

**CAPITAL MARKET LIBERALISATION
IN CHINA: PROGRESS AND
CHALLENGES**

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Executive Summary

1. Since 2012, China's capital market has continued to open up to the world despite the disruption from the stock market rout in mid-2015 and the slump in China's foreign exchange reserves.
2. The status of the yuan as an international settlement and valuation currency has fallen once capital controls are tightened. The scale of the yuan's offshore fund pool has declined as well, indicating that tightening capital controls to prevent the shrinkage of foreign reserves is directly against the process of capital account liberalisation.
3. Experiments on the stock market opening up include the Shanghai-Hong Kong Stock Connect scheme and the long-awaited Shenzhen-Hong Kong Stock Connect scheme.
4. A key effort on the exchange rate market is renminbi (RMB) joining the International Monetary Fund's Special Drawing Rights basket successfully in end 2015.
5. An important endeavour to open up the bonds market is the most recent initiative of the Bond Connect programme. On 3 July 2017, mainland China and Hong Kong launched the "Bond Connect" programme to link China's bond market with overseas investors.
6. Several valuable lessons could be drawn from the process of capital market opening up. First, a market upturn based on stimulated public expectation can be very risky. Second, the application of various financial innovations needs to be accompanied by sophisticated risk management and regulation.
7. Amidst the government's effort to rein in capital outflow, Premier Li Keqiang stated on 5 March 2017 that China will continue to liberalise the capital account.

8. In the near future the focus of capital account liberalisation is likely to focus on the bonds market as the stock market cannot attract more foreign investors without strengthening regulations.