

# Member Report of China's Economy and Capital Market

## I. China's Macro Economy for the First Half Year of 2011-2012

Since 2011, in light of complex and volatile international political and economic environment and heavy domestic development tasks, the Chinese government insisted on the work guidelines of "making progress while ensuring stability"; strived to properly deal with the relationships between economic growth, economic restructuring and inflation; increased policy controls. Overall, the national economy operates smoothly, and the economic development remains steady and sound.

The outline of China's Macro Economy for the First Half Year of 2011-2012 is as follows:

In 2011, the annual GDP was 47.1564 trillion Yuan, an increased 9.2% over the previous year, the growth rate decreased by 1.1% over the previous year. In which, the primary industry was 4.7712 trillion Yuan, increased by 4.5%; the secondary industry was 22.0592 trillion Yuan, up 10.6%; tertiary industry was 20.326 trillion Yuan, increased by 8.9%; Annual Consumer Price rose 5.4% over the previous year. In the first half of 2012, the Gross Domestic Product (GDP) was 22.70982 trillion Yuan, increased by 7.8% over the previous year, in which, a growth of 1.6% in the first quarter, and increased by 1.8% in the second quarter; primary industry GDP was 1.7471 trillion, increased by 4.3%; second industrial GDP was 11.095 trillion Yuan, increased by 8.3%; tertiary industry GDP was 9.86772 trillion Yuan, a year-over-year growth of 7.7%.

**(1) The steady growth of Agricultural Production.** In 2011, the grain planting areas were 110.57 million hectares, 700,000 hectares more than last year; annual grain output was 571.21 million tons, an increase of 24.73 million tons over last year, increase rate was 4.5%, rose for eight consecutive years. In the first half of 2012, the Summer Grain output was 129.95 million tons, an increase of 3.56 million tons in 2011, increase rate 2.8%, the highest level in history; Summer Grain sown areas were 27.576 million hectares, a slight increase of 0.1% compared with year 2011, yields up to 4,713 kg / hectares, an increase of 127 kg / ha in 2011, increase rate 2.7%.

**(2) Steady and rapid growth of Industrial Production.** In 2011, the industrial added value was 18.8572 trillion Yuan, an increase of 10.7% over the previous year; industrial added value by enterprises above a certain scale increased by 13.9%, the growth rate decreased by 1.8% from the previous year. In which, state-owned and state-holding enterprises increased by 9.9%, collective enterprises increased by 9.3%, joint-stock enterprises increased by 15.8%, foreign-funded enterprises and those invested by Hong Kong, Macao and Chinese Taipei increased by 10.4%, an increase of 19.5% in the private sector; Sales-Output Ratio of industrial enterprises above a certain scale for the year reached 98.0%, realized profits of 5.4544 trillion Yuan, a year-over-year growth of 25.4% over the previous same period, the growth rate decreased by 24%. The industrial added value by enterprises above a certain scale achieved 10.5% growth in the first half of 2012, state-owned and state-holding enterprises increased by 7.0%, the private sector increased by 15.6%, an increase of 12.4% by joint-stock enterprises, foreign-funded enterprises and those invested by Hong Kong, Macao and Chinese Taipei increased by 6.3%; national enterprises above

a certain scale realized main business income of 42.6 trillion Yuan, a year-over-year growth of 11.3%, realized profits of 2.3117 trillion Yuan, a year-over-year decline of 2.2%.

**(3) Fixed Assets Investment maintaining high levels of growth.** In 2011, the total fixed asset investment was 31.1022 trillion Yuan, an increase of 23.6% over the previous year; after deducting price factors, the actual growth rate was 15.9%. Urban fixed asset investment 30.1933 trillion Yuan, an increase of 23.8%; rural fixed assets investment was 908.9 billion Yuan, an increase of 15.3%. In urban fixed asset investment, the primary industry investment was 679.2 billion Yuan, a year-over-year growth of 25.0%; second industrial investment was 13.2263 trillion Yuan, an increase of 27.3%; tertiary industry investment was 16.2877 trillion Yuan, an increase of 21.1%. The annual development investment in Real Estate was 6.174 trillion Yuan, an increase of 27.9% over the previous year. In the first half of 2012, the country's investment in fixed assets (excluding rural households) was 15.071 trillion Yuan, a year-over-year growth of 20.4%; after deducting price factors, the actual growth of 18.0%. Investment in the primary industry was 365.4 billion Yuan, a year-over-year growth of 28.6%; investment in the secondary industry was 6.7768 trillion Yuan, increased by 23.7%; tertiary industry was 7.9288 trillion Yuan, an increase of 17.4%.

**(4) The slowdown of the growth of Social Consumption.** In 2011, the total retail sales of social consumer goods was 18.3919 trillion Yuan , an increase of 17.1% over the previous year; after deducting price factors, the actual growth rate of 11.6 % , down 3.2% over the previous year. In the first half of 2012, total retail sales of social consumer goods was 9.8222 trillion Yuan, a year-over-year increase of 14.4% in nominal terms (after deducting price factors, the actual growth of 11.2% ), down 2.4% over the same period of last year.

**(5) The Consumer Price Index rose at first and then decreased.** In 2011, consumer prices increased by 5.4% over the previous year, food prices rose by 11.8%, non-food prices rose by 2.6%; industrial producer prices rose by 6.0%, the purchasing prices of industrial producers rose by 9.1%, prices of agricultural products increased by 16.5%. In the first half of 2012, consumer prices rose by 3.3%, down 2.1% over the same period of last year. The prices of seven categories of products (food, alcohol & tobacco & daily supplies, clothing, household equipment, health care, entertainment & stationery, and residential prices) went up, while prices of transportation and communication flattened year after year. The ex-factory price of industrial producers fell by 0.6% year-over-year, the purchase price of the same fell by 0.3%.

**(6) The slowdown of the growth of total imports and exports, foreign direct investment continuing to increase.** In 2011, total imports and exports of goods were 3.6421 trillion U.S. dollar, an increase of 22.5% over the previous year, the growth rate went down by 12.2% from the previous year. In which, exports were 1.8986 trillion U.S. dollar, an increase of 20.3%, the growth rate dropped by 11%; imports were 1.7435 trillion U.S. dollar, an increase of 24.9%, the growth rate dropped by 13.8%. The trade surplus was 155.1 billion U.S. dollar, a decrease of 26.4 billion U.S. dollar over the previous year. The proportion of trade surplus to the total of import and export value increased from 8.9% in 2009 to 6.2% in 2010, and further reduced to 4.3%, the trade imbalance problem is getting better. The annual actual use of foreign direct investment by non-financial sectors was 116 billion U.S. dollar, an increase of 9.7%; the annual non-financial

direct investment in overseas was 60.1 billion U.S. dollar, a year-over-year growth of 1.8%. In the first half of 2012, the total import and export value was 1.83984 trillion U.S. dollar, a year-over-year growth of 8.0%, down by 17.8% than the same period of last year. Among this, exports were 954.38 billion U.S. dollar, an increase of 9.2%; imports were 885.46 billion U.S. dollars, an increase of 6.7%. The trade surplus was 68.92 billion U.S. dollar.

**(7) The job market remaining stable, in addition sustained growth of disposable income of residents per capita.** At the end of 2011, the number of employed persons was 764.2 million, including 359.14 million employed people in urban areas. New entrants to the urban labor force were 12.21 million throughout the year; the registered urban unemployment rate at the end of the year was 4.1%, unchanged from the end of the previous year. Throughout the year, the per capita net income of rural residents was 6,977 Yuan, a year-over-year growth of 17.9%, after deducting price factors, the actual growth of 11.4%; per capita disposable net income of urban residents was 21,810 Yuan, an increase of 14.1% compared with last year, after deducting price factors, the actual growth of 8.4%. The proportion of rural residents' food expenses to total consumption expenditure (the Engel coefficient) was 40.4%, while for urban residents was 36.3%. In the first half of 2012, urban residents per capita disposable income was 12,509 Yuan, a year-over-year growth of 13.3% in nominal terms, after deducting price factors, the actual growth of 9.7%, 2.1% higher than the same period of last year; per capita cash income of rural residents was 4,303 Yuan, a year-over-year nominal growth of 16.1%, after deducting price factors, the actual growth of 12.4%, down by 1.3% over the previous year. In the first half of 2012, median per capita disposable income of the urban residents was 10,937 Yuan, a year-over-year growth of 14.6%; median per capita cash income of rural residents was 3,690 Yuan, a year-over-year growth of 16.9%.

**(8) The slowdown of Money Supply growth and steady growth of credit quota.** At the end of 2011, the balance of Broad Money Supply (M2) was 85.2 trillion Yuan, a year-over-year growth of 13.6%, down by 6.1% over the previous year's growth. The year-end of all financial institutions and foreign currency deposit balance was 82.7 trillion Yuan, an increase of 9.9 trillion Yuan; of which, RMB deposit balance was 80.9 trillion Yuan, an increase of 9.6 trillion Yuan. The balance of foreign currency loans of all financial institutions was 58.2 trillion Yuan, an increase of 7.9 trillion Yuan; of which, loan balance of RMB was 54.8 trillion Yuan, an increase of 7.5 trillion Yuan. At the end of June 2012, the balance of Broad Money (M2) was 92.5 trillion Yuan, a year-over-year growth of 13.6%; Narrow Money (M1) totaled 28.75 trillion Yuan, an increase of 4.7%; Currency in Circulation (M0) was 4.93 trillion Yuan, an increase of 10.8%. RMB deposit balance was 88.31 trillion Yuan, 7.38 trillion Yuan of new RMB deposits, up by 42.5 billion Yuan. RMB loans were 59.64 trillion Yuan, 4.86 trillion Yuan of new RMB loans, and an increase of 683.3 billion Yuan.

## **II. The Development of China's Capital Market for the First Half Year of 2011-2012**

Since 2011, China's capital market has further optimized its structure, and constantly improved the basic systems, actively served for the economy transition. The operation of the overall market remains stable and healthy.

**(1) The scale of the stock market continues to expand, and estimated value of capital market is going to be equitable.** China actively promotes and deepens the IPO reform. In the first half of 2012, China issued the "Guiding Opinions on Further Improving the IPO reform", amended the securities issuance and underwriting management measures, strengthened information disclosure of new shares offering, improved the pricing constraints mechanism, and enhanced the autonomy and responsibility of market participants. In 2011, a total of 282 public companies initially listed on the A Shares Market, a total of 220 public companies used equity refinance, total financial value in the whole year reached 507.3 billion Yuan. In the first half of 2012, affected by the domestic and international economy, only a total of 102 public companies initially listed on the A Shares Market, and financed 72.6 billion Yuan, decreased by nearly 40% and 50% respectively comparing with the same period of previous year. As of June 30, 2012, listed companies in Shanghai and Shenzhen Stock Markets were 2,444 in total (945 in Shanghai and 1,499 in Shenzhen), the total market capitalization and the negotiable market capitalization of both stock markets reached 22.62 trillion Yuan and 17.31 trillion Yuan respectively, the proportion of Circulated Stock Value to Total Market Capitalization was 76.53%.

Since 2011, China's stock market has presented a vibrant down-trend. In 2011, the Shanghai Composite Index cumulatively declined by 21.68%; Shenzhen Component Index cumulatively decreased by 28.41% all year round; SME Index declined by 37.09% the entire year; GEM Index year cumulatively decreased by 35.88% all year round. Compared with the beginning of the first half of 2012, the Shanghai Composite Index rose by 1.18%; Shenzhen Component Index went up by 6.52%; SME Index increased by 4.23% compared with the beginning of the year; GEM index edged up 0.69%. By June 29th, 2012, calculated in settlement price of the A Shares Market in Shanghai and Shenzhen, the Stationary P/E Ratio was 14.1. The P/E Ratio of the A Shares Market in Shanghai Stock Market and Shenzhen Stock Market were respectively 11.88 and 23.47, in which, the P/E Ratio of the Main Board in Shenzhen Stock Market was 19.35, the P/E Ratio of SMEs Board was 27.26, the P/E Ratio of GEM Board was 34.16. The overall market valuation tends to be more reasonable.

**(2) The hierarchy of market systems is constantly enriched; the multi-layered capital market has made substantial achievements.** Since 2011, China has continued to strengthen the construction of multi-layered market system. Firstly, achieving steadily development of the Main Board Market, Small and Medium-sized Enterprises (SMEs) Board and Growth Enterprise Market (GEM) Board. Secondly, further regulating the bond market, optimizing bond approval system, launching non-public bond offering in the GEM Board, and improving financing services for Small and Medium-sized Enterprises (SMEs). In 2011, the total value of bond financing by listed companies was 170.74 billion Yuan, reached record levels; during the first half of 2012, the total value of bond financing by listed companies was 100.747 billion Yuan, a year-over-year growth of 43.61%. In May, 2012, the Shanghai Stock Exchange and Shenzhen Stock Exchange published the "Pilot Measures of the Shanghai Stock Exchange for the Issuance of Private Placement Bonds of Small and Medium Enterprises", and further broadened the financing channels for SMEs. Thirdly, The OTC Market achieved new development, the Pilot Projects for Unlisted Public Company Share Transfer System expanded from Zhong Guancun District to the High Technology Districts

of Four Provinces (Beijing, Shanghai, Tianjing and Hu Bei) within the whole country. The construction of the National SMEs Agency Share Transfer Corporation is also being prepared in Beijing.

**(3) Innovation of Business and Products and the Well-functioning of Market Operational System.** In Dec. 2011, China Securities Regulatory Commission (CSRC) issued "Work Guideline for the Innovation of Securities Business (Products)", specified the innovational mechanism; China encouraged the implementation of Pilot Programs for full range of Collateral Repo and Cash Management Products; promoted the orderly functioning of Margin Trading and Short Selling Business, established China Securities Finance Corporation. As of June 30th, 2012, the Security Margin Transaction Balance reached 60 billion Yuan. At the same time, futures products were constantly developed, three new financial products- Lead Futures, Coke Futures and Methanol futures were launched in 2011; pilot project for reforming hedging Mechanism of Futures such as Lead and Gold was launched, pilot projects for futures bonded delivery services preceded smoothly.

**(4) The healthy development of all types of investment intermediaries.** The China Securities Regulatory Commission continued to strengthen risk monitoring of the securities companies, and in 2011 organized an industry-wide stressing test. China supports the listing, mergers and acquisitions of qualified securities companies. In 2011, the international businesses of China securities firms were accelerated; CITIC Securities successfully listed on the Hong Kong Stock Exchange, becoming the first A + H listed securities company; more than 10 securities companies through the means of opening branches, capital increase, acquisition, strategic cooperation etc. expanded businesses in China Hong Kong, the United States, Canada and other countries and regions; private international investment business came into the practical stage. As of June 2012, there were 112 securities firms with the total assets of 1.62 trillion Yuan and net capital of 481.787 billion Yuan; the number of listed securities firms reached 19. As of the end of 2011, a total of 66 fund companies managed 914 funds, and the total net asset value of funds was about 2.19 trillion Yuan. Futures firms conducted the classification regulation, and launched the futures investment consulting business.

**(5) Strengthening Market Compliance and Integrity.** In 2011, more than 100 insider trading cases were investigated; the Administration Registry System was implemented in the listed companies, securities and futures regulatory systems. China strictly cracked down on Market Manipulation, Rat-trading and False Information Disclosure Crimes, the investigated cases were more than 200, the decisions on administrative and suspension punishment were more than 60. In accordance with the arrangements of the State Council, China steadily promotes the clean-up and rectification work of various types of trading venues. China actively updates the Capital Market Integrity Database, and integrity checking has become a necessary administrative procedure.

**(6) The Opening up and international cooperation have achieved new breakthroughs.** "Renminbi Qualified Foreign Institutional Investor (RQFII)" Pilot Program was launched, as of June 2012, 9 Fund Companies and 12 Securities Firms got business licenses. China has completed the preparatory work of the domestic investment in Hong Kong Stock Exchange Traded Fund

(ETF), modified the measures and supporting rules of the Qualified Domestic Institutional Investor (QDII), newly approved the issuance of 22 new funds.

**(7) Strengthening investor education and suitability management, increasing the protection of investors' interests.** During the past one and a half year, the securities companies in the industry actively carried out investor education and suitability management, included the requirements for investor education and suitability management into the routine business management processes; through customer classification management, provided investors with suitable products and services in the areas of fund sales, investment advices and securities transactions on the Growth Enterprise Market (GEM) Board. Meanwhile, in accordance with the relevant self-disciplinary rules, securities firms optimized self-regulation work, provided compliance education and disclosed risks to investors, and helped them with rational investment. China took effective actions against illegal account violation of trading rules, and maintained the orderly function of trading.

**(8) Guiding the industry to perform corporate social responsibilities.** To further promote the building of industrial social responsibility, the Association carried out the 2011 Survey on the Implementation of Social Responsibility by Securities Firms, and on this basis, wrote the first report reflecting the corporate social responsibility annual performance by securities firms — "2011 Corporate Social Responsibility Report". It presented the public with corporate social responsibility performance during 2011, summed up the useful experience of the industry in fulfilling their social responsibility, and strengthened the awareness of corporate social responsibility. At the same time, through the production and broadcasting of industrial promo videos, China increased the crackdown on illegal actions and conducted securities dispute mediation, analyzed the industrial suitability management status, established the Securities Industry Nonprofit Funds, and played an active role in effectively protecting the legitimate rights and interests of investors, and guiding the industry to fulfill their social responsibility.

### **III. Future Expectation for China's Capital Market**

At present, China's capital market is facing a very complex internal and external environment. From an international perspective, the debt crisis is spreading from Greece to Spain and other countries, there is a noticed weak recovery in developed economies and the declining growth rate of the emerging market economies, world economic recovery is difficult. Domestically, the problems of irrational industrial structure and the big poverty gap between the rich and the poor have not been resolved; the implementation of domestic real estate control policies and the slowdown in the economy's potential growth rate, such multiple factors superimposed on each other and resulted in the characteristics of a slowdown in China's economy appearing; exports, investment and consumer demands are insufficient. From the market perspective, compared to the international capital markets, the problems of large fluctuations, few trading varieties, and small business scale still exist in China's capital market. The competitiveness and innovation capacity of financial institutions need to be improved. The basis of the capital market remains to be strengthened, the market system and structure has yet to be well functioning.

But we should notice that China's capital market is still in an important period of strategic opportunities. From the point of view of regulatory environment, market innovation and reform should be well developed in a favorable policy environment through deregulation, maintaining the bottom line, and progressively realizing the combination of self-regulation by securities market and government supervision. On one hand, the regulatory body should insist on the principles of giving priority to the market and social autonomy, constantly change regulatory approaches and methods, strengthen behavior monitoring, regular monitoring, process monitoring and post accountability supervision; avoid systematic risks, maintain the consistency between regulatory capability, innovation process and risk control. On the other hand, the regulatory body should insist on coordinated development of innovation and regulation; encourage and guide market participants; continue to deepen securities insurance system reform, vigorously promote the reform of the bond market, accelerate the establishment of Over-the-Counter(OTC) Market based on counter transactions and by unified supervision; actively promote the reform of delisting system, further optimize the hierarchical structure of the capital market; study on the issuance of new bond varieties such as high-yield corporate bonds, municipal bonds, agency debt, explore financial innovation e.g. mergers and acquisition, securitization of assets, as well as options and futures, constantly enrich financial products and risk management tools, broaden the financing channels and the investment scope of securities firms; gradually establish a market-oriented product innovative mechanism, and open a space for the securities business innovation and product innovation.

From the point of view of innovation and business development, the Association actively encourages industry innovation, accelerates innovation and business development. Throughout an in-depth investigation of the regional equity market, the Association prepared and submitted "the Report of Guidance on Regulating Securities Firms Involved in Regional Equity Markets" to China Securities Regulatory Commission, this report was approved and has been published; in the first half of this year, the Association drafted "Approaches and Measures on Promoting the Innovative Development and Opening Up of Securities Firms", refined the detailed work, developed "Work Schedule Regarding the Implementation of the Approaches and Measures", and accelerated the promotion of industrial innovation and development. For the next stage, the Association will continue to orderly launch a series of measures to boost innovation and business development.

From the point of view of investors suitability management, the Association drafted a study on investors suitability management in the systems of the United States, Hong Kong, China Taipei, Japan, Singapore, the European Union, Germany, Canada and other countries and regions; the Compliance Professional Committee completed the "Guidelines on Suitability Management of Securities Investors", throughout an in-depth research on suitability management of overseas mature markets and current domestic practices in the areas of bonds, stock index futures, asset management, securities investment consulting, margin trading etc. This Guideline covers new ground for domestic securities suitability management. In addition, the Association increases the publicity of suitability management, successively produced special reports entitled "The Securities Association Promoting the Fulfillment of Investor Suitability Management Obligations by Securities Firms" and "Lesson Drawing from Investor Suitability Management of Countries and

Regions". These experiences lay a solid foundation for SAC to further promote the suitability management in the future.

From the perspective of self-regulation, SAC hold the fifth Member General Meeting on 23<sup>rd</sup>-24<sup>th</sup> June, 2011, and elected the new session of Board of Directors. After this transition, the Association carried out internal adjustment over departments and staff, developed the internal systems; externally strengthened the capability to serve the industry development, and established the Advisory Committees and 15 Professional Committees. Over the past year, the Professional Committees carried special research focusing on some of the hot issues during the innovative development, and participated in the work of industrial self-regulation rulemaking and examination over industry practitioners, progressively achieved the targets of building Professional Committee as "Platform of Exchanges, Discussions and Execution".

Looking ahead, China's capital market will adhere to the essential requirements of serving for the real economy, stick to the solid foundation of real economy development, continually maintain stable, healthy and coordinated economy development; the scale of the overall market continues to grow, the market structure will be optimized, product innovation and regimes continue to be improved, the capital market will be compatible with the country's economic development, consistent with the market demand, and be equipped with international competitiveness.