

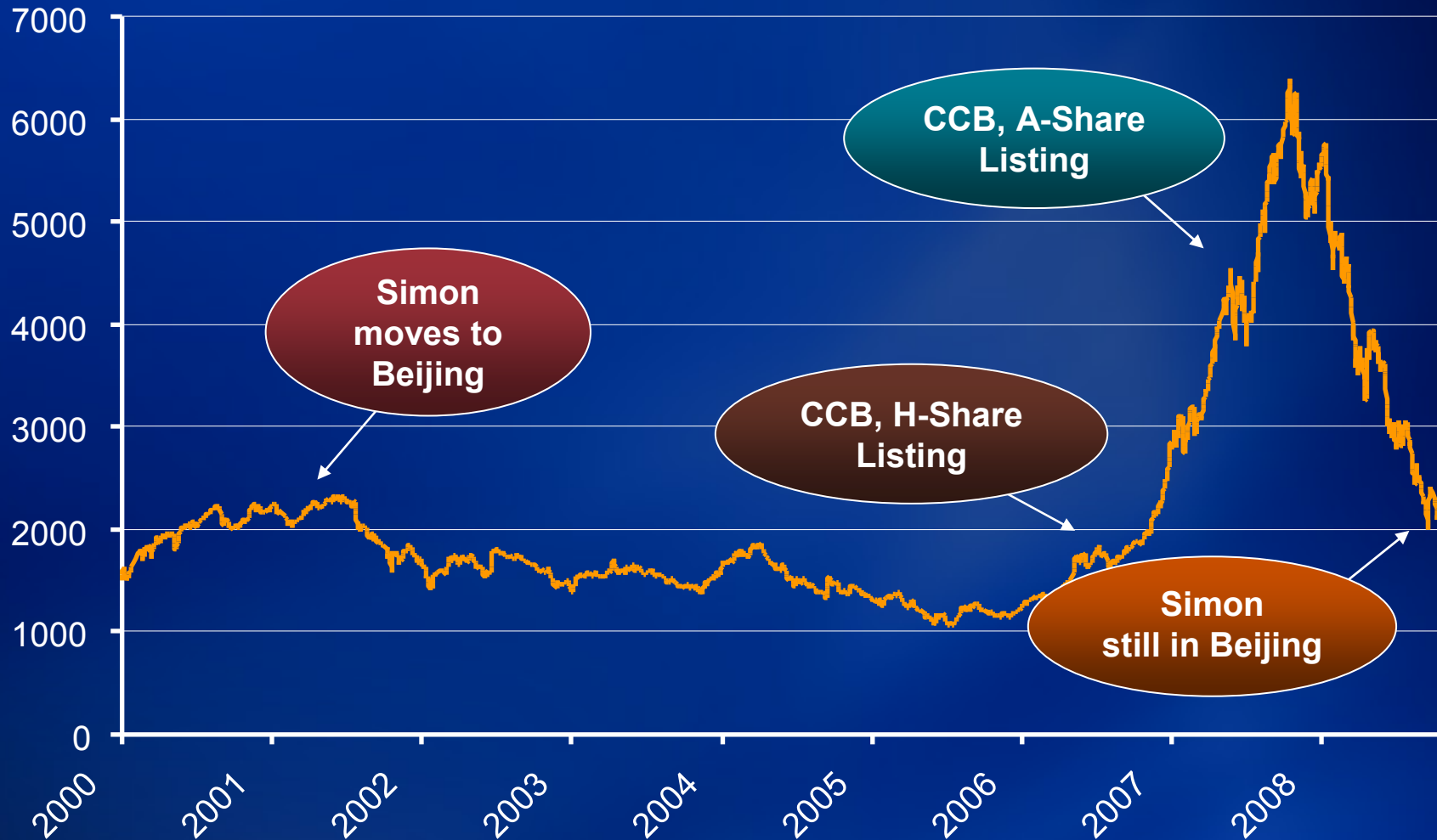


The rise of China's capital markets

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FINANCIAL SERVICES

Shanghai A-Share Market



Global Markets

Hang Seng



FTSE



Nikkei



Dow Jones



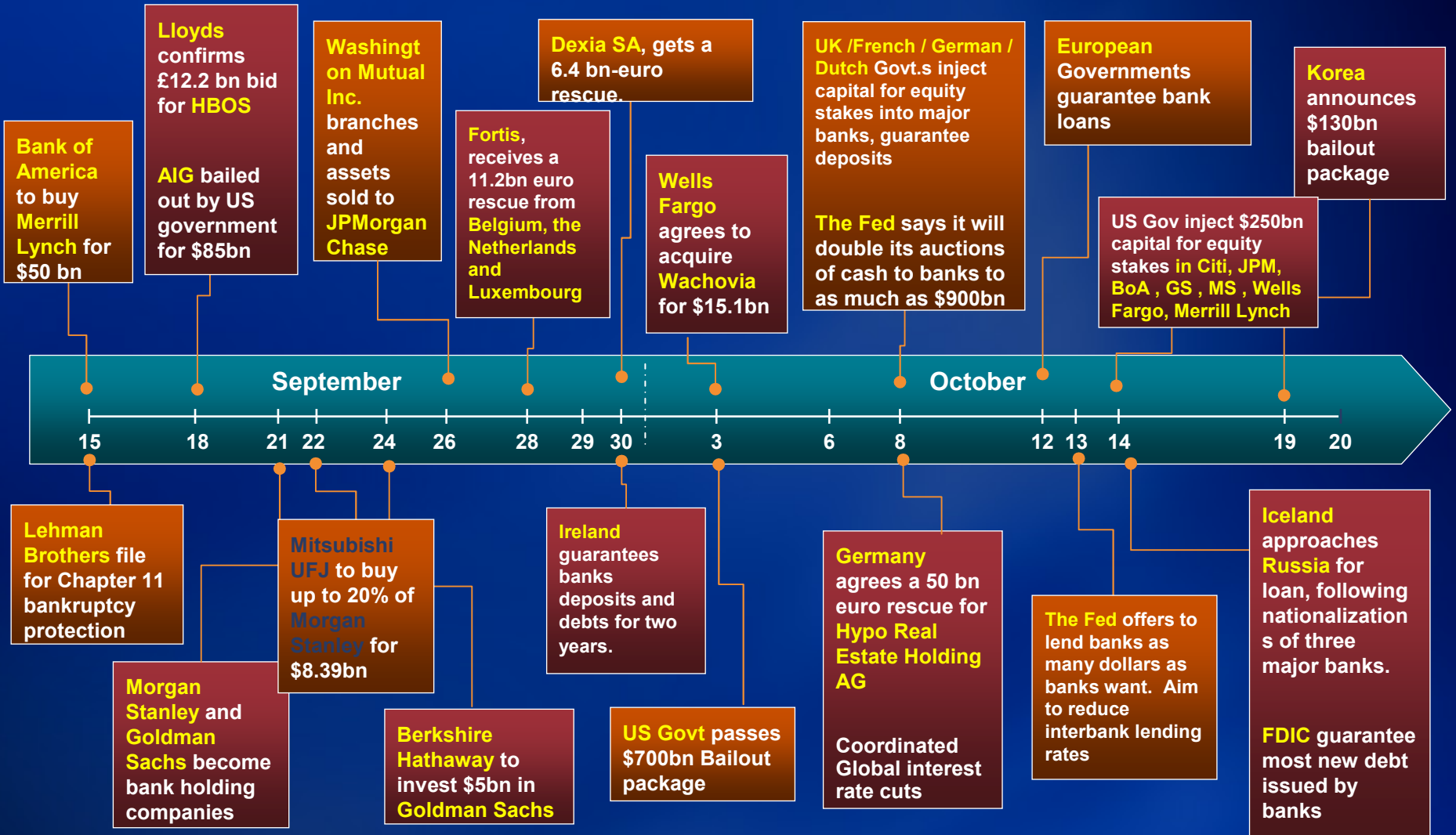
Capitalization and Turnover of Major Markets

As of 17 Oct 2008, US\$bn

Market	Market cap	Market cap 12 months ago	Change last 12 months (in%)
United States	11,263	18,737	-39.9%
Japan	2,982	4,705	-36.6%
United Kingdom	2,158	4,122	-47.7%
China	1,817	3,737	-51.4%
France	1,470	2,920	-49.6%
Hong Kong	1,330	2,786	-52.3%
Germany	1,193	2,175	-45.1%
Canada	1,082	1,871	-42.2%
Switzerland	865	1,256	-31.1%
Australia	674	1,268	-46.9%

Source: Bloomberg

Crisis Timeline



What went wrong...

- **Downturn in the U.S. housing market (“U.S. housing bubble”) and excessive speculation in housing market**
- **Risky lending and flawed borrowing practices**
- **Excessive individual and corporate debt levels**
- **Poor securitization practices and oversight**
- **Flawed oversight by mortgage brokers**
- **Excessive underwriting of high-risk mortgages**
- **Government policies leading to moral hazard**
- **Weak oversight by credit rating agencies**
- **Inactivity of Central Banks**

Crisis to Crisis

Date	Crisis	Cause	Outcome	Impact
1929	The Great Depression	<ul style="list-style-type: none"> •Fiscal control •Lack of money supply •Stock market crash 	<ul style="list-style-type: none"> •13 million unemployed • US GDP falls from \$103bn to \$55bn 	•Global
1985	Savings and Loan Scandal	<ul style="list-style-type: none"> •Financial deregulation •Exposure to complex financial products 	<ul style="list-style-type: none"> •\$150m Bailout •Bankruptcy and repossessions 	•US
1987	The Crash of 1987	<ul style="list-style-type: none"> •Loss of confidence in market legitimacy •Declining value of the US Dollar •Automated trading 	<ul style="list-style-type: none"> •Interest rates lowered •‘Circuit breakers’ introduced •Impacted global markets 	<ul style="list-style-type: none"> •US •Europe •Japan
1997	The Asian Financial Crisis	<ul style="list-style-type: none"> •Collapse of the Thai Baht •Foreign debt default •Asian export market collapse 	<ul style="list-style-type: none"> •Devaluation of currencies •Bankruptcy of Companies 	•Asia
2000	Dot Com Crash	<ul style="list-style-type: none"> •Over-inflated equity market •Y2K expenditure 	<ul style="list-style-type: none"> •Loss \$5 trillion in Market value •Fall in Investor confidence •Nasdaq falls 78% 	<ul style="list-style-type: none"> •US •Europe
2008	The Global Credit Crunch	<ul style="list-style-type: none"> •Collapse of US property •Risky lending and flawed borrowing practices 	<ul style="list-style-type: none"> •Lending freeze •Stock Markets crash •Global recession? 	?

This time it's different...



Credit Crisis in China...?

- **Cautious approach to complex, structured products**
- **Cautious approach to overseas equity and property investments**
- **Positive capital flows**
- **Adequate liquidity**
- **Domestic demand**

But....

- **Market volatility driven by retail investors**
- **Contraction of export market**

China's Annual Financing Requirement

	US\$ billion
Bank loans	1,000
Govt bonds issuance	100
Corporate bond issuance	35
Equities issuance	64

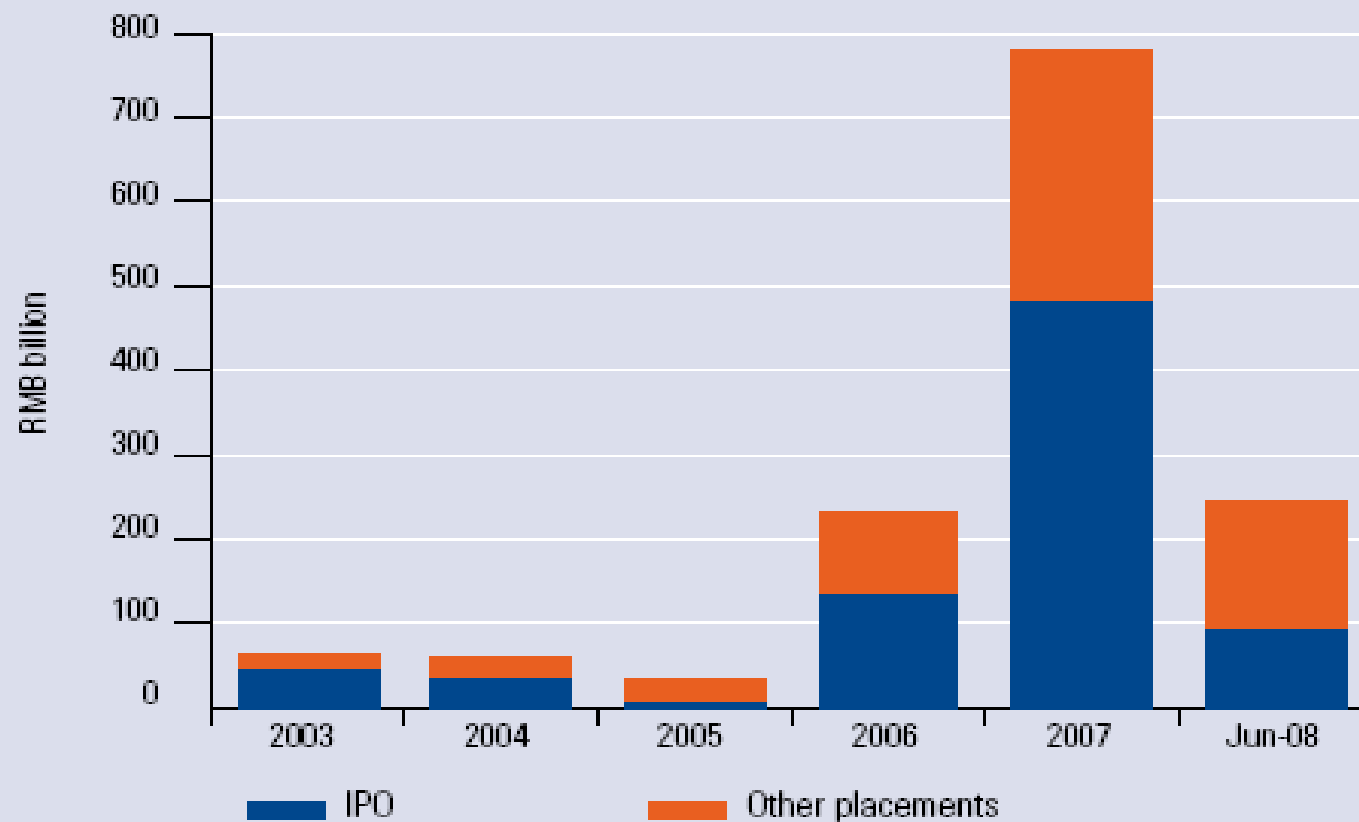
IPO Fund Raising in 2007

Stock market	US\$ billion
China	64
NYSE Group	60
London SE	50
Hong Kong Exchanges	37
Sao Paulo SE	29
BME Spanish Exchange	22
Australian SE	17
Nasdaq	16
Deutsche Borse	11

Source: World Federation of Exchanges & Deutsche Borse

Fund Raising in Mainland Bourses

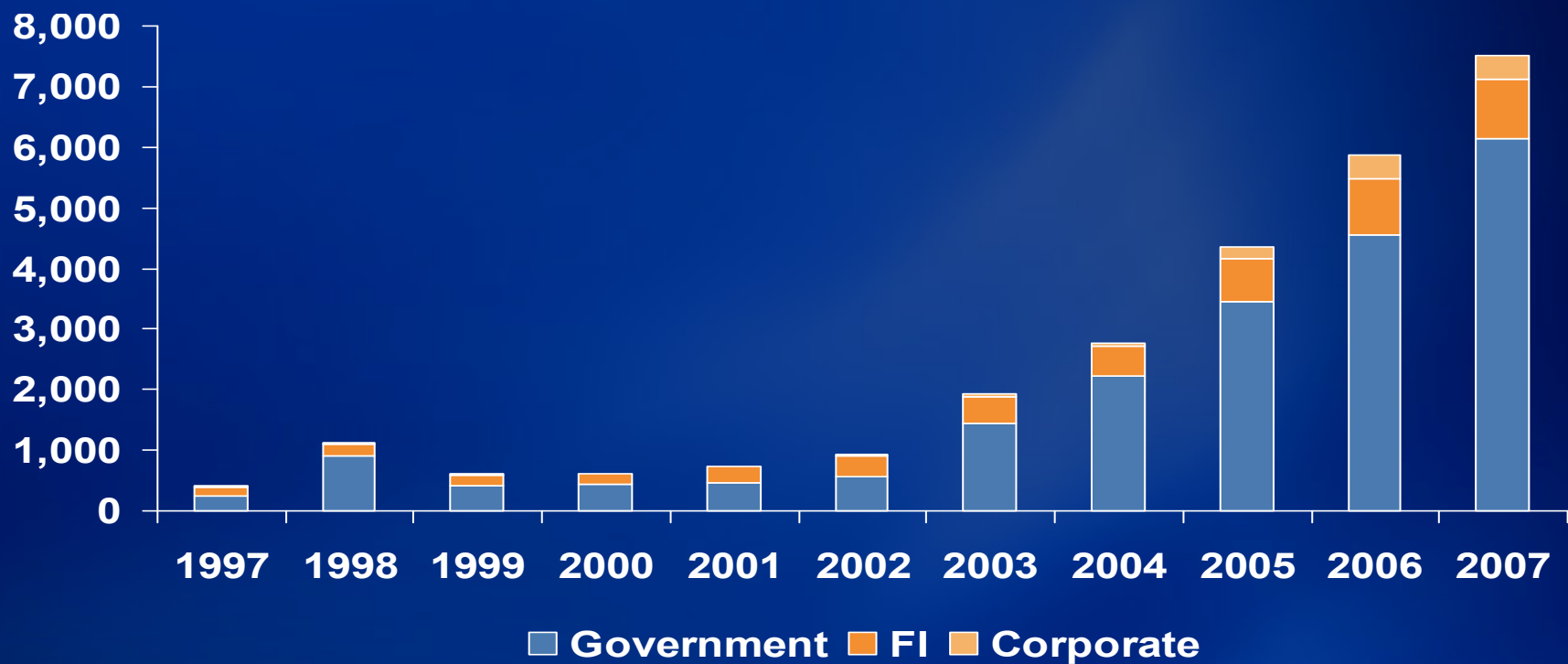
Fund raising in mainland bourses



Company	Funds Raised (million RMB)
China Coal Energy Co.	25,671
China Railway Construction Corp.	22,246
Zijin Mining Group Co., Ltd.	9,982
Jinduicheng Molybdenum Co., Ltd.	8,914
China South Locomotive and Rolling Stock Corporation Limited	6,540
Joyoung Co., Ltd.	1,510
Shanghai Metersbonwe Fashion & Accessories Co Ltd	1,383
Hangzhou Binjiang Real Estate Group Co., Ltd.	1,218
Guangdong Weihua Corp.	1,204
Shaan Xi Provincial Natural Gas Co Ltd	1,059
Guangdong Tapai Group Co., Ltd.	1,003
Better Life Commercial Chain Share Co., Ltd.	912
Zhongshan Board Ocean Motor Co., Ltd.	819
Jiangsu Hongda New Material Co., Ltd.	639
Shangdong Humon Smelting Co., Ltd.	623
Zhejiang Hailiang Co., Ltd.	614
Yantai Spandex Co., Ltd.	594
Dalian Huarui Heavy Industry Steel Casting Co., Ltd.	582
Guangdong Nan Yang Cable Group Holding Co., Ltd.	574
GoerTek Inc.	563

*** An additional 56 IPOs in 2008 raised a total of RMB16,781,000**

Gross Bond Issuance (RMBbn)



The China Derivatives Market

Driving the market:

- Banks
- Mutual funds
- Insurance companies
- Retail investors

Index futures?

Short-selling and Margin trading



The investors....

QFII – Qualified Foreign Institutional Investors – allows foreign investors limited access to the Chinese capital markets

QDII – Qualified Domestic Institutional Investors – allows domestic investors limited access to overseas markets

Partial liberalisation of China's capital account

QFII Overview

- Programme launched in December 2002
- Allows foreign institutional investors to invest in China's domestic securities markets
- QFIIs can either invest own money or channel client money to invest in China domestic market
- Currently 57 institutions with combined quota of US\$11.2bn
- Quota will be increased to US\$30bn in 2008
- Partial capital account liberalisation – capital inflow
- Restrictions prevail but constraints gradually easing
 - Relaxation of qualification rules
 - Multiple brokerage accounts
 - Investing on behalf of clients
 - Withdrawal of capital

Current QFII Regulations

CSRC, PBoC and SAFE Jointly Issued Regulations in August 2006

Type of Investor	Eligibility Criteria
Fund Managers	Operating history: 5 yrs; Securities' AUM: US\$5bn
Insurance Cos	History: 5 yrs; Securities' AUM: US\$5bn
Securities Firms	Operating history: 30 yrs; Paid-in capital: US\$1bn; Securities' AUM: US\$10bn
Commercial Banks	Ranked among top 100 worldwide in terms of total assets; Securities' AUM: US\$10bn
Other Institutional Investors*	History: 5 yrs; Securities' AUM: US\$5bn

* Refers to pension funds, charity funds, endowment funds, trust funds, government investment companies, etc.

Impact on Chinese Capital Markets

QFII funds delivered an average return of 124% in 2007

Emphasis on fundamental research

Introduces discipline to investments

Important institutional force in a retail-dominated market

Influence far outweighs its relatively small size

Expanding, although not as fast as foreign institutions wish

The investment decisions of QFIIs are closely watched by market participants

QDII Overview

- **Been talked about since 2001 - CSRC vs. SAFE**
- **April 2006 – PBoC Notice #5, allowing banks, fund managers and insurance companies to invest abroad**
- **Banking Sector**
 - QDII rules revised (CBRC) in May 2007
 - MOUs with HK, UK, Singapore, Japan, US, Korea and Australia
- **Fund management and securities companies**
 - QDII rules issued (CSRC) in June 2007
 - MOUs with 35 regions
- **Insurance sector**
 - QDII rules issued (CIRC) in July 2007
 - MOU with Hong Kong (in March 2008)
- **Currently 80 institutions with combined quota of US\$60.2bn**

Market Reception to QDII

Cool in 2006 and until summer of 2007

- Stellar A-share markets
- RMB appreciation expectations
- Unattractive product designs – structured products, fixed income, too complicated

Took off in September 2007

- China Southern, Huaxia, Harvest and Chinese International all launched mega QDII funds, massively oversubscribed

Cooled again since January 2008

- Strong appreciation of RMB
- Global economy slowdown
- Global stock market slump
- Underperformance of some existing QDII products

Implications of QDII

Limited initially due to size

Modest current scope for QDII, big growth potential

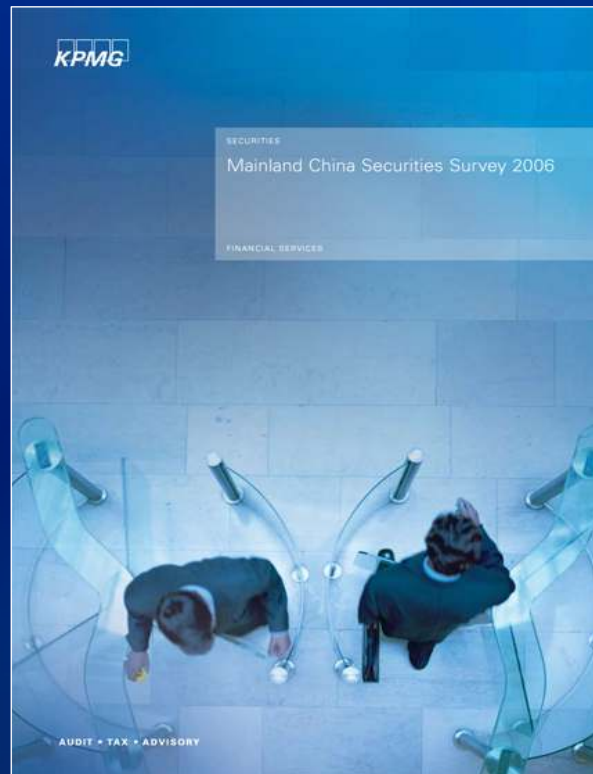
- Expansion in types of investors
- Expansion in size of outflow
- Expansion in investment choices

Destiny of QDII programme

- Full convertibility of RMB in the long run?
- Full integration of Chinese market with global markets?

Improved Market Transparency

Mainland china securities survey



Mainland china banking survey





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