the procedures for foreign exchange reserve management to ensure compliance and standardizing core business management and operational procedures to guarantee the sound and orderly investment of foreign exchange reserves. In line with the principle of ensuring safety and reasonable returns, foreign exchange reserves were used to purchase International Monetary Fund bonds. Sixth, monitoring of the foreign exchange liquidity of financial institutions was strengthened to guide financial institutions to strike a balance between safety, liquidity, and profits of domestic and overseas investments, adjust the domestic and overseas asset structure, and increase financial support for imports and exports and "going global" strategies.

VI. The RMB exchange rate regime was improved

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

Part 3 Financial Market Analysis

In Q3 2009 the financial market continued to function in a sound and stable manner and market liquidity was adequate. Trading on the money market was active and interest rates edged up amid larger fluctuations. Trading on the bond market remained brisk and bond indices fluctuated slightly. Trading on the stock market became more brisk and stock indices rallied among fluctuations.

In the first three quarters, the aggregate financing volume of the domestic non-financial sector (including the household, corporate, and public sectors) rose 158 percent year on year to 11.27 trillion yuan. Loans still dominated the financing structure. Government securities and enterprise bonds accounted for a larger percentage of the total financing volume and played a more important role in fund allocations.

Table 4: Financing by the domestic non-financial sectors

	Volume of financing (100 million yuan)		As a percentage of total financing (%)	
	First 3 quarters 2009	First 3 quarters 2008	First 3 quarters 2009	First 3 quarters 2008
Financing by the domestic non-financial sectors[1]	112 689	43 686	100.0	100.0
Bank loans	93 458	37 089	82.9	84.9
Equities[2]	2 954	3 339	2.6	7.6
Government securities [3]	7 566	642	6.7	1.5
Enterprise bonds[4]	8 711	2 616	7.7	6.0

Notes: 1. Non-financial sectors in this table include the household sector, non-financial enterprises, and the public sector.

2. Equity financing in this table does not include financing by financial institutions on the stock market.

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

4. Enterprise bonds refer to enterprise bonds, corporate bonds, short-term financing bills, and medium-term notes.

Source: The People's Bank of China.

I. Financial market analysis

1. Trading volume on the money market rose rapidly and interest rates edged up

Trading on the money market was brisk. The volume of bond repos and inter-bank borrowing on the money market continued to grow rapidly. In the first three quarters of 2009, the turnover of bond repos on the inter-bank market totaled 53.40 trillion yuan, with the daily turnover averaging 282.6 billion yuan, representing year-on-year growth of 30.8 percent. The turnover of inter-bank borrowing reached 13.72 trillion yuan, with the average daily turnover growing 20.5 percent year on year to 72.6 billion yuan. In terms of the maturity structure, overnight products were traded most frequently on the repo and inter-bank borrowing market, accounting for 77.0 percent and 82.8 percent respectively, up 17.8 percentage points and 13.0 percentage points respectively year on year. The turnover of government securities repos on the stock exchanges increased 57.3 percent year on year to 2.50 trillion yuan.

With the liquidity supply relatively adequate, the financing structure on the money market was characterized by the following: 1) The liquidity of state-owned commercial banks was abundant. Their net lending grew significantly over the same period of last year and accounted for a much larger share in the net lending of all financial institutions; 2) Net lending growth of other commercial banks moderated greatly due to their balance-sheet structure and the greater demand for short-term liquidity in the market; 3) Factors such as the recovery of the capital market and the resumption of IPOs substantially boosted the financing demands of securities and fund management companies, insurance companies, and other financial institutions. In the first three quarters of 2009, net borrowing of other financial institutions increased 4.4 times over the same period of last year. Net borrowing of securities and fund management companies and insurance companies rose 3.7 times and 1.3 times year on year respectively.

Table 5: Fund flows among financial institutions in the first three quarters of 2009

Unit: 100 million yuan

	Repo		Inter-bank borrowing	
	First 3 quarters of 2009	First 3 quarters of 2008	First 3 quarters of 2009	First 3 quarters of 2008
State-owned commercial banks	-206 565	-73 725	-16 876	23 300
Other commercial banks	-7 351	14 296	5 274	-30 951
Other financial institutions[1]	189 689	35 929	5 790	577
Of which: Securities and fund management companies	77 137	13 904	1 475	2 877
Insurance companies	32 013	13 739	—	—
Foreign financial institutions	24 226	23 500	5 812	7 073

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

Source: The People's Bank of China.

The interest rate derivatives market operated in a sound manner. In the first three quarters of 2009, market expectations remained generally stable. The turnover of bond forward and interest rate swap transactions grew 12.8 percent and -8.7 percent respectively year on year. The trading volume of forward rate agreements was relatively small. In terms of the maturity structure, 2-7 day products were traded most frequently on the bond forward market and interest rate swaps with a maturity of one year or less were traded most frequently on the interest rate swap market. The Shibor played a greater role in the pricing of interest rate derivative products. In the first three quarters, Shibor-based interest rate swaps accounted for 28.7 percent of the total RMB interest rate swaps; forward rate agreements were all traded based on the Shibor.

Table 6: Transactions of interest rate derivatives

	Bond forward		Interest rate swaps		Forward rate agreement	
	Transactions	Amount (100 million yuan)	Transactions	Nominal principal amount (100 million yuan)	Transactions	Nominal principal amount （100 million yuan）
2005	108	178	—	—	—	—
2006	398	665	103	356	—	—
2007	1 238	2 518	1 978	2 187	14	11
2008	1 327	5 008	4 040	4 122	137	114
Q1 2009	251	913	721	801	11	38
Q2 2009	406	1 945	913	1 068	6	10
Q3 2009	449	1 922	1 170	1 370	2	3

Source: China Foreign Exchange Trade System.

Money market interest rates edged up amid larger fluctuations. With abundant supply of liquidity in the market, the monthly weighted average interest rates of bond pledged repo and inter-bank borrowing basically remained at around 0.85 percent. Since late-June, due to the resumption of IPOs and other factors, money market interest rates of all maturities rose by various margins amid larger fluctuations. In September, the monthly weighted average interest rates of bond pledged repo and inter-bank borrowing registered 1.28 percent and 1.27 percent respectively, up 37 percentage points and 36 percentage points over June. At the end of Q3, overnight and 7-day Shibor posted 1.7742 percent and 1.7983 percent, up 83 percentage points and 79 percentage points respectively over the beginning of 2009 and 68 percentage points and 59 percentage points from end-June. Three-month and 1-year Shibor stood at 1.7687 percent and 2.2000 percent, down 1 percentage point and 16 percentage points respectively from the beginning of 2009, and a decrease of 45 percentage points and 33 percentage points from end-June.

2. Trading on the bond market was brisk and bond indices fluctuated slightly

The volume of spot bond trading rose rapidly. In the context of adequate liquidity and affected by factors such as the greater supply of government bonds, the recovery of the capital market, and the resumption of IPOs, financial institutions adopted different asset allocation strategies and spot bond trading was brisk. In the first three quarters, the turnover of spot bond trading on the inter-bank market totaled 36.51 trillion yuan, with an average daily turnover of 193.2 billion yuan, up 37.7 percent year on year. State-owned commercial banks were the major net buyers on the inter-bank spot bond market, with net purchases of 1.021 trillion yuan; other commercial banks and financial institutions had net sales of 660.1 billion yuan and 371.4 billion yuan respectively. The spot trading of government bonds on the stock exchanges registered 169.4 billion yuan, up 36.7 percent year on year.

Bond indices fluctuated by small margins. In the first three quarters of 2009, bond indices on the inter-bank market and stock exchanges remained generally stable. The China Bond Composite Total Return Index fell 1.32 points, or 1.0 percent, from 132.22 points at the beginning of this year to 130.90 points at the end of September.

The yield curve of government bonds on the inter-bank market moved upward. The medium- and long-term end bonds with maturities ranging from 3 to 15 years steepened and moved up. Since 2009, with economic stabilization and recovery taking hold, the overall yield curve of government bonds on the inter-bank market moved upward. The yields of medium- and long-term government bonds with maturities ranging from 3 to 15 years grew by a larger margin, some as much as 117 basis points.

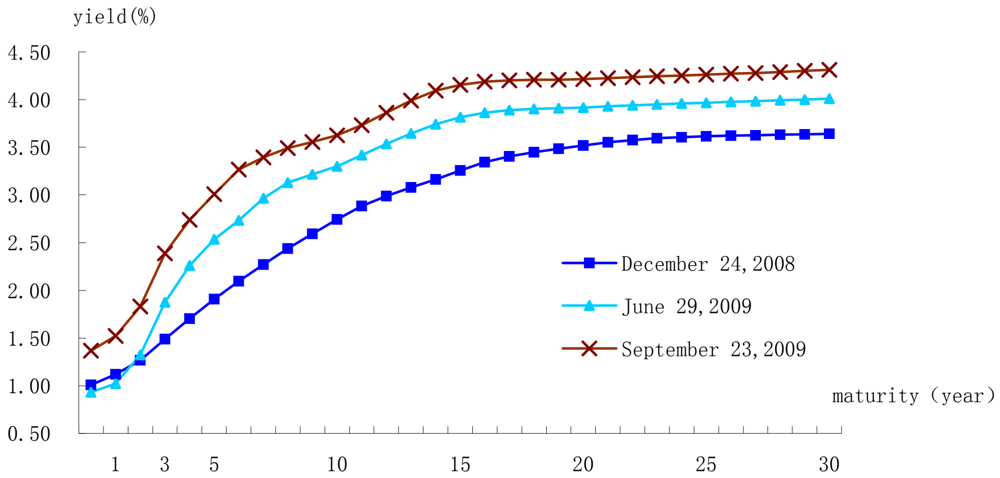

Figure 1: **Yield curves of government securities on the inter-bank bond market in 2009**

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

Bond issuances grew rapidly. In the first three quarters, a total of 3.61 trillion yuan of bonds (excluding central bank bills) was issued on the primary market, up 1.65 trillion yuan over the same period of last year, representing growth of 84.5 percent. The issuance of government bonds, bank subordinated bonds, hybrid capital bonds, and enterprise bonds accelerated significantly, playing an important role in promoting economic stabilization and recovery. By the end of September, the Ministry of Finance had completed the planned 200 billion yuan municipal bond issuance on behalf of local governments, which provided capital support for central-government-invested projects. Divided by maturities, the issuance of short- and medium-term bonds with maturities of less than 5 years accounted for 65.6 percent of the total, up 0.6 percentage points year on year. At the end of September 2009, outstanding bonds deposited with China Government Securities Depository Trust and Clearing Co., Ltd. totaled 16.48 trillion yuan, up 13.9 percent year on year. Affected by the sustained supply of abundant liquidity and the adequate supply of securities, the issue rates on the bond market rose among fluctuations. The interest rate of book-entry 10-year government bonds issued in September 2009 registered 3.44 percent, up 54 basis points over that of such bonds issued in December 2008. The issue rates of other bonds also grew by various margins.

Table 7: Issuances of bonds in the first three quarters of 2009

Type of bonds	Total value (100 million yuan)	Year-on-year growth (%)
Government securities [1]	14 350	130.4
Policy financial bonds	7 178	1.1
Bank subordinated bonds and hybrid capital bonds	2 429	356.5
Bank ordinary bonds	50	-80.0
Enterprise bonds [2]	11 909	125.5
Of which: Short-term financing bills	3 100	5.2
Medium-term notes	5 752	682.6

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

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

Source: The People's Bank of China.

The Shibor played an increasingly important role in the pricing of bonds. In the first three quarters of 2009, all 139 enterprise bonds with a total value of 269.6 billion yuan were priced based on the Shibor, and 71 short-term financing bills worth 94.3 billion yuan were issued based on Shibor, accounting for 30 percent of the total; 20 medium-term notes with a total value of 38.6 billion yuan were issued based on the Shibor, accounting for 7 percent of the total issuance.

3. The outstanding volume of paper financing gradually declined and the interest rates of bills rebounded by a small margin

In the first three quarters, a total of 7.8 trillion yuan of commercial bills was issued by the corporate sector, up 53 percent year on year. Discounted bills totaled 18.1 trillion yuan, up 90 percent year on year. Rediscounted bills amounted to 10.17 billion yuan, up 9 percent year on year. At the end of September, outstanding commercial bills stood at 4.3 trillion yuan, up 41 percent year on year. Outstanding discounted bills registered 2.8 trillion yuan, up 95 percent over the same period of last year. Outstanding rediscounted bills posted 8.77 billion yuan, twice as much the value of such bills during the previous year. Influenced by money market interest rates and the change in demand and supply on the bill market, the interest rates of bills continued to edge up in Q3.

In Q3, bill acceptances and bill discounts declined month by month. The value of outstanding discounted bills decreased by 822 billion yuan in Q3 and the share of outstanding discounted bills in all outstanding loans decreased from 9.6 percent at the end of Q2 to 7.2 percent at the end of Q3. Generally, given the accelerated growth of credit extensions, the decline of bill financing in Q3 can be attributed to adjustments in the loan structure of financial institutions and reductions of bill financing to meet medium- and long-term loan demands to prevent risks of bill financing and to regulate bill transactions. The maturing of a large amount of bills issued at the beginning of this year also contributed to the decline in bill financing.

4. Trading on the stock market became more brisk and stock indices rose amid fluctuations

With economic stabilization and recovery taking hold and influenced by the rallying of the stock markets in the major economies, the abundant liquidity supply, and other factors, trading on the domestic stock market became more brisk and stock indices rose amid fluctuations. In the first three quarters, the total turnover on the Shanghai and Shenzhen Stock Exchanges amounted to 38.75 trillion yuan, up 17.15 trillion yuan year on year. The average daily turnover posted 210.6 billion yuan, 1.8 times as much as that during the same period of last year. At the end of September, the market capitalization of tradable shares totaled 10.07 trillion yuan, an increase of 120 percent over the end of last year. At end-September, the Shanghai Composite Index and Shenzhen Composite Index closed at 2779 points and 949 points respectively, up 52.7 percent and 71.6 percent year on year and basically flat with the level during Q2 of 2008. At end-September, the average P/E ratios of A-shares on the Shanghai and Shenzhen Stock Exchanges reached 24.1 times and 35.4 times respectively from 15 times and 17 times at the end of 2008.

In Q3, the resumption of IPOs significantly moderated the year-on-year decline of stock market financing in the first half of 2009. According to preliminary statistics, a total of 295.4 billion yuan was raised by non-financial enterprises and financial institutions through IPOs, secondary offerings, rights issues, warrants, and the issuance of convertible bonds on equity markets both at home and abroad, a reduction of 38.5 billion yuan year on year. The value of funds raised in Q3 totaled 202.1 billion yuan, accounting for 68.4 percent of the total in the first three quarters, an increase of 142.4 billion yuan over the same period of last year. The Growth Enterprise Market (GEM) was launched in September and a total of 6.68 billion yuan was raised during the month. A multi-tiered capital market has taken form in China.

5. The growth of total assets in the insurance industry recovered steadily

The growth of premium income exceeded expectations. In the first three quarters, premium income in the insurance industry registered 858 billion yuan, up 8.1 percent year on year, an acceleration of 1.5 percentage points. Among this total, premium income of property insurance grew 21.4 percent year on year, an acceleration of 2.8 percentage points. Premium income of life insurance rose steadily by 4.1 percent year on year despite the large base value during the same period of last year. In the first three quarters, total compensation and benefit payments in the insurance industry increased 5.2 percent year on year to 234.2 billion yuan.

Growth in the total assets of the insurance industry rallied steadily. At the end of September, the total assets of the insurance industry amounted to 3.8 trillion yuan, up 18.9 percent year on year, an acceleration of 5 percentage points over the same period of last year and an acceleration of 3.7 percentage points over end-2008. In particular, investment-type assets grew 11.6 percent year on year, an acceleration of 0.4 percentage points; and bank deposits increased 42.9 percent over the same period of last year, an acceleration of 18.8 percentage points.

Table 8: Use of insurance funds

	Outstanding balance (100 million yuan)		As a share of total assets (%)	
	End-September 2009	End-September 2008	End-September 2009	End- September 2008
Total assets	37 880	31 854	100. 0	100. 0
Of which: Bank deposits	10 058	7 040	26. 6	22. 1
Investment	24 232	21 722	64. 0	68. 2

Source: China Insurance Regulatory Commission.

6. The foreign exchange market developed in a stable manner and the trading volume of swap transactions grew rapidly

The foreign exchange market operated in a sound manner and the trading volume of swap transactions continued to rise rapidly. The trading volume of forward transactions and currency pairs grew steadily. In Q3, the average daily turnover on the spot foreign exchange market registered significant quarter-on-quarter and year-on-year growth due to the active trading of the US dollar. The turnover of RMB foreign exchange swap transactions totaled US$251.9 billion, with the average daily turnover increasing 115 percent year on year and 27 percent quarter on quarter. The US dollar was still the most frequently traded currency on the foreign exchange swap market, with the turnover of overnight RMB/USD swaps accounting for 65.7 percent of the total turnover in swap transactions, down 1.5 percentage points over Q2. In Q3, the premium of 1-year RMB/USD swaps increased in July and August, and turned into a discount in September. The turnover on the RMB foreign exchange forward market totaled US$2.12 billion, and the average daily turnover increased 33.4 percent quarter on quarter. The turnover of 8 currency pairs reached US$8.3 billion, and the average daily turnover rose 11.1 percent quarter on quarter. The bulk of the transactions were USD/HKD and EUR/USD currency pairs, accounting for 75.8 percent of the total.

7. The trading volume on the gold market recovered and gold prices grew amid fluctuations

In Q3 of 2009, the Shanghai Gold Exchange operated in a stable manner. The trading volume of gold stood at 1149.90 tons, down 6.68 percent year on year. The turnover of gold transactions totaled 243.491 billion yuan, up 2.91 percent over the same period of the previous year. The trading volume of silver registered 4746.75 tons, up 301.97 percent year on year and the turnover of silver totaled 16.474 billion yuan, an increase of 313.09 percent compared with the same period of last year. The trading volume of platinum amounted to 15.51 tons, up 10.39 percent year on year, and the turnover of platinum stood at 4.38 billion yuan, down 13.01 percent over the same period of the previous year.

In Q3, the price of gold on the Shanghai Gold Exchange rose amid fluctuations, which was consistent with that on the international market. In Q3, the price of gold on international markets hit a record high, for the first time standing at US$1000 per ounce for many days. The domestic price of gold also rose amid fluctuations. In Q3, the peak and bottom price of gold reached 224.95 yuan per gram and 200 yuan per gram and the weighted average stood at 211.80 yuan per gram, up 18.86 yuan per gram year on year. As of end-September, the price of gold registered 219 yuan per gram, an increase of 13.71 percent over the beginning of 2009.

II. Financial market institutional building

1. Improve the basic institutional arrangements of the inter-bank bond market

Information disclosures of financial securities were further standardized. In accordance with the *Administrative Procedures for the Issuance of Financial Bonds* *on the Inter-bank Bond Market* and as approved by the PBC, the National Inter-bank Funding Center and the China Government Securities Depositary Trust and Clearing Company jointly formulated and released the *Detailed Operational Rules on Information Disclosures of Financial Securities on the Inter-bank Bond Market* on October 13, 2009, defining the details of information disclosures by financial securities on the inter-bank bond market. This move will help improve market transparency.

Financial leasing companies and automobile financing companies were permitted to issue financial securities. On September 1, 2009, the PBC and CBRC issued the *Announcement of the People's Bank of China and the China Banking Regulatory Commission*, specifying the conditions for the issuance of financial securities by automobile financing companies and financial leasing companies and regulating their practices. This was an important step forward in diversifying securities issuers and accelerating the development of the securities market.

Securities companies were allowed to invest on the inter-bank bond market as a part of their asset management plans, further diversifying the investor structure on the inter-bank bond market. *PBC Announcement No. 11* issued in July 2009 allowed securities companies to open single-purpose bond accounts for their asset management plans (including their collective asset management plan, specific asset management plan, and directed asset management plan) on the inter-bank bond market and established detailed rules and standards to regulate their business practices. Investments of asset management plans operated by securities companies in the inter-bank bond market will improve the supply of liquidity and better protect investors' interests. At present, there are five categories of non-legal person institutional investors, namely enterprise annuities, insurance products, trust products, asset management services of fund management companies for specific clients, and asset management plans of securities companies, indicating a more inclusive investor structure on the inter-bank bond market.

2. Strengthen the fundamental institutional arrangements in the securities market

The Growth Enterprise Market (GEM) was officially launched. The *Trial Provisions on the Management of the Suitability and Appropriateness of Investors on the Growth Enterprise Market* and the *Implementation Measures for the Management of the Suitability and Appropriateness of Investors on the Growth Enterprise Market of the Shenzhen Stock Exchange* entered into force on July 15, 2009. The GEM was officially launched on October 23, and the first 28 enterprises were approved to be listed on the Shenzhen Stock Exchange on October 30. The launching of the GEM enriched the multi-tiered capital market in China, and is important for the sustainable and healthy development of the capital market and China's economic and social progress.

The institutional arrangements of the futures market were improved. The *Provisions on Classified Supervision of Futures Companies (Trial)* that entered into force on September 1, 2009 defined the classification standards and evaluation processes of 11 classes in 5 categories of futures companies. The classified supervision will help optimize allocation of regulatory resources, enhance the effectiveness of regulation over futures companies, improve the awareness of compliance of futures companies, and help them establish self-regulatory mechanisms, including legal person governance and internal control. This move aimed to promote self-discipline by implementing external supervision so as to facilitate the stable and healthy development of the futures industry. Taking effect on September 1, the *Regulations on the Management of the Opening of Accounts on the Futures Market* provided that an applicant must use a real name to open an account and must follow a unified account-opening process in order to prevent risks and improve the efficiency of the futures market.

3. Improve management of insurance fund investments on the bond market

The China Insurance Regulatory Commission (CIRC) issued the *Notice on Strengthening Management of Bond Repurchase Transactions of Insurance Companies* on August 28, 2009, requiring that insurance companies improve the bond repo management system, strengthen management of funds raised via bond repo, prevent risks, and fulfill reporting obligations. The CIRC released the *Notice on Relevant Issues on Bond Investment* on September 22, 2009, amending the provisions on the share of enterprise (corporate) bonds in the investment portfolios of insurance companies, and the qualifications and credit ratings for bond issuances and the staffing of credit-rating personnel, so as to better regulate investments by insurance companies on the bond market, improve the asset allocation and structure, and diversify investment risks.

Part 4 Macroeconomic Analysis

I. Global economic and financial developments

In Q3 of 2009, driven by the large-scale macroeconomic stimulus policies taken by various countries, the global economy showed signs of stabilization and major economic indicators improved. Market confidence picked up somewhat and stock markets rallied worldwide. While continuing "quantitative easing," the major developed economies began to consider exit plans and strategies. However, contractions in the volume of global trade, high unemployment rates in the major economies, and a bleak fiscal outlook indicate that the impact of the financial crisis will linger on and the economic recovery will face large uncertainties.

1. Economic development of the major economies

The U.S. economy showed signs of recovery. In Q3 of 2009, the seasonally adjusted annualized GDP was 3.5 percent, the first quarterly growth after four straight declines. The unemployment rate continued to climb, with the monthly rates for the three months of Q3 registering 9.4 percent, 9.7 percent, and 9.8 percent (a record high in 26 years). Imports contracted more than exports, resulting in a noteworthy reduction in the trade deficit. From January to August, imports and exports fell by 29.1 percent and 20.3 percent respectively and the trade deficit totaled US$238 billion, much smaller than the deficit of US$491.3 billion during the same period of last year. For the fiscal year ending on September 30, 2009, the accumulated fiscal deficit stood at US$1.42 trillion, 3.1 times that of fiscal year 2008. Month-on-month price levels showed signs of stabilizing, with the year-on-year (YOY) CPI smoothing out in August and September after dropping notably in July. The month-on-month CPI growth for the three months of Q3 registered 0.0 percent, 0.4 percent, and 0.2 percent respectively, down 2.1 percent, 1.5 percent, and 1.3 percent compared with that during the same period of last year.

The euro area showed signs of stabilization. Driven by consumption and public expenditures created by the governments' considerable stimulus packages, the month-on-month GDP slid by 0.2 percent in Q2, much better than the -2.5 percent in Q1, and the YOY figure fell by 4.8 percent. The employment situation deteriorated further with the unemployment rate climbing month after month, registering 9.5 percent, 9.6 percent, and 9.7 percent respectively in the three months of Q3. Trade changed from a deficit to a surplus, with YOY imports and exports slumping by 25 percent and 22 percent respectively from January to August, registering a 5.2 billion euro surplus, a large contrast with the 40.5 billion euro deficit during the same period of last year. The price level declined at a slower pace with the YOY HICP dropping by 0.7 percent, 0.2 percent, and 0.3 percent and the month-on-month figures increasing by –0.7 percent, 0.23 percent, and 0.0 percent for the three months of Q3.

The Japanese economy picked up. In Q3 of 2009, the seasonally adjusted annualized GDP registered 2.3 percent, the first positive reading in five quarters. The employment situation remained grave, with the unemployment rate reaching a record high of 5.7 percent, 5.5 percent, and 5.3 percent in the three months of Q3. Trade contracted dramatically and changed from a deficit to a surplus due to the fact that imports plummeted more than exports. In Q3, YOY imports and exports declined by 39.7 percent and 34.4 percent respectively and the accumulated trade surplus totaled 1.1 trillion yen, whereas the same period of last year saw a deficit of 141.3 billion yen. Price levels fell steadily, reflected in a 2.2 percent decrease in the YOY monthly CPI for the three months of Q3 and the month-on-month growth rates were –0.3 percent, 0.3 percent, and 0.0 percent respectively.

The economies of the major emerging markets and developing countries (regions) showed signs of recovery. Driven by the considerable stimulus of the market rescue measures taken by the various governments, economic activities in a number of emerging economies gradually stabilized. In particular, the Asian emerging economies, with their fiscal accounts and balance of payments in good shape and a low external debt level, experienced a strong rebound. But some Eastern European countries lagged behind on the path toward recovery.

2. Global financial market development

The exchange rates of the major currencies saw large fluctuations and the US dollar moved continuously downward. Better readings of the economic indicators in several countries weakened the demand for the US dollar as a safe-haven and the soaring U.S. fiscal deficit added to investors' worries about the greenback's sustainability, which caused US dollar to depreciate continuously. At the end of September, the exchange rates of the euro against the dollar and the dollar against the yen closed at 1.464 dollar per euro and 89.8 yen per dollar, a depreciation of the dollar by 4.3 percent and 6.8 percent respectively compared with end-June.

The US dollar Libor fluctuated downward. The historically low federal funds rate as a result of the Federal Reserve's quantitative easing monetary policy affected the movement of the US dollar Libor. On September 30, the 1-year US dollar Libor slumped to 1.26 percent, 0.35 percentage points lower than that at end-June. The Euribor was also low. On September 30, the 1-year Euribor posted 1.236 percent, down 0.268 percentage points from that at end-June.

The yields of government securities of the major countries lost their gains from earlier rallies. At the beginning of Q3, supported by signs of a global economic recovery, yields rebounded rapidly. However, yields began to fall back from mid- to late August with market expectations that the inflation would remain subdued and the possibility that the major central banks would increase interest rates low. At the end of September, the yield of 10-year treasury bonds of the United States, euro area, and Japan closed at

3.308 percent, 3.227 percent, and 1.292 percent, down 0.235, 0.154, and 0.060 percentage points respectively.

The major stock indices rebounded strongly. Since mid-July, maintaining the steady upward momentum of Q2 and boosted by the positive economic data, the major stock indices, especially those in Europe and the U.S., had enhanced market confidence and there was a new round of rallying. At end-September, the Dow Jones Industrial Average, the NASDAQ, the STOXX50, and the Nikkei 225 closed at 9712.3, 2122.4, 2872.6, and 10133.2, up 15 percent, 15.7 percent, 19.6 percent, and 1.8 percent respectively from end-June.

3. Housing market development in the major economies

There have been signs of recovery in the U.S. housing market. In Q3 of 2009, the national housing price index was volatile, with a 0.3 percent month-on-month increase in July and -0.3 percent in August. In September, seasonally adjusted new home sales, start of new homes, and new homes yet to be sold stood at 402,000, 590,000, and 251,000 respectively, growing by -3.6 percent, 0.5 percent, and -3.8 percent month on month. The British housing market improved. Expanding demand and the low housing-price level pushed up housing prices in the UK. The Halifax housing index rose by 1.2 percent, 0.8 percent, and 1.6 percent month on month for the three months of Q3 after fluctuating in the first half of the year. Meanwhile, mortgage loan data from Q30 also pointed to a recovery in the British housing market. Japanese housing market activity remained weak. Due to sluggish demand and the outflow of capital, the start of new homes continued to decrease, as reflected in the declining monthly YOY figures, which were down 32.1 percent, 38.3 percent, and 37.0 percent respectively for the three months of Q3.

4. The monetary policy of the major economies

In Q3, the Federal Reserve, the Bank of Japan, and the European Central Bank (ECB) kept their policy rates unchanged at 0-0.25 percent, 0.1 percent, and 1 percent respectively. At the same time, the Bank of Japan extended its financial support measures. On July 6, the ECB commenced a covered bond purchase program in the amount of 60 billion euro. After keeping the purchase amounts of mortgage-backed securities, agency debts, and treasury bonds unchanged for several months, on September 24 the Federal Reserve scaled back the amounts offered in the Terms Securities Lending Facility auctions.

Since 2009, in the context of close to zero interest rates, the central banks of the major economies relied mainly on a quantitative easing mechanism, or the so-called unconventional monetary policy, by changing the size of their balance sheets to increase money supply and shore up the financial markets. However, when signs of recovery appeared, the central banks of the major economies became more cautious in choosing their policy stance. Although reticent about the unwinding of the unconventional measures, they had already initiated studies on exit strategies and methods. In the communiqué released after the September G20 meeting of finance ministers and central bank governors, the participants pledged to continue to decisively implement necessary financial support measures and expansionary monetary and fiscal policies until recovery was secured. The communiqué also stressed the need for a transparent and credible process for withdrawing extraordinary fiscal, monetary, and financial sector support as recovery became firmly secured. Furthermore, the leaders' statement at the Pittsburgh Summit published on September 25 expressed a commitment to sustain a strong policy response until a durable recovery was secured and to ensure that when growth returned, jobs would return as well. In addition, the statement also warned of a premature withdrawal of the stimulus.

When countries around the world began to talk about withdrawal and planned to implement exit strategies after the economic recovery was secured, the Board of the Reserve Bank of Australia, out of concerns of inflation and expectations of a sustained economic recovery, raised its cash rate on October 6 and November 3 for a total of 50 basis points to 3.5 percent and became the first G20 country to end its stimulus policy. On October 27, the Reserve Bank of India declared the termination of some liquidity supporting measures and required reserves for mortgage lending securities issued by banks. The Norges Bank believed inflation had been higher than expected and unemployment lower than previously projected. As a result, it raised its key interest rate by 25 basis points to 1.5 percent. On October 29, the Central Bank of the Russian Federation cut the refinancing rate by 50 basis points to 9.5 percent out of belief that it was possible to stick to the stimulus policy and further expand bank credit in the context of relatively low inflation. However, the Federal Reserve, the European Central Bank, the Bank of Japan, and the Bank of England decided to maintain their benchmark rates unchanged at their end-October or early-November meetings.

5. World economic outlook

In October the International Monetary Fund (IMF) projected that the global economy had begun to recover, although at a slow pace and with many uncertainties. It predicted that the world economic growth rate would be –1.1 percent in 2009, up 0.3 percentage point from July's projection, with the U.S., the euro area, Japan, and the emerging and developing countries slowing to –2.7, -4.2, -5.4, and 1.7 percent respectively in 2009, 3.1, 4.9, 4.7, and 4.3 percentage points lower than the real growth rate of 2008. According to the IMF, inflation in the emerging markets and developing countries would be suppressed at around 5.5 percent in 2009, down 3.8 percentage points from a year earlier. The risks of a moderate deflation in the developed countries grew and inflation was forecast to be 0.1 percent.

Major economic indicators and the performance of the global financial markets suggested that the world economy had already bottomed out. However, factors such as the choice of macroeconomic exit strategies, the sustainability of the fiscal stimulus, uncertain price movements, and the possibility of a new round of trade and financial protectionism brought about by the high unemployment rates might cast a shadow over global economic growth and many uncertainties on the path of recovery remain.

Box 2 Enhance macro-prudential oversight in response to the financial crisis

Though there are different understandings about the root causes of the international financial crisis since its outbreak, a consensus has been reached that the behavior of financial institutions, the pro-cyclicality of the financial system, and the lack of prevention of systemic risks were important factors behind the crisis. The G20 leaders' statement at the Pittsburgh Summit indicates that major failures in regulation and supervision created dangerous financial weaknesses that contributed significantly to the current crisis. The existing micro-prudential oversight system mainly focuses on the health of individual institutions. However, the health of individual institutions cannot guarantee the stability of the entire system; instead it might encourage the pro-cyclical behavior of banks. In addition, financial development has accelerated the spread of risks across different sectors. Therefore, risks might accumulate at the macro-level, adding to economic fluctuations. In view of these new developments, all the G20 summits stressed the importance of reforming the international financial regulatory system, and the Pittsburgh Summit proposed clear guidelines to improve the level and quality of capital and to adopt forward-looking provisioning to mitigate pro-cyclical fluctuations. Major international organizations including the Financial Stability Board (FSB), the IMF, and the Basel Committee on Banking Supervision (BCBS), as well as large economies such as the U.S., the Euro area, and the U.K. are also committed to facilitating reform of the international financial regulatory system.

The enhancement of macro-prudential oversight is the core of the reform of the financial regulatory system. From a cross-sectoral dimension, macro-prudential oversight shall take into account the systemic risks from the inter-linkages of different institutions, and, at the same time, safeguard the overall stability of the system through strengthening regulation of important systemic institutions and improving counter-party risk measurements and controls. From a time dimension, the aim of macro-prudential oversight is to prevent systemic risks caused by pro-cyclicality. And in terms of the purpose of the policy tools, on the one hand, the purpose is to mitigate the pro-cyclicality of new capital agreement and current accounting standards; on the other hand, by implementing counter-cyclical measures such as a minimum capital requirement, capital buffers, and a stricter provisioning policy, it is to strengthen the ability of financial institutions to withstand the crisis and to level out the through-the-cycle credit growth and economic fluctuations. That is to say, banks can avoid being forced to tighten up credit for lack of provision in times of recession only by setting aside enough provisions against loan losses during times of boom. The function of a counter-cyclical adjustment, which is a neutral and through-the-cycle arrangement, is to lower provisioning and capital requirements during a downturn and capital contractions so as to ease the credit crunch and level out the economic fluctuations, while tightening up provisioning and capital requirements during a boom and credit expansion so as to prevent risks and to enhance support for sustained economic growth. In addition, the financial supervisory and regulatory system can be strengthened through better utilization of the leverage ratio indicator and improved regulation over OTC derivatives. Recently, the G20 and FSB explicitly proposed that financial authorities should possess macro-prudential tools to tackle systemic fragility, and they are facilitating the development of such tools by international agencies and standard-setting organizations. The financial regulation reform plan of the Obama administration emphasizes the appraisal and management of the systemic risks posed by large financial institutions and gives the Federal Reserve responsibility for supervising systemic risks on the Federal Reserve. The UK has introduced a macro-prudential analysis framework and shifted the focus of supervision from micro-level toward system-wide risks. The EU will establish an European Systemic Risk Council (ESRC) to take charge of appraisal and early warning of systemic risks in EU financial markets and when necessary provide suggestions for corresponding solutions. In addition, the importance of macro policy in sustaining economic growth should not be neglected. After the burst of the Internet bubble in 2001, some developed countries adopted an expansionary macro policy, which led to a soaring fiscal deficit, and later maintained a loose monetary condition for a very long period. At the same time, they relied too much on excessive consumption based on the housing market boom to stimulate economic growth. Although these measures contributed to an economic recovery in the short term, they also sowed the seeds of a mid- and long-term financial bubble and inflation. Furthermore, industrial production and supply were promoted by economic globalization, which helped contain overall price levels. But the volatility of the prices of primary goods increased notably due to the limited supply, as was the case with asset prices. Such volatility has an increasingly important influence on financial stability and economic growth. Unfortunately, since a relatively stable CPI or core CPI was always regarded as an anchor of inflation, the policy chosen against such a backdrop more or less might have given rise to the worldwide asset and financial bubble, leading to the huge financial risks. Therefore, in terms of financial adjustments, it is necessary to further improve the monetary policy framework, pay more attention to overall price stability, strengthen international communications and coordination, and safeguard the stability of both the currency and the financial system.

II. Analysis of China's macroeconomic performance

In the third quarter of 2009, with the emergence of more positive factors, the economy continued to recover and confidence rebounded further. Performance of the agricultural sector was stable, and industrial production gathered speed. With domestic demand steadily expanding, investment growing rapidly, and consumer demand on the rise, exports and imports declined by a smaller margin. In the first three quarters, GDP grew 7.7 percent year on year to 21.8 trillion yuan, accelerating 0.6 percentage points from the level in the first half of 2009. The contribution of final consumption, capital formation, and the net export of goods and services contributed

4 percentage points, 7.3 percentage points, and -3.6 percentage points respectively to GDP growth. The CPI was down 1.1 percent year on year, flat with the level in the first half of 2009. The trade surplus expanded by US$38.5 billion yuan to US$135.5 billion.

1. Domestic demand steadily increased whereas the decline in imports and exports decreased

Urban and rural household income continued to improve and sales on the domestic market continued to grow steadily. In the first three quarters of the year, the per capita disposable income of urban residents registered 13,000 yuan, up 9.3 percent year on year in nominal terms, or 10.5 percent in real terms, an acceleration of 3.0 percentage points from the same period of last year. The per capita cash income of farmers grew by 8.5 percent in nominal terms, or 9.2 percent in real terms, to 4,307 yuan, representing a deceleration of 1.8 percentage points from the same period of last year. Household income gains supported the expansion of consumer demand. In the first half of the year, retail sales grew 15.1 percent in nominal terms year on year, or 17.0 percent in real terms, representing an acceleration of 2.8 percentage points from the same period of 2008 and their highest level since recording began. In particular, retail sales in cities were up 14.8 percent to 6.1 trillion yuan, and retail sales in counties, townships, and villages were up 16.0 percent to 2.9 trillion yuan. Consumption growth in counties, townships, and villages outperformed that in cities by 1.2 percentage points.

Box 3: Improving income distribution and supporting the expansion of household consumer demand

The global economy has stabilized, yet recovery will be a slow process. The Chinese economy is expected to face persistent pressures of shrinking external demand, and thus it is necessary to accelerate a shift to domestic-demand-driven growth, in particular consumer-demand-driven growth. As a result of a series of policy measures, such as electronic appliances and automobiles to the countryside and cash for old appliances, consumer demand has maintained a good momentum of growth. Yet, as the fiscal subsidy only aims to stimulate consumption in the short run, this is not expected to be sustainable. In the medium and long run, there are structural impediments to expansion of consumer demand, including not only the often-mentioned problems of social security, housing, education, and health care, but also the arduous task of improving the pattern of income distribution.

In China, structural imbalances in the pattern of income distribution and the rising income gap have limited the rise of ability and willingness of households to consume. On the one hand, the share of labor compensation in GDP is relatively low, and the distribution tilts toward government and enterprises. According to national economic accounting, labor compensation accounted for over 50 percent of the GDP before 1990s. The share started to decline in 2001 and reached a mere 39.7 percent in 2007.

In contrast, the share of the net product tax (as a proxy for government revenue) and the share of the depreciation of fixed assets and the operating surplus (as a proxy for enterprise income) was up from 11.7 percent and 34.9 percent respectively in 1990 to 14.2 percent and 46.1 percent in 2007. On the other hand, the income gap has been widening. According to the 2007/2008 annual report released by the UNDP, China's Gini coefficient was 0.469. This is above the internationally accepted warning level of 0.4 and above the average of the 127 countries covered by the report. International experience has shown that improvements in income distribution play a major role in supporting economic growth. In the 1960s, Japan launched a plan to double national income. The program led to a consumer revolution and eventually the take-off of the Japanese economy. With the rise of the middle class, most consumer durable goods reached more than 90 percent of Japanese households.

Recently, the authorities have taken a number of measures to adjust the pattern of income distribution. But a balanced income distribution pattern is not yet in place. It is necessary to implement a package of measures to prevent the income gap from further widening and to accelerate the growth of household income. First of all, in terms of primary distribution, there should be stronger guidance for wage levels in different regions and different industries; trade unions and other association should play a role, and the voice of workers should be enhanced; compensation of civil servants and personnel of government agencies and institutions needs to be managed in a better way, and regulation of subsidies should be combined with performance-based pay. Second, in terms of redistribution, it is necessary to improve the macro-mechanism to adjust income distribution. Tax-based adjustments, transfer payments, and public expenditures should be enhanced to benefit the people and to reduce the income gap. Third, it is desirable that the operating mechanism of the capital market be improved to provide households with more channels to generate property income and to enhance household participation in capital distributions, such as developing employee stock ownership plans of various forms and other types of equity incentives and transferring state-owned stocks to personal pension accounts, so that people of various income levels can benefit from economic development and the growth of enterprise profits. In addition, it is necessary to promote social security, medical services, housing, and educational reform in order to reduce household expenditures in these areas and to sustain the expansion of household consumption in the medium and long run.

Fixed-asset investments continued to increase rapidly. In the first three quarters of the year, completed fixed-asset investments rose by 33.4 percent to 15.5 trillion yuan, an acceleration of 6.4 percentage points from the same period of the last year and a deceleration of 0.1 percentage points from the first half of 2009; inflation-adjusted real growth posted 39.3 percent, representing an acceleration of 21.2 percentage points from the same period of last year and an acceleration of 1.0 percentage points from the first half of 2009. In terms of the rural-urban breakdown, fixed-asset investment in urban areas was up 33.3 percent year on year to 13.3 trillion yuan, representing an acceleration of 5.7 percentage points from the same period last year, whereas fixed-asset investment in rural areas was up 33.6 percent to 2.2 trillion yuan, representing an acceleration of 10.3 percentage points. With respect to the geographic breakdown of fixed-asset investment in urban areas, investment in East, Central and West China grew 28.1 percent, 38.3 percent, and 38.9 percent respectively, with investment growth in Central and West China exceeding that in East China. As for the industrial breakdown of investment, primary, secondary, and tertiary industry investment were up 54.8 percent, 26.9 percent and 38.1 percent respectively, with primary industry growing notably faster than secondary and tertiary industry.

The decline of imports and exports moderated. In the first three quarters, the volume of imports and exports totaled US$1.6 trillion, down 20.9 percent year on year, representing a moderation of 2.6 percentage points from the decline in the first half of 2009. In particular, the export volume totaled US$846.6 billion, down 21.3 percent year on year, representing a moderation of 0.5 percentage points from the decline in the first half of 2009, whereas the import volume totaled US$711.2 billion, down 20.4 percent year on year, representing a moderation of 5 percentage points from the first half of 2009, resulting in a surplus of US$135.5 billion, down US$45.5 billion from the corresponding period last year but up US$38.5 billion from the first half of 2009. In the first three quarters, actually utilized foreign direct investment posted US$63.8 billion, down 14.2 percent year on year and representing a deceleration of 3.7 percentage points.

2. Performance of the agricultural sector was stable and growth of industrial production accelerated

In the first three quarters of the year, the value added of primary industry was up 4.0 percent year on year to 2.3 trillion yuan, contributing 4.8 percent to economic growth; the value added of secondary industry was up 7.5 percent year on year to 10.6 trillion yuan, contributing 49.4 percent to economic growth; the value added of tertiary industry grew 8.8 percent year on year to 8.9 trillion yuan, representing a 45.8 percent contribution to economic growth.

Performance of the agricultural sector was stable, and annual grain output is expected to grow for the six successive year. The output of summer grain totaled 123.35 million tons, an increase of 2.2 percent year on year. In the first three quarters of the year, meat (including pork, beef, mutton, and poultry) production posted 52.8 million tons, up 5.6 percent year on year. In the first three quarters, the producer prices of agricultural products (the price at which farmers sell their products) fell 5.0 percent. The prices of agricultural capital goods posted a year-on-year decline of 2.0 percent. The producer prices of agricultural products fell at a higher rate than the producer prices of agricultural capital goods, making it difficult for farmers to increase their incomes.

Industrial production rebounded steadily, and the profit situation improved. In the first three quarters, the value added of statistically large enterprises rose 8.7 percent year on year, representing a deceleration of 6.5 percentage points from the same period of the previous year and an acceleration of 1.7 percentage points from the first six months of 2009. The sales ratio of industrial products declined by 0.3 percentage points from the same period of last year to 97.4 percent. Industrial enterprise profits grew at a decelerated pace. In the first eight months, profits of statistically large enterprises totaled 1674.7 billion yuan, down 10.6 percent year on year, representing a deceleration of 30.0 percentage points from the same period of last year and a moderation of 12.3 percentage points from the decline during the first five months.

3. The general price level dropped year on year, but by a smaller margin

The CPI dropped year on year, but by a smaller margin. In the third quarter, the CPI was down 1.3 percent year on year, representing a deceleration of 0.2 percentage points from Q2. In Q3, the CPI was down 1.8 percent, 1.2 percent, and 0.8 percent in the three months respectively. In the CPI basket, food prices began to rise whereas non-food prices declined further. In Q3, food prices were up 0.3 percent year on year, representing an acceleration of 1.3 percentage points from Q2, whereas non-food prices were down 2.0 percent year on year, representing a decline that is 0.3 percentage points larger than that in Q2. In terms of the base period factor and the new rise in price factor, the contribution of the base period factor dwindled. In Q3, the base period factor was -1.3 percent, a decline of 0.3 percentage points from Q2, and the new rise in price factor was 0.1 percent.

Due to the rise in oil and other commodity prices in the global market and stronger domestic demand for raw materials as a result of the economic recovery, the year-on-year decline in producer prices declined month by month. In Q3, the purchase price of raw materials, fuel, and power was down 11.1 percent year on year, or down 11.7 percent, 11.4 percent, and 10.1 percent respectively in the three months. The factory price of industrial products declined year on year by 7.7 percent in Q3, or by 8.2 percent, 7.9 percent, and 7.0 percent respectively in the three months. The price of agricultural capital goods was down 7.3 percent year on year, or down 7.2 percent, 7.5 percent, and 7.3 percent respectively in the three months.

International commodity prices moved up rapidly. In Q3, average crude oil futures on the New York Mercantile Exchange and the average Brent Crude Oil spot price were up 14.1 percent and 15.9 percent respectively quarter by quarter; the average spot price of copper and aluminum on the London Metals Exchange climbed 21.6 percent and 25.2 percent respectively quarter by quarter.

Import prices declined at a moderate pace. In Q3, import prices declined 17.5 percent year on year, representing a deceleration of 1.2 percentage points from Q2. Import prices declined 16.7 percent, 20.4 percent, and 15.3 percent year on year respectively in the three months of Q3. Export prices declined 8.5 percent year on year, representing an acceleration of 1.5 percentage points from Q2, or a decline of 7.1 percent, 9.3 percent, and 9.1 percent in the three months respectively.

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

The GDP deflator declined by a smaller margin. In the first three quarters, GDP was up 7.7 percent in real terms to 21.8 trillion yuan. The GDP deflator (as a ratio of nominal GDP to real GDP) was -2.8 percent, down 11.3 percentage points from the same period of last year and up 0.3 percentage points from the first six months of 2009.

The reform of resource pricing continued. In Q3, the National Development and Reform Commission adjusted the price of oil products based on the improved oil products pricing mechanism and price movements on the international market. On July 29, gasoline and diesel prices were both cut by 220 yuan per ton; on September 2, gasoline and diesel prices were increased by 300 yuan per ton; on September 30, gasoline and diesel prices were both cut by 190 yuan per ton. In July, the National Development and Reform Commission and the Ministry of Housing and Urban-Rural Development established general principles for a water price adjustment, that is, to establish a pricing mechanism that allocates water resources efficiently and enhances water efficiency to promote water conservation and sustainable use of water resources.

4. Fiscal revenues resumed growth, and fiscal expenditures expanded in a stable manner

In the first nine months of 2009, fiscal revenues (excluding debt income) reached 5.2 trillion yuan, up 5.3 percent year on year, representing a deceleration of 20.5 percentage points from the same period of last year and a rebound of 7.7 percentage points from the first half of 2009; fiscal expenditures totaled 4.5 trillion yuan, up 24.1 percent year on year, representing a deceleration of 1.4 percentage points from the same period of the last year and a deceleration of 2.2 percentage points from the first half of 2009; as a result, expenditures exceeded revenues by 631.6 billion yuan, representing a reduction of 620.3 billion yuan from the same period of last year and indicating strong fiscal pressures.

On the revenue side, fiscal revenues in the first three quarters of 2009 recovered as a result of positive economic performance, a good corporate profit situation, and large gains in consumption tax revenue after the oil products fee-to-tax reform. In particular, fiscal revenue was up 10.2 percent, 36.1 percent, and 33 percent year on year respectively in the three months of Q3. From January through September, with the domestic consumption tax revenue and business tax revenue up 79.1 percent and 13.6 percent respectively, tax revenue increased 2.2 percent year on year, its first positive growth since the beginning of 2009.

On the expenditure side, fiscal expenditures will be enhanced to support policy measures designed to maintain growth, expand domestic demand, and improve the people’s welfare, with more inputs into infrastructure, environmental protection, social security, medical services, and other areas. From January through September, expenditures on transportation, environmental protection, agriculture, forestry, and water conservancy, medical services, science and technology, and social security and employment were up 66.3 percent, 56.4 percent, 51.2 percent, 30.5 percent, 28.7 percent, and 17.7 percent respectively year on year.

5. There remained a surplus in the balance of payments (BOP)

Due to the impact of the international financial crisis, the total volume of both the BOP and the surplus declined. The balance of payments improved, yet a net inflow remained. In the first half of the year, the BOP surplus was down 26 percent year on year to US$195.5 billion, including US$134.5 billion in the current account balance (down 30 percent year on year) and US$61 billion in the capital account balance (down 15 percent year on year). At end-September, foreign exchange reserves reached US$2272.6 billion, an increase of US$326.6 billion from end-2008 and a deceleration of US$50.8 billion from the same period of last year.

The total volume of the outstanding external debt fell with the improved maturity structure. As of end-June 2009, the outstanding external debt posted US$360.58 billion, a reduction of US$14.082 billion, or down 3.76 percent from the end of 2008. Among this total, the registered outstanding external debt was US$251.08 billion, down US$9.482 billion or 3.64 percent from end-2008, accounting for 69.6 percent; the outstanding short-term debt stood at US$194.37 billion, a decrease of US$16.42 billion or down 7.79 percent from end-2008, accounting for 53.9 percent.

6. Sectoral analysis

The profits profile continued to improve and industrial production accelerated. From

January through August, 36 out of 39 sectors saw year-on-year profit growth or a moderate decline. In particular, year-on-year growth of power generation, building materials, transportation equipment manufacturing, specialized equipment manufacturing, and the chemical fiber industries accelerated 179.4 percentage points, 7.7 percentage points, 21.8 percentage points, 8.2 percentage points, and 77.1 percentage points respectively from the first five months of this year, whereas petroleum processing and the coking sector resumed making profits. Raw material production quickly recovered. Exports of high-tech products and mechanical and electrical equipment improved remarkably. Coal, power, and oil output and transportation recovered substantially. From January through September, crude coal output and power generation were 2.14 billion tons and 2.6511 trillion kilowatts per hour respectively, up 10.3 percent and 1.9 percent year on year; crude oil output was 140 million tons, down 0.5 percent year on year, representing a moderation of 0.5 percentage points from the first half of 2009; freight volume grew 5.0 percent year on year to 20.17 billion tons, representing a year-on-year rise of 5.0 percent and an acceleration of 2.5 percentage points from the first half of 2009.

(1) The real estate industry

In the first nine months of the year, sales of commercial property grew rapidly throughout the country. Property prices rallied, growth of investment in real estate development accelerated gradually, and real estate lending surged.

Investment in real estate development accelerated. The completed floor area and area under construction both increased. Land acquisitions and the floor area of new projects declined by a smaller margin. From January through September, investment in real estate development was up 17.7 percent year on year to 2.51 trillion yuan, representing an acceleration of 7.8 percentage points from the first half of 2009 but a gap of 15.6 percent points with the year-on-year urban fixed-asset investment growth. In particular, investment in commercial residential housing was 1.76 trillion yuan, representing year-on-year growth of 13.4 percent and an acceleration of 6.1 percentage points from the first two quarters, accounting for 70.2 percent of the total. From January through September, completed floor area reached 334 million square meters, up 24.7 percent year on year and representing an acceleration of 2.4 percentage points from the first half of 2009, whereas floor area under construction was 2.775 billion square meters, up 15.4 percent year on year and representing an acceleration of 2.7 percentage points from the first six months of the year. From January through September, land acquisitions by developers declined 22.1 percent year on year to 215 million square meters, and the floor area of new projects declined 0.4 percent year on year to 732 million square meters, both declining by a smaller margin month by month.

Sales of commercial real estate increased rapidly. In the first three quarters, the total floor area of sold commercial real estate grew 44.8 percent year on year to 584 million square meters, an acceleration of 13.1 percentage points from the first half of 2009. Total sales revenue increased 73.4 percent year on year to 2.75 trillion yuan, an acceleration of 20.4 percentage points from the first six months of 2009. Sold acreage and sales revenue of commercial housing were up 23.2 percent and 47.3 percent respectively from the peak during corresponding periods, that is, the first three quarters of 2007.

Property prices rebounded further. In September, property prices in 70 large- and medium-sized cities were up 2.8 percent year on year (representing positive growth for four successive months), and were up 0.7 percent month on month (representing positive growth for seven successive months and a deceleration from August). The price of new homes was up 2.7 percent year on year and 0.8 percent month on month, whereas the price of pre-owned homes was up 3.8 percent year on year and 0.5 percent month on month. In September, 66 out of 70 large- and medium-sized cities saw price hikes for new homes, whereas 60 cities saw hikes in the prices of pre-owned homes.

Outstanding commercial real estate loans accelerated. As of end-September 2009, outstanding commercial real estate loans of major financial institutions totaled 6.81 trillion yuan, up 28.3 percent year on year and representing an acceleration of 14 percentage points year on year and 9.5 percentage points from end-June. Among this total, outstanding real estate development loans registered 2.47 trillion yuan, up 25.3 percent year on year and representing an acceleration of 4.8 percentage points from end-June, and outstanding home purchase loans posted 4.35 trillion yuan, an increase of 30.1 percent year on year and an acceleration of 12.3 percentage points from the end of June.

(2) Communications and transportation industry

Communications and transportation as an important basic industry in the national economy play an irreplaceable role in promoting growth. The industry was significantly affected by the international financial crisis. While addressing the challenge, there were efforts to restructure and the industry gradually recovered with the support of the macroeconomic policies and industrial rejuvenation program.

Investment in the communications and transportation industry rose rapidly. Due to the economic stimulus package, fixed-asset investments in the communications sector and most transportation sectors increased more rapidly than the 33.4 percent growth in total fixed-asset investments. From January through September, fixed-asset investment in communications was up 43.0 percent year on year to 755.5 billion yuan; fixed-asset investments in railways, roads, intra-city communications, and marine transportation were up 87.5 percent, 50.7 percent, 66.2 percent, and 38.3 percent respectively; fixed-asset investment in civil aviation reversed its 2008 decline and grew 28 percent against the background of the rapid growth in the domestic aviation industry.

The communications and transportation industry recovered. From January through September, cargo volume was up 5.0 percent year on year, representing an acceleration of 2.5 percentage points from the first half of 2009; the volume of passenger transport was up 3.7 percent year on year, flat with that during the first half of 2009. The volume of bulk cargo picked up notably, but import and export goods grew at a slower rate. In the first three quarters, major ports handled a total of 3.52 billion tons of cargo, up 6.1 percent year on year and an acceleration of 4.2 percentage points from the first half of 2009; cargo of import and export goods totaled 1.45 billion tons, up 3.1 percent year on year and representing an acceleration of 3.8 percentage points.

The communications and transportation industry still faces difficulties. With uncertainties remaining in the global economy, the risk of a decline in external demand still exists. Although the domestic economy is recovering, there is a mismatch between the rapidly expanding communications and transportation ability and the recovering demand for such services. Moreover, because enterprise performance is lackluster, the road transportation sector is under pressure of shrinking demand and the profits of aviation and port transportation enterprises have declined to varying degrees. The supply of funds faces a bottleneck because of huge construction and fund demands in the communications and transportation infrastructure programs. In 2009, a large number of planned communications and transportation infrastructure projects was launched and the pace of construction in key projects was accelerated. This has intensified pressures for the input of funds. For example, a total of 600 billion yuan was planned for railway infrastructure investment in 2009, 43.3 percent of which was to be made in Q4. Having received a large amount of investments, the communications and transportation industry faces strong profit pressures for the near term as demand for transportation has yet to fully recover. However, as the global and domestic economy gradually recover and the effects of the policy measures unfold, the communications and transportation industry as a whole will maintain a good momentum of development.

Part 5 Future Monetary Policy Stance

I. Macroeconomic outlook

As a result of the package of plans and policy measures introduced to address the global financial crisis, China fended off the unprecedented external shock in the first three quarters of 2009, supported by expansion of strong domestic demand. The decline in economic growth has been quickly reversed, and the Chinese economy is gaining momentum for stabilization and an upswing. In general, as the global economy is likely to improve since the worst of the crisis is over and as the package of measures aimed to deal with the crisis is further implemented and enhanced, the Chinese economy is expected to continue its sound and relatively rapid growth.

In general, going forward, more factors supportive of economic development will emerge. On the one hand, the stimulus package will continue to work. Newly started projects are increasing rapidly. In the first three quarters, total planned investment for projects under construction rose 37.1 percent year on year, an acceleration of 19.0 percentage points, whereas total planned investment for newly started projects saw year-on-year growth of 83.0 percent, which represents a dramatic acceleration of 81.3 percentage points. As local governments are eager to promote development and expand investment, and fiscal and financial supports remain strong, investment is expected to maintain its momentum of growth. On the other hand, the higher social security level, medical and health care reform, increased agricultural subsidies, and a series of measures to expand consumption, plus the improving economic situation, corporate profits, and employment, will help increase household income and the propensity to consume, and will contribute to stronger consumption. Confidence in the prospects of sound and rapid economic growth has been further enhanced. According to the urban depositors' survey conducted by the PBC in the third quarter of 2009, there was the first feeling of a recovery in income in two years, and expectations for employment in the fourth quarter improved, with employment sentiment rising 2.7 percentage points quarter-on-quarter. The business survey in the third quarter shows macroeconomic expectations jumped 4.4 percentage points from the second quarter, whereas the survey of bankers indicates that the sentiment of bankers regarding the macro economy showed a strong rebound of 15.4 percentage points from the previous quarter, and macroeconomic expectations continued to improve, up 6.8 percentage points from the previous quarter. Moreover, as the global economy gradually improves, the contribution of net exports to economic growth, which is negative this year, is expected to become positive in 2010 and to contribute to sound and relatively rapid economic growth.

In spite of these supportive factors, there are many difficulties to sustain sound and rapid economic growth. At the global level, although the world economy has recently displayed increasing positive signals, the prospects for a global recovery, remain uncertain. Intensifying trade frictions, the exit from the stimulus policies, as well as other uncertainties, will affect global economic performance. The weak external demand will continue to have an impact on the Chinese economy. At the domestic level, the current rise in domestic demand is not firmly established, and economic growth is primarily driven by the stimulus policies. Efforts are needed to jump-start private investment, enhance the contribution of domestic demand to economic growth, and address the structural issues and the worsening overcapacity problem that may arise from the rapid growth in government investment. There is also uncertainty over the extent to which the consumer market can be further tapped.

Price movements call for attention. With the introduction of the stimulus package, the downward price movements since the fourth quarter of 2008 were curbed, deflation expectations were eased notably, and market confidence was greatly enhanced. There is also a certain degree of inflation expectations in the market, as reflected by the sharp rise in commodity and asset prices since 2009 as a result of, among others, the massive stimulus programs of the major economies. In general, inflation expectations and price movements will be subject to the future performance of the real economy and the intensity and pace of the macroeconomic policies. As the global and domestic economies improve and global monetary conditions remain loose, the movements of various prices and broader overall price stability in the longer-term need to be closely watched.

II. Policy stance for the next stage

The Chinese economy is still at a key juncture of moving toward stabilization and an upswing. In accordance with the overall arrangements of the State Council, the PBC will continue to implement a relatively loose monetary policy. It will properly handle the pace and intensity of policies, and increase policy flexibility and sustainability in line with international and domestic economic developments and price movements. Efforts will be made to achieve the right balance between supporting sound and relatively rapid economic growth and preventing and resolving financial risks, improve management of inflation expectations, enhance the sustainability of financial support to economic development, and ensure that the financial system will perform in a sound and stable fashion. Coordination and cooperation between fiscal and monetary policy will be strengthened, and investment plans will be implemented in a scientific and reasonable manner. Moreover, it is important to speed up the economic restructuring, accelerate reforms in key areas, enhance the vitality of private businesses, ensure that the market mechanism plays a greater role in allocating resources effectively, and enhance the growth potential and build new endogenous economic driving forces by shifting the growth pattern and adjusting the economic structure.

First, the PBC will maintain adequate liquidity in the market and guide money and credit to grow properly. To this end, the PBC will carefully arrange the mix and term of monetary policy tools and manage the intensity of monetary policy operations in line with economic and financial developments and changes in foreign exchange flows.

Second, the PBC will properly handle the pace of credit supply and provide more balanced and sustainable credit support to safeguard financial stability. It will guide commercial banks to smooth the credit supply, optimize the credit structure, and, in line with the industrial policies and the differentiated credit policies, continue to give strong support to SMEs, agriculture, farmers, and rural areas, employment programs, and other weak links. In particular, it will encourage commercial lenders to fully implement financial policies aimed at supporting SMEs. To prevent potential credit risks, it will rein in lending to industries with excess capacity, highly polluting, highly energy- and resource-consuming industries, as well as industries with inefficient duplicate construction. Drawing on the lessons from the global financial crisis, the PBC will establish a macro-prudential management system step by step and integrate it into the macroeconomic management framework. The system is expected to play a counter-cyclical adjustment role across business cycles, enhancing the resilience of the financial system and the sustainability of financial support to economic development.

Third, the PBC will endeavor to promote financial market development and direct private investment. It is necessary to improve the debt-financing system for local governments and to increase the transparency of and internal and external restrictions on local governments' debts based on risk controls and proper institutional arrangements. It is also desirable to step up innovation of financial products, allow a wider range of financial institutions to issue debts, and continue to move ahead with the pilot innovation programs, including asset-backed bills and collective bonds of SMEs. A larger range of overseas institutions will be granted access to the domestic bond market.

Fourth, the PBC will steadily advance the reform of market-based interest rates, improve the RMB exchange rate mechanism, and strengthen and improve foreign exchange administration. The PBC will continue the establishment of a benchmark interest rate system on the money market. In line with international fund flows and the exchange rate movements of the major currencies, the RMB exchange rate mechanism will be improved in accordance with the principle of making it a self-initiated, controllable, and gradual process. Development of the foreign exchange market will be advanced, more tools for exchange rate risk management will be introduced, and the capability of financial institutions for independent risk pricing and risk management will be improved. The pilot program of RMB settlement of cross-border trade transactions will be continued. It is also necessary to further facilitate outbound investments and steadily open up the domestic capital market.

Furthermore, efforts will be made to vigorously advance reform and structural adjustments to promote stable and sustainable economic development. The economic structural adjustments and reform aimed at promoting consumption and expansion of domestic demand will continue to transform the pattern of economic development. Fiscal policy should play a greater role in optimizing the economic structure, improving income distribution, and increasing expenditures on programs aimed at improving the people's livelihood. More efforts will be made to improve the structure of income distribution, increase the share of household income, and further improve the social security level. Capital investment in human resources will be increased by a large margin, and proactive policies will be implemented to support employment. Efforts will be made to accelerate urbanization, relax controls on investment and financing, and boost private investment. Measures will also be taken to promote market-oriented reforms in resources, energy, and other sectors, strengthen private business, improve economic efficiency, and allow economic growth to be more solidly based on domestic demand.