Comments on Lord Turner's presentation from a Chinese perspective

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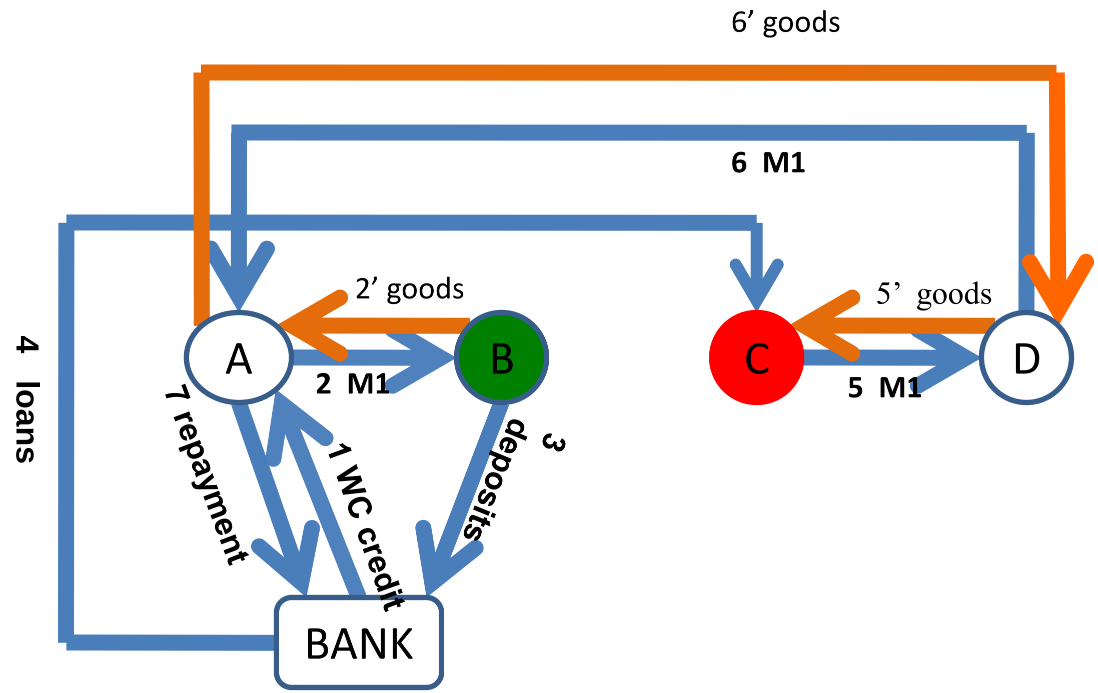
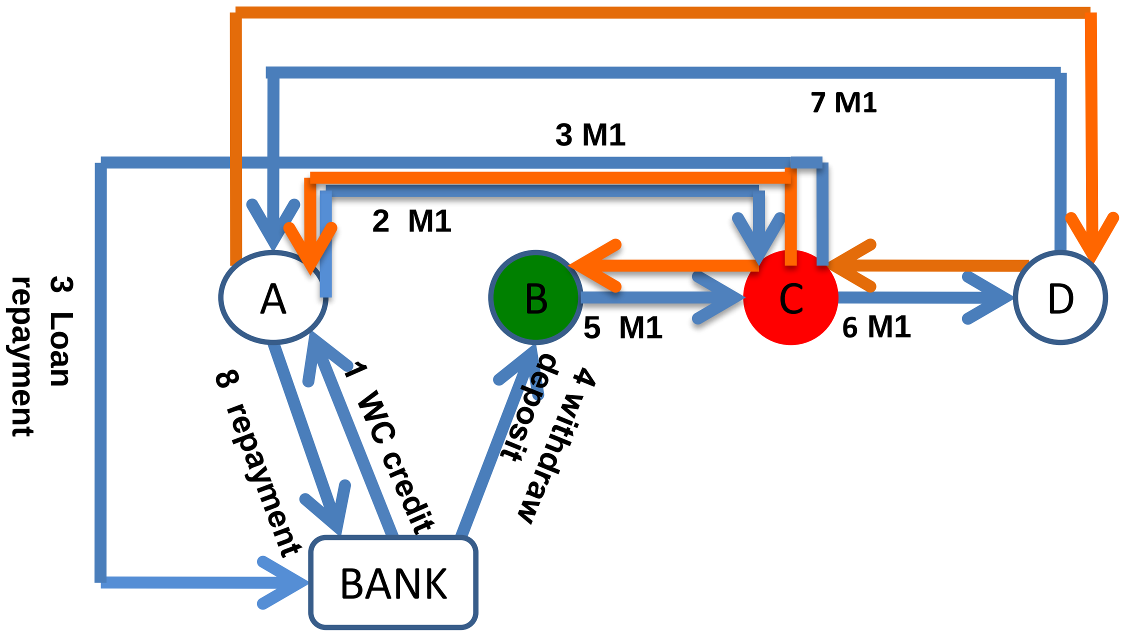
Money and credit flows under equilibrium



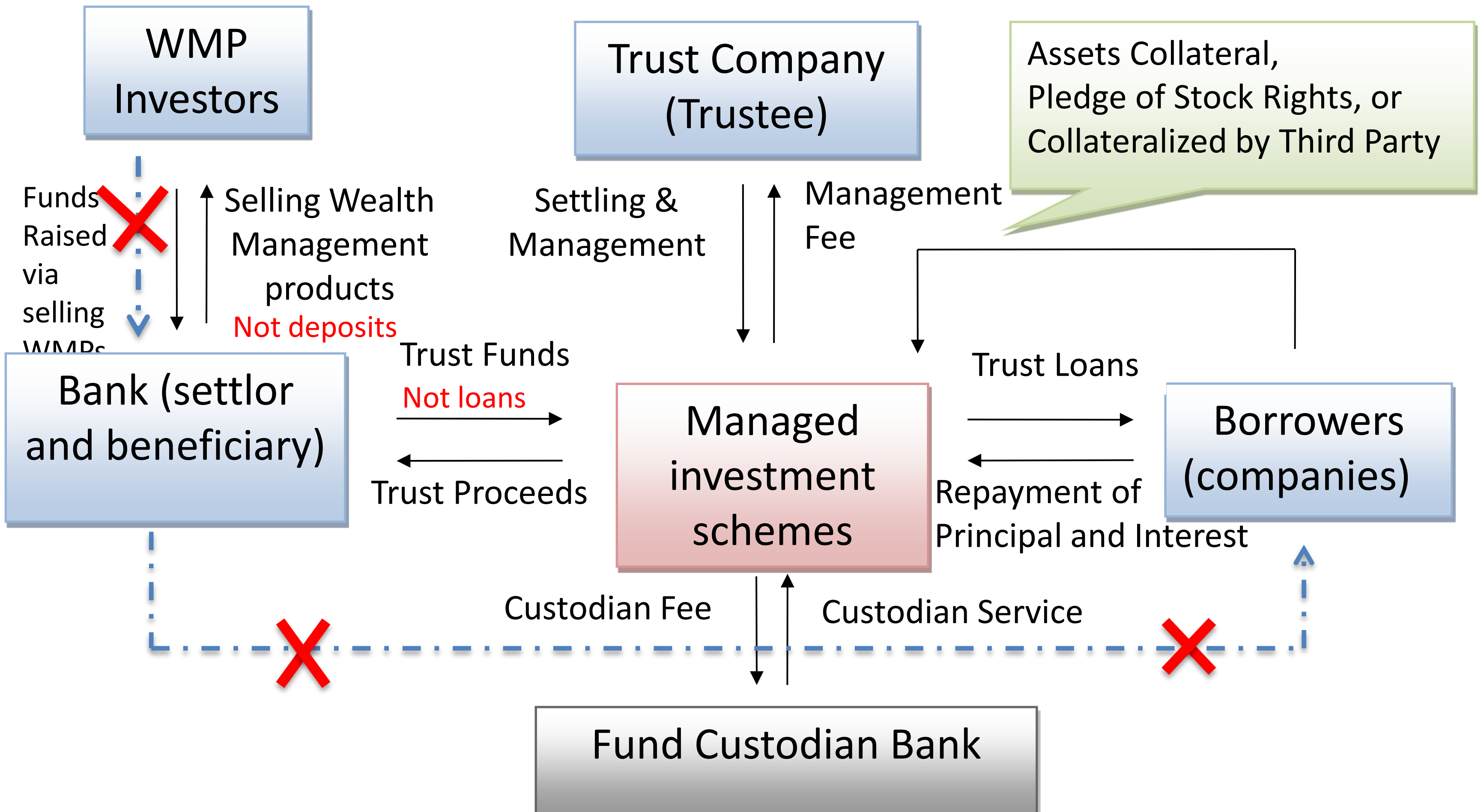
1. M1 is medium of exchange
2. Deposits represent transfer of purchase power from B to C. Income of B is saved and lent to C
3. For given nominal incomes, medium of exchange M1 is given by the central bank.
4. But because of large transfer of purchase power among economic entities, there are deposits (=loans). Meaning there are other types of money and hence M2 can be much bigger.
5. However, as long as S=I and M1 is given, regardless the amount of M2 (and credit), there will be no inflation
6. 1 and 7 will disappear from bank's balance sheet quickly, but 3 and 4 will stay until maturity
7. Whether the loans will be repaid or roll-over is the key for financial stability

Money and credit flows and repayment



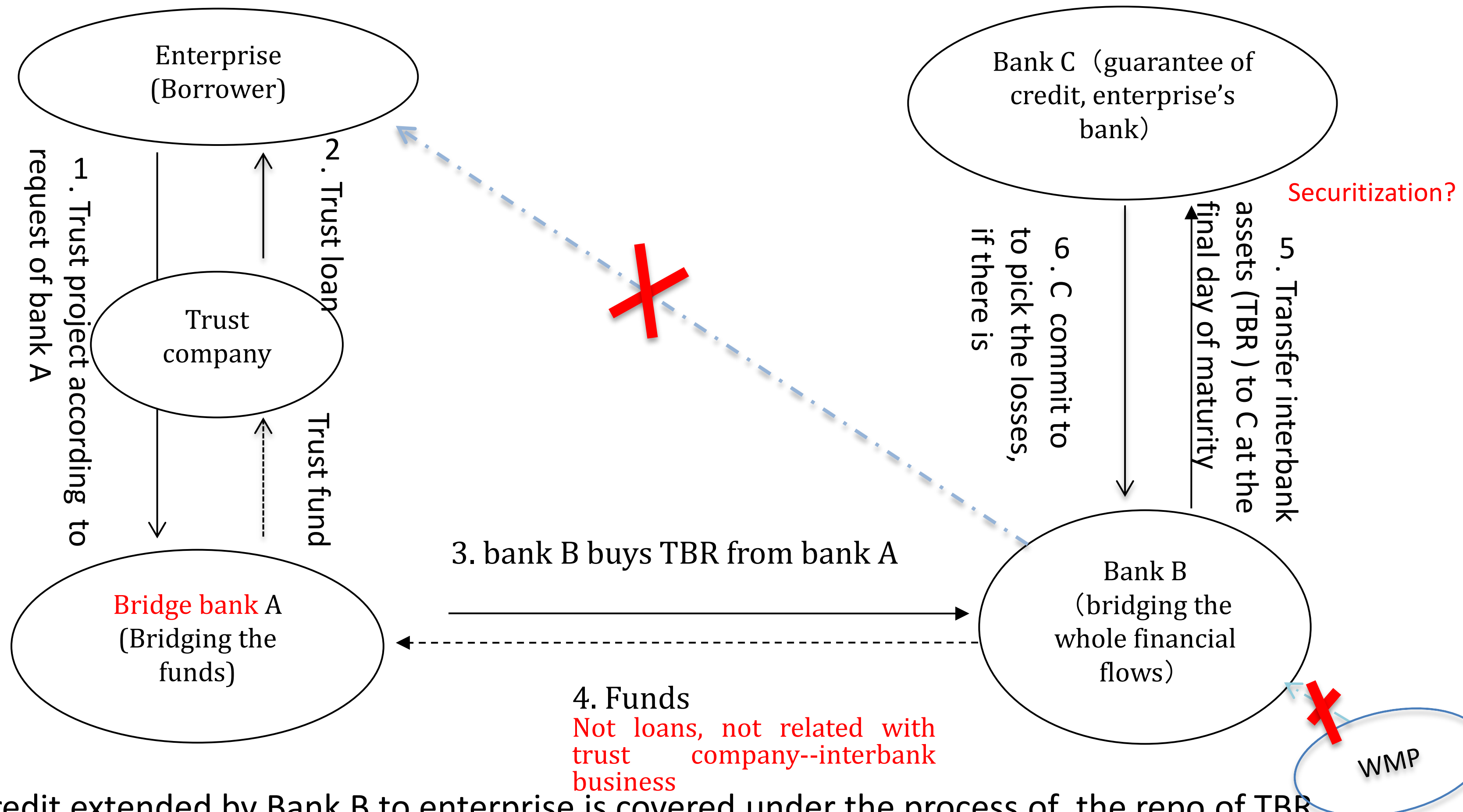
1 assume that B no longer produce any product
2 C produces enough to sell to A as well as B and is able to repay the loans to the bank
3 because the investment made by C in previous period, total products increase and so will M1

The increase in financial intensity in China case 1: WMP via Bank-Trust Cooperation



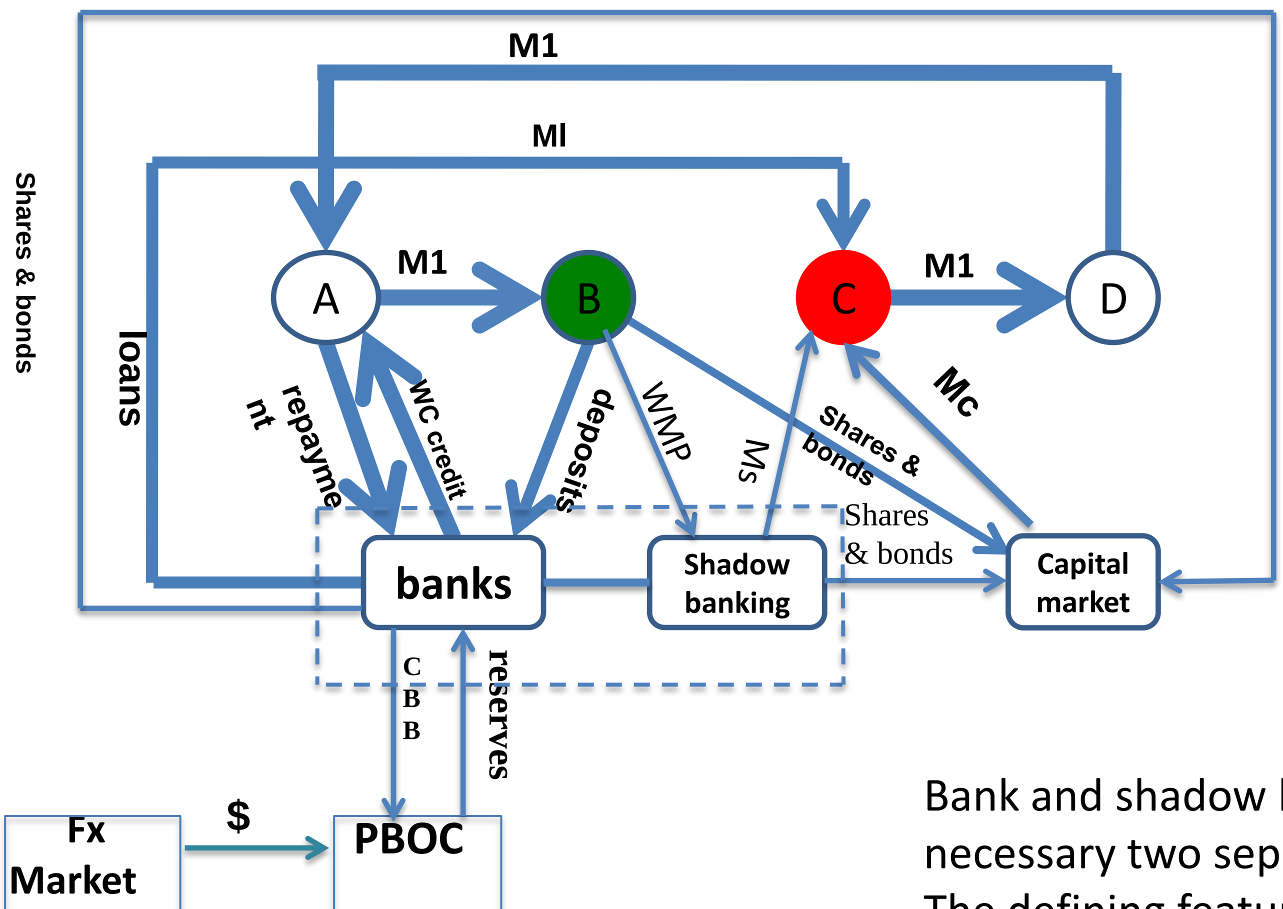
By doing so banks are able to offer higher interest rates to attract funds to evade regulation on the loan-to-deposit ratio, and to lower capital requirement

Interbank business



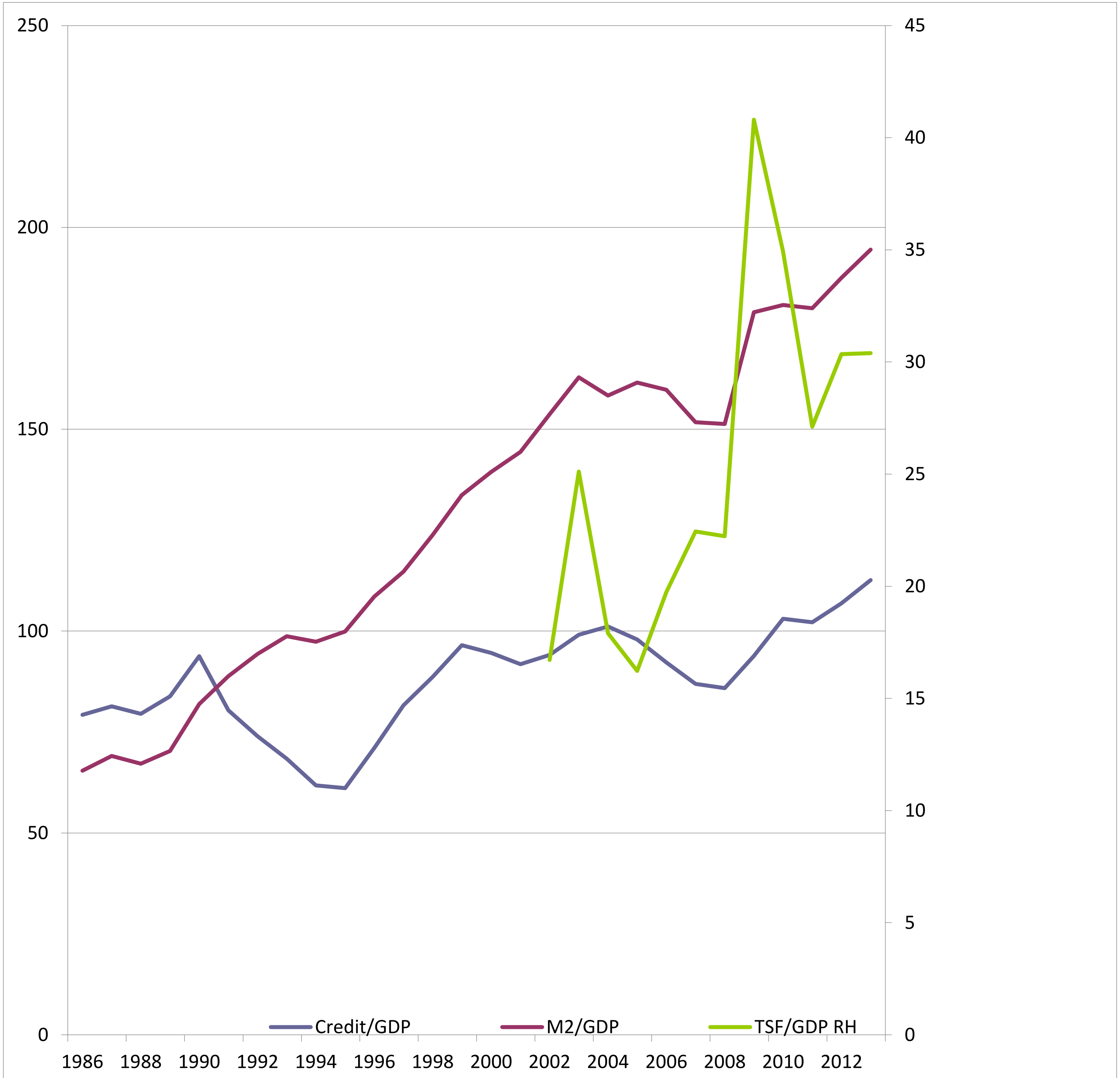
The credit extended by Bank B to enterprise is covered under the process of the repo of TBR between banks, because banks are no longer allowed to raise funds via WMP to finance its own borrowers. Everything is legal

M1, M2 and Social finance flows



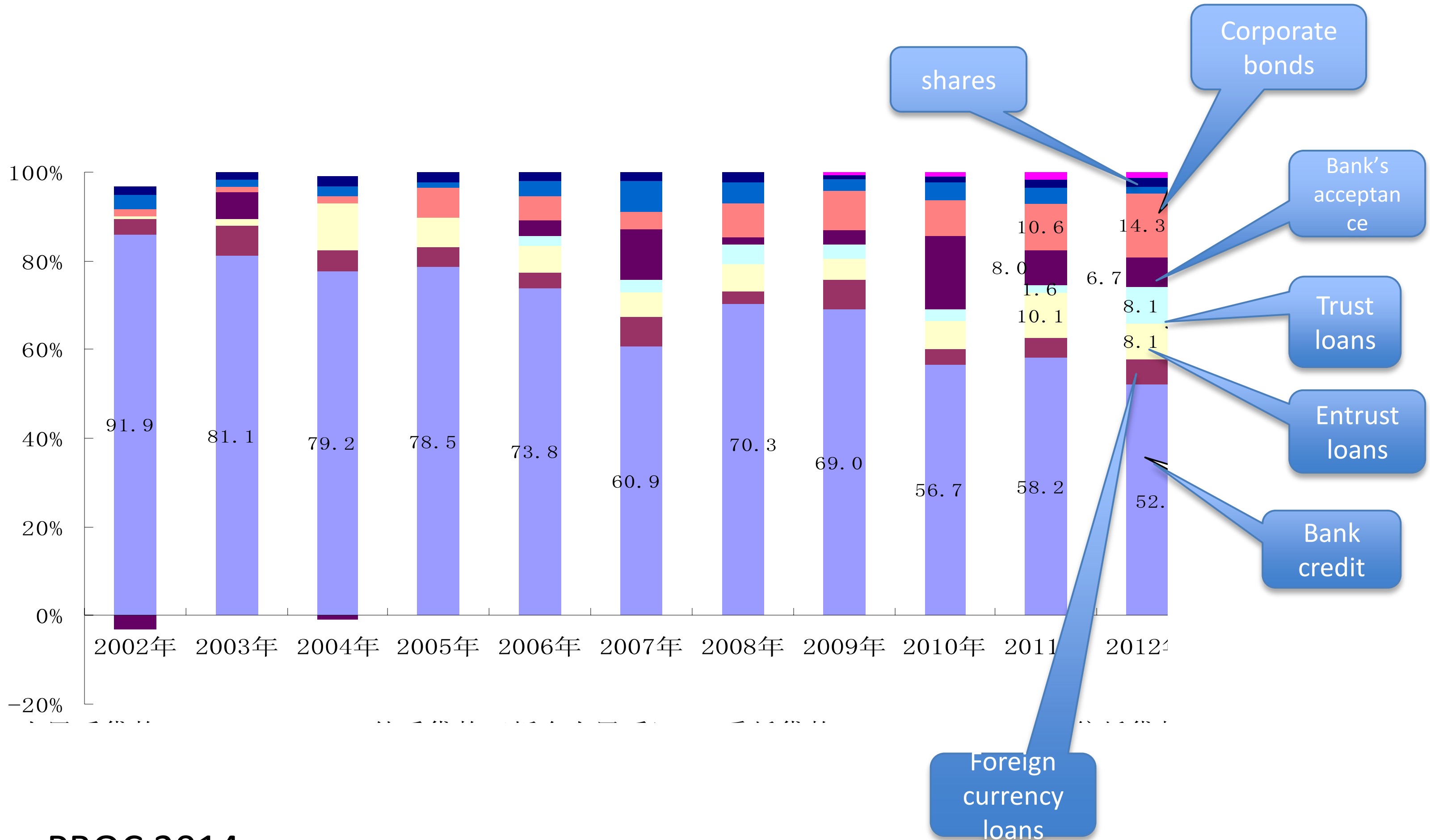
Bank and shadow bank are not necessary two separate entities. The defining features lie in their activities. The same entity can be both bank and shadow bank

China’s financial intensity



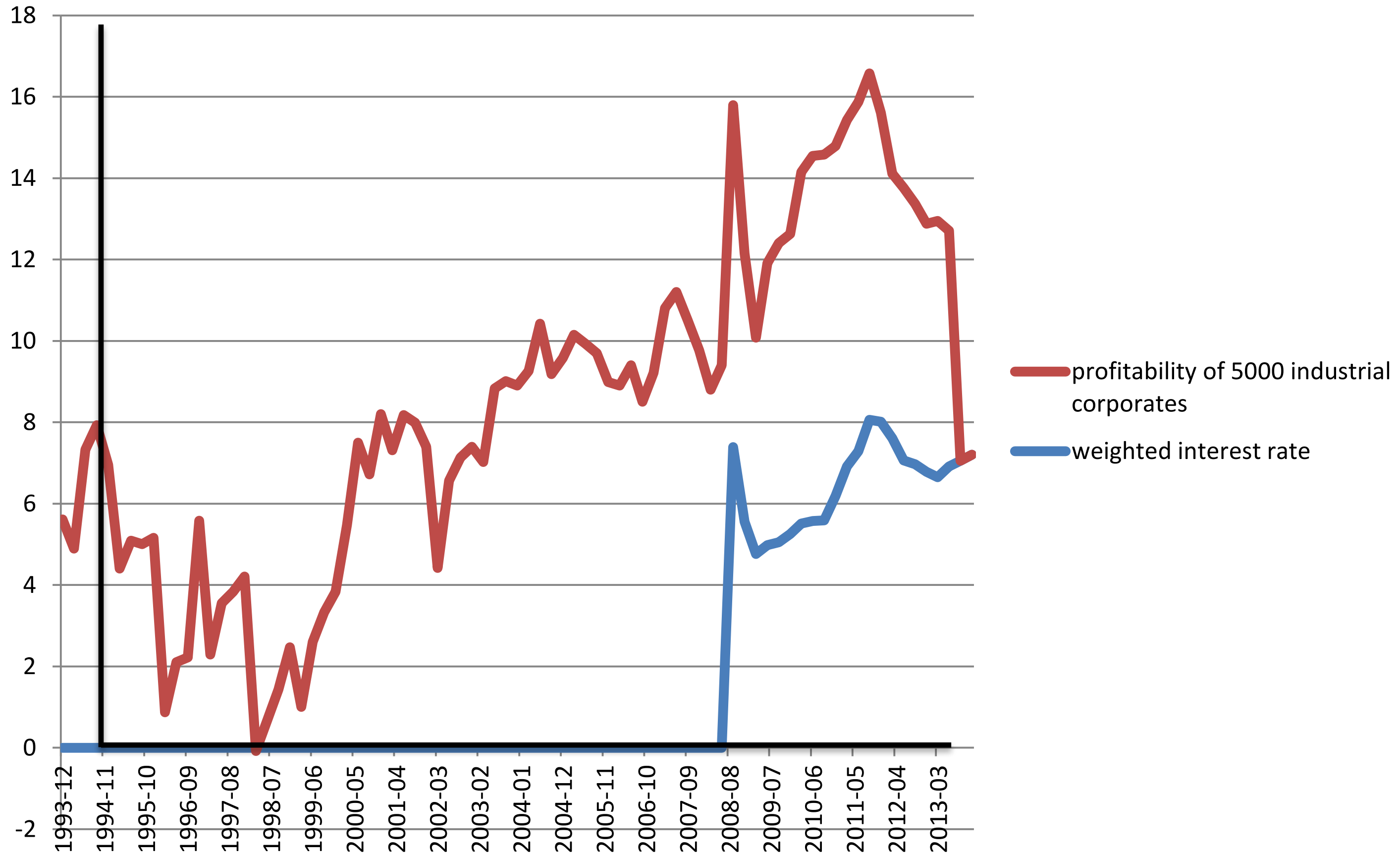
Sources: wind and PBOC

Structural of social finance



Source: PBOC 2014

Interest rate vis-à-vis industrial profitability



Source: Wind

Note: Data for weighted interest rate was unavailable before 2008