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.

2003	2004	2005	2006
	- 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.

2003	2004	2005	2006
- Chinese authorities introduce measures that promote FDI and other capital flows. - Qualified Foreign Institutional Investor (QFII) program launched[2]	- 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 QFIIs 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.

2003	2004	2005	2006
- 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]	- 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.	- 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	- 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).