

## **Xiang Junbo: Deepening financial reform to create a favorable environment for enterprises**

Speech by Mr Xiang Junbo, Deputy Governor of the People's Bank of China, at the Euro Finance China Conference 2005, Shanghai, 9 November 2005.

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Ladies and Gentlemen,

Good morning. It's a pleasure to be here today to participate in the Euro Finance China Conference. In recent years, China has been enjoying a rapid economic growth, gradually pushing forward its financial reform, and continuously pursuing the opening-up policy. Against this background, there have been significant changes in the business environment of multi-national enterprises. It is of vital importance for us to discuss the issues regarding Cash, Treasury and Risk Management, which is the theme of this conference to facilitate an improved business pattern and efficiency for multi-national enterprises.

As we know, economy and finance serve complementary to each other. An equilibrium and rapid development of national economy is needed to create a favorable external environment for the deepening of financial reform. While the introduction of various financial reform measures contributes to a better business climate for micro-economic participants.

China has been maintaining a stable and rapid economic development momentum in recent years, and has achieved marked success in many sectors; new progress has been made in the course of opening up, which guaranteed a smooth conduct of financial reform.

First and foremost, national economy witnessed a steady and quality growth. With the GDP growth of 2005 expected to register at 9.4 %, China's annualized GDP growth rate during " the Tenth 5-Year Plan Period " is likely to average at 8.8%, representing an acceleration of 0.5 percentage points over that of " the Ninth 5-Year-Plan Period", while the volatility of economic growth is likely to be controlled within a band of 2 percentage points, 0.5 percentage points lower compared with that recorded for the "Ninth 5-Year Plan Period". Generally, China has enhanced the capability for economic growth, and is much more resilient against fluctuations with heightened economic stability.

Secondly, employment continued to scale up. Employment has become an increasingly pressing issue for China due to its large population. During "the Tenth 5-Year Plan Period", newly created jobs in the urban areas increased from 7.89 million in 2001 to 9.8 million in 2004. And the figure is expected to exceed 9 million this year, which to certain extent will ease the unemployment pressure.

Thirdly, consumption has been steadily upgraded. During "the Tenth 5-Year Plan Period", per capita disposable income of the urban and rural residents is expected to increase by 9.5% and 5% respectively a year on average. The continuous and rapid income growth expanded household consumption, fostering a shift of consumption from focusing on satisfying basic needs to that seeking to live a comfortable life.

Fourthly, social security system was further improved. A sound social security system constitutes the basis of maintaining a stable social and economic development. During "the Tenth 5-Year Plan Period", China's social security system has further been consolidated, with the pilot program of urban social security system further developed with notable progresses achieved in terms of building pension, unemployment, and the medical care security system. Efforts have also been made to explore a security system committing minimum protection for residents in the rural areas.

Fifthly, external sector recorded a rapid development. After the accession into WTO, China engaged itself more deeply and broadly in the international arena in terms of division of labor. The shift of international industries stimulated the substantial growth of processing export. China's rapid industrialization and urbanization process combined with the factors such as abundant labor forces and cheap prices, etc, created new opportunities for international manufacturing industry. FDI also maintained rapid growth.

Sixthly, agricultural production remained stable. China's grain production experienced large fluctuation in the past several years. The shrinkage of grain production and the rise of grain prices once exerted negative influences on the economic development. Thanks to the concerted efforts, grain production

of this year started to rebound, removing the supply-demand gap, which has contributed to the stability of grain production and prices.

In the context of a sustained and rapid development of national economy, China has continuously introduced various measures to speed up the share holding restructuring of the wholly state-owned commercial banks, to foster an improved financial market, to conduct the reform on RMB exchange rate regime, and to advocate the construction of financial eco-system, etc. All these measures will definitely impose profound influences on the business environment of enterprises.

First, the share holding reform of the State-owned commercial banks has helped establish credit discipline, which could gradually reduce the enterprises' reliance on the banking system for finance. In recent years, China has consistently pursued the principles to establish a standard corporate governance structure and to transform the operational mechanism. Through the deepening of internal reform, and backed by the favorable government policies and financial support, the restructuring aims to develop a new system and new mechanism required by the modern financial institutions. So far, the Bank of Communications has successfully completed IPO, China Construction Bank also was successfully listed in HK Stock Exchange on October 27. The Industrial and Commercial Bank of China has completed their share holding restructuring. The credit business of commercial banks will be more rationalized on one hand with the gradually improved corporate governance structure and the strengthened external supervision, on the other hand, commercial banks have to adopt cautious stance for their business expansion due to the rigid requirement on capital adequacy ratio. Against this background, enterprises are encouraged to explore new financing channels instead of overly depending on bank loans for financing needs. Meanwhile, financial innovations are advocated to mitigate potential risks in the economic and financial operations.

Secondly, financial market was further improved, facilitating the market access of enterprises, and making it possible to rationalize the financing structure. We speeded up the development of financial market especially the inter-bank bond market in order to address the waning direct financing proportion and to diversify financing channels for enterprises while further steps were taken to implement the commercial bank share holding restructuring. Highlighting market principles, institutional investors were cultivated in the course of inter-bank bond market development while priority attention was paid to preventing new risks. With major measures in place, qualified enterprises were allowed to issue short-term financial bills in the inter-bank bond market; foreign-funded commercial banks with RMB business license can join bond underwriters' syndicate to provide underwriting services in the inter-bank bond market; International development agencies were approved to issue RMB bonds in the national inter-bank bond market; Pan-Asia Bond Index Fund and ABF China Bond Index Fund have been launched in the inter-bank bond market; Bond forward transaction has been introduced; Efforts have been made to improve information disclosure system, and strengthen market disciplinary mechanism. etc. The adoption of these measures signified an important step forward to enhance the influence of financial market as well as its role in resource allocation; Enterprises could enjoy the access to broader financing channels, and favorable conditions were created to prevent them from exposing to risks. At the same time, these measures lay a foundation for the rapid development of financial derivative products.

Thirdly, better exchange risk management of enterprises is required by the RMB exchange rate regime reform. On July 21 this year, the PBC announced to reform the exchange rate regime by moving into a managed floating exchange rate regime based on market demand and supply with reference to a basket of currencies. This reform is a self-initiated action consistent with the reality of China's market economy situation. In the short term, some less competitive enterprises are bound to face intensified pressures. In this case, the enterprises should lose no time to learn and master all possible instruments to hedge foreign exchange risks and to become more adaptable to the floatation and movement of exchange rate. However, in the long run the adjustment of the exchange rate will provide incentives for these enterprises to transform their operational mechanisms, strengthen their self-innovative capability, accelerate economic restructuring, shift growth patterns of foreign trade, and upgrade the overall efficiencies of national economy. It is also conducive to achieving a basic equilibrium of the trade balance in goods and services, strengthening the independence of monetary policy, and enhancing the preemptiveness and effectiveness of financial macro control policies.

Fourthly, 9 reform measures on foreign exchange capital management were launched on a trial basis in Pudong district Shanghai with the purpose to create a favorable policy environment for multinational enterprises. Previously, taking the facilitation of trade and investment, and the improvement of exchange market construction into consideration as the basic principle, reform on foreign exchange management was spearheaded in an innovative, gradual and controllable way as required in Pudong

District of Shanghai by introducing the 9 policy measures, steps will be taken to conduct centralized management of foreign exchange capital in the domestic market, centralize the management of RMB capital, deal with cross-border capital operation, streamline the procedures of trade revenue and expenditure in foreign exchange, streamline the procedures under non-trade item, pursue financial innovation, and establish a monitoring and assessment system. The introduction of these policies is bound to facilitate the centralized foreign exchange management of multi-national enterprises, enhance their regional headquarters' capability of foreign exchange management, it also marks great significance to expand cross-border capital utilization of enterprises, support domestic enterprises' overseas investment, encourage banks to conduct derivative products innovation, and to create a favorable policy environment concerning foreign exchange management.

Fifthly, financial eco-system was improved, laying a solid foundation for the sustained development of various enterprises. The concept of financial ecology construction initiated by the People's Bank of China has received nation-wide attention recently. Financial ecologic situation will not only affect the transmission of monetary policy, efficiency of resource allocation, financial stability and development, but also directly take effects on the operation and transaction costs of enterprises as well. A sound financial ecologic environment comprises not only comprehensive and integrated institution building on a macro basis, but also improvements in micro infrastructures related to corporate governance, credit culture both for individuals and enterprises, bank-enterprise relationship, intermediary services, etc. With regard to the financial ecology construction, great efforts have been made to enhance the legal system building, engaging in the research, deliberation and draft work on some related clauses in the "Property Law", "Enterprises Insolvency Law" and the "Criminal Law" in terms of property right and financial claim protection and the definition of financial crimes. On the other hand, a nation-wide publicity campaign concerning financial ecology construction has been launched to create a sound institutional and public environment, so as to ensure various enterprises develop on an equitable basis.

These financial reform measures not only stressed the market-based orientation of China's financial reform, but also reflected the goals of our reform to create a favorable environment for enterprises. The People's Bank of China will continue to push China's financial reform forward in a steady manner, guaranteeing a better monetary and financial environment for enterprises.

Taking future development trend into consideration, China's economy is expected to enter a stage characterized by steady growth. Currently China is speeding up its urbanization and industrialization process with corresponding growth in investment and demand. Consumption is expected to expand further due to the large population; steady increase of household income and an upgraded consumption structure will also benefit consumption; and favorable external environment will continue to serve a strong engine for China's economic growth. All these positive factors will provide a sound macro economic environment for the deepening of financial reform.

Now I would like to share my insights with you on the financial reform and development trend closely related to the development of enterprises.

First, continue to pursue a sound monetary policy. In 2006, China will continue with its sound monetary policy, measures will be taken to maintain the steady growth of money and credit, monetary policy will play a greater role in keeping RMB value stable and managing the equilibrium of money and credit aggregates. Based on the changes of economic and financial situation, PBC will maintain appropriate growth of money and credit by using a mix of monetary policy instruments in a flexible manner and controlling the scale of policy. Efforts will be made to provide quality financial services to enterprises by strengthening the coordination between RMB and foreign currency policies, and improving the formation mechanism of RMB interest rate and exchange rate. In the future, on one hand the PBC will make adjustments of the exchange rate band when necessary in line with the market development as well as the economic and financial situations. At the same time, the PBC will exercise due responsibility to conduct management and adjustment of the RMB exchange rate based on market supply and demand so as to safeguard a more flexible exchange regime on a market basis and to ensure that the RMB exchange rate is basically stable at an adaptive and equilibrium level. On the other hand, it's not enough by the exchange rate alone to keep the equilibrium of BOP due to the price rigidity existed in some aspects of China's economy. Continuous internal economic policy adjustments are needed to strengthen the coordination between various macro policies, expand consumption, and ensure a balanced development between economic restructuring and the BOP.

Secondly, Actively promote the construction of financial market. Currently, the financing structure, featuring high proportion of indirect financing and low proportion of direct financing, remains to be

rationalized. Financial risks are too much concentrated in the banking sector, which weakens the role of market in resource allocation and results in the high financial leverage ratio of enterprises. Such a financing structure has also brought about difficulties in the conversion of savings into investment, asset and liability management and risk control. Prime attention will be paid to developing direct financing products and risk management instruments, further promoting financial innovation and market system construction. Financial bonds issued by commercial banks as a new liability instrument will be launched on a timely basis to improve the status of maturity mismatch between asset and liability. Efforts will also be made to actively develop institutional investors, and expand the scope of investors. The market infrastructure will be strengthened to create a sound legal and technical environment for the development of financial market. More financial derivative products will be gradually introduced in line with the market situation, while the monitoring, analysis and regulation concerning market risks will be intensified to ensure a sound, effective performance of financial market.

Thirdly, speed up the reform of financial institutions. Under the overall guidance of financial system reform, China will continue to conduct the share holding restructuring of wholly state owned commercial banks by introducing various measures to transform their operational mechanism and improve corporate governance. The overhauling of policy banks will escalate to transform them into development financial institutions with strong competitiveness and financial viability in accordance with the requirements of the market economy. Comprehensive financial reform will be carried out in rural areas, steps will be taken to deepen the reform of RCCs, and some pioneering work will be launched to explore an effective pattern to combine policy and commercial financial support for the rural economy. Participation of social capital in the restructuring of small and medium-sized financial institutions will be encouraged. With strengthened supervision and capital base, financial institutions with various ownership structures will be cultivated. Deposit insurance system will be improved in order to develop a deposit insurance system compatible with Chinese situation.

I would also like to take this opportunity to give you a brief introduction of the People's Bank of China Shanghai Head Office. The PBC Shanghai Head Office was established on August 10 this year; its establishment will promote the development of Shanghai as an international financial center, take advantage of the first-hand contacts with the financial markets, and enable the central bank to better serve the financial markets. As an integral part of the PBC Headquarters, the PBC Shanghai Head Office will perform its functions under the guidance and authorization of the PBC Headquarters, and is mainly responsible for the implementation and management of part of the central bank's business. The goal is to build Shanghai Head Office into "Two Platforms, One Window and One Center", namely, the platforms for the open market operation and the monitoring of financial markets, an important window for international exchange and cooperation, and a center for some financial services and related researches and development work. By far, the construction of Shanghai Head Office is undergoing smoothly, I hope through joint efforts by all relevant parties, Shanghai Head Office will play an active role in boosting financial market construction, promoting the efficiency of central bank's financial services, and creating a better financial environment for enterprises.

Finally, I wish this conference a complete success.

Thank you.