Yi Gang: Further open up the financial sector to promote high-quality growth

Speech by Mr Yi Gang, Governor of the People's Bank of China, at the China Development Forum "Greater Opening-up for Win-Win Cooperation", Beijing, 24 March 2019.

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Ladies and Gentlemen,

Distinguished Guests,

It is a pleasure to attend the China Development Forum and share with you observations on the progress and outlook of financial sector opening-up in China.

In 2018, under the leadership of the Party Central Committee with Comrade Xi Jinping at the core, the financial sector has enhanced support to the real economy, effectively mitigated and resolved financial risks, and deepened reform and opening-up. First, providing a proper monetary environment, enhancing the counter-cyclical role of monetary policy and providing adequate liquidity. Second, providing targeted support to key areas and weak links in the economy, through the “synchronized use of three arrows”, i.e. bank lending, supporting bond issuing by private enterprises, establishing equity financing instruments for private enterprises. Better financial services have been made available to the micro and small enterprises and the private sector. Third, managing and resolving financial risks effectively, the macro leverage ratio has stabilized and a balance achieved between stable growth and risk prevention. Fourth, achieving both the external and internal balance, the RMB exchange rate has been basically stable at an adaptive and equilibrium level and the BOP position has been broadly balanced. Fifth, making progress in financial sector opening up, as reflected in new measures of regulatory system reform, the improvement in the interest rate and exchange rate regime, and further opening-up of the financial sector. Promoting greater openness has been our priority in the financial sector.

I.Breakthroughs in Financial Sector Opening-up

In terms of financial service sector opening-up, President Xi Jinping announced last April in Boao to further open up the service sector “sooner rather than later”, in particular the financial service sector. The People’s Bank subsequently released in Boao on behalf of the Chinese Government a timetable for the implementation of 11 specific measures. Up till now, most of the measures have materialized. The very few measures that are yet to materialize have reached the final stage of law amendment, and applications from foreign investors have been received and are being processed. Foreign financial institutions now have improved market access: the UBS has increased its shareholding in UBS Securities to 51 percent, effectively holding a controlling stake; Allianz has been approved to establish the first foreign controlled insurance company in China; the Standard and Poor’s has received a credit rating license in China; American Express is creating a joint venture in China and it has been approved to start preparation to provide electronic payment service in China.

On financial market opening, China has been working to expand access to the onshore bond, stock and derivatives markets in line with international standards, mostly by offering more channels for cross border investment flows, and improving institutional arrangements. These efforts have contributed to increased openness, stronger competitiveness and greater influence of the Chinese financial markets, which have been widely acknowledged in international markets, as highlighted by the inclusion of China’s A shares in the MSCI index in June 2018, and the announcement by FTSE Russell in September 2018 on including A shares in its key emerging market indexes. Overseas investment in China’s bond market increased by nearly 600 billion yuan in 2018, and the outstanding investment by overseas bond investors has reached 1.8 trillion yuan. Moreover, Bloomberg has confirmed that it will include Chinese bonds in its Bloomberg Barclays Global Aggregate Index starting in April this year.

Reforming the RMB exchange rate regime has also made progress. China remains committed to market based reforms, which we believe are essential for improving the managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. The People’s Bank has largely phased out regular interventions in the foreign exchange market, and the RMB has become more flexible. Market participants are able to adapt to this increased flexibility.

II.Further FInancial Sector Opening-Up is a Task that We Must Continue Carrying Out

Financial sector opening is a key component of China’s broader opening up strategy. Further opening is an independent policy choice we have made. It is essential for the development of the financial sector and a necessary step towards deepening supply-side structural reform in the financial sector and quality development of the real economy.

First, the financial sector is in essence a competitive service industry. The financial sector and financial markets have three major functions. The first one is efficient resource allocation. The savings rate is high in China. On the one side are those who save money, on the other side are those who need money. The financial sector performs the function of asset allocation in that it allocates them to banking, securities and insurance products and transforms savings into financial assets. In addition, more and more institutional investors need to invest in China’s financial market, including central banks, asset management companies and pension funds. One of the tasks for financial market is to open up in an orderly manner to enable convenient and effective asset allocation by both foreign and domestic investors. This is the first important function of the financial markets.

The second major function is risk management, i.e. through price discovery and risk management tools. The day-to-day tradings on the financial market necessitate continued price discovery and accurate pricing. If we take Government securities yield curve as the risk-free interest rates, financial market will price all kinds of risk premiums of financial products in transactions and send clear signals. Moreover, financial market also provide all kinds of hedging tools and adequate liquidity to facilitate the selling and buying activities of market participants, and enable effective hedging of risks. Once the foreign investors are investing in the onshore market, they will find a lack of derivatives, hedging tools and other financial products. This year our priority is to create a supportive environment to provide hedging tools for investors to effectively hedge and manage risks.

The third function is to provide financial services to households and enterprises. Financial services are mostly about resource allocation and risk management. Here I wish to emphasize that professional financial services lower transaction cost and save time. Efficiency of financial services can be measured by the time saved. For example, 20 years ago, one had to spend half a day to go to several places to pay the water, electricity and housing bills. Ten years ago, a one-hour visit to the bank would do the job. Today, the bills can be paid in five minutes through online banking service or mobile payment applications. This shows that financial services are much more efficient today. It save consumers time just like eating out is more efficient than cooking at home, and buying apparel in a store is more efficient than making it yourself. Therefore, the financial sector is in essence a competitive service industry.

We will advance supply-side structural reform and open up to foreign investors so that the financial system can perform the three functions properly. On one hand, it increases the supply of financial factors by bringing in financial institutions, services and products. It allows us to make better use of both overseas and domestic markets and resources, improve resources allocation, and meet the needs for diversified financial services. On the other hand, opening up of the financial sector will help improve domestic institutional arrangements. In this process, China has been learning from institutional arrangements from the advanced economies, making rapid progress in corporate governance of financial institutions, financial market development and financial regulation.

III. Some thinking on Further Opening up the Financial Sector

In recent years, remarkable progress has been made in the opening up of China's financial sector. Nevertheless, the degree of openness is not high and there is much room for further improvement. We should aim high and continue our efforts in opening up the financial sector.

Firstly, we should promote financial service sector opening-up, financial market opening up and RMB exchange rate regime reform in a well-coordinated way. For the opening up of the financial sector, equal treatments should be provided for both Chinese and foreign institutions in terms of regulatory requirements and standards such as equity holding, form of establishment, shareholder qualification, scope of business and number of licenses. Chinese and foreign-funded institutions should be treated equally in a way that is more transparent and consistent with international practice. To open up the financial market, we will further connect domestic and foreign capital markets, by further improving the QFII regime, Shanghai-Hong Kong Connect and Shenzhen-Hong Kong Connect. We will also continue the exchange rate regime reform, to enhance the flexibility of RMB exchange rate and its role as the automatic stabilizer for the macro economy and balance of payments.

Secondly, pre-establishment national treatment and negative list should be applied. Financial institutions, Chinese and foreign alike, shall have equal access to all areas excluding those listed on the negative list.

Thirdly, institutional arrangements for financial sector opening-up should be improved to achieve institutional and systemic opening-up. Convergence with international rules and standards will accelerate and accounting, taxation and other supporting rules will be improved. We will also strengthen top-level design and unify relevant rules. For financial services of the same or similar category, different rules should be harmonized.

Fourthly, the business environment should be improved. We will further cut red tapes, streamline procedures for administrative approval, and enhance its transparency and efficiency. There will be improved coordination and communication in policy making to increase transparency and have simple and transparent rules.

Fifthly, financial regulation will be improved. Financial institutions, domestic or foreign, shall operate with licenses and under regulation. Greater market access will go hand in hand with better financial regulation and regulatory capacity will match openness.

IV. Improve Risk Prevention System for a More Liberalized Financial Sector

Financial sector opening up does not by itself lead to financial risks, but may add to the complexity of financial risk prevention. Therefore, efforts should be made to improve the financial risk prevention system to catch up with the progress of openness.

Since 2018, significant progress has been made in the prevention of financial risks in China. Firstly, the financial regulatory system has been reformed. The State Council Financial Stability and Development Committee have enhanced the coordination in the financial sector. The PBC serves as the Committee's Secretariat to support its day-to-day operation. Mandates of the PBC have been strengthened with more coordination responsibility. Allocation of the regulatory resources has been improved. Secondly, macro leverage ratio stabilized. As the supply-side structural reform deepens, macro leverage ratio fell by 1.5 percentage points from end-2017 to 249.4 percent at end-2018. Going forward, as China's financial market evolves and the share of direct financing rises, part of the debt financing will be converted into equity financing, which will facilitate stabilization of macro leverage ratio. Third, the shadow banking sector has been better regulated. We introduced new regulations and supporting measures to address the irregular and unlawful activities in the financial markets, effectively containing the disorderly development of shadow banking system. Fourth, macro-prudential management has improved, with measures to strengthen regulation of the Systemically Important Financial Institutions (SIFIs), to improve the macro-prudential management of cross-border capital flow, resulting in stronger resilience to withstand the impact of cross-border capital flows. In addition, we have made important progress in the resolution of high-risk institutions in a smooth and orderly manner, so as to maintain the order in the financial market.

Going forward, we will continue to improve the financial risk prevention and management system to keep pace with further opening-up.

First, the coordinating role of the State Council Financial Stability Development Committee should be fully utilized, to make better overall plans in rolling out policy measures with proper strength and paces to generate synergy.

Second, the two-pillar framework of monetary and macro-prudential policies should be enhanced. We will strengthen the counter-cyclical role of monetary policy to ensure that the economy operates within a reasonable range. We will constantly improve the macro-prudential policy framework and strengthen regulation of financial holding companies and SIFIs. We will also add new instrument to the policy toolkit, enhance the real-time monitoring of the financial market, and prevent risk contagions across markets, regions and borders.

Third, we will accelerate the development of financial market infrastructures and improve comprehensive financial sector statistics. We will use advanced technologies and payment and settlement system to monitor and regulate the online, offline fund flows within China and across the borders, so that all fund flows are under the radar of financial regulators.

Fourth, we will improve the resolution mechanism for failing financial institutions. We will explore ways to develop market-oriented and law-based exit mechanism for financial institutions, with deposit insurance as its platform.

This year, we will follow President Xi Jinping’s remarks that “when it comes to improving financial services and preventing financial risks, a key component is to deepen reform and opening up”, steadily promote the opening up of the financial sector to facilitate the supply-side structural reform and the structural improvement of the financial system, and to support high-quality economic growth.

Thank you!

Appendix

Transcript of the Question and Answer Session

Question: Financial sector opening up is politically controversial in some countries. Does China face a similar situation?

Answer: There are different opinions with regards to financial sector opening up in China. Some support greater opening while others have concerns. Looking at China’s experience in opening up, all the liberalized sectors have become more competitive and provided better services, while the closed ones are less efficient and backward. So I think financial sector opening up is good for China, especially for the Chinese people, because it enables competition between domestic and foreign institutions. As a result this improves services and efficiency in China’s financial market. Our conclusion is that further opening up do more good than harm. Meanwhile, we have make preparation in terms of laws and regulations accordingly and formulated a roadmap and timetable based on Chinese circumstances. All these are in China's own interests.

Question: Thank you, Governor Yi, for the very encouraging update on the progress of financial market opening-up. Some foreign media seems to think that the lack of central bank independence in China provides room for risk control on the one hand but does not facilitate monetary policy flexibility on the other hand. Could you share your thoughts with us?

Answer: The central bank formulates and implements monetary policy in accordance with the Law of the People's Republic of China on the People's Bank of China promulgated in 1995. Since 1995, the conduct of monetary policy in China has been sound. Domestic prices have remained stable. The RMB has been a strong currency, appreciating about 30 percent and more than 20 percent respectively against a basket of currencies and the US dollar in the past two decades and more. Looking at the capital flows and balance of payment, current account surplus as a share of GDP declined from 10 percent in 2007 to 0.5% in 2018. The BOP is broadly balanced.

Under the current monetary policy framework, we have plenty of monetary policy instruments including interest rate policy and required reserve ratio and are capable of managing risks effectively. As I see it, we are able to meet the need of financial industry opening-up. Many global investors want to invest in RMB assets. To meet this demand, we will facilitate foreign investment, and improve the transparency of legal framework, regulations, accounting system and tax regime. The opening-up for financial institutions and financial service will follow the same rationale. Under the current monetary policy framework we are able to manage financial risks associated with China's integration into the global economy and economic globalization. As the country has integrated into the global economy through trade, investment, services and tourism, we will further open up financial sector and improve monetary policy accordingly.

Question：Financial innovation, including the rapid development of Fintech, drives the global expansion of new financial business, and brings increasing challenges to regulators. What are your views on regulatory coordination with other countries in this field?

Answer：First of all, financial innovation is good. Technologies in financial innovation reduce cost, promote financial inclusion, and benefit the general public. Second, financial sector is a licensed sector. In particular, when it involves raising money from general public, special attention should be paid to risk prevention. In licensing businesses, the emphasis is to protect public interest, especially interests of retail depositors and investors. This is of utmost importance. Third, financial innovation has increased the importance of cross-border regulatory coordination. Many financial innovations involve cross-border flows of money, service and asset management. Cross-border regulatory coordination is thus imperative. We discuss many of these issues in the FSB meetings, talking about how to have effective liquidation when problem arises to protect the interests of creditors in different countries more fairly.