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

**Foreign Exchange Policy and FX Market and Financial Product Development:**

- 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.
- September: Daily band for RMB spot against non-USD currencies widened to 3%.
- November: Central bank does FX swap with local banks.

**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 launched.
- 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.
- 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.

### Notes

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.

- 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 (3\(^{rd}\) 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 11\(^{th}\) 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.\(^5\)

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\(^4\) 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).