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Institute of International Finance

Global Economic and Financial Outlook

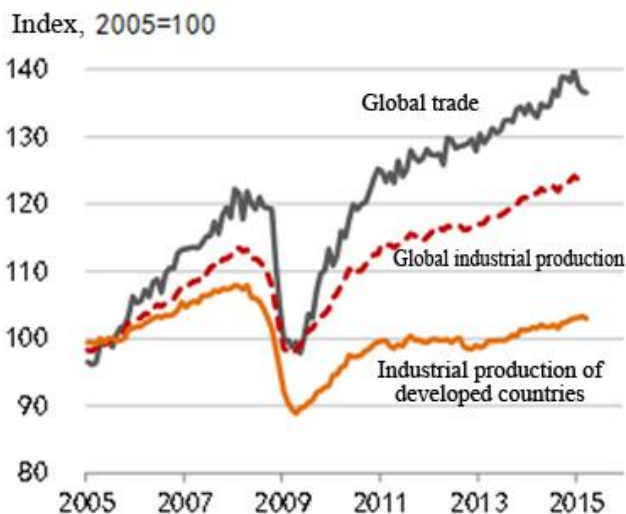
Q3 2015 (Issue 23)

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Highlights

- In the first half of 2015, developed economies were back on track while emerging economies diverged. Despite a relatively accommodative policy environment, recovery of the real economy remains fragile with prices hovering at low levels.
- Global financial market conditions were generally stable. The US financial risk index was in the safe zone. Financial risks of the EMs increased, the exchange rate of dollar stabilized, and commodity prices rebounded somewhat.
- Global economy is expected to further recover in the third quarter, though the regional divergence still exists. The risks of the financial markets will surge, especially fueled by the expectation of a rate hike by the US Fed.
- This report analyzes the global liquidity status, the stock market trends, the Fed's monetary normalization and Grexit, as well as the prospects of the RMB internationalization under the "One Belt and One Road" initiative.

Indices of Global Industrial Production and Trade



Source: BOC Institute of International Finance

BOC Institute of International Finance Global Economic and Financial Research Team

Head of Team: Chen Weidong

Deputy Heads: Cao Yuanzheng

Zhong Hong

Team members: Wang Jiaqiang

Chen Jing

Wang Youxin

E Zhihuan (Hong Kong)

Huang Xiaojun (New York)

Lu Xiaoming (New York)

Qu Kang (London)

Contact: Wang Jiaqiang

Tel.: 010-66592331

Email: wangjiaqiang@bankofchina.com

Keep Alert for Global Economic Risks in Profound Adjustment

-- Global Economic and Financial Outlook (Q3 2015)

In the first half of 2015, the global economy had a shaky and weak recovery. The capital market boomed amid an easy monetary policy, and the forex market fluctuated largely against the backdrop of the differentiated prospects of regional development. After a profound adjustment, the global economy will face new downside risks in a shift of the regional and demand structures as well as the policy mix. This report focuses on the movement of global liquidity, the stock market bubbles, the Fed's monetary policy normalization and the Greek debt crisis, as well as the development prospects of the RMB internationalization under "One Belt and One Road" initiatives.

Part I Quarterly Economic Review and Outlook

I. Weak global economic recovery

In the second quarter of 2015, the global economic recovery gained a stronger momentum compared with January-March period. The US economy turned around the unexpected contraction in the first quarter, while the European and Japanese economies were on the path of steady recovery. However, some large emerging economies (Russia and Brazil) were trapped in recession, partially offsetting the growth in developed economies. Overall, the global economy expanded at a seasonally adjusted annualized rate of 2.6% in the second quarter of this year, rebounding from the previous quarter's 1.8%.

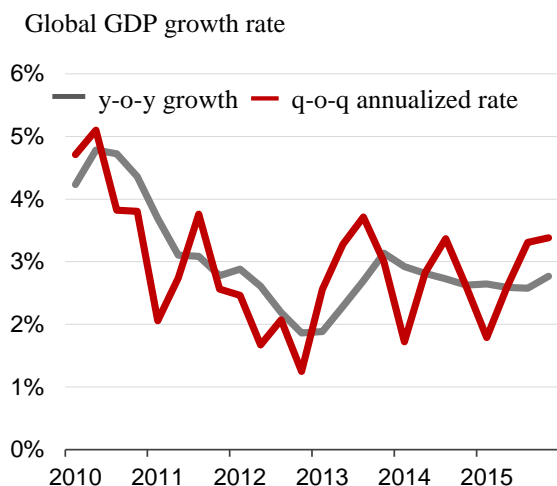
Looking into the second half of this year, we estimate a faster growth both in the developed and developing countries, particularly the US will ramp up growth, and economic decline in Russia and Brazil will dramatically narrow. The global economy is expected to grow faster in the second half of this year, with a seasonally adjusted annualized rate of 3.0% in the third quarter (Figure 1). Due to the undershooting economic performance in the first quarter however, we have revised down our forecast for the annual global GDP growth rate to 2.8% from previous 3% for 2015, as the expansion seems weak, similar to the situation of 2014.

In contrast to a waning momentum of GDP growth, price and employment indicators tend to be promising. Prices in the Euro Zone climbed under the QE measures by the European Central Bank ("ECB"), lowering the deflation risks. Commodity prices bounced back to some extent which is helpful in curbing a global deflation. Job data continued to improve, with the unemployment rate of the OECD countries falling to 6.9% in April from the post-crisis peak of 8.7%, and the downward trend is expected to last.

Global industrial production maintained growth, while international trade saw double-dipping (Figure 2). In the first three months of 2015, the global industrial output grew by 0.3% quarter-on-quarter, slowing down compared with 1.0% posted in the previous quarter. The industrial output in the major economies increased at a slower pace in the first half of this year. In the January-March period, affected by large swings in exchange rates of major currencies,

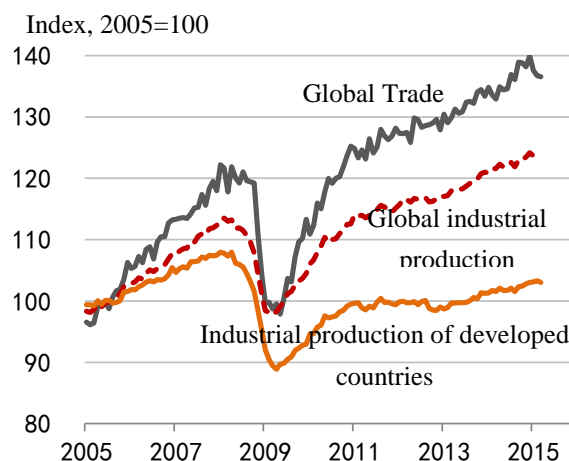
plummeting oil prices, regional turmoil, weak demand and the trend of “de-globalization”, the global trade of goods fell 1.5% from the last quarter of 2014 when a 1.2% quarter-on-quarter growth was recorded. The WTO predicts that the global trade will only increase 3.3% in 2015, the fourth consecutive year of slump.

Figure 1: Global economic trends



Source: BOC Institute of International Finance, Wind

Figure 2: Global industrial production and trade



In terms of specific economies (Table 1), the US may gain significantly stronger growth in the second half of 2015 with the whole year’s GDP growth estimated to reach 2.5%, primarily driven by: 1) an overall accommodative monetary policy despite rate hike; 2) low energy prices and surging asset prices in real estate sector and stock markets will prop up consumer spending. However, the sluggish energy sector and a stronger dollar will weigh on the economy. The potential long-term US economic growth has been dramatically lower than the pre-crisis level of 3%.

The Euro Zone and Japanese economies, benefiting from the local QE policy, weak euro and yen as well as dropping energy prices in the second half of this year, are foreseen to grow by 1.5% and 1.2% in 2015 respectively, slightly up from our previous projection. However, the protracted Greek debt problems may lead to its exit from the Euro Zone and impose an adverse impact on the European economy. Thanks to their unique external and internal conditions and resilient policies, the UK, Canada and Australia are on faster track of economic growth among developed countries and enjoy relatively stable financial conditions. Their economies are estimated to expand between 2%-3% in 2015.

Despite an estimated improving economic performance in the EMs in the second half of 2015, the regional economies present very different patterns. The strongest momentum comes from the Asia Pacific region. China and India are expected to gain growth of more than 7% throughout the year. Especially India, benefiting from its changing monetary policy, opening-up and investment, may outperform China for the first time with a GDP growth of about 7.5% in 2015. Due to the impact of recessions in Russia and Brazil, economic growth in Eastern Europe and Latin America will be the weakest in the EMs. Russia is a victim of plunging oil prices and geopolitical tensions, while Brazil is affected by drought, rate hikes against inflation and lack of investor confidence. Middle East and African economies will grow at a slower pace under the impact of sluggish commodity prices, geopolitical instability and weak external demand.

Table 1: Growth forecast of global economy and major economies (%)

Region	Y/Q Country	2013	2014	2015 ^f	2014				2015			
					Q1	Q2	Q3	Q4	Q1	Q2 ^e	Q3 ^f	Q4 ^f
America	US	2.2	2.4	2.5	-2.1	4.6	5.0	2.2	-0.2	2.0	3.0	3.0
	Canada	2.0	2.4	2.0	1.0	3.4	3.2	2.2	-0.6	1.5	2.0	2.5
	Mexico	1.4	2.1	2.5	1.4	4.2	2.1	2.7	1.6	3.0	2.8	2.8
	Brazil	2.5	0.0	-1.0	-0.7	-2.4	0.3	0.5	-0.6	-3.0	-0.5	0.5
	Chile	4.2	1.9	2.5	2.7	-0.3	1.5	3.4	4.2	1.0	3.0	2.0
	Argentina	2.9	0.5	1.5	-2.7	3.1	-2.1	0.1	1.5	2.0	1.0	0.5
Asia-Pacific	Japan	1.6	-0.1	1.2	4.4	-6.8	-2.0	1.2	3.9	2.0	1.5	1.0
	Australia	2.1	2.7	2.6	4.0	2.2	1.3	1.9	3.8	3.0	2.8	3.0
	China	7.7	7.4	7.0	6.6	8.2	7.8	6.1	5.3	6.5	7.5	7.5
	India	6.4	7.3	7.5	6.6	7.0	9.1	5.7	8.7	7.3	7.5	7.8
	South Korea	3.0	3.3	3.0	4.4	2.0	3.2	1.1	3.3	4.0	3.5	3.5
	Indonesia	5.6	5.0	4.5	4.7	4.9	4.9	4.9	4.5	4.0	4.5	4.5
Europe Africa	Euro Zone	-0.5	0.9	1.5	0.9	0.4	0.7	1.4	1.5	1.5	2.0	2.0
	UK	1.7	2.8	2.6	3.6	3.4	2.5	2.5	1.2	3.0	3.0	3.0
	Switzerland	1.9	2.0	1.0	2.2	0.8	2.4	2.1	-0.8	1.0	1.5	1.0
	Russia	1.3	0.6	-3.0	-0.1	0.6	0.1	-0.5	-8.7	-3.0	-0.5	2.0
	Turkey	4.2	2.9	3.5	5.4	-0.2	1.7	3.1	5.3	3.0	5.0	5.0
	South Africa	2.2	1.5	2.0	-1.6	0.5	2.1	4.2	1.3	2.0	2.0	2.0
Global GDP		2.5	2.6	2.8	1.7	2.8	3.3	2.6	1.8	2.6	3.0	3.2

Note: Quarterly growth rate refers to quarter-on-quarter seasonally adjusted annualized rate, e for estimation, and f for forecast.

Source: BOC Institute of International Finance

II. Risks of shifting gears in global economy

Up till now, the long-lasting tottering global economic recovery shows that the new growth engine has not yet emerged as the restructuring is far from being in place. Unexpected shocks from natural disasters, geopolitical tensions and related fields constantly perturb the economic recovery. In the future, the global economy will face three major structural shifting risks in a profound adjustment.

Firstly, rupture of regional momentum shift. In 2008-2009 when the global recession was triggered by the financial crisis, all economies suffered nose-dive. In the economic recovery that followed, different regions took turns functioning as growth drivers. During the global recession, the EMs expanded and served as buffer. In the European debt crisis, the US and the EMs played the role of stabilizing forces. In the current EM downturn, the world relies on the developed economies to restore strength. However, the performance of the developed economies has been lukewarm recently. In the near future, the world economy will face the challenge of losing momentum in all regions, especially among the developed countries that are haunted by mounting debt and high unemployment, while the EMs will find debt risks accumulating.

Secondly, shift of imbalanced demand. Demand slid due to the global economic crisis. Frequent breakout of geopolitical unrests prevented the multilateral trade negotiations from reaching consensus, and as a result, the dependence of global economy on cross-border trade and investment decreased. Against the backdrop of “de-globalization”, countries cast hope on endogenous growth and regional trade agreements. Meanwhile, those economies with weak domestic demand (particularly Japan and Europe) struggled to boost external demand through depreciation of local

currencies. This correction of demand imbalance may eventually lead to competing devaluations in the exchange rates, prompting risks from demand restructuring and stalling shift toward an endogenous growth.

Thirdly, misplay of policy shift. Countries have increasingly relied on loose monetary policy rather than the fiscal policy to stimulate consumption since the financial crisis. However, easing monetary schemes failed to reverse the long-term potential downtrend, creating new asset bubbles instead, causing distortion of resource allocation and mismatching risk preferences based on wrong price signals. The fundamental driving force of economic growth still depends on fiscal policy to encourage innovation, improve labor productivity, and boost investment and consumption growth. Therefore, before easing monetary policy gives way to active fiscal policy, policymakers face the challenge of timing to switch. An exit too early may lead to inadequate stimulative effect, yet an exit too late may generate an even bigger bubble. The Fed is about to embark on normalizing its monetary policy, while the Euro Zone is still in the early phase of the quantitative easing efforts. Any misplay of policy shift could trigger new instability and adverse shocks.

III. Easy monetary policy to stay, fiscal policy and structural reforms can play a bigger role

In 2015, the **general** tone of global monetary policy remains accommodative with its limited support to boost demand, aimed to win time for structural reforms. In case the monetary policy is unable to spur long-term economic growth potential, countries with extra capacity are advised to reinforce fiscal policy support, meanwhile pay more efforts on structural reforms so as to promote sustainable recovery and economic restructuring.

Divergence is emerging in the global context of accommodative policy. The Fed is likely to kick off rate hike right before the end of 2015, though Russia, Brazil and a few other EMs may tighten their monetary policies against inflation pressure. However, prices in Europe and Japan are still at a very low level, the economic growth is not robust, and their local QE policies may last one to two years. Close attention should be paid to the spillover of the global liquidity and swelling asset prices driven by the easy monetary policies.

There is only little leeway for a global expansionary fiscal policy. Developed countries face ballooning public debt, yet inflation is well below the target, making it difficult to lower their debt levels. EMs have also witnessed a rising funding cost as a result of economic slowdown, currency depreciation, upward interest rates and other factors. In general, only China, South Korea, India and some other Asian countries as well as some Middle East oil producing countries with abundant financial resources (clustered in the “One Belt and One Road” area), are still capable to pump fiscal spending through investment in public infrastructure, expand demand in the short term and increase potential output in the medium term.

Developed countries need to continue their efforts to push forward structural reforms, particularly in Europe and Japan. Europe needs to take concrete reform measures to promote the free flow of the labor market, lower the threshold for starting up business, improve the efficiency of government services and increase job opportunities for the unemployed. Japan will need to take initiatives to further help women and the immigrants to join the labor force in response to the impact of decreasing and aging population. Certainly some EMs have more work to do in terms of industrial restructuring and market-oriented reforms.

Part II Quarterly Financial Review and Outlook

I. Global financial market generally stable

Money market liquidity and credit risks eased. The most important impact to money market funds in 2015 derives from the Basel III rules for LCR implementation. The money market funds are required to hold more high-quality liquid assets, but banks start weaning. US banking sector has already trimmed exposure to the prime US dollar-denominated money market funds of the European financial institutions, and cut the number of the funds under their own management. Moreover, US dollar-denominated money market funds have shown signs of deteriorating credit and market risks. Since the end of 2014, the A2/P2 spread of US non-financial commercial paper has increased sharply from the safe zone, swinging on the edge of the unstable zone, indicating rising liquidity and credit risks in the money markets. This situation got eased in the second quarter, but in the near future it is difficult to fall back to the level of 2014.

Uptrend in the stock market continued with possible larger swings. With the market expectations of a postponed rate hike by the Fed, the US stock market surged in the second quarter of 2015. Meanwhile, the Euro Zone bourses rallied as stimulated by the QE scheme of the ECB. These two bullish stock markets pushed up the MSCI World Index over the same period of time, rekindling close attention by the central banks over a stock bubble. In terms of volatility, S&P500 Index and VIX fell back and remained stable in the second quarter after experiencing a sharp rise over the first quarter, meanwhile an upbeat of CBOE Eurocurrency ETF Volatility Index accelerated. With the Fed's rate hike over the coming quarter, the stock market volatility is likely to further rise.

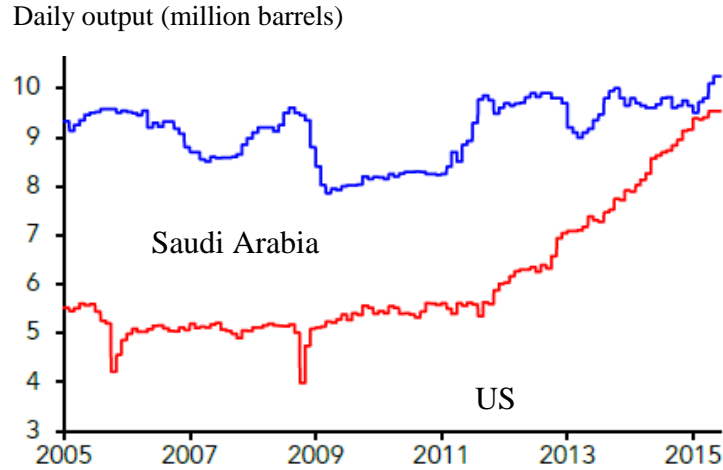
Bond market risk was aggregating. The European government bond reversed a negative yield in the second quarter as the European economy and stock market expanded. In early June, the German government bond yielded close to 1%, the highest since 2015. Bond market liquidity risk and enlarging swings in April to June period has drawn regulatory and market attention. Over the past few years, the bond market developed with overvaluation risk accumulating which possibly exacerbates the selling pressure in the future. Banking sector has substantially cut the government and corporate bond positions required for market-making, straining the bond liquidity in the secondary market which drives up yields and fluctuations or even lead to market turmoil in presence of a selling pressure.

A dollar-driven forex market faces growing uncertainties. Given dollar appreciation and expectation of further appreciation in the first quarter, falling earnings on dollar carry trade and QE policy in the Euro Zone, the euro became the carry trade funding currency of choice, taking over the dollar. In the second quarter however, with the market expectation of a postponed rate hike by the Fed, bouncing interest rates in the Euro Zone, and strengthening euro against the dollar, losses loomed on euro carry trades. Investors cut euro short positions, complicating the arbitrage trading and adding further uncertainty. The volatility index of dollar versus major currencies was in the unstable zone in the April to June period. This situation will last as long as the Fed's monetary policy stance remains unclear.

Sluggish commodity market persists. International oil prices edged up slowly in the second quarter of 2015. OPEC has no intention to cut output, Iran will soon export crude oil, and US crude oil production also rise steadily (Figure 3), indicating an abundant global oil supply. The US may cut production in the second half of this year, while demand of the non-OECD countries is likely to

pick up. However, it is unlikely that the oil price will keep surging in the next six months given the US crude oil inventory has reached an historic high, and global demand is still inadequate, particularly in China. We estimate that the price of Brent crude oil futures will inch up to USD63-64/barrel, and the WTI will slightly lower to USD59-60/barrel in the third quarter.

Figure 3: Comparison of crude oil output between the US and Saudi Arabia

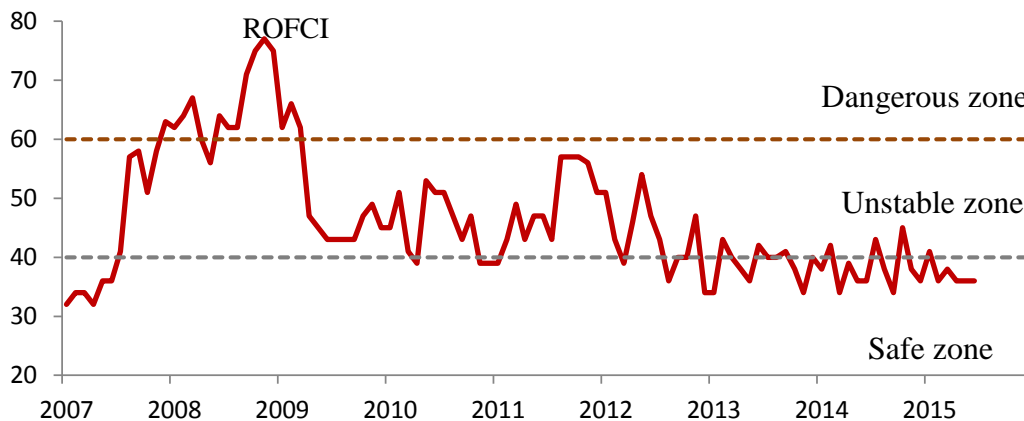


Source: IIF

II. US Risk of Financial Crisis Index steady

The average of the US Risk of Financial Crisis Index (ROFCI) fell to 36 in the second quarter from 38.33 in the previous one, still in the safe zone (Figure 4). The overall financial risk is relatively stable, but composition of risks has changed: 1) Stock market witnessed increasing fluctuations in the middle of the second quarter, followed by a buoyant bond market risk. 2) Risk in non-financial money markets fell after a spurt in the early quarter. 3) Forex market was volatile all along. Banking and economic data improved significantly during the quarter. In the third quarter, close attention is needed on the major influential forces to the financial risk index, particularly the uncertainty of the Fed’s rate decision.

Figure 4: US ROFCI



Source: BOC Institute of International Finance, BOC New York Branch

III. EM financial condition improving

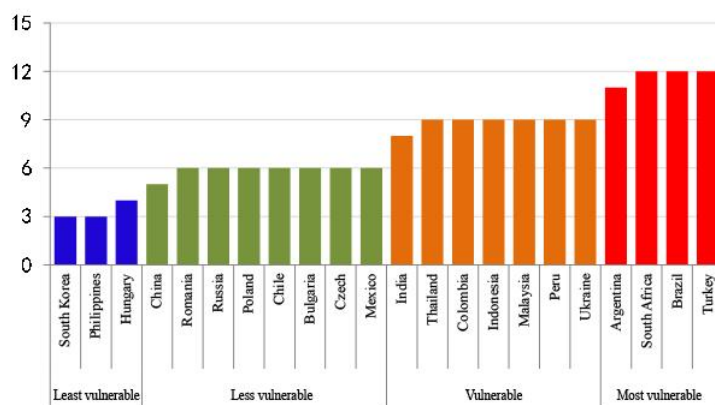
The IIF EM Coincident Indicator as well as financial market indicators show that the financial condition of the emerging economies has improved in the second quarter, among which Asia outperformed Latin America. The better performance was primarily due to the rebounding oil prices. However, commodity prices, stock market and exchange rates remained unstable.

Cross-border capital outflows. Expectation of a postponed rate hike by the Fed and bullish EMs attracted net capital inflows in the second quarter. However, the slowdown in the emerging economies and diverged monetary policies went against a bullish outlook and prompted larger fluctuations in May. The IIF in May predicted the net capital inflow to the EMs will be short of capital outflow in 2015, estimating the net outflow will edge up to USD130 billion from USD74 billion in 2014.

Stock market outlook is promising. Data indicated low risks in the EM bourses in the second quarter and implied a good prospect for the third quarter. (1) TTM P/E ratio of MSCI EMs Index inched up to 11.66, slightly higher than the average of 11 over the past ten years, but still lower than the global market average of 15.99. (2) Market volatility declined, lower than the average of 24.71. (3) The correlation between EMs in May dropped to 0.11, lower than historical average of 0.2. In addition, correlation between EMs and the US stock market also dropped to below average. Yet variation in investment returns enlarged with the stock return dispersion in May rose to the highest level since the crisis.

Bond market refinancing is heavily burdened. EMs issued more corporate bonds in the second quarter with corporate debt-to-GDP ratio hitting 80%, in which the dollar-denominated debt accounted for 40%. With the appreciation of US dollar and slowdown in EMs growth, the dollar-denominated bond issuers faced rising pressure for repayment and refinancing, particularly those in the sectors of consumer goods, real estate which relied heavily on domestic revenues. Meanwhile, the international brokers trimmed the market-making business in EMs, strangling the liquidity in the secondary market and leaving the market more fragile and volatile.

Financial vulnerability of the EMs. Based on the IIF data, we made an analysis on the financial vulnerability of the 22 countries in the EMs. In details, we categorized financial vulnerability into four classes: the least vulnerable, less vulnerable, vulnerable and the most vulnerable. Vulnerability index consists of four parts: the external financial vulnerability (the country's dependence on foreign capital); domestic financial vulnerability (the country's financial sector and the real economy status); the vulnerability of economic policy (policy credibility and political stability); and composite index (total points of the above three measurements): 3-4 points: the least vulnerable; 5-7 points: less vulnerable; 8-10: vulnerable; and 11-12 points: the most vulnerable. Based on our analysis, Turkey and Bulgaria are currently the most vulnerable in terms of external financial vulnerability. Turkey, Peru and Brazil are the most vulnerable in terms of domestic financial vulnerability. Brazil, Ukraine and Argentina are the most fragile countries of policy vulnerability, while Turkey, Brazil, South Africa and Argentina are those financially most vulnerable by composite index (Figure 5).

Figure 5: Financial vulnerability index of 22 EMs

Source: IIF, BOC Institute of International Finance

Part III Hot Topic Analysis

I. Global liquidity, trend and management policies

Global liquidity usually refers to the availability of capital globally that can be used to purchase goods or assets. It does not simply sum up the liquidity of all individual countries but instead mainly targets a very limited number of reserve currencies that flow across the globe, including US dollar, Euro, Pound Sterling, and Japanese Yen. Spurred by the easy monetary policies of major economies, the global liquidity is in a new round of cyclical expansion, the risk of which should be closely monitored.

I.1 Factors triggering the change in global liquidity

Bank for International Settlement (BIS) classifies global liquidity into official liquidity and private liquidity. Official liquidity is defined as the capital unconditionally used by monetary authorities in making payments, including base currency, foreign exchange reserve, currency swap and special drawing rights. Central banks create official liquidity while IMF, whose function and relevant policies only cause liquidity to flow across borders, does not create liquidity. Private liquidity, on the other hand, refers to the financing activities conducted on the foundation of cross-border transactions carried out by banks and other financial institutions. Official liquidity relates to monetary policies while changes in private liquidity reflect economic behaviors of private sectors. Both are results from a series of factors.

First, macro economic factors and macro economic policies. Macro economic conditions impact the cost of capital, expected return and risk preference and determine, to a certain extent, the global liquidity. Monetary policies determine short-term interest rates and thus impact the risk-free yield curve through policy rates. The interest rate level will impact private credit growth rate, total capital amount and liquidity conditions. It is worth noting that long-term interest rates are not only impacted by monetary policies but also by saving ratios and investment modes. Exchange rate policies are an important factor that impacts the global liquidity. Floating exchange rates help alleviate macro policy's spillover effect and lessen the capital flows caused by currency mismatch, while fixed exchange rates are viewed as an implicit guarantee that will give rise to activities aimed at hedging foreign currency lending. Exchange rate flexibility and domestic financial structure are the factors that determine the growth in credit and liquidity in the liquidity-receiving

countries.

Second, financial regulation. Capital's cross-border liquidity is determined by the depth and width of the financial market, financial instruments and financial infrastructure (including cross-border payment and settlement system) and the way financial institutions conduct international business, which are primarily affected by financial regulation. Meanwhile, financial regulation impacts behaviors of financial institutions and transaction counterparties. Coordination between regulatory policies and other policies may help eliminate regulatory arbitrage.

Third, financial integration. Integration facilitates cross-border capital flow. In addition to global banks, other highly active financial institutions (such as global investment funds) play a more positive role in the international market by increasing the number and diversity of market participants to add more liquidity to the market.

Fourth, financial innovation. Increasing varieties of financial instruments have made it possible to increase capital liquidity in the market through innovative means of payment. For instance, asset securitization converts less liquid assets to assets of higher liquidity.

Five, risk preference. Risk preference and liquidity have a two-way relationship. The former determines the amount of liquidity that market participants are willing to supply. In the meantime, risk preference is also affected by status of liquidity. An easing liquidity environment encourages investors to increase the leverage ratio and enhance risk-taking level and as a result, boost asset prices and value in pledge, which help obtain more liquidity.

I.2 Changes in current global liquidity

First, global liquidity is in a new round of cyclical expansion. Global liquidity was adequate from 1995 to 2007. The Asian financial crisis occurred in this period had little impact on global liquidity, thanks to the financial liberalization and innovation starting from the mid-1990s. The subprime crisis in 2007 suddenly drained the liquidity, and global liquidity entered the shrinkage stage. Subsequently, major economies adopted extraordinary monetary policies to inject liquidity. Official liquidity expansion compensated, to a certain extent, for the private liquidity contraction. Given that major economies in the world will stick to easy money policies, global official liquidity is likely to grow continuously. In the meantime, the economic recovery and return of investor confidence will increase private liquidity.

Second, global liquidity imbalance further intensifies. Even before the financial crisis, global imbalance was blamed and attributed as one of the major reasons causing the global financial crisis. Developing countries tend to acquire liquidity via current account channels and deficit countries tended to be the suppliers of liquidity, therefore, liquidity imbalance is a major mechanism leading to global economic imbalance. Easing policies have dominated the global economic policies in the post-financial crisis era when countries seek to boost economic growth by borrowing more, resulting in fast rising scale of debt. Emerging economies have intensified overseas financing efforts taking advantage of global easy monetary condition and increased the use of leverage, while private funds from developed country have invested heavily in EMs to seek higher returns. After the financial crisis, global capital inflow to EMs has risen from 10% before the crisis to nearly 50%, indicating the comeback of global liquidity imbalance.

Third, contagion effect of global liquidity intensifies. Private sectors are playing an increasing role in generating global liquidity, rising from less than USD1 trillion in 1998 to USD7 trillion in 2004. The financial crisis had brought it down abruptly to the negative territory but it has gone up to over USD1 trillion in recent years. Private liquidity is closely related to international capital flow, cross-border banking business and cross-border investment portfolio, and is a major source of

balance sheet mismatch and systematic risks. The contagion effect of private liquidity exists in the following two aspects: first, cross-border contagion, especially between markets with loose capital control; second, financial market contagion that usually starts from short-term credit market and is later transmitted to securities, foreign exchange and other markets.

I.3 Relevant management policies on global liquidity

Global liquidity operates in pronounced cycles and may experience tumbling liquidity as affected by negative factors. As for financial stability, two kinds of policies may be considered. First, to counteract global private liquidity accelerating mechanism so as to mitigate the global liquidity cycle and the sharp rise in relevant asset prices; second, to respond to sudden shortage in global liquidity, in a bid to prevent the breakage between financial system and economic growth. Liquidity regulation mainly includes the following:

First, tighten regulation to prevent excessive liquidity. Reducing the pro-cyclicality in the financial system helps stabilize the global capital flow and thus reduce the global liquidity shock. The financial regulatory authority of a country must exert effective regulation on its own financial institutions, such as banks. The regulatory measures include: first, take capital and liquidity related measures such as formulating rules on core capital adequacy ratio and on restricting leverage ratio. Second, closely monitor banks' off-balance sheet activities, pay attention to the systematic impact of shadow banking, increase minimum capital requirements and security deposits for financial derivative transactions and off-balance sheet activities, and other risk isolation measures to prevent risks from affecting banking systems.

Second, macro control policies and central bank's liquidity policies. With the deposit insurance system and the central bank acting as the lender of last resort, domestic liquidity shock may be avoided. The central bank may: (1) implement its expected monetary policy stance; (2) support market operation; (3) provide support in liquidity to a limited number of banks. These measures will reallocate central bank's reserves or increase the total reserves of the central bank. Global liquidity shocks often lead to a severe shortage in foreign exchange liquidity, which may be relieved by building a huge foreign exchange reserve through the following measures: (1) build foreign exchange reserves to prevent liquidity risks caused by abrupt currency conversion; (2) diversify foreign exchange liquidity mechanism and adjust currency structure dynamically and gradually; (3) carry out direct arrangement between Central Banks of different countries such as bilateral currency swaps.

Third, international cooperation in emergencies. The recent financial crisis indicates that among the financial participants, the central bank may provide a large amount of foreign exchange liquidity through timely and flexible regulation. The liquidity provided directly by the foreign central banks may have a strong and lasting impact on the market confidence. To counter the global liquidity risks, countries must carry out cross-border cooperation, push forward the building of bilateral, regional and global multilateral mechanism. They also need to avoid ethic risks, maintain sovereignty over monetary policy-making as well as control the financial risks associated with the central bank's provision of liquidity.

II. Out of line with fundamentals, which course will global stock markets follow?

II.1 Global stock markets continue to rise sharply

In the first half of 2015, stock markets in both developed and emerging countries rose sharply and turned bullish again. MSCI Growth Index climbed to its historical high of 235.2 points on April 10th, 167.4% higher than the lowest point in early 2009, and is still in a high level despite some

slight fallbacks recently. Regionally, as of June 16th, 2015, MSCI Growth Index grew 6.9% from the beginning of the year for developed markets and 4.9% for EMs. This round of bull market has demonstrated the following characteristics:

First, a booming stock market does not reflect the fundamentals in economy. In the first half of 2015, among the developed markets, only the European and Japanese markets performed well. The German DAX Index, French CAC40 Index and Japanese Nikkei 225 Index rose by 13.1%, 13.82% and 16.37% respectively from early 2015, while the GDP year-on-year growth in these three countries in 2014 was merely 1.6%, 0.4% and -0.1%, respectively. By contrast, Australia, US and UK that posted a GDP growth of 2.4%, 2.4% and 2.8% respectively witnessed mediocre performance in the stock market (Table 2). Emerging economies followed a similar trend. China entered the stage of new normal while the economic conditions in countries like Russia and Brazil worsened but their stock markets were stronger. India and Indonesia, on the other hand, delivered fairly good economic results but their stock markets have seen negative growth since the beginning of the year.

Table 2: Stock market performance for major countries and regions in 2015 (as of June 16th)

	Country	Stock Index	Highest point around 2007	Lowest point since 2007	Current	Growth from early 2015
Developed Countries	Japan	Nikkei 225	18295.27	6994.90	20046.36	16.37
	France	CAC-40	6168.15	2465.46	4907.34	13.82
	Germany	DAX Index	8117.79	3588.89	12390.75	13.10
	UK	FTSE 100 Index	6754.10	3460.71	6812.51	4.56
	Australia	Australia S&P 200	6851.50	3120.80	5478.60	1.84
	US	DJIA	14198.10	6469.95	17965.60	0.40
Emerging Economies	Korea	KOSPI	2085.45	892.16	2051.32	5.90
	Singapore	ST Index	3831.19	1455.47	3327.70	-2.15
	China	SHCI	6124.04	1664.93	5106.04	45.87
	Russia	RTSSTD	2498.10	492.59	943.54	25.76
	Brazil	Brazil IBOVESPA	73920.39	29435.11	52815.99	10.70
	India	Bombay SENSEX Index	21206.77	7697.39	26840.50	-2.98
	Indonesia	JKSE	2838.48	1089.34	4899.88	-5.29

Source: WIND, BOC Institute of International Finance

Second, small and medium enterprises led the rise in stock price. As of June 16th, 2015, out of the major stock indices in the US, Nasdaq that comprises small and medium high-tech companies rose 5.7% from early 2015 while the blue chip-packed DJIA rose only 0.4%. Similarly in China, SME Composite Index rose 145.14% from early 2015 but the Shanghai (securities) composite index only rose 45.87% in the same period.

Third, emerging and consumption industries rose sharply while traditional industries waned gradually. Five emerging or consumption industries led the rise in this round of bull market: health care equipment and service, retail, automobile and auto parts, bio-pharmaceutical and life science, durable consumer goods and garment. As at the end of June 16th, 2015, indexes of the five industries have risen over 7.3% on average (Table 3), apparently higher than traditional industries.

Table 3: MSCI global industry index growth (as of June 16th, 2015)

Top ten industries with highest growth %	Growth % from early 2015	Top ten industries with highest growth %	Growth from early 2015
Health care equipment & Service	12.4	Media	7.3
Retail	10.9	Capital goods	5.7
Automobile and auto parts	10.4	Insurance	5.7
Bio-pharmaceutical and life insurance	8.6	Software and service	5.1
Durable consumer goods and garments	7.4	Comprehensive finance	5.1

Source: WIND, BOC Institute of International Finance

II.2 Excessive liquidity drove the stock market to rise

QE policies, low global interest rates, transformation in the mode of economic growth and limited investment options combined to push up the global stock prices in 2015.

First, the QE policies adopted by major developed economies provided sufficient liquidity to drive up the stock market. After the global financial crisis in 2008, developed economies led by US Fed took QE policies, directly injecting money into the market to boost the economy. Instead of flowing into the real economy, a majority of the massive new liquidity went to the stock market and real estate market, fueling this round of stock price hike.

Second, many countries announced to lower interest rates in the first half of 2015 (Table 4). With rising treasury prices for many countries and negative interest rates of an increasing number of countries, investors chose to move their capital from the bond market to the stock market.

Third, an increasingly aging population has brought about changes to the mode of economic growth and industry structure. Consumption-related industries related to elderly care, medical treatment and similar types have grown rapidly and, when combined with the internet technology, have given rise to a new round of industry upgrade, laying the foundation for the rise of consumption-related stock prices.

Fourth, prices for energy, gold and other commodities remained sluggish, leaving few options for investment. Excessive capital could only be put on the stock market to seek excess returns.

Table 4: Major moves by central banks in the first half of 2015

Central bank	Current interest rate (%)	Changes in first half of 2015	Remarks
China	2.25	Lowered interest rates twice in March and May	
Russia	11.5	Lowered interest rates four times in February, March, April and June	
Korea	1.5	Lowered interest rates twice in March and June	
Brazil	13.75	Raised interest rates four times in January, March, April and June	Only one with interest rate increase
India	8.25	Lowered interest rates three times in January, March and June	
Indonesia	7.5	Lowered interest rates once in February	
Danmark	-0.75	Lowered interest rates four times in January and February	Negative interest rate
Poland	1.5	Lowered interest rate once in March	
Sweden	-0.25	Lowered interest rates twice in February and March	Negative interest rate
Switzerland	-0.75	Lowered interest rate once in January	Negative interest rate
Turkey	7.5	Lowered interest rate once in January	
Peru	3.25	Lowered interest rate once in January	
Canada	0.75	Lowered interest rate in January	
Australia	2	Lowered interest rate twice in February and May	
European Central Bank	-0.2	QE	Negative interest rate

Source: BOC Institute of International Finance

II.3 Potential risks in stock market must be closely monitored

This round of rise in stock price was mainly driven by liquidity. The changing international economic and financial environment may reverse the excessive supply of liquidity and consequently burst the bubble in the stock market. The following risks must be closely monitored to prevent the grave economic crises from occurring.

First, US monetary policy normalization. Once US Fed starts to increase the interest rate, foreign capitals will flow back to the US, which will drain the liquidity from emerging economies and defuel their stock markets, likely to burst the bubble.

Second, a continued global economic slowdown. An economic slowdown will reduce enterprise profits, which will inevitably suppress stock prices and bring uncertainty to the global stock market.

Third, a worsened deflation. Sluggish commodity prices combined with sharp decline in enterprise profits cannot sustain the continued rise of stock prices.

Fourth, industry preference adjustment. The continued rise in global stock markets has pushed up short-term risks and heightened the pressure of market adjustment. Investors have begun

adjusting the industry structure in their investment portfolios to mitigate the risks caused by a slowing economy and overvalued industries. Investors will suffer from the shift in industry preference in the stock market if they have not initiated the adjustment in time.

III. The monetary policy normalization by the US Fed and the change in interest rate market

Since a few years ago, the monetary policy normalization has been discussed on the market as the trend of US Fed after it drops the QE policy. In 2014, Federal Open Market Committee (FOMC) announced to end the QE policy officially and shift the focus of monetary policy to adjusting federal funds interest rates. By then, the monetary policy normalization started to be officially discussed.

Monetary policy normalization is clearly defined in the US Fed's related documents: it refers that the FOMC will take steps to remove the easy money policies that the US Fed has maintained for years to restore the US economy during and after the financial crisis that began in 2007. Specifically, (1) while the US economy allows, raise the federal funds target range of interest rate by 25 basis points; cap the upper limit of the range with interests from excess reserves and keep the lower limit with overnight reverse repurchase agreement or other instruments, and exit when conditions permit; (2) to gradually and designedly reduce the size of the Fed's securities holdings; after the first federal funds rate hike, end the scheme of reinvesting the profits gained in QE period but continue holding MBS portfolios.

In short, the broader definition of monetary policy normalization includes revision to the two key contents in the US Fed's monetary policies adopted in 2008 (QE and zero interest-rate policy). Currently, the first task of the broadly-defined normalization has been accomplished, which is to exit QE. Narrowly speaking, monetary policy "normalization" means to end the zero interest-rate policy. Therefore, FOMC has made it clear that it will continue using federal funds rate as key policy interest rate in the normalization process. When the target range of federal funds rate is increased, the tightening policy will impact other short-term interest rates or exert broader influence to the macro economy.

FOMC indicates that it will set the timetable of monetary normalization based on the evaluation results of current and expected US employment maximization and the 2% inflation target. The evaluation process will take into full consideration of various information including labor market, inflationary pressure and inflationary expectation index, as well as the US Fed's account of the development in financial and international market. Based on the current labor market data and the futures market for the federal funds rate, we predict that the US Fed will start raising the interest rate before the end of 2015 and it may take 2-3 years for the federal funds interest rate to gradually shift to neutral level.

What are the characteristics of and reasons for this round of interest rate normalization? A revisit to the US history of economic cycle tells us that it has been normal for interest rates to remain a rising trend in a long-term economic expansion. In the current cycle, however, interest rates have not been raised after the economic recovery started nearly seven years ago, which is hardly normal. The delay in interest rate hike is attributable to the following reasons: (1) the magnitude of the financial crisis in 2008 and the ensuing recession; (2) the current economic recovery has taken longer than the others in the American history; (3) the extraordinary QE policy taken by the US Fed has kept the mid to long-term interest rates below the free market level for an extended period of time; (4) extremely stringent financial regulation has dragged the credit expansion by the financial institutions to a certain extent.

With the exception of the Great Depression in 1929-1933, nothing in the American history can match the financial crisis started seven years ago and the subsequent economic recession as well as the extremely low interest rate level that has lasted for quite a number of years. Compared to the Great Depression, the extreme expansionary monetary policy adopted by the US Fed was for completely different reasons. While the US Fed adopted the policy during 1929-1933 to satisfy the need of the Department of the Treasury, the latest extremely low rate policy (including quantitative easing) was introduced to drive the US economic recovery. The two periods are hardly comparable whether in the level of economic development or the US Fed's monetary policy system and structure.

To better learn from the history, we have picked the recent two cycles of interest rate increase to analyze their relevant conditions. The two cycles started in June of 2004 and February of 1994 respectively. In June of 2004 when the US Fed first raised the interest rate, the unemployment rate in the US was at about 5.6%, inflation rate at 2.8% and real GDP was at approximately 4%; these ratios were at above 6%, 2% and approximately 3.7% respectively when the US Fed made the first interest rate increase in February of 1994.

With 5.6% of unemployment rate, -0.1% of inflation rate and -0.7% real GDP, the current US macro-economic environment is generally weaker than that in the last two normalization periods. With the exception of unemployment rate that is at a similar level, the inflation rate is far below the 2% target for the US Fed to normalize its monetary policy. In addition, the global crude oil market environment is likely to keep the current inflationary condition to last. Moreover, current US Fed's balance sheet is far above that in the previous two cycles. Lastly, the current financial regulation environment is much more stringent, making the next monetary policy normalization more complex.

Taken together, the federal funds' real interest rate for the past 50 years (federal funds interest rate minus inflation rate) is approximately 2.25% on average. Presumably, an average inflation rate close to the US Fed's 2% target means that the long-term federal funds rate needs to stay at the level of about 4.25%. Given the inflationary level at present and future trend of two years, and the drag effect created by stringent financial regulatory environment, we predict that the federal funds rate will gradually move up no later than the end of 2015, and will move slowly to 1.5% by the end of 2016. The rise will likely speed up in 2017 and eventually arrive at about 3.5%. Although long-term market rate will usually enter the upturn cycle in the process of federal funds rate normalization, whether the mid to long-term rate will be normalized after 30 years of declining remains to be seen.

IV. Progress in the Greek debt negotiation and probability of Greece leaving the Euro Zone

IV.1 Greek debt negotiation enters a deadlock with mounting risk of default

Since the Greek Coalition of the Radical Left took power in January this year, its negotiations with international debtors such as IMF, ECB and European Commission on debt repayment has not been going smoothly. Greece pled for a last aid fund of EUR7.2 billion to help it weather the economic turmoil. Negotiations surrounding the Greek debt repayment have dragged on for over four months but the gap between the two sides has not been narrowed. The differences between Greece and its three major debtors focus on Greece's fiscal budget: while the debtors worried that the Greek government may again turn in a budget deficit and its fiscal expenditure may exceed its revenue, they demanded that the Greek government should cut the pension expenditure and increase tax rate to bridge the gap. The Greek government, on the other hand, has firmly refused the demand to carry out fiscal reform and claimed that the debtors should be responsible for

Greek's deteriorating economic situation.

Feeling no options left for it, Greece filed an application to IMF in early June for delaying its repayment of a EUR300 million debt due on June 5th and for making a lump-sum repayment of four debts amounting to EUR1.5 billion on June 30th. Among IMF's member states that have received its financial aid, Zambia is the only one that chose to make lump-sum repayment of several debts in the 1980s and no economically developed member state has chosen to do so. After the application was filed, Greek's negotiations with IMF were suspended on June 11th for lack of progress in technical matters. On the 14th of the same month, the aid talks between Greece and its international debtors came to an end after lasting for only 45 minutes without reaching any agreement due to the unbridgeable differences between them. Now IMF's task force has left Brussels, officially sending the negotiation on the Greek debt into a deadlock.

Greece has repaid a total of EUR7.5 billion mature debt so far this year, a 10% of its GDP. Regardless, it has to make two more repayments to IMF by June 30th and July 20th for EUR1.5 billion and EUR3.5 billion respectively, which is very unlikely given the current situation. June 30th of 2015 will be the earliest time for Greece to default on its outstanding debt and the finance minister's conference of the Euro Zone to be convened on June 18th will therefore be the last chance for Greece to reach a new agreement with all its debtors on debt repayment to avoid a default.

IV.2 A default on debt does not equal to Greece's exit from the Euro Zone

The unpromising debt negotiation with Greece has raised the risk level of Greek sovereign debt default. Standard and Poor, the international rating agency, adjusted Greek sovereign debt rating from B-/B down to the junk level of CCC+/C in mid April and issued a negative comment on its outlook. Greece is in the verge of a national bankruptcy.

A default on debt does not necessarily mean that Greece is sure to exit the Euro Zone. Given that all EU members have attached a great importance to keeping the momentum of a fragile economic recovery and political unity in the Euro Zone, Euro Zone may choose to allow Greece to stay within the organization even at the time of the debt default, in the hope of preventing a new round of European banking crisis and euro crisis, the worst scenario likely to be triggered by Greece's exit. Actually, Greece has entered technical default many times in the past few years, which did not affect its Euro Zone membership.

The Greek debt crisis has led to significant fluctuations in the return on its national debt and has created obvious spillover effect over the return on national debts of other countries in Southern Europe. On June 16th, the rate of return on Greece ten-year national debt surged 51 basis points to finish at 12%. Meanwhile, during the two days from June 15 to 17, 10-year Italian, Spanish and Portuguese national debts all showed an average daily rise in rate of return from 15 to 23 basis points. Affected by the Greek issue, the rate of return between 10-year Spanish national debt and 10-year German debt widened to a new high since July last year, while that between Italy and Germany or Portugal and Germany climbed to the highest level since November last year.

If Greece exits euro, it will have a more evident negative impact on the national debts of other European countries and end the relatively stable situation in Europe after the European debt crisis. As a result, investor confidence on euro will tumble hugely. In addition to the heavy blow on Europe's stock market and bond market, the euro will likely suffer further large depreciation and speculations that euro will phase out of history will reoccur. Greece's exit from euro will cast shadow on the future of Euro Zone's fragile economic recovery and its long-term negative impact on euro's credit is difficult to estimate.

In addition, the total amount of deposit in Greek banks has dropped 14% since the end of 2014 and is continuing dwindling. Greece's exit from the Euro Zone will further increase the deposit outflow and severely damaged its domestic currency system and macro economy. Consequently, the banking system bankruptcy and banking crisis will become highly probable. More importantly, Greece's exit from the Euro Zone will inflict severe damage to European banking industry. IMF's March data indicate that ECB's total risk exposure at Greek banks amounted to nearly EUR110 billion and in the meantime, banks from nearly all EU countries are exposed to risks from Greek banks. As a result, a bankrupt Greek banking sector will lead to surge in European banks' bad debt ratio, which will pose threats again to the European banks' balance sheets that the EU has spent so many efforts in repairing.

IV.3 The financing situation in Greece may worsen in near future, likely to trigger privatization and capital control measures

From a macro perspective, since it won the national election in this January of this year, the ruling Greek Coalition of Radical Left has insisted on anti-austerity fiscal measures and once halted the projects to privatize state-owned assets including the Piraeus Port. However, the current situation suggests that even if Greece can repay all its outstanding debts and survive the peak in debt repayment in September with international aid, it has a gap of EUR25 billion to fill before the end of next year. With its economy further slipping and tax revenue further dwindling, the financing shortage in Greece may likely get worse.

To uproot the crisis, Greece may have to restart executing the major plans to privatize its state-owned assets in order to perform its obligations under some of the aid agreements it reached with EU and IMF. In short-term, some cabinet members from the ruling Coalition of Radical Left have begun drafting post-debt default plans. Such plans primarily imitate the measures taken by the government of Iceland in 2010, namely to enforce capital control and to establish the "bad debt bank" to accept non-performing assets after the nationalization of banks.

V. RMB Internationalization in the building of "One Belt and One Road"

On March 28th, 2015, NDRC, Ministry of Foreign Affairs and Ministry of Commerce jointly issued the *Vision and Action on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road*, symbolizing that the concepts to build the "Silk Road Economic Belt" and "21st Century Maritime Silk Road" proposed by President Xi Jinping in September and October of 2013 respectively have been put into action. The initiatives have become a national strategy for coordinating domestic and international issues. As a key strategy in driving China's all-round opening up to the outside world, the "One Belt and One Road" strategy will have a profound impact on global economic landscape and nearby regional economic development, drive China's economic restructuring and development of financial market as well as provide new source of power for internationalizing RMB.

V.1 RMB's function in cross-border capital flow and financing arrangement in the building of "One Belt and One Road"

The internationalization of RMB has taken a unique path that drives cross-border usage of RMB by developing its offshore market. In the past five years, the RMB offshore market has undergone a huge transformation with regards to its scale and structure and has made significant improvement in many important functions including the supply of RMB liquidity, settlement and payment channels, places for foreign exchange transactions, convenience in investment and financing, and risk management platform. In the background of "One Belt and One Road", it will be the key in the

internationalization of RMB to further increase the width and volume in the use of RMB after its cross-border usage in trade has reached a high level.

While the “One Belt and One Road” strategy progresses, RMB can play a positive role in cross-border capital flow and financing arrangement, thus offering a new source of power to drive its internationalization.

Firstly, People’s Bank of China has signed bilateral currency swap agreements with central banks of Kazakhstan, Uzbekistan and other countries along the “One Belt and One Road”, and has appointed RMB settlement banks, made relevant settlement arrangements in related countries and regions, laying a solid foundation for the usage of RMB in these countries. Financial institutions may open up more trade and investment channels, develop cross-border financial business that targets the countries along the “One Belt and One Road”, and funnel more RMB capital into this region to form a capital pool of a certain magnitude, with an aim to establish an offshore RMB market in these places.

Secondly, RMB may play its role in the cross-border capital flow and financing arrangement in the “One Belt and One Road” through bond issuance. The State Council has recently announced its decision to remove the regional restrictions on domestic enterprises and commercial banks that go overseas to issue RMB-denominated bonds, widening the financing channels for domestic enterprises. The “One Belt and One Road” strategy supports the governments and enterprises and financial institutions with acceptable credit rating along the way to issue RMB-denominated bonds in the Chinese territory. In the meantime, it allows qualified Chinese financial institutions and enterprises to issue RMB and foreign currency-denominated bonds in overseas markets and encourages the use of raised funds in countries along the “One Belt and One Road”.

Thirdly, increase the share of RMB funds in projects funded by Asia Infrastructure Investment Bank and Silk Road Fund, intensify cooperation with multilateral international financial institutions and push forward the use of RMB in regions along the “One Belt and One Road” under multilateral financial cooperation framework.

Fourthly, promote RMB pricing and payment in local markets by wide participation of Chinese financial institutions in “One Belt and One Road” related projects, with an aim of making RMB as the major currency of pricing, settlement, investment and financing in these regions.

Fifthly, countries along the “One Belt and One Road” have close economic and trade ties with each other. The “One Belt and One Road” strategy proposed by China to build a community of common destiny will lead to massive trade activities and infrastructure investment in the region, and may give rise to a regional economic community of certain form. China has continuously stepped up efforts in carrying out economic and trade cooperation with other countries along the “One Belt and One Road”, and has intensified investment in the region to foster a RMB investment and financing market while seeking participation in related projects in these countries. With the integrated market of “One Belt and One Road”, and by taking advantage of the offshore RMB markets, the legal system and market rules following international principles as well as the strength in language and culture, China’s financial sector may learn from the experience in building a differentiated competitive edge to push forward the development of RMB offshore financing market, enlarge its potential customer base to include countries along the road and expand the investment target from securities financial market to infrastructure and industry. After the RMB offshore market is basically established, we need to accelerate establishing a RMB offshore regional center and explore on the possibility of building a RMB currency region on the basis of the “One Belt and One Road” strategy.

V.2 Possible issues in the usage of RMB in building “One Belt and One Road”

As most countries along the “One Belt and One Road” are emerging economies that are in very different stages of economic development, the region will, in a considerably long period of time, face the issues of insufficient infrastructure in transportation and communication, incompatible laws and policies, and lack of political mutual trust. As a result, while the “One Belt and One Road” strategy is executed, the geopolitical risks, cultural and religious conflicts and terrorist risks must not be overlooked.

In addition to the national and regional risks, RMB, while used in the implementation of the “One Belt and One Road” strategy, will also be restrained by factors such as less-developed local financial market and financial infrastructure, making the internationalization of RMB in this region a tough challenge with unexpected problems.

V.3 Policy measures in the future

Firstly, we must emphasize on cooperation with the World Bank, Asian Development Bank and other multilateral institutions, and at the same time, step up connections with large financial institutions including the central banks and sovereign funds in countries along the route such as Thailand, Indonesia, Kazakhstan and Mongolia, take advantage of RMB’s chance in joining SDR to promote RMB business to countries along the way, and push major countries to take RMB into their reserve assets portfolio, therefore providing substantial support to the internationalization of RMB.

Secondly, while the “One Belt and One Road” strategy is moving along, China needs to probe into the possibility of building an energy finance market system, so as to deal with the volatility in international energy prices by integrating the energy sector with financial sector. In doing so, China will also attain a higher level of energy security, have the opportunity to use RMB in settling oil sales and expand the use of RMB in oil pricing and trading.

Thirdly, we need to further open up the capital accounts, intensify interactions with domestic and international institutions and platforms, constantly enrich RMB-denominated products and services, build and secure RMB’s leading role in the “One Belt and One Road” financial market.

Fourthly, we need to improve the domestic financial market. Despite the rapid growth in China’s financial market in recent years, it lags far behind the developed markets and some emerging markets in the scale and structure of the stock market and bond market, and needs to continue optimizing its market system and structure, operation mechanism, infrastructure and external environment to create a multi-layered capital market system with a rational structure, complete functions, transparent and standard practice, stable and efficient operation as well as an open and inclusive mentality.

In summary, as an unprecedented and comprehensive systematic project which is complex and calls for long-term efforts, the “One Belt and One Road” strategy aims at making trade cooperation, road connectivity, policy exchanges, currency circulation, and people-to-people communication. To achieve these goals, the Chinese banking sector must take more stringent risk control measures, intensify communication and consultation, make full use of multilateral, bilateral, regional and sub-regional cooperation mechanisms and platforms, in an effort to expand common interests and jointly promote RMB internationalization.

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