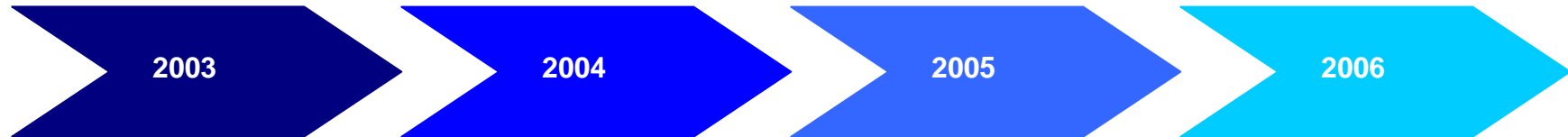


Fact Sheet: Chinese Actions on Exchange Rate Flexibility, Financial Sector Reform and Balanced Growth



Foreign Exchange Policy and FX Market and Financial Product Development: Foreign exchange trading systems and financial instruments for managing and hedging foreign exchange risk are critical elements of a market-based flexible exchange rate regime.

- June: Regulators allow foreign banks to offer foreign exchange (FX) products
- June: Chinese begin work with the Chicago Mercantile Exchange to offer FX futures in China.
- October: Chinese announce plan to introduce Reuters-based onshore non-renminbi FX trading platform.
- October: Central bank lifts ceiling on bank lending rates.

- May: Banks allowed to trade non-RMB spot currency pairs in China on Reuters system; Chinese banks can act as market makers.
- July: China abandons RMB peg, adopts managed float.
- August: China introduces inter-bank forward FX market.
- August: New measures expand ability of institutions to trade and hedge FX risk.¹
- September: daily band for RMB spot against non-USD currencies widened to 3%.
- November: Central bank does FX swap with local banks.

- January: Introduced OTC interbank trading in RMB current (spot) delivery; allow banks to act as FX market makers.
- February: First RMB interest rate swap.
- March: China and CME agree to allow electronic trading of CME FX and interest rate products to Chinese financial institutions and investors.

Liberalization of Capital Flows: An important part of China's strategy to prepare for a market-based exchange rate is to expand capital flow transactions in order to increase the depth and liquidity of foreign exchange markets, making them more efficient at transmitting price signals.

- Chinese authorities introduce measures that promote FDI and other capital flows.
- Qualified Foreign Institutional Investor (QFII) program launched²

- July-August: Select Chinese domestic institutional investors (QDII) authorized to invest in overseas assets.
- Nov/Dec: limits raised on amounts emigrants, travelers, and students can take out of China.

- February: Eliminated surrender requirements on certain commercial firms' FX receipts.
- June: Raised quota for QFII from \$4 billion to \$10 billion.

- April: Liberalized FX regulations allowing Chinese firms/residents to buy more foreign assets.³
- April: 54 foreign and domestic banks operating in China allowed to trade FX swaps.

¹ Aug-2005: Expanded participants in FX forwards market and allowable transaction coverage, reduced maturity restrictions, and allowed banks more discretion to quote prices; launched onshore RMB-foreign currency swaps in interbank market; allowed qualified non-bank entities to access FX spot market.

² QFII: Qualified Foreign Institutional Investor – a foreign entity allowed to invest up to a certain quota amount in China's domestic capital markets.

³ April-2006: Individuals can convert more RMB to take out of China, commercial banks can buy foreign bonds; securities firms can buy foreign assets

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Financial Sector Reform: a well-supervised, well-capitalized, well-managed banking system will help ensure that removing controls on capital flows and interest rates is done in a manner that safeguards financial stability. Letting market forces play a greater role in determining interest rates is a crucial component of a more market-based exchange rate regime. Liberalizing equity markets can also energize market forces.

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|---|--|---|---|
| <ul style="list-style-type: none">- December: \$45 billion recapitalization of two of the four large state-owned banks, after their sell-off of non-performing loans to state-owned asset management companies.- December: Foreign banks allowed greater renminbi business and larger stakes in joint ventures.- 2003: Foreign investment in Chinese banks accelerates.⁴ | <ul style="list-style-type: none">- 1Q: Bank regulator imposes tighter capital adequacy requirements and stricter loan classification.- September: lowered restrictions on foreign bank entry and branching.- October: Ceiling on bank lending lifted giving banks greater scope to price loan risk. | <ul style="list-style-type: none">- April: \$15 billion recapitalization of ICBC (3rd of 4 large state-owned banks).- April: regulators launch program to convert non-tradable listed company shares to tradable shares.- October: Regulators approve RMB-denominated bond issue by Asian Development Bank and IFC.- November: Limited foreign strategic investments in listed domestic companies allowed.- 2005: 2 of five largest state banks conduct successful overseas IPOs | <ul style="list-style-type: none">- January: Central bank launches nationwide consumer credit bureau.- April/May: Expansion of QFII program. |
|---|--|---|---|

2006 – Boosting Domestic Demand: China's growth strategy as laid out in the recent 11th Five-Year Plan emphasizes domestic demand, particularly consumption, with a strong focus on rural economic development and expanding social services such as education and health care. Measures taken since 2003 to expand domestic demand:

- **Reduce Taxes:** Doubled threshold income level for personal income tax (2005); Abolished agricultural tax (2006)
- **Increase Household Income:** established minimum wage system to raise wages and increase income of lower income urban households.
- **Develop Rural Areas:** Increased central government funding to support lower taxes and fees in rural China and to finance infrastructure to supply drinking water, conventional electricity and hydropower, and roads in rural areas.
- **Encourage Consumer Credit:** Encourage financial institutions to lend to households; increase residential mortgage and automobile loans.⁵

⁴ Examples of Foreign Investment in China's Financial Sector: Citibank acquires stake in Shanghai Pudong Development Bank (Jan-2003); Newbridge Capital acquired small stake in China Minsheng Bank (March-2004) and 18% stake in Shenzhen Development Bank (May-2004); Goldman Sachs approved to control a JV securities firm (Sept-2004); Bank of America acquires 9% stake in China Construction Bank (Oct-2005); Merrill Lynch and others acquire stake in Bank of China (Aug-2005); Goldman Sachs, American Express and others acquire stake in ICBC (Jan-2006).

⁵ Both GM and Ford have established auto finance companies in China (in addition to several foreign auto companies).