

## **China's Financial Market: Development and Outlook**

Ladies, Gentlemen and Friends,

I am very pleased to attend the 2015 annual meeting of the International Capital Market Association in the beautiful financial and commercial capital of Amsterdam. I would also like to thank the International Capital Market Association for making special arrangements for China, giving my colleagues and myself the opportunity to introduce the latest dynamics and upcoming trends in the development of the Chinese financial market.

**Firstly, I will provide a general introduction of China's overall financial market situation.**

China's financial market has undergone a process of gradual development in line with reform to its national economic structure. The achievements have been remarkable despite the fact that development period has not been long. At present, China has already basically established monetary, bond, stock, insurance, gold, foreign exchange and financial derivatives markets – a relatively comprehensive and multi-layered financial market system. The encouragement of financial support to develop the real economy, the prevention and diffusion of financial risks as well as the promotion of China's increasing economic and financial globalisation are all playing important roles.

In the monetary market, 2014 saw inter-bank borrowing and the bond repurchase market reach 226.1 trillion Yuan in accumulated turnover. In the stock market, the total market value in 2014 was 37 trillion Yuan (roughly USD6 trillion), with a total turnover of 74.2 trillion Yuan. According to statistics from the World Federation of Exchanges (WFE), the aggregate market value is second only to the United States, ranking second in the world. In the foreign exchange market, China's inter-bank foreign exchange trading volume reached USD8.9 trillion in 2014, continuing two years of double-digit growth. In the gold market, the trading volume in Shanghai gold futures ranked number 2 world-wide and number 1 in Asia. In 2014, the Shanghai Gold Exchange established an international board and progress was made in promoting China's gold market as well as its integration with the international market. In the futures market, regarding commodity futures in 2014, the total volume of the Shanghai and Shenzhen 300 stock index futures and treasury futures amounted to 292 trillion Yuan. In the financial derivatives market, development has been quick with four categories of products having already been formed: interest rates, bonds, exchange rates and credit derivatives.

The bond market is China's most dynamic financial market, its most active component. In 2014, China's bond market reached 35 trillion Yuan (roughly USD5.7 billion). Government bonds, financial bonds and corporate credit bonds each account

for about one third. According to statistics from BIS, China's world ranking rose to third place. Within that, the corporate credit bond market reached 11 trillion Yuan (roughly USD1.8 trillion), second only to the United States, ranking second world-wide. In 2014, annual cash bonds and repurchase transactions totalled 358.3 trillion Yuan. As an important component of corporate credit bonds, since 2008 the inter-bank bond market has been flourishing. The debt financing instruments of non-financial enterprises registered by the National Association of Securities Dealers has seen rapid year-on-year growth, registering a total of 726.55 billion Yuan at the end of 2008 which increased to 16.11 trillion Yuan at the end of 2014. In 2014, new issuance of debt-financing instruments reached 4.1 trillion Yuan, accounting for 80.8% of China's corporate credit bonds and totalling 15.3 trillion Yuan, accounting for 76.2%, reaching 7 trillion Yuan and accounting for 59.3%.

**Secondly, I would like to talk about the construction of a secondary market system and the trading situation within China's inter-bank market.** In recent years, in line with a series of institutional improvements and reforms, China's inter-bank secondary market trading products have consistently flourished; trade has expanded; participants have become more diversified; there has been continuous infrastructural improvement which provides a good trading platform for all types of agencies.

**In terms of product type,** the variants available for trading are continuously improving. **In the field of basic products,** variants of inter-bank lending as well as the bond system are quite good. Within this, bonds including government, quasi-governmental credit institutions, financial institutions bonds, non-financial enterprises and other types of bodies which issue products with differing life spans, play important roles in supporting the real economy. **In the field of derivatives,** bond forwards, interest rate swaps, forward rate agreements of interest rate derivatives, foreign exchange forwards, foreign exchange swaps, currency swaps and foreign currency derivatives of exchange rate derivatives and credit risk mitigation tools as representing credit derivatives constitute the main sequence of complete derivatives products. With the emergence of some online trading products, net settlements and transaction reversal mechanisms, progress has been made in improving the operational efficiency of the market, strengthening risk control and enhancing operational stability.

**In terms of the size of the inter-bank bond market in China,** secondary market cash bonds, buy-backs and lending transactions totalled more than 300 trillion Yuan in 2014, 300 times larger than growth in 1997. In China's inter-bank derivatives market, the principle sum of interest rate derivative transactions in 2014 came close to 3 trillion Yuan. Currency derivatives came to more than USD3 trillion, 100 times more than growth in 2005.

**From an investors' viewpoint,** from the establishment of 16 commercial banks in 1997 by participants in China's inter-bank market, and following more than ten years

of construction, it has gradually developed to cover a wide range of insurance, securities, funds and other financial institutions, supplementary pensions, insurance products, trust products, unincorporated investment subjects, as well as non-financial institutions, overseas agencies, including all types of institutional investors. With the recent opening up to foreign investors proceeding at a rapid pace, an increasing number of qualified foreign investors (QF11), RMB qualified foreign institutional investors (RQF11) and three types of foreign institutions have entered the inter-bank market to conduct trading. As of 26 March 2015, the Exchange Bureau has approved 267 QF11 investments amounting to USD72.149 billion and 111 RQF11 investments totalling 329.8 billion Yuan. Foreign institutions actively participate in China's inter-bank market, further enriching the main types of market investment and improving market liquidity.

**Looking at infrastructure and system construction, in the trading foreground,** the China Foreign Exchange Trade System (CFETS) provides the inter-bank market financial institutions and the unincorporated organisations with trading systems and organisations and straight through processing (STP) services for the market. The Beijing Financial Assets Exchange (CFAE) offers trade services to non-financial institutions qualified investors. Currently, a whole process of online operations has already been fully implemented for secondary trading in China's inter-bank bond market. Online trading of interest rate swaps in derivatives has also mostly been realised. **In the trading background,** "China Government Securities Depository Trust & Clearing Co. Ltd" and "the Inter-Bank Market Clearing House Company Limited" constitute the two largest central depository agencies providing market participants with bond registration and trusteeships. Both are connected to the high value payment system of the People's Bank of China and provide market participants with comprehensive trade-by-trade settlements of delivery versus payments (DVP). In recent years the Inter-Bank Market Clearing House Company has also launched net clearing services. Such progress has improved market efficiency, transparency and security. Currently, China has already developed a relatively modernised payment system, securities exchange system, custody and clearance system - fostering positive inter-action between infrastructure and market development.

Although in recent years the development of China's financial market has been quite fast, when compared with mature market economies, there remains a substantial disparity. For example, there is still an insufficient range of investor types, in particular the number and type of foreign investors needs to be improved. Another example is the ongoing gap in the development of derivative products. In 2014, China's over-the-counter (OTC) derivatives trading volume made up 4% of spot market trading volume. However, I believe that as the market continues to develop, these problems will be properly resolved.

**Thirdly, I would like to introduce the National Association of Financial Market Institutional Investors (NAFMII) which promotes the continuous development of**

## **China's inter-bank market, especially in the realm of innovation.**

In 2007, market participants voluntarily formed the self-regulatory organisation of NAFMII which implemented a widely used mature bond market issuance registration system for non-financial corporate debt financing tools, focusing on compliance with procedures, not issuing substantive judgements, high efficiency, less rent-seeking, effective elimination of implicit guarantees from managers, and encouraging investors to cultivate their own risk awareness.

At the same time, NAFMII set up self-regulatory rules, effectively regulating non-financial corporate debt-financing instruments related to relevant party conduct in all aspects of innovation, registration, issuance, trade, information disclosure and follow-up management. In recent years, NAFMII has focused on the real economy, complying with the demands of market development, fully integrating market resources and positively carrying out innovative work. Currently, the inter-bank bond market has begun to form a multi-level, complete chain, integrals product innovation tool box. The tool box includes short-term bonds, medium-term notes, SME collection notes, regional consolidated notes, asset-backed notes, project income notes and other sequences of products supporting the foundation. It also includes foreign non-financial companies Renminbi debt financing instruments, long-term limited rights medium-term notes, merger and acquisition notes, targeted convertible notes, supply chain finance bills, venture capital debt financing instruments, green bonds and other new series leading innovation products. It may also include structuring, credit enhancement, embedded options, floating interest and multi-currency design as well as other technology. It involves carrying out intense and thorough work on basic and innovation products as well as portfolio innovation, in order to meet the diversified investment and financial needs of investors and issuers. Within this, it actively implements the central authority's promotion of cross-border use of the Yuan and realises the requirements of the capital market two-way open policy. NAFMII promotes overseas non-financial companies issuing RMB debt-financing instruments within Chinese territory, the first phase of overseas non-financial companies RMB debt-financing instruments – Daimler AG registered 5 billion Yuan in directional tools at the end of 2013 and in the first phase in March 2014 successfully issued 500 million Yuan. This marked the official establishment of overseas non-financial companies in domestic RMB market financing channels.

## **Fourth, China's inter-bank market development prospects**

The next stage will see further improvement in the function of the financial market within the development of China's economy. Currently, China's economic development is upgrading and remodeling to a new normal, namely the promotion of economic restructuring and improvement, systemic adjustment and resolving over capacity. The core of it is to change the method of economic development as well

as the economic structure. The market mechanism will play a decisive role in the process of resource allocation. The traditional growth engine of industry has slowed but taking the new format, the rapid development of new business models and the internet economy as representing new accelerated growth points, a new entrepreneurial tide is on the rise. At the same time, the “One Belt, One Road” initiative and other strategies are gradually being pushed out as part of a series of major projects along with the launch of public infrastructure projects – and these will be conducive to stable investment and economic growth.

The new economic normality also requires the corresponding old financial models to reform. It demands the vigorous development of a multi-level capital market, the optimisation of the financial structure, increasing the proportion of direct financing and using risk-based pricing mechanisms for correct and reasonable screening programmes. China’s financial market will continue in a direction of reform and marketisation while promoting significant progress in interest rate marketisation reform, the orderly liberalisation of interest rates by financial institutions, the continuous strengthening of market-based pricing and self-regulatory mechanisms as well as a context of continuous improvement in capital account convertibility. The financial market will follow a broader, deeper, more open and higher as well as steady developmental direction. Demand for all types of derivatives will continue to increase and they will increasingly become important foundations for market pricing.

According to a May 2015 unified deployment from the State Council entitled “Concerning Several Opinions to Further Promote the Healthy Development of Capital Markets”, by 2020 China will have basically formed a reasonably structured, fully functioning, standardised and transparent, robust and efficient, open and inclusive multi-level capital market system. In the future, China’s development will be vigorous with an internationally competitive financial market, fully developed services for the real economy, a financial market where each department manages risk effectively and fully developed to realise the economic globalisation needs of the financial market. Within an environment of controllable risk, there will be a vigorous promotion of derivative innovation.

Opening up and marketisation means continuous and deepening inter-action between China and other national financial institutions, with both parties obtaining even more opportunities. As the self-regulatory organisation for the inter-bank market, MAFMII will continue to uphold the aims of “self-regulation, innovation and service” , practising the principles of marketisation development. On the one hand, it will continue to promote the healthy development of China’s inter-bank market and on the other hand, it will continuously deepen communication with the world’s main financial markets, regulatory bodies and international financial organisations in order to increase understanding, deepen cooperation, make progress in improving the participation of the Chinese financial market into the main category, broadening and deepening market development, expanding investment

and financing channels for the international market and providing a better platform for domestic and foreign market members.

I believe in every respect that with hard work, we will certainly be able to build an efficient and steady international capital market which promotes stability in the international financial system and development of the world economy. Thank you!