Box 2.2

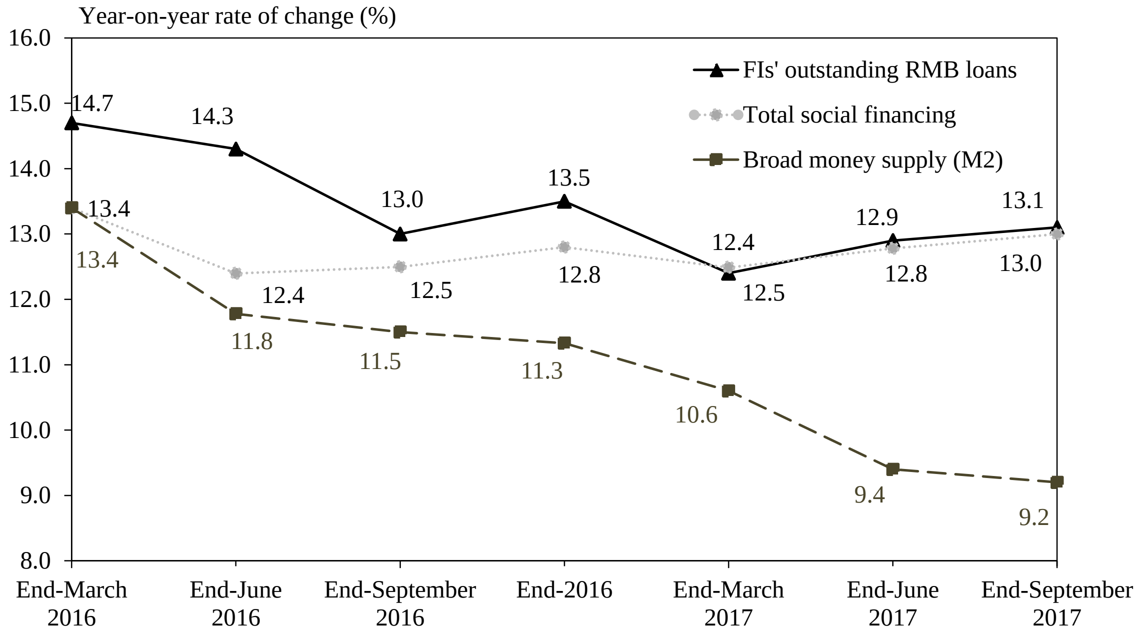
Recent developments on the Mainland's monetary environment and financial stability

Positioned as the nation's southern gateway, the economic and financial ties between Hong Kong and the Mainland are getting increasingly close. The monetary environment and financial stability in the Mainland hence could have a bearing on our economy. This article briefly analyses a series of selected macroeconomic and monetary indicators, with the aim of giving an overview of the monetary policy pursued by the Mainland authorities and their efforts in containing financial risks so far in 2017.

During the first three quarters of 2017, the pace of expansion of the Mainland's broad money supply (M2) continued to moderate (registering a 9.2% year-on-year growth at end-September, which was 0.2 and 1.4 percentage points lower than that at end-June and end-March respectively), staying below the target of around 12% set at the beginning of the year. Meanwhile, financing and credit grew steadily, with the stock of total social financing(1) and the outstanding Renminbi (RMB) loans of financial institutions (FIs) maintaining an annual growth rate of 12-13% (***Chart 1***). The moderation of M2 growth alongside the steady expansion of financing and credit reflected to a certain extent that the Mainland authorities seek to strengthen financial regulation, reduce leverage within the financial system and shorten the capital chain, while addressing the financing demand of the real economy, thereby enhancing the efficiency and quality of the financial sector in serving the real economy.

In fact, since December 2016, the Central Economic Work Conference has clearly indicated that the task of containing financial risks should be elevated to a higher priority. The movements in the Mainland's monetary and financing indicators reflected that the People's Bank of China (PBOC) has been implementing monetary policy along with the prescribed direction, striking a proper balance between maintaining steady economic growth and taking forward supply-side structural reform in the Mainland. Holistically, the monetary policy has remained prudent and neutral, along with the general direction to ensure the stability of market liquidity.

Chart 1: M2 expanded at a moderated pace while financing and credit posted steady growth amid a prudent and neutral monetary policy pursued by the Mainland



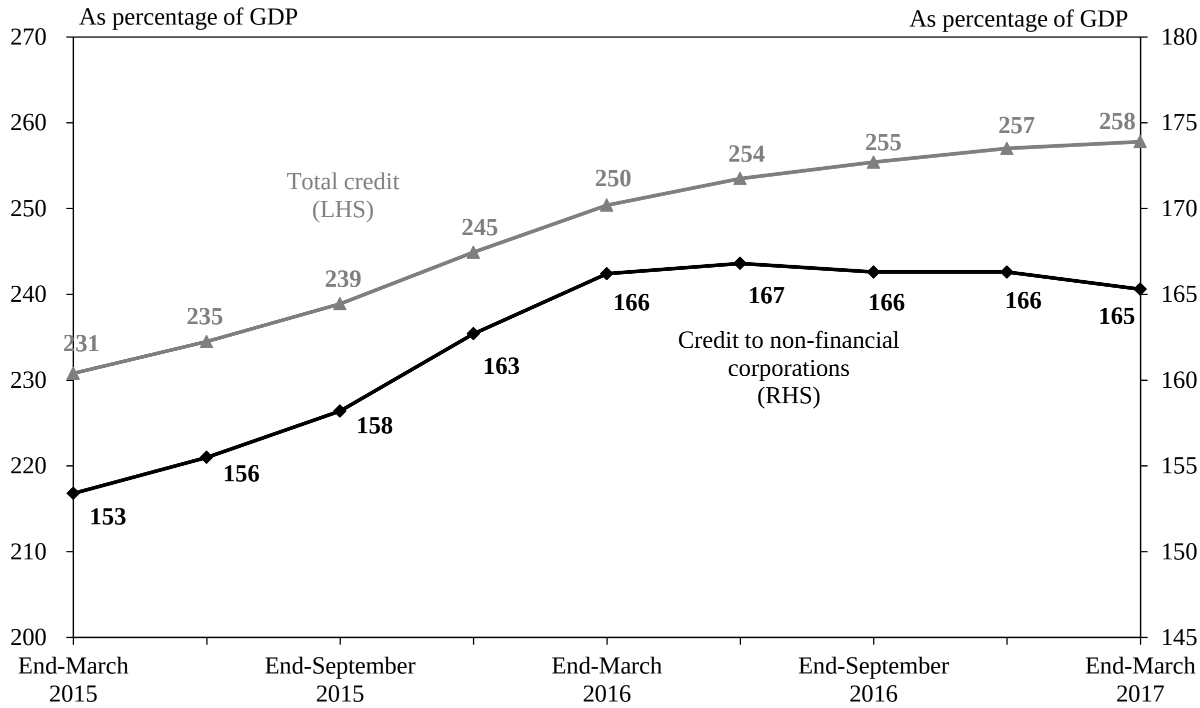
---

(1) Total social financing refers to the outstanding balance of funds raised by the real economy (domestic non-financial corporations and individuals) from the financial system.

Box 2.2 (Cont'd)

The prudent and neutral monetary policy plays a pivotal role in enabling the Mainland economy to "stabilise growth and prevent risks". Since the start of 2017, the Mainland economy has fared well, sustaining a sound and upward momentum with a year-on-year growth of 6.9% in real terms in the first three quarters, higher than the target growth rate of around 6.5% set at the beginning of the year. Foreign exchange reserve has been on the rise during the first three quarters and has stayed above the level of US$3 trillion, while RMB exchange rate has also remained stable. Meanwhile, according to the estimation of the Bank for International Settlements, the Mainland's overall leverage ratio is still on the rise, albeit at a tapered pace. The non-financial corporations leverage ratio, which is of particular concern, has even trended downward, reflecting the favourable development in deleveraging the economy (***Chart 2***).

Chart 2: Mainland's overall leverage ratio rose at a moderated pace while non-financial corporations leverage ratio reverted to a decline



The PBOC is making relentless efforts in enhancing the macro-prudential assessment framework this year, with the off-balance-sheet wealth management businesses formally covered within the scope of broad credit indicators since the first quarter. Relevant authorities such as the PBOC, the China Banking Regulatory Commission, the China Securities Regulatory Commission and the China Insurance Regulatory Commission have also been taking responsive measures to curb regulatory arbitrage activities by FIs. In July 2017, the National Financial Work Conference specifically called for the enhancement of the financial sector to better serve the real economy, the strengthened containment of financial risks and the deepening of financial reforms. The Conference also announced the establishment of the Financial Stability and Development Committee under the State Council and the further strengthening of the PBOC's role in macro-prudential management and systemic risk prevention. All these developments bespoke the importance attached by the Mainland authorities to preempting economic and financial risks. It is envisaged that financial regulators in the Mainland will continue their concerted effort to enhance the financial system and regulatory framework, with a view to maintaining financial stability and facilitating the growth of the real economy.

Box 2.2 (Cont'd)

In September 2017, the PBOC announced the implementation of a targeted reserve requirement ratio (RRR) cut policy(2) for FIs with loans reaching a certain proportion in the inclusive finance area. The differentiated required reserve ratios, as enabled by the targeted cut, will encourage FIs to increase credit availability for inclusive finance, so as to step up support for the relatively weak sectors of the Mainland economy and conform with the nation's development direction to encourage entrepreneurship and innovation. This clearly reflects the key support of the monetary policy to economic restructuring, transformation and upgrading. For the rest of 2017, a prudent and neutral monetary policy as well as ongoing enhancements to the regulatory regime will continue to provide an environment conducive to risk prevention. To ensure the stable development of the economy, the Mainland authorities will closely monitor both the domestic and external economic environments, stay vigilant to the financing conditions of the real economy and make use of various monetary policy instruments to ensure the stability of liquidity. With the opportunities brought about by the Belt and Road Initiative and the Guangdong-Hong Kong-Macao Bay Area, as well as the continued sound and stable development of the Mainland's financial system, Hong Kong stands to benefit significantly from its role as the nation's international financial centre and offshore RMB business hub.

(2) The targeted RRR cut policy will be implemented starting from 2018. For commercial banks with outstanding loans or new loans in the inclusive finance area reaching 1.5% or 10% of the total loans in the previous year, an RRR cut of 0.5 or 1.5 percentage point(s) will be applied respectively. The inclusive finance businesses cover loans to small and micro enterprises with credit line for a single client below RMB 5 million, operating loans to businesses established by self-employed individuals and small and micro enterprise owners, loans to farmer households, guaranteed loans to new businesses, loans to those registered in poverty document, student loans, etc. The PBOC estimated that the policy could cover all of the large- and medium-sized commercial banks, about 90% of city commercial banks and about 95% of non-county rural commercial banks.