

Zhou Xiaochuan: China's financial market – innovation and development

Speech by Mr Zhou Xiaochuan, Governor of the People's Bank of China, at the National Association of Financial Market Institutional Investors (NAFMII) Inaugural Meeting, Beijing, 3 September 2007.

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Ladies and Gentlemen,

Good morning! It is a pleasure to attend the inaugural meeting of the National Association of Financial Market Institutional Investors (NAFMII). NAFMII's establishment is a major event in the development of China's financial markets, and a concrete practice of implementing the spirit of the National Financial Work Conference. On behalf of the People's Bank of China, I would like to warmly congratulate you.

In the year 1792, a group of twenty four traders gathered under a buttonwood tree at 68 Wall Street, signed the now famous Buttonwood Agreement, and agreed to follow the principles of fair trading in the Agreement. This agreement marked the beginning of industry self regulation in the U.S. financial sector. In the more than 200 years since then, various self-regulatory organizations have been established by participants of financial markets in countries throughout the world, and rules of self discipline formulated.

In China, after ten years of development, the inter-bank market has evolved into a multi-layered system with many sub-sectors including bonds, inter-bank borrowing, bills, gold and foreign exchange markets. In this system, major participants are qualified institutional investors and the trading is based on direct enquiries between two parties. The market is expanding steadily. Take the inter-bank bond market as an example. At end August 2007, the stock of bonds reached 10.48 trillion yuan, about 25 times of that at end 1997; participants numbered 7,137, about 446 times of that at end 1997. The range of market participants expanded from just commercial banks to all kinds of institutional investors, and products on the market have been diversified from government securities and policy financial bonds to a much larger collection including government securities, central bank bills, policy financial bonds, commercial bank financial bonds, enterprise bonds, short-term financing bills, asset-backed securities, bonds issued by international development institutions, U.S. Dollar-denominated bonds, and etc.

In China, the inter-bank market is a typical OTC market. In terms of international experience of OTC market development, various self-regulatory organizations (SROs) such as the National Association of Securities Dealers (NASD), the Japan Securities Dealers Association (JASD), the Korea Securities Dealers Association (KSDA) have all played a very important role in promoting innovation and development, regulating market behaviors, safeguarding the industry's interests, and forestalling market risks, and are an integral part of financial market regulation system in their respective country. Experience has shown that the SROs enable market participants to mobilize themselves to exercise self discipline, help the transformation of government functions, make the regulation more responsive to market demand, and promote market innovation and development in a market-based approach.

In recent years, a lot of achievements have been made in China's financial market development. However, the financial sector has its problems. For example, the imbalance between direct and indirect financing remains serious as bank loans still dominate financing; the financial market development is lopsided as the bond market still lags behind securities market, and enterprise bond market remains under-developed; information disclosure, credit rating and other essential mechanisms have yet to play a sufficient role; the range of financial products are not diversified and market functions are yet to be fully played out. It is an imperative task to promote innovation and development in the financial market. For quite some time, we focused on liquidity management in the inter-bank money market, but did not

fully acknowledge the financing, value discovery and risk management functions of the market. As a result, launching of financial products that are conducive to market development and urgently needed by market participants has been delayed. I hope that the Association will gather members' wisdom and serve their need; and innovation of market participants will be given full play to develop innovation mechanisms and patterns based on the special features of OTC market.

In the future, the products that are developed based on members' need, and are suitable for trading among institutional investors who have pricing and risk managing abilities will be registered at the NAFMII and reported for filing with the regulatory authority. Administrative exam and approval procedure will be abolished for such products.

As the agency that oversees the operation of NAFMII, the PBC has a lot of expectations on the newly established organization. I hope that the Association will provide good services to its members and to the government and the general public, exercise self regulation functions, and contribute to innovation, reform and development of financial markets in China through hard work and innovation.

Thank you.