China Monetary Policy Report

Quarter Three, 2019

(November 15, 2019)

Monetary Policy Analysis Group of

the People's Bank of China

Executive Summary

Since Q3 2019, the overall performance of the Chinese economy has been steady, with structural adjustments making solid progress. Investment growth has slowed down but stabilized, while consumption and employment have been broadly stable and the price hikes have displayed significant structural characteristics. Meanwhile, external and domestic challenges and uncertainties have continued to weigh down on the economy. Downward pressures have built up. In accordance with the decisions of the CPC Central Committee and the State Council and to ensure that the financial sector serves the needs of the real economy, the People's Bank of China (PBC) has implemented a sound monetary policy and enhanced countercyclical and structural adjustments by combining reform and adjustment measures to accommodate both short-term and long-term considerations and internal and external balances. Reform measures have been adopted to improve the transmission of monetary policy, and to lower overall financing costs. With all these efforts, the PBC has created a favorable monetary and financial environment for achieving the "six stabilities", namely stability of employment, the financial sector, external trade, foreign investment, domestic investment, market expectations, and high-quality economic growth.

First, measures were taken to deepen the supply-side structural reforms in the financial sector to improve the transmission channel. On August 17, the PBC announced improvements in the loan prime rate (LPR) mechanism designed to straighten out market-based pass-through channels, providing an incentive to improve bank operations, removing the implicit floor on loan rates, and helping reduce financing costs for businesses. The PBC also encouraged banks to replenish tier-1 capital with perpetual bonds and supported such issuances with central bank bills swaps (CBS).

Second, adjustments were made to maintain liquidity at ample and appropriate levels and to guide the reasonable growth of money supply and aggregate financing. On September 6, the PBC cut the required reserve ratio (RRR) by 0.5 percentage points for all banks, releasing about RMB800 billion. The Medium-term Lending facility (MLF), Standing Lending Facility (SLF), open market operations, and various other monetary policy instruments were flexibly employed to maintain appropriate liquidity and stable money market interest rates.

Third, measures were adopted to promote a targeted supply of credit, to facilitate structural adjustments, and to support private enterprises and micro and small enterprises (MSEs). In addition to the continued use of central bank lending and central bank discounts to encourage financial institutions to optimize the credit structures, on September 6 the PBC announced an extra RRR cut of 1 percentage point for city commercial banks that operate only within the province where they are registered, releasing about RMB100 billion. It also announced a plan to include the use of released funds by these banks for lending to private companies and MSEs in the MPA assessment for the purpose of providing incentives to small and medium-sized banks to serve local clients and the real economy.

Fourth, the steady and orderly advancement of risk resolution of the Baoshang Bank ensured an accurate demolition of bombs, helping prevent and mitigate financial risks. The smooth takeover and subsequent entrustment of the Baoshang Bank put an end to irregularities and contained a risk contagion, protecting the customers' legitimate rights and interests, breaking rigid payments in accordance with the laws and regulations, and promoting reasonable credit stratification in the financial markets. To prevent liquidity risks arising from small and medium-sized banks, the PBC established the "four lines of defense," namely liquidity injections through central bank discounts, the SLF, the required reserve ratio, and central bank lending, and it stabilized market confidence through timely monetary policy operations, thus maintaining the stable functioning of the money market, the bill market, and the bond market.

Fifth, initiatives were taken to strike a balance between an internal and external equilibrium and to absorb external shocks. On August 5, driven by market forces, the RMB depreciated beyond 7 against the US dollar and functioned as an "automatic stabilizer." With two-way fluctuations driven by demand and supply, the RMB exchange rate has been basically stable at an adaptive and equilibrium level. The PBC continued regular bill issuances in Hong Kong to further enrich the high-rated short-term RMB-denominated products in the Hong Kong market and to facilitate the development of offshore RMB money markets and RMB internationalization.

Overall, the sound monetary policy achieved significant results and transmission improved remarkably. As of end-September, broad money (M2) and aggregate financing to the real economy (AFRE) grew 8.4 percent and 10.8 percent year on year, respectively, broadly matching or slightly outpacing nominal GDP growth in the first three quarters, reflecting the stronger countercyclicality of monetary policy. New RMB loans posted RMB13.6 trillion in the first three quarters, topping the figure from the same period of the last year by RMB486.7 billion, which mainly went to sectors in greatest need of credit, including private enterprises and MSEs. Overall financing costs for businesses have remained stable but with a slight decline. The weighted average interest rate of corporate bonds dropped 1.26 percentage points from a peak in 2018 to 3.33 percent in September, while the weighted average interest rate of bonds issued by private firms dropped 1.8 percentage points. Interest rates on new enterprise loans decreased 0.36 percentage points from the previous year's peak. At the end of September, the CFETS RMB exchange-rate index was 91.53, and market expectations tended to be stable. The major macroeconomic indicators remained within a reasonable range. In the first three quarters, the GDP grew 6.2 percent year on year and the CPI rose 2.5 percent year on year.

Many positive factors point to the stable development of the Chinese economy. Substantial progress has been made in the "three critical battles," namely preventing and defusing major risks, conducting targeted poverty alleviation, and controlling pollution. Supply-side structural reforms have deepened and supply and demand have been generally balanced. Growth remains resilient, the reform and opening-up have continued, and the effects of the macroeconomic policies gradually unfold. There is no basis for persistent inflation or deflation. However, external uncertainties and destabilizing factors are on the rise as the global economy faces stronger downward pressures and the major economies have limited monetary policy space. Both short- and long-term domestic developments, and internal and external changes have presented risks and challenges. Downward pressures on performance have grown and the endogenous drivers for growth need to be further enhanced. In addition, given the relatively large year-on-year increase in food prices, we need to be on the watch for a proliferation of inflationary expectations.

Going forward, under the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, the PBC will fully follow the policy orientation of the CPC Central Committee and the State Council. Focusing on the three tasks of serving the real economy, forestalling financial risks, and deepening reforms in the financial sector, the PBC will continue to implement a sound monetary policy. Efforts will be made to properly manage the strength and pace of policy measures and to intensify countercyclical and structural adjustments as appropriate to respond to short-term downward pressures on the economy. The PBC is determined not to "flood the market with liquidity," and to properly align the growth of M2 and aggregate financing with nominal GDP growth. Measures will be taken to guide inflation expectations to maintain overall stability of consumer prices. The PBC will continue market-based reforms to reduce financing costs for the real economy, promote wider use of the LPR in the banking sector, and encourage financial institutions to strengthen support for the real economy, particularly the private sector and the MSEs. The sustainable bank capital replenishment mechanism will be further improved to support capital replenishments by small and medium-sized banks from more diversified sources in an effort to optimize their capital structure. The PBC will coordinate policies regarding domestic and foreign currencies to strike a balance between an internal and external equilibrium and to keep the RMB exchange rate basically stable at an adaptive and equilibrium level. We will improve risk monitoring and continue to prevent and resolve risks while promoting high-quality development. Targeted measures will be taken to effectively address risks in key areas. We will further supply-side structural reforms in the financial sector, develop a modern central banking system and a modern financial system that are highly adaptive, competitive, and inclusive, and bring about a virtuous cycle among the supply system, the demand system, and the financial sector.

Contents

Boxes

Tables

Figures

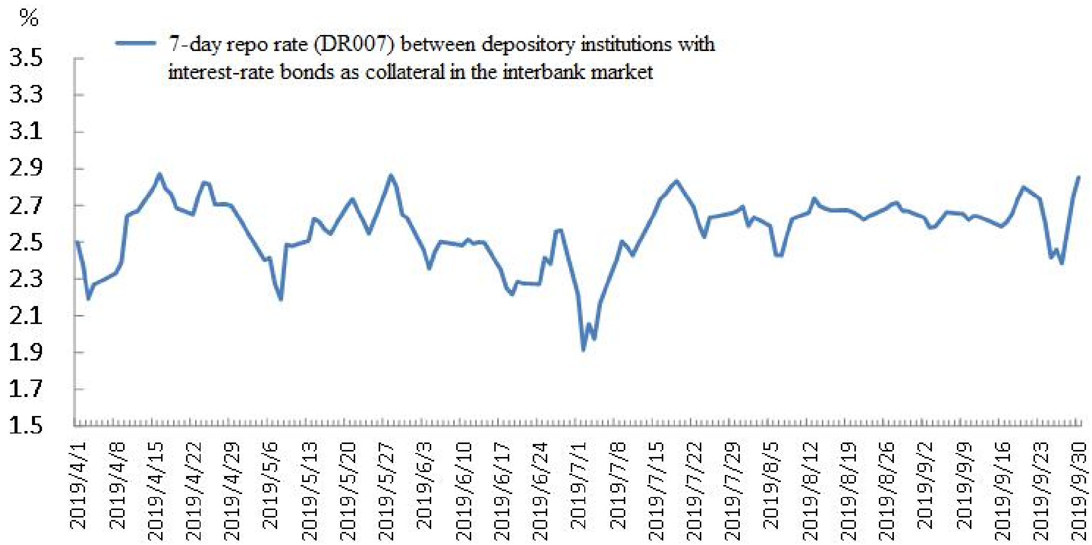
Part 1. Money and Credit Analysis

Since the beginning of Q3 2019, following the policy arrangements of the CPC Central Committee and the State Council, the PBC has implemented sound monetary policies, strengthened countercyclical adjustments, ramped up structural adjustments, and adopted reform measures to smooth the monetary policy transmission. As a result, transmission efficiency picked up, social aggregate financing costs dropped, and the sound monetary policy delivered outstanding results.

I. Liquidity was ample and appropriate in the banking system

Facing complex and serious conditions both at home and abroad, the PBC adopted policies based on China's economic conditions, remained focused, and continued to implement a sound monetary policy. We acted appropriately to conduct countercyclical adjustments, flexibly employed various monetary policy instruments including the reserve ratio, the Medium-term Lending Facility (MLF), open market operations, central bank lending, central bank discounts, and Standing Lending Facility to maintain ample and appropriate liquidity and to guide the smooth operation of money market rates. At end-September, the excess reserve ratio for financial institutions registered 1.8 percent, 0.6 percentage points lower than that at the end of the previous year, or 0.3 percentage points higher year on year.

Figure 1 Interest Rates in the Money Market



Source: www.chinamoney.com.cn.

Box 1 A Proper Interpretation of the Change in the Size of the Central Banks' Balance Sheets

The change in the size of the PBC's balance sheet has recently garnered market attention. At present, China still implements a normal monetary policy, and the required reserve ratio (RRR) is one of its major policy instruments. Despite moderated growth or even a possible drop in the PBC's aggregate assets, a lower RRR loosens liquidity constraints and enhances money creation capacity, which is fundamentally different from a "balance sheet unwinding" after overseas central banks pause their quantitative easing. As a result, the monetary policy stance should not be judged by simply copying international experience to look at the change in the size of the PBC's balance sheet. Instead, the change in the excess reserve ratio is a fundamental indicator of a short-term stance, while the long-term stance is reflected by a change in the RRR constraints on the banks' capacity to create money.

1. **The expanding or unwinding of the Fed's balance sheet suggested an accommodative or a tightened monetary policy stance, respectively**

The Federal Reserve is a typical central bank in the advanced economies that implemented unconventional monetary policies after the global financial crisis. Before the crisis, treasury bonds on the asset side and cash issuance on the liability side accounted for about 90 percent of the respective category on the Fed's balance sheet, and their amounts were basically equivalent. Interest rates are the main policy instruments whereas the RRR is seldom employed by the Fed.

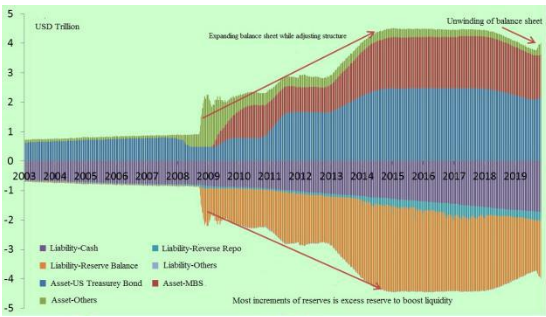


Figure 2 Balance Sheet of the Fed

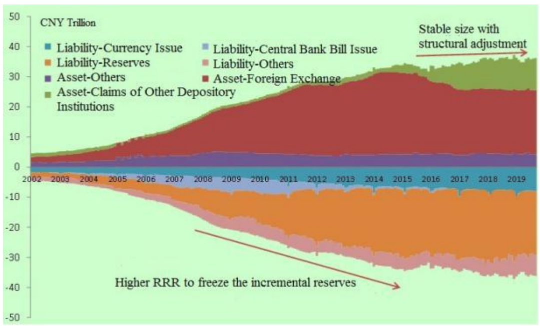


Figure 3 Balance Sheet of the PBC

After the eruption of the crisis, as interest rates dropped to close to zero and conventional interest rate instruments became non-effective, the Fed conducted three rounds of quantitative easing (QE) to purchase treasury bonds and mortgage-backed securities (MBS) to further ease monetary conditions. On its balance sheet, holdings of treasury bonds and MBS on the asset side as well as the reserve balance on the liability side grew rapidly (Figure 2). Given the relatively low RRR in the US for a number of years, incremental reserves were mainly driven by excess reserves, which was equivalent to direct liquidity injections into the market, reflecting the Fed's accommodative monetary policy stance. The Fed started to unwind its balance sheet in 2017 by stopping its reinvestment of some maturing bonds. On the balance sheet, its holdings of treasury bonds and MBS on the asset side and the reserve balance on the liability side (mainly excess reserves) went down steadily. Liquidity in the banking sector dropped directly, indicating a tightened monetary policy.

2. **An expansion of the PBC's balance sheet indicated "a tightened stance," while a shrinking suggested "a loosened stance" at the current stage**

Currently, the PBC's balance sheet differs significantly from that of the Fed in terms of its structure. For the PBC, the balance sheet mainly reflects the relationship between the central bank and the commercial banks. Foreign-exchange reserves (under the item of funds outstanding for foreign exchange on the balance sheet) and claims on banks constituted the lion's share on the asset side, while the liability side was predominantly made up of debts to banks and cash. Meanwhile, China implemented a normal monetary policy and the RRR played an important role as a standard monetary policy instrument. Thus, a change in the balance sheet has different implications for the PBC and the Fed, respectively.

From 2002 to 2014, the PBC witnessed a rapid increase in funds outstanding for foreign exchange on the liability side and excess reserves on the liability side. Despite a balance-sheet expansion during this period, the PBC raised the RRR to freeze liquidity in the banking system (by reducing excess reserves). As funds available to banks dropped, which imposed liquidity constraints on banks' behavior in creating deposits by loans, the monetary policy stance was then "tightened" (Figure 3). The monetary policy, on balance, was sound as it sterilized the passive increase in funds outstanding for foreign exchange.

Since 2015, growth of PBC balance sheet slowed down significantly alongside substantial structural adjustments. Funds outstanding for foreign exchange decreased rapidly, and the PBC used instruments such as the MLF and the Pledged Supplemental Lending (PSL) to offset a shortfall in subsequent funds. Meanwhile, the PBC reduced the RRR to offset additional payments of required reserves incurred from deposit increases. In fact, the RRR cut did not change the size of the central bank's balance sheet, and it only affected structure on the liability side. But considering the strong policy effect of such a policy, the PBC may reduce repos, conduct MLF operations, and adopt other measures to ensure ample and appropriate liquidity in the banking system. In addition, banks may also reduce their liabilities to the PBC as their operations require, and the central bank's balance sheet may grow at a slower pace or may even contract in size. As a result, the month-on-month contraction of the PBC's balance sheet mostly occurred in the same or the following month of the RRR cut. But in the long run, the RRR cut relaxed liquidity constraints on the banks' behavior in creating deposits by loans, played an offsetting role against the backdrop of a credit tightening, and thus on the whole contributed to the stability of monetary conditions.

Furthermore, the PBC's balance sheet is related to seasonal factors, and tax payments and fiscal expenditures and cash injections and withdrawals all brought about a change in the size of the central bank's balance sheet. Therefore, there is not too much meaning to monitor the size of the PBC's balance sheet at a certain point. From a longer-run perspective, despite some fluctuation in the growth rate of the PBC's balance sheet since 2005, except for the year 2009 to 2010, the growth rate of outstanding loans in China's financial institutions remained basically stable, which also indicated that on the whole China's monetary policy was sound.

II. Lending by financial institutions grew relatively rapidly, whereas lending rates dipped slightly

Lending grew rapidly, providing stronger support for the real economy. At end-September, outstanding loans by financial institutions in domestic and foreign currencies grew 12.0 percent year on year to RMB155.6 trillion, up by RMB13.8 trillion from the beginning of the year and an acceleration of RMB537.2 billion from the corresponding period of the previous year. Outstanding RMB-denominated loans grew 12.5 percent year on year to RMB149.9 trillion, up by RMB13.6 trillion from the beginning of the year and an acceleration of RMB486.7 billion from the first three quarters of 2018.

Monetary policies enhanced support for structural adjustments, and loans to micro and small enterprises (MSEs) increased rapidly. Since 2019**, t**he PBC has continued to encourage financial institutions to enhance their credit support for MSEs, which has yielded good results. Inclusive MSE loans rose by RMB1.8 trillion in the first three quarters of the year, with increments 1.4 times growth in 2018. Outstanding MSE loans at end-September grew by 23.3 percent year on year, up 8.1 percentage points over that in the previous year. Inclusive MSE loans supported 25.69 million micro and small business entities, a year-on-year growth of 31.4 percent. By sectors, growth of RMB loans to the household sector slowed down, registering 15.9 percent at end-September, down 1.2 percentage points from end-June and down 2.3 percentage points from end-2018. In particular, individual mortgage loans grew by

16.8 percent, down 0.5 percentage point from end-June and down 1 percentage point from end-2018. Individual mortgage loans rose by RMB3.3 trillion in the first three quarters of the year. Loans to non-financial enterprises and public entities increased by RMB8.2 trillion from the beginning of the year, an acceleration of RMB1.1 trillion as compared with the previous year. In terms of maturity, growth of medium and long-term loans remained stable, up by RMB8.9 trillion in the first three quarters of the year, an acceleration of RMB188.3 billion from the corresponding period of 2018 and accounting for 65.7 percent of the total new loans.

Table 1 The Structure of RMB Loans in the First Three Quarters of 2019

RMB100 million

	Outstanding amount at end-September	Year-on-year growth	Increase from the beginning of the year	Year-on-year acceleration
RMB loans to:	1499247	12.5%	136268	4867
Households	535666	15.9%	56777	-74
Non-financial enterprises and public entities	950424	11.0%	82168	11024
Non-banking financial institutions	7919	-14.2%	-2841	-5714
Overseas	5238	4.2%	163	-368

Source: The People's Bank of China.

Table 2 New RMB Loans by Financial Institutions in the First Three Quarters of 2019

RMB100 million

	Increase from the beginning of the year	Year-on-year acceleration
Chinese-funded large-sized banks [1]	57895	6076
Chinese-funded small and medium-sized banks [2]	77284	-287

Small-sized rural financial institutions[3]	18248	947
Foreign-funded financial institutions	741	-338

Notes: 1. Chinese-funded large-sized banks refer to banks with assets (in both domestic and foreign currencies) of RMB2 trillion or more (according to the amount of total assets in both domestic and foreign currencies at end-2008).

2. Chinese-funded small and medium-sized banks refer to banks with total assets (both in domestic and foreign currencies) of less than RMB2 trillion (according to the amount of total assets in both domestic and foreign currencies at end-2008).

3. Small-sized rural financial institutions include rural commercial banks, rural cooperative banks, and rural credit cooperatives.

Source: The People's Bank of China.

The weighted average interest rate on loans dipped and the rates on corporate loans continued to fall. In September, the weighted average interest rate on loans stood at 5.62 percent, down 0.04 percentage point from June and down 0.3 percentage point year on year. In particular, the weighted average interest rate on ordinary loans reached 5.96 percent, up 0.02 percentage point from June and down 0.23 percentage point year on year; the weighted average interest rate on bill financing posted 3.33 percent, down 0.31 percentage point from June and down 0.89 percentage point year on year; the weighted average interest rate on individual mortgage loans was 5.55 percent, up 0.02 percentage point from June and down 0.17 percentage point year on year. By reforming and improving the loan prime rate (LPR) mechanism, market-oriented measures to reduce real interest rates on corporate loans have gradually yielded positive results. Thus, the interest rate on corporate loans newly issued in September fell 0.36 percentage point from last year's peak.

After the reform of the LPR formation mechanism, banks adjusted their pricing methods. The lending rates are formed by adding a few basis points to the LPR instead of the previous floating rates based on multiples of the benchmark rate. The statistical methods changed accordingly. In September, the share of loans with rates above, at, or below the LPR registered 83.05, 0.55, and 16.40 percent, respectively. The LPR premium decreased in general compared with that in August.

Table 3 Shares of RMB Lending Rates at Different Levels in the First Three Quarters of 2019

%

Month	LPR-bps	LPR	LPR+bps					
			Subtotal	(LPR, LPR+0.5%)	[LPR+0.5%, LPR+1.5%)	[LPR+1.5%, LPR+3%)	[LPR+3%, LPR+5%)	LPR+5% and above
August	15.55	0.32	84.13	20.26	26.96	16.69	10.46	9.76
September	16.40	0.55	83.05	21.11	26.67	16.25	10.15	8.86

Source: The People's Bank of China.

Looser monetary policies were adopted in the developed economies, such as the United States and Europe, prompting a dip in interest rates on foreign currency deposits and loans. In September, the weighted average interest rates on demand large-value USD-denominated deposits and large-value USD-denominated deposits with maturities within 3 months registered 0.39 percent and 2.25 percent, up 0.07 and down 0.35 percentage points from June respectively. The weighted average interest rates on USD-denominated loans with maturities within 3 months and with maturities between 3 months (including 3 months) and 6 months registered 3.31 percent and 3.04 percent, respectively, down 0.34 percentage points and down 0.32 percentage points from June, respectively.

Table 4 Average Interest Rates of Large-Value USD-denominated Deposits and Loans in the First Three Quarters of 2019

%

Month	Large-value deposits						Loans				
	Demand deposits	Within 3 months	3–6 months (including 3 months)	6–12 months (including 6 months)	1 year	More than 1 year	Within 3 months	36 months (including 3 months)	6–12 months (including 6 months)	1 year	More than 1 year
January	0.42	2.74	3.40	3.64	3.77	3.77	3.94	4.06	3.72	3.99	4.90
February	0.45	2.70	3.29	3.44	3.63	3.53	3.62	3.90	3.58	3.79	4.32
March	0.44	2.67	3.26	3.38	3.39	3.58	3.63	3.59	3.87	3.66	4.65
April	0.46	2.61	3.12	3.28	3.37	3.48	3.73	3.71	3.40	3.68	4.43
May	0.42	2.55	3.13	3.50	3.11	3.33	3.68	3.54	3.34	3.70	4.31
June	0.32	2.60	3.04	2.93	3.04	3.04	3.65	3.36	3.21	3.22	4.38
July	0.35	2.55	2.93	2.78	3.02	2.86	3.59	3.29	3.13	2.94	4.37
August	0.38	2.39	2.78	2.91	2.88	3.46	3.40	3.12	2.82	3.00	4.24
September	0.39	2.25	2.66	2.83	2.64	2.87	3.31	3.04	2.83	3.22	3.76

Source: The People's Bank of China.

The growth of deposits was stable. At end-September, outstanding deposits in domestic and foreign currencies in all financial institutions posted RMB195.9 trillion, up 8.1 percent year on year, which was the same pace as that at-end June, an increase of RMB13.4 trillion from the beginning of the year, rising RMB1.4 trillion more year on year. Outstanding RMB deposits registered RMB190.7 trillion, up 8.3 percent year on year, 0.1 percentage point lower than that at end-June and 0.1 percentage point higher than that at the end of the last year, up by RMB13.2 trillion from the start of the year, an acceleration of RMB1.2 trillion from 2018. Outstanding deposits in foreign currencies stood at USD732.2 billion, up USD4.7 billion from the beginning of the year, an acceleration of USD52.0 billion from the previous year. Term deposits accounted for 90.6 percent of new deposits by households and non-financial enterprises in the first three quarters of 2019, down 18.8 percentage points year on year. In terms of sectors, households and non-financial enterprises registered a year-on-year acceleration of RMB2.9 trillion and RMB920.4 billion respectively, whereas deposits by non-banking financial institutions recorded a year-on-year deceleration of RMB1.8 trillion.

Table 5 The Structure of RMB Deposits in the First Three Quarters of 2019

RMB100 million

	Deposits at end-June	Year-on-year growth	Increase from the beginning of the year	Year-on-year acceleration
RMB deposits:	1907341	8.3%	132174	12083
Households	801298	14.4%	85323	28873
Non-financial enterprises	577652	5.5%	15229	9204
Public entities	307207	5.6%	21763	-5255
Fiscal	48526	-6.3%	7987	-2661
Non-banking financial institutions	161121	1.2%	1228	-17748
Overseas	11538	0.8%	643	-331

Source: People's Bank of China.

III. Money supply and aggregate financing to the real economy increased reasonably

Growth of M2 and aggregate financing to the real economy (AFRE) were basically aligned with or slightly higher than nominal GDP growth, demonstrating an intensified countercyclical adjustment. At end-September, outstanding M2 stood at RMB195.2 trillion, up 8.4 percent year on year, an acceleration of 0.3 percentage point from the end of last year. Moderate growth of money supply bolsters high-quality economic development. Outstanding M1 stood at RMB55.7 trillion, year-on-year growth of 3.4 percent. Outstanding M0 reached RMB7.4 trillion, up 4.0 percent year on year. In the first three quarters of 2019, RMB92.1 billion of net cash was injected into the economy, a rise of RMB31.2 billion year on year.

The AFRE increased moderately. According to preliminary statistics, the outstanding AFRE reached RMB219.04 trillion at end-September, up 10.8 percent year on year, an acceleration of 0.2 percentage point over the same period of the last year. In the first three quarters of 2019, the incremental AFRE reached RMB18.74 trillion, up RMB3.28 trillion year on year. Growth of the AFRE was characterized by the following: First, RMB loans saw a large increase. In the first three quarters, RMB loans by financial institutions to the real economy increased by RMB13.9 trillion, an acceleration of RMB1.1 trillion year on year and accounting for 74.2 percent of the incremental AFRE. Second, the decrease in entrusted loans, trust loans, and undiscounted bankers' acceptances narrowed significantly. Third, corporate debt financing witnessed a significant increase, whereas equity financing saw a year-on-year decrease. Fourth, local government special bonds registered a greater year-on-year growth. Fifth, asset-backed securities by deposit-taking financial institutions recorded a year-on-year deceleration and loan write-offs leveled off as compared with the previous year.

Table 6 The AFRE in the First Three Quarters of 2019

	At end-September 2019		In the first three quarters of 2019	
	Stock (RMB trillion)	Year-on-year change	Flow (RMB trillion)	Year-on-year change (RMB100 million)
The AFRE	219.04	10.8	187378	32775
Of which：RMB loans	148.58	12.7	138962	10975
Foreign currency loans (RMB equivalents)	2.19	-10.6	-811	1102
Entrusted loans	11.73	-8.5	-6454	5138
Trust loans	7.68	-4.1	-1078	3589

Undiscounted bankers' acceptance bills	3.28	-12.7	-5224	1562
Corporate bonds	22.64	13.7	23937	6955
Local government special bonds	9.43	31.4	21658	4704
Domestic equity financing by non-financial enterprises	7.24	4.1	2343	-756
Other financing	6.05	31.3	8067	-1464
Of which：Asset-backed securities by deposit-taking financial institutions	1.46	47.2	1853	-1240
Loan Write-Offs	3.66	38.5	6472	14

Notes: 1. The AFRE (stock) refers to the balance of financing provided by the financial system to the real economy at the end of a certain period of time. The AFRE (flow) refers to the volume of financing provided by the financial system to the real economy during a certain period of time.

2. Since July 2018, the PBC has improved its statistical method for the AFRE and has included "asset-backed securities by deposit-taking financial institutions" and "loan write-offs" in AFRE statistics, under the item of "other financing." Beginning in September 2018, the PBC began to incorporate "local government special bonds" into the AFRE statistics. Local government special bonds are recorded when claims and obligations are registered with custody institutions.

3. Year-on-year statistics in the table are calculated on a comparable basis.

4. Since September 2019, the PBC has further improved the statistics on "corporate bonds" contained in the AFRE by incorporating "asset-backed corporate securities in exchanges" into the item of "corporate bonds."

Sources: People's Bank of China, China Banking and Insurance Regulatory Commission, China Securities Regulatory Commission, China Central Depository & Clearing Co., Ltd., National Association of Financial Market Institutional Investors, etc.

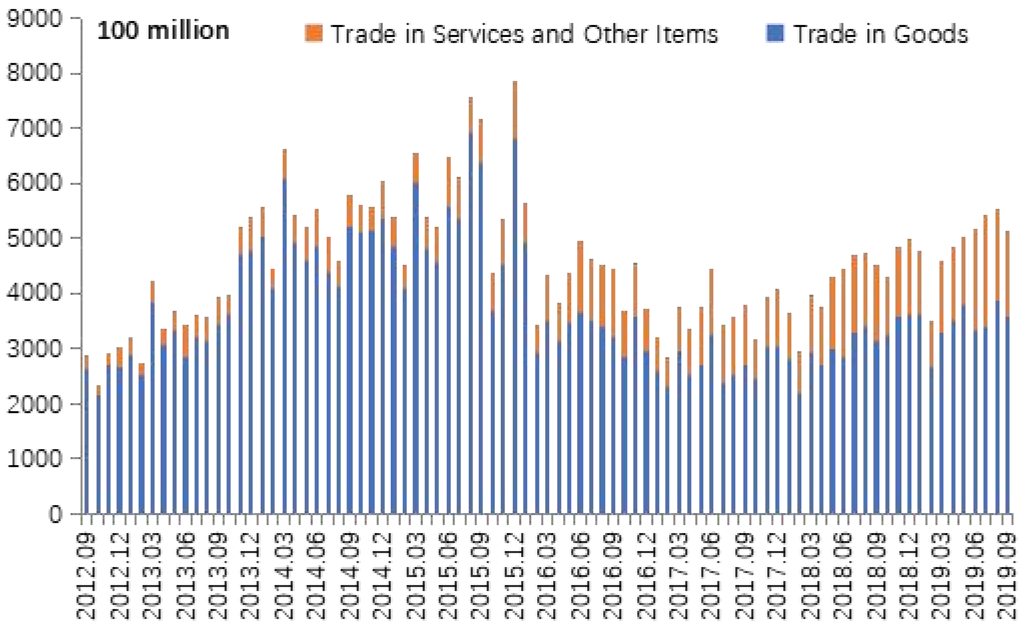
IV. The RMB exchange rate remained basically stable, with generally balanced cross-border capital flows

Cross-border capital flows and foreign exchange supply and demand were basically in equilibrium, and the RMB exchange rate remained basically stable at an adaptive and equilibrium level. Since the beginning of 2019, the foreign exchange market witnessed sound operations with stable market expectations. On August 5, the RMB weakened beyond 7 per USD amid escalating China-US trade tensions, while market expectations remained stable. Beginning in September, the US dollar index went down as the Federal Reserve cut interest rates on two occasions. Moreover, with expectations that China-US trade talks were picking up and market risk preferences were rising, the RMB exchange rate appreciated slightly against the USD and against a basket of currencies. On November 5, the MLF rate was lowered by 5 basis points, shoring up market confidence. Consequently, the offshore and onshore RMB exchange rates against the USD successively exceeded 7. The movement of the RMB exchange rate was characterized by distinct two-way volatility.

In the first three quarters of 2019, the RMB exchange rate devalued slightly wit sustained flexibility. The China Foreign Exchange Trade System (CFETS) RMB exchange rate index and the RMB exchange rate index based on the special drawing rights (SDR) basket depreciated 1.88 percent and 1.59 percent, respectively. According to calculations by the Bank for International Settlements (BIS), the nominal effective exchange rate (NEER) and the real effective exchange rate (REER) of the RMB depreciated by 2.16 percent and 0.92 percent, respectively. The RMB central parity against the USD depreciated 2.96 percent from end-2018 to hit 7.0729 at the end of September. In the first three quarters of 2019, the annualized volatility rate on the central parity of the RMB against the USD stood at 2.98 percent. Foreign investors increased their holdings of domestic bonds and funds through the Shanghai Stock Connect and the Shenzhen Stock Connect, which had a net inflow of about RMB600 billion.

Cross-border RMB transactions continued to grow with generally balanced receipts and payments. In the first three quarters of 2019, cross-border receipts and payments in RMB totaled RMB14.4 trillion, up 20 percent year on year. In particular, RMB receipts and payments registered RMB7.4 trillion and RMB7 trillion, respectively. And RMB cross-border receipts and payments under the current account grew 20 percent over the previous year to RMB4.4 trillion. In particular, settlement of trade in goods registered RMB3.1 trillion, whereas settlement of trade in services and other items registered a cumulative RMB1.3 trillion. RMB cross-border receipts and payments under the capital account posted RMB10 trillion, up 20 percent year on year.

Figure 4 Monthly RMB Payments and Receipts under the Current Account



Source: The People's Bank of China.

Part 2. Monetary Policy Operations

Since the third quarter of 2019, the PBC has implemented a sound monetary policy while following the fundamental requirements for the financial sector to serve the real economy in accordance with the decision-making and arrangements of the CPC Central Committee and the State Council. While strengthening countercyclical adjustments to address the increasing downward pressures on the domestic economy, the PBC intensified the structural adjustments in spite of difficulties and integrated reform with adjustments, short-term with long-term perspectives, and internal with external equilibrium. With the efforts to enhance the effectiveness of adjustments via reform, the PBC cultivated a proper monetary and financial environment for keeping employment, the financial sector, foreign trade, foreign and domestic investment, and expectations stable and for achieving high-quality economic growth.

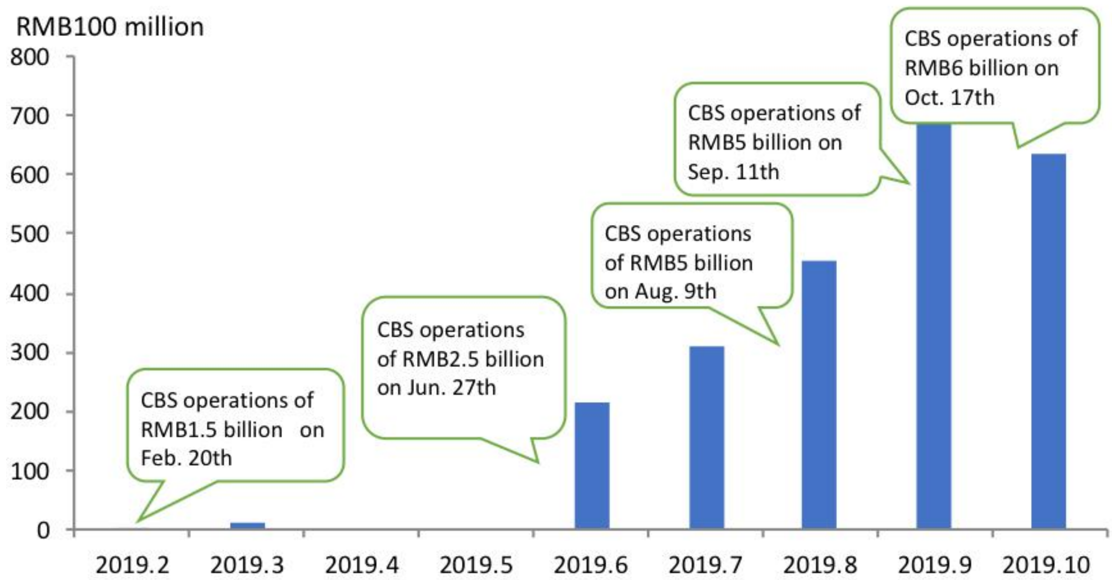
I. Conducting Open Market Operations (OMOs) in a flexible manner

Maintaining reasonable and adequate liquidity in the banking system by making comprehensive use of monetary policy tools to provide short-, medium-, and long-term liquidity. Facing the mounting downward pressures on the domestic economy and the increasing internal and external challenges, the PBC closely monitored the supply-demand changes of liquidity in the banking system. On the basis of satisfying the demand for medium- and long-term liquidity with comprehensive required reserve ratio (RRR) cut, targeted RRR cut, Medium-term Lending Facility (MLF), and other policy tools, the PBC flexibly conducted OMOs, mainly through 7-day repos, to keep aggregate liquidity reasonable and adequate and to offset the influence of short-term factors such as tax payments and government bond purchases. As the end of the third quarter approached, the PBC responded in advance to the increasing fluctuations in the supply and demand of market liquidity caused by seasonal factors such as regulatory assessments and changes in treasury funds. In the middle of September, the PBC timely initiated a 14-day repo and continuously conducted operations to meet the cross-quarter demand for funds in the market, which ensured stable market liquidity before the 70th anniversary of the founding of the People's Republic of China and the end of the quarter, and also created a favorable market environment for small and medium-sized institutions to manage liquidity at the end of the quarter.

Keeping the repo rate stable for OMOs and maintaining smooth movement of money market rates. From the third quarter, against the background of rate cuts by the Federal Reserve and other central banks, the PBC continued to keep the 7-day repo rate stable at 2.55 percent based on the domestic situation, which stabilized market expectations. In the third quarter, the 7-day interbank reverse repo rate (DR007) for depository institutions moved smoothly within a reasonable range, with the average rate standing at 2.59 percent, one basis point lower than that during the same period of the last year. At the end of September, the DR007 was 2.85 percent, 19 basis points lower than that at the end of 2018.

Conducting successive central bank bill swap (CBS) operations. Since the third quarter, the PBC has conducted CBS operations three times, totaling RMB16 billion, with a term of three months and a rate of 0.10 percent at each time. Starting from August, the operation was conducted once a month based on market demand. In terms of practical effects, it has played a positive role in improving liquidity in the secondary market of banks' perpetual bonds, enhancing the willingness of market participants to subscribe to perpetual bonds, and supporting banks to issue perpetual bonds to supplement capital. Liquidity in the secondary market of the banks' perpetual bonds has improved significantly. With the volume of spot bond transactions increasing from less than RMB2 billion in the first quarter to RMB146 billion in the third quarter and the use of the banks' perpetual bonds as collaterals in repurchase transactions continuing to rise in scale, the banks' perpetual bond market has shown a trend of positive development.

Figure 5 Volume of Spot Transactions of Banks' Perpetual Bonds



Source: China Foreign Exchange Trade System.

Issuing central bank bills in Hong Kong on a regular basis. Since the third quarter, the PBC has successfully issued five batches of central bank bills, respectively on August 14, September 26, and November 7 in Hong Kong, totaling RMB70 billion. Among these, there were three-month, six-month, and one-year bills, registering RMB40 billion, RMB10 billion, and RMB20 billion, respectively. In 2019, the PBC successfully issued 11 batches of central bank bills in Hong Kong, totaling RMB140 billion, thereby establishing a regular mechanism for the issuance of central bank bills in the city.

Box 2 Establishing a Regular Mechanism for Issuing RMB-denominated Central Bank Bills in Hong Kong

Since November 2018, the PBC has issued 13 batches of RMB-denominated central bank bills in the offshore market of Hong Kong, totaling RMB160 billion, thereby establishing a regular mechanism for issuing central bank bills in Hong Kong. As of the end of October 2019, the balance of RMB central bank bills in Hong Kong was RMB80 billion.

Open to offshore market investors for bidding, RMB central bank bills are issued through the Central Moneymarkets Unit (CMU) of the Hong Kong Monetary Authority. The terms are mainly three months, six months, and one year, and occasionally one month if necessary. So far, the bills have been issued every 1.5 months, and the volume has been mainly decided by market demand. Since November 2018, the three-month, six-month, and one-year central bank bills issued in Hong Kong by the PBC have reached RMB70 billion, RMB20 billion, and RMB50 billion respectively, and one-month bills totaled RMB20 billion. In the issues so far, the bid amount was over 2 times the issued amount each time, and the subscribers included a variety of international investors, such as commercial banks, funds, central banks, and international financial organizations, which indicated that foreign investors were confident about the RMB and Chinese economy. The issuing scale matched market demand well, and the pricing was basically consistent with market expectations.

As a monetary policy tool suitable for China's national conditions, central bank bills have played an important role during various historical periods. In 2002–2011, against the background of continuous foreign exchange inflows in large amounts, the PBC created and issued central bank bills for draining excess liquidity in addition to adopting RRR and other tools so as to avoid ultra-loose liquidity in the banking system. Featuring regular and short-term issues, the central bank bills are conducive to forming a continuous risk-free yield curve. During its early stage of development, China's bond market was short of short-term instruments, so central bank bills fit in as a short-term liquidity management tool and promoted the development of China's money market and bond market. After 2013, as the foreign exchange situation changed, central bank bills were temporarily withdrawn from the open market operations after completing their historical mission for a certain period.

In recent years, with the continuous improvement in RMB internationalization, changes have taken place in the regulatory monetary policy environment. Since the end of 2018, during the critical period characteristic of increasing uncertainties and long-term impacts from external shocks, central bank bills in the monetary policy toolbox of the PBC have been activated in the offshore market and have played an important role in promoting RMB internationalization. First, they have enriched the high-rating RMB investment products and the RMB liquidity management tools in the Hong Kong market, thereby meeting the demand of international investors for short-term RMB assets of high quality and good liquidity. Second, they have improved the offshore RMB yield curve and provided a benchmark for the issuance and pricing of other offshore RMB bonds, thereby promoting the development of the offshore RMB money market. Third, they have changed the structure of the RMB market, which used to be dominated by the foreign exchange market and promoted better-structured and balanced development of the offshore RMB market.

Next, the PBC will continue to improve the regular mechanism for issuing RMB central bank bills in Hong Kong by reasonably arranging the scale of issues and the varieties of terms according to market demand and motivating other issuers to issue RMB bonds in the offshore market so as to promote the sustainable and sound development of the offshore RMB market. In the future, central bank bills will also play an important role in promoting financial supply-side structural reforms and RMB internationalization.

II. Conducting Standing Lending Facility and Medium-term Lending Facility operations

Standing Lending Facility (SLF) operations were conducted in a timely way to fully meet the demand of locally incorporated financial institutions for short-term liquidity, while the SLF interest rate played the role of a ceiling for the interest rate corridor to facilitate the stable operation of the money market. In the first three quarters of 2019, the PBC conducted SLF operations worth a total of RMB318.2 billion, of which RMB119 billion was from Q3 operations. At end-September, the outstanding SLF stood at RMB60 billion while the overnight, seven-day, and one-month SLF interest rates remained unchanged from the end of the previous quarter at 3.40 percent, 3.55 percent, and 3.90 percent, respectively.

The PBC conducted MLF operations when necessary to guarantee the supply of base money, with the bid-winning MLF interest rate falling slightly. In the first three quarters, MLF operations totaled RMB2.29 trillion, of which RMB1.15 trillion, entirely in one-year maturity, was put into operation in Q3, with the bid-winning interest rate for the last of Q3 operations unchanged from end-Q2 at 3.30 percent. At end-September, the outstanding MLF was at RMB3.167 trillion, a decrease of RMB1.7645 trillion from the beginning of 2019. On November 5, the PBC conducted an operation worth RMB400 billion via its one-year MLF, with the bid-winning interest rate falling 5 basis points from the previous operation to 3.25 percent, which helped push up the risk appetite of the market and boosted confidence. The decline in the bid-winning MLF interest rate, indicating a reduction in the average marginal cost of funds for financial institutions, is conducive to bringing down real lending rates for enterprises and reducing social financing costs.

III. Lowering the RRR for financial institutions

On September 6, the PBC announced a broad RRR cut of 0.5 percentage points for financial institutions (excluding finance companies, financial leasing companies, and auto finance companies). Moreover, an additional RRR cut of 1 percentage point was to be carried out especially for city commercial banks operating solely within provincial-level administrative regions, with the targeted reduction to be phased in successively on October 15 and November 15. This round of RRR cuts has increased the supply of stable long-term funds to commercial banks, freeing up approximately RMB900 billion in long-term funding, with around RMB800 billion and RMB100 billion released by the broad RRR cut and the targeted RRR cut, respectively. At the same time, the cost of funds has been reduced as the interest payment by commercial banks is estimated to be RMB15 billion less annually.

Carrying out targeted RRR cuts for city commercial banks is a major step to improve the RRR framework, which features “three tranches and two preferential treatments” and is aimed at applying relatively low RRRs to small and medium-sized banks. It also constitutes an important part of the financial supply-side structural reform. Previously, uniform RRRs were applied to city commercial banks regardless of whether they were small and medium-sized city commercial banks serving local development or large ones undergoing rapid cross-provincial expansion and having considerable amounts of interbank assets. Consequently, positive incentives were lacking in terms of encouraging and guiding city commercial banks to do their part as locally incorporated financial institutions by focusing on local development and serving the real economy. This round of targeted RRR cuts, which was carried out especially for city commercial banks operating solely within provincial-level administrative regions, has improved the business environment for city commercial banks serving local entities and the real economy in a move to support their locally oriented development as well as their return to fundamentals. For city commercial banks that are eligible for targeted RRR cuts, lending with the freed funds to private enterprises and micro and small enterprises (MSEs) will be subject to the macroprudential assessment (MPA).

IV. Promoting the replenishment of bank capital

Issuing perpetual bonds proved to be remarkably effective to promote the replenishment of bank capital through multiple channels. Bank capital is an important link in the circulation between the financial sector and the real economy. In 2019, credit contraction pressures were quite high in China due to various factors at home and abroad. Given that replenishing capital is an important way to ease the pressures, issuing perpetual bonds became a breakthrough to promote the replenishment of bank capital via multiple channels. With trigger terms for the replenishment of core Tier 1 capital, which may trigger write-downs, perpetual bonds are among the high-quality tools for capital replenishment. In 2019, the PBC resolved the conflict between legal and regulatory requirements for the issuance of perpetual bonds by setting a bank's liquidation date as the maturity date of its perpetual bonds. Through joint efforts by the agencies concerned, tax rules for perpetual bonds were clarified and the scope of perpetual bond investors was expanded. Moreover, the CBS was launched. All these moves contributed to the successful issuance of perpetual bonds and enhanced the ability of banks to provide sustainable support for the real economy. As of end-September 2019, a total of RMB455 billion worth of perpetual bonds had been issued by nine banks, and another 17 banks would be issuing over RMB470 billion of perpetual bonds. As a result, credit contraction has been turned around effectively, and efforts to support the relatively fast growth of bank lending in 2019 have achieved notable success. Judging by the composition of investors in banks' perpetual bonds, investments from asset management products, such as banks' wealth management products, asset management products of funds and securities companies, and trust schemes, have made up more than 80 percent of the total issuance of perpetual bonds. This shows that perpetual bonds not only provide a continuous supply of funds to replenish bank capital but they also meet people's investment needs and broaden the channels for turning savings into long-term investments.

V. Further improving the macroprudential policy framework

The role of the MPA was effectively brought into play to optimize the credit structure and to promote the financial supply-side structural reform. The PBC has resorted to the MPA to support the guiding role of structural monetary policy tools. For city commercial banks that have enjoyed targeted RRR cuts, lending with the freed funds to private enterprises and MSEs will be put under the MPA, which is to be duly implemented no later than end-2019. Starting Q3 2019, application of the Loan Prime Rate (LPR) and the competitive setting of lending rates have been put under the MPA item of pricing conduct assessment. This move is aimed at promoting the use of the LPR among banks and reducing financing costs for the real economy via reform measures.

Work was done to further improve the framework for regulating systemically important financial institutions. In accordance with the requirements of the *Guidelines on Improving the Regulation of Systemically Important Financial Institutions*, the PBC has been working with other agencies concerned to formulate the *Measures for the Assessment of Systemically Important Banks*. Based on their size, interconnectedness, substitutability, and complexity, an indicator system for the assessment of systemically important banks (SIBs) in China is to be established, assessment methodologies and procedures are to be clearly laid out, and a list of SIBs will be released in due course, together with additional regulatory requirements.

Steps were taken to formulate rules for the regulation of financial holding companies. With a view to promoting the regulated development of financial holding companies, preventing financial risks effectively, and better serving the real economy, the PBC released the *Trial Measures for the Supervision and Administration of Financial Holding Companies* (Draft for Comment) to solicit public opinion from July 26 to August 24, 2019. In response to the feedback, work is now underway to make further improvements. In line with macroprudential management concepts and based on consolidated supervision, the *Measures* provide for all-round, sustained, and penetrating regulation over the capital, conduct, and risks of financial holding companies.

VI. Supporting weak links in the economy, such as private firms and MSEs

The PBC actively leveraged central bank lending, central bank discounts, Pledged Supplementary Lending (PSL), and other policy instruments to guide financial institutions to increase support for the weak links in the economy, such

as private firms and MSEs, agriculture, rural areas, and rural residents, as well as for poverty alleviation. First, efforts were made to comprehensively implement and further optimize the pricing mechanism for loans using funds from central bank lending for poverty alleviation. Financial institutions were guided to properly determine the interest rates of loans using funds from central bank lending for poverty alleviation so as to effectively reduce the financing costs in poverty-stricken areas. Second, central bank lending to support special poverty alleviation projects was set up, enabling a number of nationwide banks to increase credit supply in areas of extreme poverty, including three autonomous regions, i.e., Tibet, four prefectures in southern Xinjiang, and the Tibetan areas in four provinces and three autonomous prefectures, i.e., Linxia in Gansu, Liangshan in Sichuan, and Nujiang in Yunnan, in a bid to cut down on the financing costs in these areas and to achieve the goal of targeted poverty alleviation and elimination. A total of RMB7.6 billion of central bank lending in support of special poverty alleviation projects was issued in October. Third, efforts were made to reinforce management of the collateral of central-bank lending and the SLF. Collateral was classified based on its credit rating and liquidity, and differentiated requirements for collateral were specified according to the demands of monetary policy operations in an attempt to effectively safeguard the security of central bank funds. At end-September, outstanding central bank lending to support agriculture, rural areas, and rural residents posted RMB220.7 billion. Outstanding central bank lending for MSEs and poverty alleviation posted RMB263.4 billion and RMB138.7 billion, respectively. Outstanding central-bank discounts stood at RMB442.7 billion. In the first three quarters of 2019, the PBC provided RMB137.5 billion of net PSLs to policy banks and development banks, of which RMB3.9 billion was provided in the third quarter, with the outstanding volume at end-September reaching RMB3.517 trillion.

The Targeted Medium-term Lending Facility (TMLF) was conducted on a quarterly basis. The TMLF provided a stable and long-term financing source for financial institutions to expand credit supply to private firms and MSEs at preferential interest rates. In January, April, and July 2019, the PBC conducted three one-year TMLF operations, with the same interest rate of 3.15 percent and volumes of RMB257.5 billion, RMB267.4 billion, and RMB297.7 billion, respectively. Upon maturity, the facility can be renewed twice based on the demands of financial institutions. At the end of September, the total outstanding balance stood at RMB822.6 billion.

VII. Leveraging the structural guidance role of credit policies

The PBC stepped up efforts to promote the integration of supply-side structural reforms and structural adjustments of credit policies in order to reinforce structural adjustments and to channel financial resources into the key sectors and weak links in economic and social development.

First, financial services were provided to deepen targeted poverty alleviation. A credit surveillance and reporting mechanism in extremely poor areas was set up, and the coverage of fundamental financial services in these areas was broadened. Financial institutions were encouraged to intensify efforts to cultivate credit growth drivers centered on poverty alleviation work, i.e., to ensure that people in poverty-stricken areas need not to worry about food or clothing and they can enjoy compulsory education, basic medical care, as well as safe housing, and to promote poverty-reducing industries.

Second, financial services were enhanced to support rural revitalization. Centered on property-rights reform in rural areas, the PBC explored financing collateralized by shares of collective assets and the right to use state-owned farmland from agricultural reclamation in line with the laws and regulations. Moreover, the PBC also researched an effective mode to comprehensively promote collateralized loans against operational rights for contracted farmland.

Third, financial services were reinforced to support MSEs. The PBC held a work conference to discuss the structural adjustments of credit with banking institutions and to guide financial institutions to lend with willingness, bravery, capacity. and expertise. Financial institutions were backed up to issue financial bonds to support MSEs. A cumulative total of RMB150.8 billion of financial bonds to support MSEs was issued in the first three quarters and all the funds raised were used to grant loans to MSEs.

Fourth, the PBC effectively supported employment and business start-ups through financial assistance. Banking institutions were encouraged to enhance the credit supply to support start-up businesses of women and migrant workers returning to their hometowns. The PBC also implemented relevant policies, such as raising the secured loan quotas for start-up businesses and supporting social groups including veterans and college graduates to start their own businesses or to secure job opportunities.

Furthermore, the PBC continued to improve financial services for the manufacturing industry and the modern service industry, made efforts to provide better financial services for national strategies, and strengthened financial support for the key sectors and weak links in the economy.

VIII. Deepening the market-oriented interest rate reform

The PBC reformed and improved the formation mechanism of the LPR and actively promoted its application.

First, efforts were made to reform and improve the LPR formation mechanism. On August 17, the PBC issued an announcement on reforming and improving the LPR formation mechanism (see Box 3). The PBC announcement on August 25 stipulated that starting from October 8, new individual commercial housing loans were to be priced by adding a few basis points to the LPR.

Second, the PBC also worked to improve the LPR quoting mechanism. The LPR quoting banks are required to provide quotes of the average lending rates of their prime clients based on their own quoting models, and the PBC will regularly examine and appraise the scientific basis and authenticity of their quotes.

Third, the PBC actively promoted application of the LPR. The PBC prompted banking institutions to use the LPR as the pricing reference for new loans as soon as possible. The banks' concerted practices to set an implicit interest rate floor for loans were resolutely banned. Moreover, application of the LPR was incorporated into the MPA and the self-discipline mechanism. The deepening of the market-oriented interest rate reform and the launch of the new LPR formation mechanism will contribute to improving the monetary policy transmission mechanism, enhancing the efficiency of resource allocations in the market, and cutting down on the financing costs of businesses. **With the effects of the LPR reform further realized, the efficiency of the transmission from market interest rates to lending rates is expected to rise, lowering the lending rates of enterprises.**

Box 3 Reforming and Improving the Loan Prime Rate (LPR) Formation Mechanism

In line with the strategies and arrangements of the State Council, on August 17, 2019 the PBC released an announcement on reforming and improving the LPR formation mechanism to advance the market-oriented reform of interest rates on loans. Significant progress has been made in the market-oriented interest-rate reform.

The reform measures on improving the LPR formation mechanism are characterized by the six "news." The first is the new quoting rules. Quoting banks are required to make quotes of the lending rates applied to their own prime clients on an authentic basis, reflecting a market-based quoting price formation mechanism. **The second is the new formation mechanism.** The LPR is calculated by adding a few basis points to the interest rate of open market operations, which mainly refers to the rate of the MLF. The LPR quotes are notably more market-oriented and flexible. **The third is the new maturity.** In addition to the current one-year LPR, the LPR with a maturity of over five years will also be made available in the market, serving as the pricing reference for long-term lending by banks such as mortgage loans. **The fourth is new quoting banks.** Quoting banks are expanded from the original ten nationwide banks to eighteen banks, incorporating an additional two city commercial banks, two rural commercial banks, two foreign-funded banks, and two private banks. The representativeness of the LPR is thus effectively improved. **The fifth is the new quoting frequency.** The LPR quoting banks shall submit their quotes on a monthly basis instead of on a daily basis so as to encourage banks to place a priority on the practice of quotes and to improve the quality of quotes. **The sixth is new requirements for LPR applications.** The PBC will prompt banking institutions to use the LPR as the main pricing reference for new loans as soon as possible. The banks' concerted practice to set an implicit interest-rate floor for loans is resolutely banned. Moreover, application of the LPR is incorporated into the MPA and the self-discipline mechanism.

From August 20, when the new LPR made its debut, to October 21, when the new LPR was published for the third time, one-year and five-year LPRs fell by 15 and 5 bps as compared with the benchmark lending rates with corresponding maturities, respectively. Meanwhile, the PBC urges financial institutions to use the LPR in setting prices, promoting the LPR as the main price-making benchmark for lending by financial institutions. In general, phased achievements have been made in reforming and improving the LPR formation mechanism. New bank loans using the LPR in price-setting accounted for 46.8 percent in September, most of which was corporate lending. With the effects of the LPR reform further realized, the efficiency of the transmission from market interest rates to lending rates is expected to rise, pushing down the lending rates of enterprises. The new corporate lending rate in September was 0.36 percentage point lower compared with the annual high in 2018, reflecting the preliminary policy effects of reducing the real lending rates by the market-based reform measures.

Going forward, the PBC will continue to improve the LPR quotations and applications, guide and prompt financial institutions to set reasonable prices, remove the implicit interest rate floor for loans, improve the transmission from market interest rates to lending rates, and step up efforts to explore the scheme for replacing the pricing benchmark of existing bank loans with the LPR. In the meanwhile, the PBC will also make efforts to safeguard the competitive order of the deposit market and to keep the costs of banks' liabilities at a basically stable level.

IX. Improving the market-oriented RMB exchange rate regime

The PBC has placed priority on the domestic side while appropriately balancing the internal equilibrium and the external equilibrium. With reference to the foreign-exchange rates of a basket of currencies, the RMB exchange rate floated both upward and downward on the basis of market supply and demand and remained basically stable at a reasonable and equilibrium level. The foreign-exchange market has been generally stable with a more market-based RMB exchange rate. In the third quarter, the highest and lowest central parities of the RMB against the USD were RMB6.8513 and RMB7.0884 per USD, respectively. During the 65 trading days, the RMB appreciated on 25 days and depreciated on 40 days. The biggest intra-day appreciation and depreciation was 0.30 percent (203 bps) and 0.66 percent (458 bps), respectively. The RMB exchange rate against other major international currencies floated two-ways with both appreciations and depreciations. At the end of September, the central parities of the RMB against the euro and the Japanese yen stood at RMB7.7538 per euro and RMB6.5699 per 100 yen, representing an appreciation of 1.21 percent and a depreciation of 5.80 percent, respectively, from end-2018. From the RMB exchange-rate regime reform in 2005 to end-September 2019, the RMB appreciated by a cumulative 29.15 percent against the euro and 11.20 percent against the yen. Direct RMB trading was buoyant on the interbank foreign-exchange market with an increase in liquidity, which lowered the conversion costs for market participants and facilitated bilateral trade and investment.

Table 7 Trading Volume of the RMB Against Other Currencies in the Interbank Foreign Exchange Spot Market in Q3 2019

RMB100 million

Currency	USD	EUR	JPY	HKD	GBP	AUD	NZD
Trading volume	133722.60	4300.39	937.32	452.63	356.41	117.33	31.22
Currency	SGD	CHF	CAD	MYR	RUB	ZAR	KRW
Trading volume	306.65	13.40	56.99	10.12	23.85	0	21.07
Currency	AED	SAR	HUF	PLN	DKK	SEK	NOK
Trading volume	2.85	9.95	0	0	1.66	6.58	0.75
Currency	TRY	MXN	THB	KHR	KZT	VND	MNT
Trading volume	0	0	62.10	0	0.003	0.016	0

Source: China Foreign Exchange Trade System.

At end-September, under the bilateral currency-swap agreements between the PBC and foreign monetary authorities, the latter utilized a total of RMB33.007 billion and the former utilized the equivalent of USD329 million of foreign currencies. These operations played a positive role in promoting bilateral trade and investment.

X. Advancing the risk resolution of the Baoshang Bank in a prudent and orderly manner and deepening the reforms of financial institutions

The risk resolution of the Baoshang Bank was promoted to the target in a prudent and orderly manner, which forestalled and mitigated financial risks. Because of the significant credit risks of the Baoshang Bank, the PBC and the CBIRC, in accordance with the laws, decisively took over the Baoshang Bank on May 24 in a bid to protect the legitimate rights and interests of depositors and other clients. Under the joint efforts of the relevant parties, the takeover has advanced smoothly, with the successful completion of acquisitions and transfers of large-value debts at the first stage and asset liquidation and capital verification at the second stage. Based on the achievements of the two stages, market-oriented reforms and restructuring are being pushed ahead during the third stage. The business of the Baoshang Bank has been operating normally, and there have been no bank runs or other mass incidents. In general, the decisive takeover contained the risks and discouraged financial irregularities. The risk resolution of the Baoshang Bank by means of an acquisition and takeover not only ensured maximum protection of the legitimate rights and interests of its clients but also put an end to the practice of de facto guaranteed repayments in line with the laws and regulations, which corrected the radical behavior of some institutions so as to enhance market discipline and to foster reasonable stratification of credit in the financial market.

Meanwhile, the PBC injected liquidity into the market by a variety of means in a decisive manner and set up “four defense lines” to prevent liquidity risks of small and medium-sized banks. The PBC’s monetary policy operations stabilized market confidence in a timely manner and prevented the risk of contagion from the Baoshang Bank to other small and medium-sized banks, which play an important role in the stable operation of financial markets where money-market instruments, drafts, and bonds are traded. Looking forward, the PBC, jointly with other relevant authorities, will further improve the reform and restructuring plan of the Baoshang Bank and promote these tasks in a proactive manner. At the same time, efforts will be stepped up to strengthen weaknesses in the regulatory systems, enhance shareholder management and corporate governance in small- and medium-sized banks, and foster their healthy development.

Reform plans for development and policy-oriented financial institutions have been comprehensively implemented. The PBC, together with members of the reform working group, orderly advanced reform measures, such as establishing a board of management system, improving the governance structure, and refining the scope of business. As of now, new boards of directors of the China Development Bank, the Export-Import Bank of China, and the Agricultural Development Bank of China have been established and are functioning effectively. The PBC will continue to encourage these three banks to clarify their functions and to improve their risk management and control so as to better serve the national strategies.

XI. Deepening the reforms of foreign exchange administration

The foreign-exchange administration has served the real economy. First, a pilot program for facilitating foreign exchange receipts and payments for trade in goods was steadily carried out to provide conveniences for compliant enterprises. **Second,** electronic filing for taxation has further expanded its coverage, effectively facilitating foreign-exchange payments for enterprises. **Third,** the operations and management of cross-border funds of multinational companies were more centralized so as to facilitate trade, investments, and financing.

Reforms in key areas of foreign exchange administration were deepened. First, the investment limit for qualified foreign institutional investors (QFII/RQFII) was removed, and the *Notice on Issues Concerning Further Facilitating Investments by Overseas Institutional Investors in the Interbank Bond Market* was formulated to facilitate RMB asset allocations for these investors. **Second**, the *Guidelines for a Statistical Declaration of the Balance of Payments (BOP) by Banks (2019)* were revised and released, further improving the BOP statistical declaration system. **Third**, the *Statistical System for Foreign Exchange Settlements of Banks* was revised and published, aiming to standardize statistics related to the settlement of foreign exchange.

Supervision of the foreign exchange market was strengthened. Multiple agencies jointly cracked down on underground banks and their counterparties, strengthened cross-border regulatory cooperation, and prudently disposed of illegal online foreign exchange trading platforms in a bid to severely crack down on violations of the foreign exchange laws and regulations.

Part 3. Financial Market Conditions

In Q3 2019, the financial market generally operated smoothly. Money market interest rates remained at a low level but transactions continued to grow. The coupon rates of financial bonds and corporate debenture bonds declined, and the volume of cash bond issuances and transactions increased. Stock market indices fluctuated with an increasing turnover. The growth of premium income in the insurance sector picked up and asset growth in the insurance sector accelerated.

I. Financial market overview

1. Money market interest rates remained at a low level and market transactions were active

Liquidity in the banking system was at an ample and appropriate level, and money market interest rates remained at a low level. In September, the monthly weighted average interest rate of interbank lending and pledged repos posted 2.55 percent and 2.56 percent, respectively. The monthly weighted average interest rate of government-backed bond repos among deposit-taking institutions posted 2.45 percent, overall 11 basis points lower than that of pledged repos. The Shibor saw a short-term increase and is expected to remain stable in the medium and long term. At end-September, the overnight and 7-day Shibor posted 2.64 percent and 2.84 percent, respectively. The 3-month and 1-year Shibor posted 2.73 percent and 3.05 percent, respectively.

The market saw active repo transactions and interbank lending, which exhibited a decline in lending growth by large and medium-sized banks and a rapid increase in borrowing by insurance companies. In the first three quarters of 2019, the cumulative trading volume of bond repos on the interbank market reached RMB614 trillion, representing an average daily turnover of RMB3.3 trillion and a year-on-year increase of 16.2 percent. The cumulative trading volume of interbank lending reached RMB119.7 trillion, with an average daily turnover of RMB636.5 billion and a year-on-year increase of 18.7 percent. In terms of the maturity structure, overnight repos and overnight lending accounted for 85.2 percent and 91.7 percent, respectively, of the total turnovers in bond repos and interbank lending, increasing 4.4 percentage points and 1.8 percentage points year on year. The volume of bond repos traded on the exchange markets increased 2.6 percent year on year to RMB179.8 trillion. In terms of the market composition of the fund flows, Chinese-funded large and medium-sized banks were net lenders, with a decreased volume of year-on-year net lending. Other financial institutions and vehicles as well as securities companies were net borrowers, with net borrowing of RMB200.8 trillion, accounting for 85.7 percent of overall net borrowing. Net borrowing by insurance companies grew rapidly.

Table 8 Fund Flows among Financial Institutions, Q1-Q3 2019

RMB100 million

	Repos		Interbank lending	
	Q1–3 2019	Q1–3 2018	Q1–3 2019	Q1–3 2018
Chinese-funded large banks①	–1,459,948	–1,216,825	–219,620	–214,156
Chinese-funded medium-sized banks②	–557,039	–716,120	–106,491	–112,352
Chinese-funded small-sized banks③	138,117	381,610	82,008	140,885
Securities institutions④	633,339	498,260	195,045	143,819
Insurance institutions⑤	61,983	48,317	189	634
Foreign-funded banks	70,940	54,274	-17,989	-5,865
Other financial institutions and vehicles⑥	1,112,608	950,484	66,859	47,035

Notes：①Chinese-funded large banks include the Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, China Construction Bank, China Development Bank, Bank of Communications, and Postal Savings Bank of China.

②Chinese-funded medium-sized banks refer to policy banks, the China Merchants Bank and the eight other joint-equity commercial banks, the Bank of Beijing, Bank of Shanghai, and Bank of Jiangsu.

③Chinese-funded small-sized banks refer to Hengfeng Bank, China Zheshang Bank, China Bohai Bank, other city commercial banks, rural commercial banks, rural cooperative banks, private banks, and village and township banks.

④Securities institutions include securities firms and fund-management and futures companies.

⑤Insurance institutions include insurance firms and corporate annuities.

⑥Other financial institutions and vehicles include urban credit cooperatives, rural credit cooperatives, finance companies, trust and investment companies, financial leasing companies, asset management companies, social security funds, mutual funds, wealth management products, trust plans, and other investment vehicles. Some of these financial institutions and vehicles do not participate in the interbank lending market.

⑦A negative sign indicates net lending and a positive sign indicates net borrowing.

Source: China Foreign Exchange Trade System.

The interbank CD and negotiable CD businesses witnessed orderly development. In Q3 2019, a total of 7,275 interbank CDs were issued on the interbank market, raising RMB4.55 trillion. Trading volume on the secondary market totaled RMB33.58 trillion. By end-September, outstanding interbank CDs reached RMB10.10 trillion. In Q3, the average weighted interest rate of 3-month interbank CDs was 2.86 percent, 19 basis points higher than that of the 3-month Shibor. A total of 12,476 negotiable CDs were issued by financial institutions, raising RMB2.59 trillion and with a gain of RMB202 billion year on year. The orderly issuance of negotiable CDs further extended the market-based pricing range of financial institutions' debt-based products. In this way, financial institutions' capability for independent pricing was enhanced and the formation and transmission mechanism of the market-based interest rate was improved.

Interest rate swaps were active. In Q3 2019, the RMB interest rate swap market witnessed 62,900 transactions, increasing 26 percent year on year, with the volume of the notional principal totaling RMB5.03 trillion, an increase of 0.58 percent year on year. In terms of the maturity structure, contracts with maturities of up to one year traded most briskly and the volume of the notional principal posted RMB3.28 trillion, accounting for 65.2 percent of the principal of all maturities. The 7-day fixing repo rate and the Shibor served as the reference rates for the floating leg of the RMB interest rate swaps, accounting for 70.7 percent and 27.8 percent, respectively, of the total notional principal of the interest rate swaps.

Table 9 Transactions of Interest Rate Swaps, Q1-Q3 2019

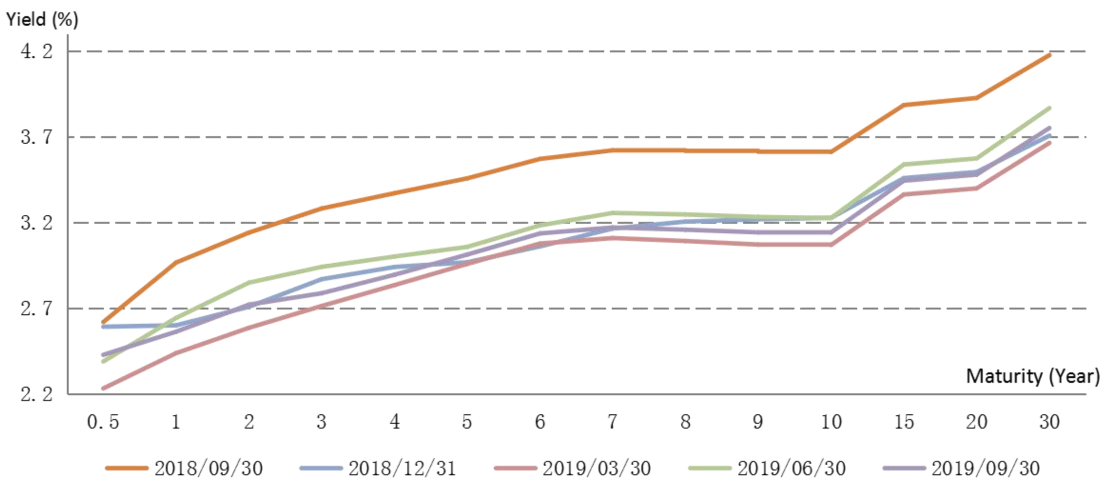
	Transactions	Notional principal (RMB100 million)
Q1-Q3 2019	62,876	50,304.7
Q1-Q3 2018	49,885	50,016.0

Source: China Foreign Exchange Trade System.

2. The coupon rate of corporate debenture bonds declined, and transactions and the issuance of cash bonds expanded

The government bond yield curve moved downward. In the first three quarters of 2019, government bond yields of all maturities generally decreased. At end-September, the yields of 1-year, 3-year, 5-year, 7-year, and 10-year government bonds posted 2.56 percent, 2.79 percent, 3.01 percent, 3.17 percent, and 3.14 percent respectively, decreasing 8 basis points, 15 basis points, 5 basis points, 9 basis points, and 9 basis points, respectively, from end-June. The spread between 1-year and 10-year government bonds was 58 basis points, the same as that at end-June. The ChinaBond Composite Net Price Index, the ChinaBond Composite Full Price Index, and the Shanghai Securities Exchange Government Bond Index posted 102.23, 119.62, and 175.53 at end-September, recording an increase of 0.41 percent, 0.44 percent, and 1.28 percent respectively.

Figure 6 Yield Curves of Government Securities on the Interbank Market



Source: China Central Depository & Clearing Co., Ltd.

In general, the coupon rates of government bonds remained stable; the coupon rates of corporate debenture bonds and financial bonds issued by the China Development Bank fell. The coupon rate of 10-year government bonds issued in September was 3.29 percent, unchanged from the rate in June. The coupon rate of 10-year financial bonds issued by the China Development Bank was 3.43 percent, 16 basis point lower than the rate in June. The average rate of 6-month short-term financing bills issued by AAA-rated enterprises was 2.43 percent, 50 basis points lower than the same rate in June. The average coupon rate of 5-year medium-term notes was 4.27 percent, dropping 35 basis points from June.

The volume of cash bond transactions increased rapidly. In the first three quarters of 2019, the cumulative volume of cash bond trading on the interbank market posted RMB153.2 trillion, representing an average daily turnover of RMB814.7 billion and an increase of 51 percent year on year. In terms of trading participants, Chinese-funded small and medium-sized banks and securities institutions were net bond sellers, with net sales totaling RMB7.1 trillion, while other financial institutions and vehicles were net bond buyers, with net purchases totaling RMB6.9 trillion. Chinese-funded large banks shifted from net buyers in H1 2019 to net sellers, with net sales totaling RMB40.5 billion in Q1–Q3. In terms of products, RMB28.9 trillion of central and local government bonds were traded, accounting for 18.9 percent of the total cash bond transactions on the interbank market. Spot trading of financial bonds and corporate debenture bonds accumulated RMB108 trillion and RMB16.3 trillion, respectively, accounting for 70.5 percent and 10.6 percent, respectively. The volume of cash bond transactions on the stock exchanges totaled RMB6.1 trillion, registering an increase of 32.5 percent year on year.

Year-on-year growth in the volume of bond issuances accelerated. In the first three quarters of 2019, a total of RMB33.9 trillion of bonds was issued with a year-on-year increase of RMB1.3 trillion. The issuance of debt-financing instruments by non-financial enterprises and corporate bonds experienced a considerable increase. At end-September, the total volume of all types of outstanding bonds posted RMB95.7 trillion, with an increase of 15.1 percent year on year.

Table 10 Bond Issuances, Q1-Q3 2019

RMB100 million

Type of bond	Issuances	Year-on-year change
Government securities	29,787	3,402

Local government bonds	41,822	3,828
Central bank bills	0	0
Financial bonds①	190,351	-13,334
Of which: Financial bonds issued by the China Development Bank and policy financial bonds	28,910	2,134
Interbank certificates of deposit	129,506	-28,844
Corporate debenture bonds②	77,126	19,007
Of which: Debt-financing instruments of non-financial enterprises	50,251	8,992
Enterprise bonds	3,606	-155
Corporate bonds	16,781	7,484
Bonds issued by international institutions	330	-218
Total	339,417	12,686

Notes: ① Including financial bonds issued by the China Development Bank, policy financial bonds, bonds issued by commercial banks (including ordinary bonds, subordinated bonds, and hybrid bonds), bonds issued by securities firms, and interbank certificates of deposit.

② Including debt-financing instruments issued by non-financial enterprises, enterprise bonds, corporate bonds, convertible bonds, bonds with detachable warrants, privately placed MSE bonds, and asset-backed securities on the Shanghai Stock Exchange and the Shenzhen Stock Exchange issued by non-financial enterprises.

Sources: People's Bank of China, China Securities Regulatory Commission, and China Central Depository & Clearing Co., Ltd.

3. Bill financing rose rapidly and interest rates fluctuated within a narrow range

The bill acceptance business witnessed rapid growth. In the first three quarters of 2019, commercial drafts issued by enterprises totaled RMB15 trillion, rising 14.4 percent year on year. At end-September, outstanding commercial drafts stood at RMB12.4 trillion, increasing 24.3 percent year on year. Outstanding commercial draft acceptances continued to expand rapidly by RMB1.4 trillion from the beginning of the year and by RMB129 billion from end-June. In terms of the sectoral structure, outstanding bankers' acceptances were concentrated in the manufacturing, wholesale, and retail sectors. In terms of issuers, 70.1 percent of the outstanding bankers' acceptances were issued by medium and small enterprises.

Bill financing expanded rapidly, while interest rates in the bill market dropped slightly. In the first three quarters of 2019, total discounts by financial institutions amounted to RMB27.0 trillion, growing 35.2 percent year on year. At end-September, bills outstanding rose 47.2 percent year on year to RMB7.5 trillion, accounting for 5.0 percent of total outstanding loans, which was 1.2 percentage points higher than the figure in the previous year. Bill financing continued its upward trend, increasing by RMB1.7272 trillion during the first three quarters of 2019 and by RMB546.4 billion during Q3. Liquidity in the banking system was ample and appropriate, and interest rates in the bill market dropped slightly in the third quarter.

4. Stock indices fluctuated with increased trading volume

Stock indices fluctuated. At end-September, the Shanghai Stock Exchange Composite Index closed at 2,905 points, falling 2.5 percent from end-June. The Shenzhen Stock Exchange Component Index closed at 9,446 points, rising 2.9 percent from end-June. The ChiNext Index closed at 1,628 points, increasing 7.7 percent from end-June. In end-September, the weighted average P/E ratio of A-shares on the Shanghai Stock Exchange was 13.8, the same as that at end-June. The weighted average P/E ratio of A-shares on the Shenzhen Stock Exchange rose from 23.5 at end-June to 24 at end-September.

Turnover on the stock markets increased significantly. During the first three quarters, the combined turnover of the Shanghai and Shenzhen Stock Exchanges reached RMB99.9 trillion and the average daily turnover was RMB546 billion, with an increase of 39.2 percent year on year. Turnover on the ChiNext totaled RMB17.3 trillion, with an increase of 35.7 percent year on year. At end-September, the combined market capitalization of the Shanghai and Shenzhen Exchanges posted RMB44.5 trillion, with an increase of 12.5 percent year on year. The market capitalization of tradable shares on the ChiNext posted RMB3.5 trillion, an increase of 30.5 percent year on year.

The size of financing dropped year on year. In the first three quarters, domestic enterprises and financial institutions raised a total of RMB491.4 billion by way of IPOs, additional offerings, rights issues, and warrant exercises on the domestic and overseas stock markets, registering a decrease of 16.6 percent year on year. Among this total, RMB450.2 billion was raised on the A-share market, decreasing 8.5 percent year on year.

5. Growth of premium income in the insurance sector picked up with higher asset growth rate

In the first three quarters, total premium income in the insurance sector amounted to RMB3.5 trillion, with a year-on-year increase of 12.6 percent, 14.1 percentage points higher than the growth rate in 2018. Claim and benefit payments totaled RMB941.1 billion, with a year-on-year increase of 3.1 percent. Specifically, total property insurance claim and benefit payments increased 9.4 percent year on year, while total life insurance claim and benefit payments fell 2.2 percent year on year.

Table 11 Asset Allocations in the Insurance Sector at End-September 2019

RMB100 million, %

	Outstanding value		As a share of total assets	
	End-September 2019	End-September 2018	End-September 2019	End-September 2018
Total assets	199,601	178,754	100.0	100.0
Of which: Bank deposits	25,213	22,850	12.6	12.8
Investments	152,558	135,889	76.4	76.0

Source: China Banking and Insurance Regulatory Commission.

Growth of insurance assets accelerated. At end-September, total assets in the insurance industry increased 11.7 percent year on year to RMB20 trillion, an acceleration of 2.3 percentage points from end-2018. Among this total, outstanding bank deposits increased 10.3 percent year on year and investment-linked assets increased 12.3 percent year on year.

6. Swap transactions on the foreign exchange market saw rapid growth

In the first three quarters of 2019, turnover of spot RMB/foreign exchange transactions totaled USD6 trillion, an increase of 13.3 percent year on year. Turnover of RMB/foreign exchange swap transactions totaled USD12.8 trillion, an increase of 12 percent year on year. Specifically, overnight RMB/USD swap transactions posted USD7.4 trillion, accounting for 57.7 percent of total swap turnovers. Turnovers on the RMB/foreign exchange forward market totaled USD59.5 billion, dropping 12 percent year on year. Turnovers of foreign currency pair transactions totaled USD340.6 billion, rising 136 percent year on year. In particular, the EUR/USD pair registered the largest trading volume, accounting for 60.3 percent of the total market shares.

Participants on the foreign exchange market expanded further. At end-September, there were 701 members on the foreign exchange spot market, 240 members on the foreign exchange forward market, 235 members on the foreign exchange swap market, 194 members on the currency-swap market, and 142 members on the foreign exchange options market. There were 32 market makers on the spot market and 27 market makers on the forward and swap markets.

7. Gold prices rose quarter on quarter, with the trading volume growing steadily

Gold prices moved up and then down, with an increase from end-June. In Q3 2019, the international gold price peaked at USD1,546.1 per ounce and hit a trough of USD1,387.9 per ounce, closing at USD1,485.3 per ounce at end-September, representing a gain of 5.42 percent from end-June. The peak and trough prices of gold (AU9999) on the Shanghai Gold Exchange were RMB369.24 per gram and RMB306.20 per gram, respectively. At end-September, the AU9999 closed at RMB344.49 per gram, increasing 9.56 percent from end-June.

Trading volume on the Shanghai Gold Exchange grew steadily. In the first three quarters of 2019, the cumulative volume of gold trading on the Shanghai Gold Exchange was 54,900 tons, representing a gain of 10.71 percent year on year and the turnover posted RMB16.91 trillion, increasing 26.40 percent year on year.

II. Development of institutional arrangements in the financial markets

1. Strengthening market arrangements for the securities industry and improving the financial services provided to private enterprises

Officially launching the Science and Technology Innovation Board and releasing detailed transaction rules and regulations. The debut of the Science and

Technology Innovation Board saw the listing of 25 companies on the Shanghai Stock Exchange (SSE) on July 22. The China Securities Regulatory Commission (CSRC), together with the NDRC, the PBC, and other departments, issued the *Opinions on Strengthening the Sharing of Regulatory Information on Relevant Market Participants and Improving the Joint Punishment Mechanism for Dishonesty in the Pilot Program of the Registration System on the STAR Market.* The Opinions clarified the punishments for dishonesty in the pilot registration-based IPO system and improved the working mechanisms, such as inter-departmental regulatory information inquiries and default information-sharing, so as to strengthen the creditworthiness of information disclosures by issuers and listed companies.

Diversifying the spectrum of participants in cash bonds transactions on the stock exchanges and allowing more issuers to issue convertible bonds on the stock exchanges. In August, the CBIRC, the PBC, and the CSRC jointly issued the *Notice on Relevant Issues Concerning Banks' Participation in Bond Trading on the Stock Exchanges*. The Notice expanded the scope of participants in bond trading on the stock exchanges and allowed more banks to conduct bond transactions on the stock exchanges, including the policy banks and the China Development Bank, large state-owned commercial banks, joint-stock commercial banks, city commercial banks, foreign banks in China, and other domestic listed banks. Under the guidance of the CSRC, self-disciplinary organizations, including the stock exchanges, issued the *Measures for Implementation of Non-Public Offerings of Convertible Corporate Bonds by Non-Listed Companies*. The Measures enable non-listed companies to issue convertible corporate bonds, thus further broadening the financing channels for private enterprises.

Encouraging commercial banks to issue financial bonds for innovation and entrepreneurship. On August 2019, the PBC, together with the CBIRC, issued the *Opinions on Supporting Commercial Banks to Issue Financial Bonds for Innovation and Entrepreneurship.* The Opinions encouraged commercial banks to issue financial bonds for innovation and entrepreneurship and to increase the credit supply in the innovative and entrepreneurial sector so as to tap the creative potential of various innovative entities and to support the adjustment of the economic structure and industrial upgrading.

2. Improving institutional arrangements in the insurance market

Strengthening asset-liability management and forestalling the risks of a matching

imbalance. On July 24, the CBIRC issued the *Interim Measures for the Administration and Supervision of Insurance Assets and Liabilities*. The Interim Measures require insurance companies to assume primary responsibility for asset-liability management, to build up and enhance the asset-liability management system, and to constantly improve the management of assets and liabilities.

Further standardizing the insurance agency business of commercial banks. On August 23, the CBIRC issued the *Measures for the Administration of the Insurance Agency Business of Commercial Banks*. The Measures standardize the insurance agency business of commercial banks with respect to business access, business plan, business exit, supervision, regulation, and so forth, thus building up a system at the regulatory level that unifies the entire process of the insurance agency business of commercial banks.

Reinforcing connected transactions management. On August 25, the CBIRC promulgated the *Measures for the Administration of Connected Transactions of Insurance Companies*. The Measures clarify the principle of strict and penetrating regulation, aiming to build a censorship and reporting system that covers the entire process. The connected transactions and the use of large value funds in companies with unsound corporate governance will be placed under special monitoring. The number and volume of connected transactions will be controlled to forestall any risks of tunneling.

3. Enhancing overall management of the financial infrastructure and boosting the opening-up of the financial sector

Enhancing overall management of the financial infrastructure. In September 2019, the *Work Plan for Overall Supervision of the Financial Infrastructure* was reviewed and passed at the 10th meeting of the Central Committee for Deepening Overall Reform. The financial infrastructure is not only the foundation to secure the stable and efficient operation of financial markets but also the basis for implementing macro prudential management and for strengthening risk prevention. Overall supervision will be strengthened over the financial infrastructure with unified regulatory standards, sound business access management, an optimized infrastructure layout, and an improved managing structure, for the purpose of forming an advanced, reliable, and resilient financial infrastructure system with a reasonable layout and effective management.

Further Opening Up the Financial Sector. On July 20, the Financial Stability and Development Committee under the State Council announced eleven measures concerning the further opening-up of China's financial sector. The opening-up focused on substantially easing the restrictions on market access in the banking, securities, and insurance industries, moving forward the removal of the foreign ownership cap to year 2020, broadening their business scope, and further facilitating foreign institutional investors to invest in the interbank bond market.

Part 4. Macroeconomic Overview

I. Global Economic and Financial Developments

1. Global economic growth moderated amid weaker momentum, as uncertainties from trade frictions and geopolitics became a drag on growth

Global growth presented an obvious downward tread. In its October *World Economic Outlook*, the International Monetary Fund (IMF) forecast that the global economy would grow 3.0 percent in 2019, a downward revision by 0.2 percentage point compared to its July forecast. The growth forecasts for most advanced economies and emerging market and developing economies were both revised downward. In its September forecast, the Organisation for Economic Co-operation and Development (OECD) revised downward global growth by 0.3 percentage point compared with its May forecast to 2.9 percent.

Table 12 Macroeconomic and Financial Indicators in the Major Advanced Economies

Country	Indicator	2018 Q3			2018 Q4			2019 Q1			2019 Q2			2019 Q3		
		Jul.	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.
United States	Real GDP Growth (annualized quarterly rate, %)	2.9			1.1			3.1			2.0			1.9		
	Unemployment Rate (%)	3.9	3.8	3.7	3.8	3.7	3.9	4.0	3.8	3.8	3.6	3.6	3.7	3.7	3.7	3.5
	CPI (year-on-year, %)	2.9	2.7	2.3	2.5	2.2	1.9	1.6	1.5	1.9	2.0	1.8	1.6	1.8	1.7	1.7
	DJ Industrial Average (end of the period)	25415	25965	26458	25116	25538	23327	25000	25916	25929	26593	24815	26600	26864	26403	26917
Euro Area	Real GDP Growth (annualized quarterly rate, %)	1.6			1.2			1.3			1.2			1.1		

	Unemployment Rate (%)	8.1	8.0	8.0	8.0	7.9	7.9	7.8	7.8	7.7	7.6	7.6	7.5	7.6	7.5	7.5
	HICP (year-on-year, %)	2.2	2.1	2.1	2.3	1.9	1.5	1.4	1.5	1.4	1.7	1.2	1.3	1.0	1.0	0.8
	EURO STOXX 50 (end of the period)	3525	3393	3399	3198	3173	3001	3159	3298	3352	3515	3280	3474	3467	3427	3569
United Kingdom	Real GDP growth (year-on year, %)	1.6			1.5			2.1			1.3			...		
	Unemployment Rate (%)	4.0	4.0	4.1	4.1	4.0	4.0	3.9	3.9	3.8	3.8	3.8	3.9	3.8	3.9	...
	CPI (year-on-year, %)	2.5	2.7	2.4	2.4	2.3	2.1	1.8	1.9	1.9	2.1	2.0	2.0	2.1	1.7	1.7
	FTSE 100 (end of the period)	7749	7432	7510	7128	6980	6728	6969	7075	7279	7418	7162	7426	7587	7207	7408
Japan	Real GDP Growth (annualized quarterly rate, %)	-1.9			1.8			2.2			1.3			...		
	Unemployment Rate (%)	2.5	2.4	2.3	2.4	2.5	2.4	2.5	2.3	2.5	2.4	2.4	2.3	2.2	2.2	2.4
	CPI (year-on-year, %)	0.9	1.3	1.2	1.4	0.8	0.3	0.2	0.2	0.5	0.9	0.7	0.7	0.5	0.3	0.2
	NIKKEI 225 (end of the period)	22554	22865	24120	21920	22351	20015	20773	21385	21206	22259	20601	21276	21522	20704	21756

Sources: Statistical bureaus and central banks of the relevant economies.

A synchronized slowdown was reported in the advanced economies, where the growth rate, inflation, and the interest rate all remained at low levels. The US economy was generally sound, but business investment remained anemic. The manufacturing PMI and the Consumer Confidence Index both showed signs of an economic slowdown. Growth in the euro area was sluggish. Germany, the top performer, lost growth momentum， posting zero growth in Q2. Japan's economy moderated after a rebound in the first half-year, and uncertainties about Brexit still weighed on growth in the UK. Most advanced economies saw subdued inflation and a low unemployment rate. The inflation rate in the US, euro area, and Japan was consistently below the 2 percent target. The Philips Curve was flattening due to the following reasons: first, low inflation expectations weighed down actual inflation; second, unemployment data did not reflect real demand and supply, and there was slackness remaining in the labor market; third, globalization and technological progress also contributed to the low inflation.

Growth performance in the emerging market economies diverged, but also showed sluggishness. Growth in India and Mexico moderated to varying degrees in 2019. Growth in Russia, South Africa, and Argentina remained at low levels, despite a slight rebound. The Turkish economy contracted for two consecutive quarters. Political turmoil in Argentina reignited financial market turbulence. Other emerging market economies have not yet seen any pressures of large capital outflows.

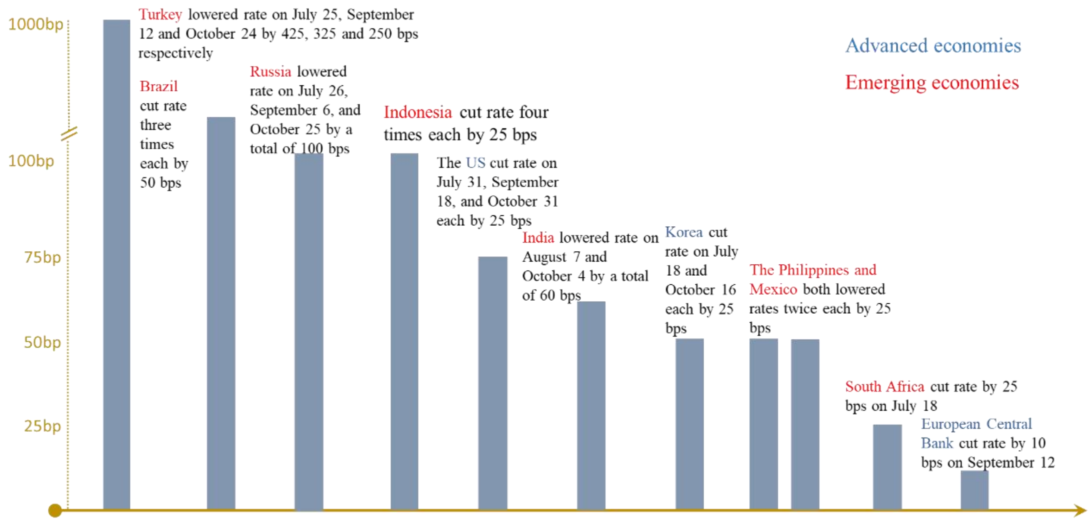
Global trade growth moderated. Since the end of 2018, global trade growth has slowed down gradually, even posting negative growth of –0.14 percent in Q2 of 2019 for the first time since the outbreak of the global financial crisis. The global economy and trade are intertwined. Shrinking trade may aggravate an economic slowdown by further undermining corporate investment. The IMF forecast that the volume of global trade would only grow 1.1 percent in 2019, a sharp drop from growth of 3.6 percent in 2018.

2. The central banks started to cut rates, global financial vulnerabilities continued to pile up, and risk aversion in financial markets increased somewhat

Central banks around the globe started to cut rates. Since Q3, the US Fed has cut rates on three occasions; it stopped unwinding the balance sheet two months in advance, rescheduling to August from October 2019, and repurchase operations and purchases of short-term Treasuries were resumed. At its September meeting, the European Central
Bank lowered the deposit facility rate by 10 basis points to –0.50 percent, the first rate cut since 2016. It also announced that it would restart its asset purchase program. The Bank of Japan and the Bank of England maintained their monetary easing. In addition, the central banks in about forty advanced and emerging market economies, such as Australia, New Zealand, India, Korea, Russia, and Turkey, have cut their rates since 2019, either due to weaker growth momentum or to achieve their inflation targets.

A prolonged easing monetary policy contributed to the accumulation of financial vulnerabilities. Specifically, first, the debt burden on the global corporate sector increased amid rising vulnerabilities. High-risk debts also accounted for one-third of the total corporate debt. Second, the low interest-rate environment prompted investors to increase their holdings of high-risk and less liquid securities, resulting in larger risk exposure. Third, the share of external debt was high in the emerging market economies. The external debt-to-export ratio had already jumped to 160 percent from 100 percent during the global financial crisis. In some economies, the ratio was even as high as over 300 percent, which heightened the debt risks in the emerging markets.

Figure 7 Monetary Policies in Some Economies since the Third Quarter of 2019



Source: Central banks of the relevant economies.

Risk aversion rose in the financial market, but the market did not roil. The US dollar recently again strengthened on the back of uncertainties and risk aversion, while other major currencies weakened slightly. The government bond yield dropped in most major economies and gold prices climbed. However, risk aversion did not result in any large turbulence in the financial market, with the VIX staying below the recorded high of 2018, and stock market performance in the major economies also remained stable.

3. Issues and trends that merit attention

First, trade tensions remain a major risk to global growth. Risk factors and uncertainties such as trade tensions have gradually increased since May, thus hurting global business and investment sentiment. Although lately the risks have receded somewhat, uncertainties remain. If they escalate again, the global supply chain will be further disrupted and global productivity and output growth will be affected in the medium term.

Second, the global loose monetary environment has promoted financial asset prices and debt accumulation, and the vulnerability of the financial system has continued to rise. In this context, risk factors may lead to a sharp rise in risk aversion and impact the stability of the financial system and affect global economic growth.

Third, low growth, low inflation, and a low rate pose a challenge to monetary-policy adjustments. The room for further rate cuts is limited, and the marginal effects of prolonging unconventional monetary policies, such as quantitative easing, may also be limited. Policymakers may need to consider policy coordination and implement structural reforms to improve long-term growth momentum and resilience.

In addition, the global economic slowdown may further aggravate regional geopolitical conflicts in some parts of the world, with some impact on the global market and the industrial chain. Climate change and environmental factors are also having a growing impact on the economy and finance. Economies around the globe need to strengthen their capacity to address the economic recession in a coordinated manner. In the meantime, risks from new technologies or cyber security pose new challenges to global financial supervision.

II. Macroeconomic developments in China

Since the third quarter of 2019, China has continued to deepen supply-side structural reforms, enhance countercyclical adjustments, and strive to keep employment, the financial sector, foreign trade, domestic and foreign investment, and expectations stable in the face of the grim and complicated situations at home and abroad. The national economy has been generally stable, and the restructuring efforts have yielded solid results. Investment has stabilized while slowing down, consumption and employment have largely been stable, and price levels have witnessed an obvious structural rise. According to preliminary statistics, GDP in the first three quarters of 2019 registered RMB69.8 trillion, up 6.2 percent year on year, among which the GDP in Q3 grew by 6.0 percent. The CPI in the first three quarters witnessed year-on-year growth of 2.5 percent, and the surplus in goods trade reached RMB2.05 trillion.

1. Consumption grew steadily and investment stabilized while slowing down.

Household income grew at a steady pace, and consumption made a greater contribution to economic growth. In the first three quarters of 2019, per capita disposable income posted RMB22882, up by 8.8 percent in nominal terms and 6.1 percent in real terms year on year, which was basically in tandem with economic growth. The income distribution structure continued to improve. The per capita income of urban residents was 2.75 times that of rural residents, narrowing the gap by 0.03 year on year. According to the Q3 Urban Depositors' Survey conducted by the PBC, 27.7 percent of consumers were inclined to "consume more," up by 1.3 percentage points and 1.7 percentage points from the previous quarter and the same period of 2018, respectively. The contribution of final consumption expenditures to economic growth remained high, reaching 60.5 percent in the first three quarters, 0.4 percentage points higher than that in H1 and 40.7 percentage points higher than the Gross Capital Formation respectively. Total retail sales of consumer goods rose by 8.2 percent year on year to RMB29.7 trillion, with the growth in rural areas continuing to outpace that in urban areas by 1.0 percentage point in Q3.

Investment in fixed assets stabilized while decelerating, and growth in investment in infrastructure picked up. In the first three quarters of 2019, fixed-asset investments throughout China (excluding those by rural households) grew by 5.4 percent year on year to RMB46.1 trillion, 0.4 percentage points lower than that in H1. Specifically, the growth of investment in the manufacturing industry slowed down moderately to 2.5 percent year on year, 0.5 percentage points lower than that in H1. The growth of investment in infrastructure picked up and reached 4.5 percent year on year, 0.4 percentage points higher than that in H1. Real estate investment grew steadily to a year-on-year rate of 10.5 percent, 0.4 percentage points lower than that in H1. By investment entities, the growth of private investment decelerated slightly to 4.7 percent year on year, 1.0 percentage point lower than that in H1, and investment by state-owned enterprises and state-controlled entities grew 7.3 percent year on year, 0.4 percentage points higher than that in H1.

Import and export growth continued to slow down and the layout of the international market became more diversified. In the first three quarters of 2019, the import and export of goods rose by 2.8 percent year on year to RMB22.91 trillion, 1.1 percentage points lower than that in H1. Specifically, exports increased by 5.2 percent to RMB12.48 trillion, 0.9 percentage points lower than that in H1, and imports declined by 0.1 percent to RMB10.43 trillion, whereas H1 had witnessed growth of 1.4 percent. The trade surplus expanded by 44.2 percent year on year to RMB2 trillion, while the trade structure continued to improve. The share of general trade in total exports and imports increased and hit 59.5 percent, up 1.1 percentage points from the same period of the last year. Exports moved further up the value chain. Exports of machinery and electronics grew by 4.7 percent, accounting for 58.1 percent of total exports. Private enterprises became more vigorous, with their exports rising by 13 percent, accounting for 51.3 percent of the total, 3.5 percentage points higher than that during the same period of the last year. The layout of the international market became more diversified. Imports from and exports to the emerging markets grew by 5.4 percent. In particular, imports from and exports to countries along the Belt and Road grew by 9.5 percent, and their share increased by 4 percentage points to 29 percent compared with that in 2013. In the first three quarters of 2019, statistically large industrial firms (SLIFs) delivered RMB9.1 trillion worth of goods, up 2.4 percent year on year.

Utilized foreign investment increased and the industrial structure of outbound investments continued to improve. During the first three quarters of 2019, 30,871 new foreign-invested companies were established nationwide, down 32.8 percent year on year. Actually utilized foreign investment recorded RMB683.21 billion, an increase of 6.5 percent year on year, 0.7 percentage points lower than that in the previous year. During the first three quarters, actual investment in China by ASEAN countries grew by 17.5 percent year on year and that by the countries in the region of the Belt and Road Initiative (BRI) rose by 14.9 percent. During the first three quarters, outward direct investments by domestic investors in non-financial enterprises rose by 3.8 percent year on year to RMB555.11 billion, among which new investments to the countries in the BRI region accounted for 12.4 percent. Outbound funds were mainly invested in leasing and commercial services, manufacturing, and the wholesale and retail industries, which accounted for 33 percent, 17.5 percent, and 10.5 percent of the total, respectively. There were no new outward investments in the real estate, sports, and entertainment industries.

2. Industrial production faced pressures while the service sector grew rapidly.

The share of tertiary industry continued to rise. In the first three quarters of 2019, the value-added of the primary, secondary, and tertiary industries registered RMB4.3 trillion, RMB27.8 trillion, and RMB37.7 trillion respectively, up 2.9 percent, 5.6 percent, and 7.0 percent year on year. The value-added of the primary, secondary, and tertiary industries accounted for 6.2 percent, 39.8 percent, and 54.0 percent of GDP, respectively. The share of tertiary industry was 14.2 percentage points higher than that of secondary industry, 1.3 percentage points higher than that in the same period of the last year.

Agricultural production was satisfactory. The yield of summer crops totaled 168 million tons, up 606,000 tons from the previous year. The agricultural planting structure continued to improve, with an increase in the planting areas of high-quality rice and soybeans and a reduction in the planting areas of maize. During the first three quarters, the output of pork, beef, mutton, and poultry recorded 55.08 million tons, a decrease of 8.3 percent year on year. Of this, the year-on-year output of poultry, beef, and mutton increased by 10.2 percent, 3.2 percent, and 2.3 percent, respectively, whereas that of pork declined by 17.2 percent to 31.81 million tons.

Industrial production was under some pressure and restructuring continued to make progress. During the first three quarters of 2019, the value-added of SLIFs increased by 5.6 percent year on year in real terms, decelerating by 0.4 percentage points from H1. Specifically, the value-added growth of the high-tech manufacturing industries and the strategic emerging industries were respectively 3.1 and 2.8 percentage points higher than that of the SLIFs. During the first three quarters, the total profits of the SLIFs reached RMB4.6 trillion, down 2.1 percentage points from the same period of the last year, and the profit margin was 5.9 percent.

The service sector grew rapidly. During the first three quarters of 2019, the value-added of the service sector grew by 7.0 percent year on year, the same level as that in H1. The value-added of the information communications/software/information technology service sector, the leasing/commercial service sector, and the transport/warehousing/posts sector grew by 19.8 percent, 8.0 percent, and 7.4 percent year on year, respectively, 12.8, 1.0, and 0.4 percentage points higher than the growth of tertiary industry.

3. Growth of consumer prices accelerated and producer prices moved down.

Growth of the GDP deflator declined. In Q3, the GDP deflator (the ratio of GDP at current prices to GDP at constant prices) rose 1.5 percent year on year, decelerating by 0.5 percentage points compared with Q2.

Driven mainly by food prices, CPI growth witnessed an obvious structural acceleration. During the third quarter, the CPI rose by 2.9 percent year on year, an acceleration of 0.3 percentage points from the previous quarter. The price of pork rose rapidly, with the month-on-month growth rate at around 20 percent in August and September consecutively, which was accompanied by a relative shortage of fresh fruits, hence an accelerated growth of food prices. Food prices rose by 10.1 percent in Q3 year on year, an acceleration of 2.7 percentage points compared with Q2. Growth of non-food prices decelerated. Prices went up by 1.1 percent year on year, a deceleration of 0.5 percentage points compared with Q2. Growth of the prices of consumer goods picked up, while the prices of services slowed down. In Q3, the price of consumer goods rose by 3.7 percent year on year, 0.6 percentage points higher than that in Q2. The price of services went up by 1.6 percent year on year, 0.3 percentage points lower than that in Q2.

The declining price of capital goods pulled PPI growth from positive territory to negative territory. In Q3, the PPI edged down by 0.77 percent year on year, while in Q2 it rose by 0.5 percent year on year. The price decline accelerated successively from July to September, registering 0.3 percent, 0.8 percent, and 1.2 percent respectively. Specifically, the PPI growth of consumer goods rose steadily by 0.9 percent year on year, on par with that in Q2, while the PPI of capital goods declined by 1.33 percent year on year, but in Q2 it rose by 0.4 percent year on year. The Purchasing Price Index for Industrial Products (PPIRM) edged down by 1.2 percent year on year, while in the previous quarter it rose by 0.1 percent. The PPI of agricultural produce rose by 13.9 percent year on year, an acceleration of 4.8 percentage points from the previous quarter. The year-on-year growth of the Corporate Goods Price Index (CGPI) decelerated in each month, registering 0.1 percent, 0.0 percent, and –0.1 percent in July, August, and September, respectively. Specifically, the year-on-year price growth of primary products decelerated, the price decline of intermediate products accelerated and the price growth of end products accelerated.

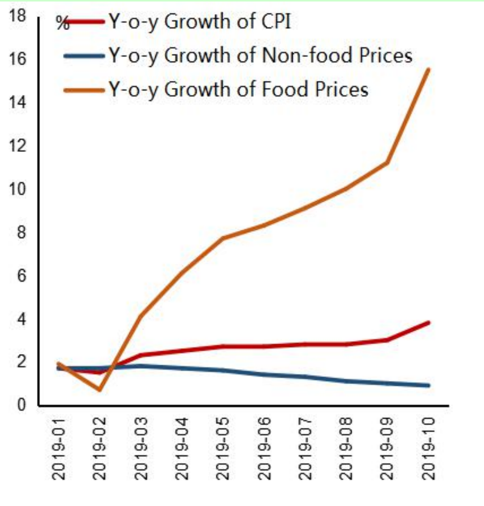
Box 4 Taking A Holistic View of Changes in the CPI and PPI

As major economic indicators, the CPI and PPI measure changes of prices in consumption and production, respectively, during a certain period. Since the beginning of 2019, the year-on-year change of the CPI has risen gradually from 2 percent to 3.8 percent in October. The year-on-year change of the PPI declined gradually to –1.6 percent in October after hitting this year's high of 0.9 percent in April. This phenomenon should be analyzed thoroughly and viewed from an all-round perspective.

The year-on-year growth of the CPI has accelerated but with obvious structural characteristics, which calls for vigilance against a dispersion of inflation expectations. The year-on-year growth of the CPI has climbed up month after month since the beginning of 2019 mainly due to the rapidly rising food prices, especially the rising pork prices. Considering that this will affect the cost of households' food basket, it warrants attention and should be dealt with appropriately. In the first ten months of 2019, food prices went up by 7.4 percent year on year. In particular, due to African swine fever, the supply of pigs decreased rapidly and pork prices increased by 29.7 percent year on year, which then led the prices of beef, mutton, and eggs to rise by 10.2 percent, 11.7 percent, and 4.5 percent, respectively, due to a substitution effect. This was the most important factor driving the upward trend of the CPI. In addition, the prices of fruits and vegetables also went up due to extreme weather during several individual months but recently they have retreated and stabilized. The prices of other goods and services, excluding food, have largely remained stable since the beginning of 2019 (Figure 8). In the first ten months of 2019, non-food prices and service prices rose by 1.4 percent and 1.8 percent, respectively, year on year, which marked low levels during the past nearly two years. Among these, the price of clothing, rent, travel, and health care increased moderately by 1.7 percent, 2.0 percent, 2.0 percent, and 2.5 percent respectively year on year, whereas the prices of transportation and telecommunications dropped by 1.7 percent.

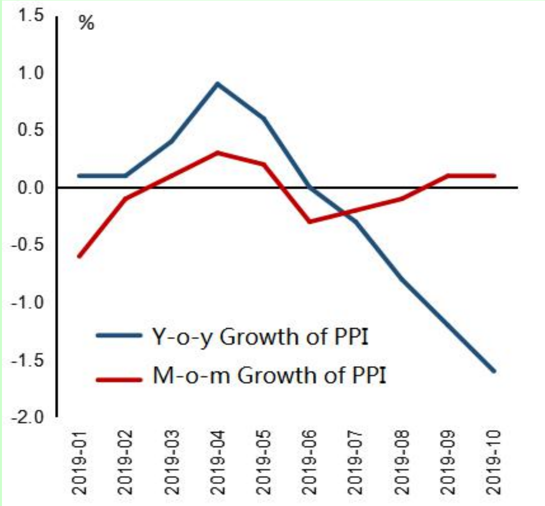
A faltering PPI usually indicates weak industrial demand. Nonetheless, the year-on-year decline of the PPI accelerated in recent months, mainly due to the base effect so that it does not necessarily imply strong deflation pressure on industrial goods. A carry-over effect of the year-on-year decline of 1.6 percentage points in October was derived from a high base from the same period of the previous year, accounting for 1.2 percentage points. The remaining 0.4 percentage point was due to the new inflationary factors whereby the PPI declined by 0.6 percent month on month in January but has rebounded somewhat since June. In general, there have not been any evident downward pressures on the prices of industrial goods. As the base effect ebbs gradually in the next several months, the year-on-year change in the PPI is expected to rebound.

Figure 8 Year-on-Year Growth of the CPI, Food, and Non-Food Prices



Source: National Bureau of Statistics

Figure 9 Year-on-Year and Month-on-Month Growth of the PPI



Source: National Bureau of Statistics

Considering China's economy is generally steady with largely balanced supply and demand, there is no momentum for persistent inflation or deflation. It is expected that entering the second half of 2020 the impact of the carry-over effect on the PPI will be smaller than that in 2019 and it will become more stable. Also, the shock of rising food prices on the CPI will gradually wane. The gap between these two indices is expected to narrow. During the next stage, China will adopt a sound monetary policy which is neither too tight nor too loose, conduct pre-emptive adjustments and fine-tunings according to economic growth and price changes, stabilize the inflation expectations of the economic participants, and ensure that the overall price level remains within a reasonable range.

4. Growth of fiscal expenditures was fairly rapid

Growth of fiscal revenue slowed down. In the first three quarters, revenue in the national general public budget totaled RMB15.1 trillion, up 3.3 percent year on year and registering a deceleration of 0.1 percentage point from H1 2019. Specifically, tax revenue amounted to RMB12.7 trillion, down 0.4 percent year on year. Non-tax revenue reached RMB2.4 trillion, up 29.2 percent year on year. The domestic value-added tax and the domestic consumption tax grew by 4.2 percent and 15.8 percent year on year, respectively. The corporate income tax saw a year-on-year increase of 2.7 percent, while the personal income tax dropped 29.7 percent year on year.

Growth of fiscal expenditures was fairly rapid. During the first three quarters, expenditures in the national general public budget hit RMB17.9 trillion, up 9.4 percent year on year, registering a deceleration of 1.3 percentage points from H1 2019 and representing an acceleration of 1.9 percentage points from the same period of 2018. In terms of the structure, expenditures on infrastructure investments saw substantial growth, with expenditures on urban and rural communities, agriculture, forestry and water conservancy as well as transportation climbing by 5.1 percent, 2.6 percent, and 5.4 percent year on year, respectively.

During the first three quarters, budgetary revenue from nationwide government-managed funds totaled RMB5.3 trillion, up 7.7 percent year on year. In particular, revenue from land sales grew by 5.8 percent year on year. Budgetary expenditures from nationwide government-managed funds increased by 24.2 percent year on year to RMB6.2 trillion.

5. The labor market remained stable

In September, the surveyed unemployment rate in the urban areas stood at 5.2 percent, staying within the range of 5.0–5.3 percent for nine consecutive months. In the first three quarters, a total of 10.97 million new jobs were created in the urban areas, accounting for 99.7 percent of the annual target. As of end-September, the population of migrant workers grew 2.01 million to reach 183.36 million, a year-on-year increase of 1.1 percent. According to the survey of urban depositors conducted by the PBC, the Employment Sentiment Index posted 45.4 percent in the third quarter, up 1.2 percentage points from the previous quarter and from the same period of 2018, while the Employment Prospective Index reached 52.6 percent in the third quarter, up 0.3 percentage point from the previous quarter and up 0.9 percentage point from the same period of 2018, respectively.

6. The balance of payments remained basically in equilibrium

According to preliminary data, China’s current account surplus stood at USD143.2 billion in the first three quarters. To be specific, trade of goods saw a surplus of USD343.5 billion, up 34 percent year on year, whereas trade in services registered a deficit of USD201.7 billion, down 12 percent year on year. Under the non-reserve financial account, direct investments and securities investments continued to register a surplus. Specifically, direct investments posted a surplus of USD27.7 billion and securities investments registered a surplus of USD40 billion. At end-September, foreign exchange reserves stood at USD3.2045 trillion, up USD36.5 billion from end-2018. As of the end of June, the balance of foreign debt (including domestic and foreign currencies) was US$190.8 billion, an increase of US$26.3 billion from the end of March. Among this, the short-term external debt balance was US$1214.4 billion, accounting for 61 percent of the external debt balance, a decrease of 3 percentage points from the end of March.

7. Analysis by sector

7.1 The real estate sector

Since Q3 2019, on the whole the real estate sector has witnessed stable operations, with the growth of real estate loans moderating, the year-on-year growth of housing prices declining, and the growth of both investments in real estate development and newly started real estate projects decelerating steadily.

The number of cities with rising housing prices fell moderately. In September 2019, among the 70 medium and large-sized cities nationwide, 53 cities saw month-on-month growth of newly built residential housing prices, ten less than that in June. The number of cities with year-on-year housing price growth decreased from June by one, or 69 cities. Second-hand residential housing prices rose month on month in 40 cities, five less than in June. 59 cities registered a year-on-year increase of second-hand residential housing prices, nine less than in June.

Housing sales recovered slightly. During the first three quarters of 2019, housing sales hit RMB11.15 trillion, up 7.1 percent year on year, 1.5 percentage points higher than that in H1 2019. The total floor area of sold units declined 0.1 percent year on year to reach 1.192 billion square meters, reflecting a slowing downward trend. In particular, residential housing accounted for 87.8 percent of the sold floor area and 87.4 percent of sales.

Growth of investments in real estate development and the floor area of newly started real estate projects saw a moderate slowdown. During the first three quarters of 2019, real estate investments in China totaled RMB9.8 trillion, up 10.5 percent year on year and a deceleration of 0.4 percentage points from H1 2019. The floor area of newly started real estate projects rose 8.6 percent year on year to hit 1.66 billion square meters, a deceleration of 1.5 percentage points from H1 of 2019. The floor area of real estate projects under construction increased 8.7 percent year on year to reach 8.34 billion square meters, while the floor area of completed real estate projects dropped 8.6 percent year on year to reach 470 million square meters.

Growth of real estate loans moderated. At end-September, outstanding real-estate loans by major financial institutions (including foreign-funded financial institutions) stood at RMB43.3 trillion, up 15.6 percent year on year and a deceleration of 1.5 percentage points from H1 2019. Outstanding real estate loans accounted for 28.9 percent of total bank lending. Specifically, outstanding individual housing loans amounted to RMB29.05 trillion, up 16.8 percent year on year, representing a deceleration of 0.5 percentage points from H1 2019. Outstanding housing development loans posted RMB8.33 trillion, rising 17.3 percent year on year and a deceleration of 3.4 percentage points from H1 2019. Outstanding land development loans decreased 6.4 percent year on year to RMB1.36 trillion, 0.4 percentage points larger than the drop in H1 2019.

Growth of loans for affordable housing slowed down. At end-September, outstanding loans for government-subsidized housing development totaled RMB4.65 trillion, up 9.4 percent year on year and a deceleration of 3.5 percentage points from end-June. New loans for affordable housing development in the first three quarters reached a cumulative RMB332.82 billion, accounting for 31.1 percent of all new real-estate development loans, a deceleration of RMB584.36 billion as compared with the corresponding period in 2018. As of end-September, loans for 373 affordable housing projects in 85 cities had been approved, with RMB87.22 billion of the loans issued as scheduled and RMB86.02 billion of the principal repaid.

7.2 The agriculture sector

Agriculture is the foundation for building a moderately prosperous society in all respects and realizing modernization. In the context of increasing downward pressures on the Chinese economy and the complicated and rapidly changing international trade environment, it is of special importance to make efforts to strengthen the development of agriculture and rural areas to help them catch up and to improve the work of agriculture, rural areas, and farmers.

Under the strong leadership of the CPC Central Committee and the State

Council, new achievements have been made in the development of agriculture and rural areas. First, the supply capacity of agricultural products has continued to be enhanced and the mix of crop varieties has been optimized. In recent years, grain output has exceeded 650 million metric tons in consecutive years and the conditions for agricultural production picked up significantly. At end-2018, the comprehensive mechanization rate for the cultivation of the main crops and the harvest exceeded 67 percent. **Second,** the integration of agriculture and finance has been actively promoted. New types of businesses, including the Internet Plus Modern Agriculture initiative, have taken shape. Online rural retail sales in China registered RMB1.37trillion in 2018. **Third,** the continued growth of farmers' income effectively stimulated consumer spending in the rural areas. **Fourth,** the environment for agricultural products has gradually improved and green development has made tremendous achievements. The use of both chemical fertilizers and pesticides for the three main crops of rice, wheat, and corn saw zero growth in 2018.

Some noteworthy problems still exist in the development of agriculture and the economy in the rural areas. First, the sharp fluctuations in hog prices and feed costs call for effective risk-management tools. **Second,** stepped-up efforts need to be made to transform the mode of agricultural development. Production of low and medium-standard cropland accounts for an overly large proportion of total output and problems in the ecological environment of agriculture are acute. The quantity and quality of some agricultural products cannot meet domestic demand. **Third,** problems between agricultural technologies and demand for the development of green agriculture still exist and breakthroughs in scientific research in key fields are yet to be made.

Going forward, efforts will be made to further deepen supply-side structural reforms, attach importance to infrastructure construction, technological innovation, and structural adjustments, support projects that meet the requirements of green agriculture, optimize and improve service channels, as well as explore the financial service mode based on multi-party cooperation. Efforts will also be made to fully implement financial policies and allocate financial resources to the countryside, enhance agro-linked credits, relax restrictions on access to social capital, and encourage innovation in social-capital cooperation.

Part 5. Monetary Policy Stance to be Adopted at the Next Stage

I. Outlook for the Chinese economy

For the next period, there are a number of favorable factors that will support the steady growth of the Chinese economy. China is still and will long remain in an important period of strategic opportunities. The "three critical battles" to prevent and defuse major risks, to conduct targeted poverty alleviation, and to control pollution are making substantial progress. The supply-side structural reforms are deepening. Economic growth remains resilient. Employment remains stable, household income is witnessing steady growth, and the people's livelihood continues to improve. All these factors have contributed to maintaining sustained and healthy economic development and social stability. In addition, the effects of the proactive fiscal policy and the sound monetary policy are gradually unfolding. Support from the financial sector to the real economy, especially to private enterprises and MSEs, is constantly increasing. The resumption of the Sino-US trade negotiations will be helpful to stabilize market confidence. Meanwhile, financial risks have been prevented and managed in a prudent and decisive manner. The high-speed growth of the macroeconomic leverage ratio has been initially contained, and the overall risks in the financial sector are under control. The quality and efficiency of financial services supporting the real economy have gradually improved. The RMB exchange rate remains generally stable at an adaptive and equilibrium level, and the economy's capability to cope with external shocks has been strengthened.

However, it should be noted that the external environment remains complicated, downward pressures on the economy continue to rise, and some enterprises face more difficulties in their business operations. With the deceleration of global economic growth, monetary policy in the major economies has shifted toward a more accommodative stance. In addition to the elevated geopolitical risks, the external uncertainties and destabilizing factors have increased. Domestic economic performance faces mounting risks and challenges, and firms tend to be more cautious in making decisions about production and investments. Investments in the manufacturing industries and private investments have slowed down, and weakening external demand has placed pressures on export growth. Furthermore, the endogenous drivers for growth need to be further enhanced. **It is necessary to view these developments from an objective and rational perspective, remain confident, and keep firm. We need to make full preparations and make efforts to do our own work well.** We will reinforce the countercyclical adjustments, strengthen the structural adjustments, and combine reform and regulation, short- and long-term measures, and the domestic and external equilibrium, so as to help generate effective final demand and to foster new growth engines.

Inflation is generally under control amid increasing uncertainties. The magnitude of price increases mainly depends on the economic fundamentals and the changes in market supply and demand. Recently, China's economy has been generally stable, and a balance has been struck between aggregate supply and demand. Supply-side reforms have been further advanced, as the role of the market continues to play out. Therefore, there is no basis for continuous inflation or deflation in China. However, due to the influence brought by the African swine fever and some periodic factors, the prices of pork have witnessed a rapid hike. The substitution effect in consumption has led to a rise in the prices of mutton, beef, poultry, and eggs. These two factors have driven the rise of consumer prices to be somewhat expanded. As for the PPI, its growth has decelerated due to factors such as the marginally weakened demand of firms for production, the year-on-year decline in commodity prices, and the relatively high base over the same period of the previous year. However, the PPI has recently witnessed a month-on-month rise. In general, it still takes some time to help supplies recover from the shocks brought by the African swine fever. The prices of consumer goods still will face upward pressures in the short run, which call for continuous and close monitoring of the changes so as to guard against the widening range of inflation expectations.

II. Monetary policy during the next stage

Looking forward, the PBC will adhere to the guidance of Xi Jinping's Thought on Socialism with Chinese Characteristics for a New Era, comprehensively implement the overall arrangements of the CPC Central Committee and the State Council, stick to the guiding principles of pursuing progress while ensuring stability, uphold the concept of new development, take solid measures to stabilize employment, the financial sector, foreign trade, foreign investment, domestic investment, and market expectations. It will remain firm, continue to implement well a sound monetary policy, adopt innovative approaches to improve financial macro-management, and intensify countercyclical adjustments. It will continue to forestall and defuse risks in the course of promoting high-quality development, properly handle short-term downward pressures on the economy, and resolutely refrain from massive and indiscriminate stimuli. Emphasis will be placed on guiding expectations and preventing the widening range of inflation expectations. Efforts will be made to strengthen macro-policy coordination, to coordinate RMB and foreign exchange policies and to strike a balance between an internal and external equilibrium. We will deepen supply-side structural reforms in the financial sector, establish a modern central-bank system, and make the modern financial system more adaptable, competitive, and inclusive so as to foster a virtuous cycle in the national economy.

First, the PBC will implement a sound monetary policy, strengthen

countercyclical adjustments, and maintain reasonable and adequate liquidity and proper growth of AFRE. China will remain firm in its monetary-policy stance, actively maintain its status as one of the few major economies carrying out a normal monetary policy, and enhance management in a more forward-looking, targeted, and effective manner. Pre-emptive adjustments and fine tunings will be made in light of economic growth and price developments, and they will be carefully calibrated to strengthen expectation management and to guard against the widening range of inflation expectations. The PBC will continue to strike a balance between the aggregates and the structure and enhance monetary-policy transmissions at the micro level on both the supply and demand sides so as to ease pressures from the contraction of local credit. It will improve the market environment and supporting policies for the capital replenishment of banks and optimize a sustainable system and mechanism for capital replenishment. It will promote capital replenishment via multiple channels, such as the issuance of perpetual bonds by commercial banks and it will focus on supporting the capital replenishment of small- and medium-sized banks so as to optimize their capital structure. Efforts will be made to improve arrangements related to the Macro Prudential Assessment (MPA) and to guide financial institutions to enhance their support for private enterprises and micro and small enterprises (MSEs).

Second, the PBC will give full play to the role of monetary and credit policies in promoting structural optimization, with a view to better serving the real economy. Various kinds of monetary policy instruments will be adopted, such as targeted RRR cuts, central bank lending, and central bank discounts, the mix of which will be innovative and will enrich the monetary-policy tools. Efforts will be made to employ structural monetary policy instruments to provide money supply in a targeted manner. Continuous efforts will be made to give play to a policy synergy of all related departments, to guide and support financial institutions to optimize their credit structure, and to beef up support for those providing financial services to weak links and key sectors in the economy. The PBC will further improve the RRR policy framework featuring the "three notches and two preferential treatments," and will guide local financial institutions to focus on providing financial services to the real economy, such as the MSEs. It will step up support for the bond market and bill financing, employ the loan prime rate (LPR) well, and encourage banks to increase the credit supply and to reduce the financing costs for private enterprises and MSEs. Financial institutions will be guided to strike a good balance between providing support to win the critical battle of poverty alleviation and preventing related risks. It will beef up financial support for poverty alleviation in key areas and for the pro-employment policies, and will strive to achieve fuller employment with better-quality jobs. It will continue to optimize financial services offered to the manufacturing industry, new consumption areas, entrepreneurship and innovation, and national key strategies. In accordance with the fundamental principle of adopting city-specific policies, it will carry out a long-term regulation mechanism in the real estate sector and refrain from launching a short-term stimulus through the housing market.

Third, the PBC will further deepen the reforms of market-based interest rates and of the RMB exchange-rate formation regime to enhance the efficiency of financial resource allocations. The PBC will improve the LPR formation mechanism of commercial banks, encourage banks to employ the LPR under more circumstances via the MPA. It will remain resolved to break the invisible floor of loan interest rates in the banks' cooperative behavior. Efforts will be made to smooth monetary policy transmission, to promote the convergence between the government suggested benchmark interest rate for commercial bank lending and deposits and market-oriented money market rates, and to induce actual interest rates to be obviously lowered through market-based reforms. Efforts will be made to improve the central bank policy rate system and to enhance the PBC's capacity to manage interest rates. The PBC will make full use of the self-disciplinary mechanism in setting the interest rates, maintain order in fair pricing, and keep the costs of commercial banks basically stable on the liability side. It will urge commercial banks to reduce surcharges for loans and will ensure a reduction in the financing costs of MSEs, with a view to better serving the real economy. It will continue to improve the managed floating exchange rate regime based on market supply and demand and with reference to a basket of currencies so as to stabilize market expectations and to maintain exchange rate flexibility. It will make the exchange rate an automatic stabilizer and keep the RMB exchange rate basically stable at an adaptive and equilibrium level. It will accelerate development of the foreign exchange market, stick to the principle of financial services supporting the real economy, and provide exchange rate risk management services to import and export companies based on their actual needs. Efforts will be made to steadily promote the convertibility of the RMB under the capital account, to improve the policy framework and infrastructure designed for use of the RMB in cross-border transactions, and to promote the use of the RMB in cross-border trade and investment.

Fourth, the PBC will further improve the financial market system to fully leverage the role of financial market in stabilizing growth, restructuring the economy, promoting reforms, and guarding against risks. Continuous efforts will be made to enhance the development of tools for bond financing of private enterprises and to promote the two-way opening-up of the bond market in a steady and orderly manner. More measures will be taken to strengthen infrastructure building in the financial market, such as constantly optimizing the institutional arrangements for trading, clearing, and settlement, and improving the market-based assessment system for market-makers so as to increase liquidity in the bond market. An integrated management framework for the infrastructure of the financial market will be set up and improved to further strengthen the screening and warning of bond default risks. The PBC will improve the disposal mechanism of bond defaults and properly handle bond repurchase defaults so as to prevent risks contagion.

Fifth, the PBC will deepen supply-side structural reforms of the financial sector and improve the modern financial system with a higher level of adaptability, competitiveness, and inclusiveness. The PBC will strengthen institutional construction and enhance governance capability of the financial sector. It will firmly implement the new development concept and enhance the functions of financial services. Committed to serving the real economy and people's daily needs, it will focus on adjusting and optimizing the financial system, including the financing structure, the system of financial institutions, and the market and product systems, so as to establish a multi-tier and differentiated banking system with wide coverage. It will continue to deepen the reforms of large commercial banks and other large financial enterprises so as to improve their capability for management and risk control. It will also deepen reforms of small and medium-sized banks, improve their corporate governance structure and their internal risk control system appropriate to their features so as to fundamentally solve their development problems through institutional arrangements and mechanisms. It will continue to promote comprehensive implementation of the reform plans for development financial institutions and policy banks so as to improve their governance system and incentive mechanism. Further efforts will be made to expand the opening-up of the financial sector and to relax controls on market access of the banking, securities, and insurance industries.

Sixth, the PBC will win the critical battle of preventing and defusing major financial risks. Following the leadership of the Financial Stability and Development Committee under the State Council, the PBC will fully play its role as the committee's Secretariat, improve the coordination mechanism for local financial supervision, press ahead with the implementation of schemes for preventing and mitigating major financial risks, and continue to forestall and resolve risks alongside promoting high-quality development. It will orderly promote structural deleveraging, guard against abnormal fluctuations in the financial market, and dispose of risks in key areas. Further measures will be taken to close the regulatory loopholes and to highlight the responsibility of financial institutions to prevent risks.