China Monetary Policy Report

Q1 2020

(May 10, 2020)

Monetary Policy Analysis Group of

the People's Bank of China

Executive Summary

In Q1 2020, the sudden outbreak of COVID-19 had an unprecedented impact on China's economic and social development. Under the strong leadership of the CPC Central Committee, with the people across China uniting and fighting intensely, the battle against COVID-19 has achieved significant strategic results, and the efforts to coordinate pandemic containment with economic and social development have made positive progress. With regular pandemic containment measures remaining in place, economic operations and social functioning have gradually returned to normal, and livelihood and production order have recovered at an accelerating pace. In Q1 2020, the gross domestic product (GDP) fell 6.8 percent year on year, and the consumer price index (CPI) rose 4.9 percent year on year. Employment was generally stable, the structure of foreign trade continued to improve, and the balance of payments remained basically in equilibrium.

Upholding the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, the People's Bank of China (PBC) resolutely implemented the decisions and arrangements of the CPC Central Committee and the State Council. Taking the initiative and acting quickly, the PBC pursued a sound monetary policy that was more flexible and appropriate. With COVID-19 containment as the top priority, the PBC focused its efforts on supporting the recovery and development of the real economy and used a mix of tools to combat the shocks from the pandemic.

First, work was done to keep liquidity adequate at a reasonable level. Since the beginning of 2020, the PBC has released RMB1.75 trillion worth of long-term funds by cutting the required reserve ratio (RRR) three times, and after the Spring Festival the PBC injected RMB1.7 trillion of short-term liquidity. By rationally calibrating the intensity and pace of open market operations (OMOs), the PBC ensured stable operations of the financial market. **Second,** money and credit support was intensified to combat the impact of COVID-19. The PBC launched RMB300 billion in special central bank lending for key areas and enterprises engaged in pandemic containment, provided RMB500 billion of special quotas for central bank lending and central bank discounts to support the resumption of work and production, and increased the quotas for central bank lending and central bank discounts by an additional RMB1 trillion to facilitate the economic recovery and development. **Third,** reform measures were adopted to smooth the transmission of monetary policy. The PBC proceeded with the market-based interest rate reforms, promoted application of the loan prime rate (LPR), and facilitated the shift in the pricing benchmark for outstanding floating-rate loans so as to lower the real interest rates on loans. **Fourth,** efforts were made to strike a balance between internal and external equilibria, with attention mainly focused on domestic conditions. Remaining basically stable, the RMB exchange rate moved in both directions with more flexibility. **Fifth,** work was done to safeguard the bottom line that no systemic risk should occur. Financial risks were effectively controlled.

Overall, the sound monetary policy produced good results with transmission efficiency enhanced significantly, and it proved to be forward-looking, precise, proactive, and effective. At end-March 2020, broad money (M2) and aggregate financing to the real economy (AFRE) grew 10.1 percent and 11.5 percent year on year, respectively, representing smooth growth. The social financing costs declined notably in Q1, and the average rate on ordinary loans registered 5.48 percent in March, down 0.62 percentage points from July 2019, when the LPR reform was yet to be launched. The structure of money and credit was further improved, as the inclusive loans for micro and small businesses (MSBs) grew in both volume and coverage and were offered at lower prices. The RMB exchange rate moved in both directions, and market expectations were stable. At end-March, China Foreign Exchange Trade System (CFETS) RMB Index registered 94.06, 2.92 percent higher than that at end-2019.

With the pandemic continuing to spread and the world economy falling into recession, destabilizing factors and uncertainties have increased significantly. The trend that the Chinese economy will continue to grow amid stability in the long run remains unchanged, but current economic development faces unprecedented challenges, which necessitates work to fully estimate the difficulties, risks, and uncertainties, enhance the sense of urgency, and ensure solid implementation of tasks concerning economic and social development. Going forward, under the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, the PBC will resolutely implement the decisions and arrangements of the CPC Central Committee and the State Council, and promote pandemic containment as well as social and economic development in a coordinated manner. Under the precondition of keeping the pandemic containment measures in place, the PBC will adhere to the guiding principle of pursuing progress while ensuring stability, follow the new development philosophy, earnestly fulfill its duties to ensure stability on six fronts, namely, employment, the financial sector, foreign trade, foreign investment, domestic investment and expectations, and comprehensively implement the task of maintaining security in six areas, namely, safeguarding employment, the people's basic livelihood, market entities, food and energy security, stability of industrial and supply chains, as well as the smooth functioning of grassroots administration, so as to secure a decisive victory in the battle against poverty and to complete the building of a moderately prosperous society in an all-round way. The PBC will pursue a sound monetary policy that is more flexible and appropriate, while the intensity, focus, and pace of policy conduct will be properly managed to accommodate the changes in the pandemic containment situation and economic development at different stages. Attaching higher priority to supporting the recovery of the real economy, the PBC will intensify countercyclical adjustments, adopt both aggregate and structural policies to keep liquidity adequate at a reasonable level, and help the real economy, especially the micro, small and medium-sized enterprises (MSMEs), to tide over the difficulties. The role of central bank lending and central bank discount policies as a propelling force will be brought into full play to provide financial services precisely for pandemic containment, resumption of work and production, and development of the real economy. The relationship among stabilizing growth, ensuring employment, adjusting structures, preventing risks, and controlling inflation will be properly handled, while work will be done to keep prices basically stable and to guide expectations in various ways. Banks will be encouraged to replenish capital through multiple channels so as to enhance their capacity to serve the real economy as well as to forestall and defuse financial risks. The PBC will make continued efforts to deepen the LPR reform and proceed with the shift in the pricing benchmark for outstanding floating-rate loans, so as to smooth the mechanism of monetary policy transmission and to guide the market lending rates to move downward. The PBC will coordinate RMB and foreign exchange policies, and balance domestic and external economic dynamics. It will strike a balance among maintaining the flexibility of the RMB exchange rate, improving the macroprudential policies for cross-border capital flows, and strengthening international coordination of macro policies, so as to keep the RMB exchange rate basically stable at an adaptive and equilibrium level.

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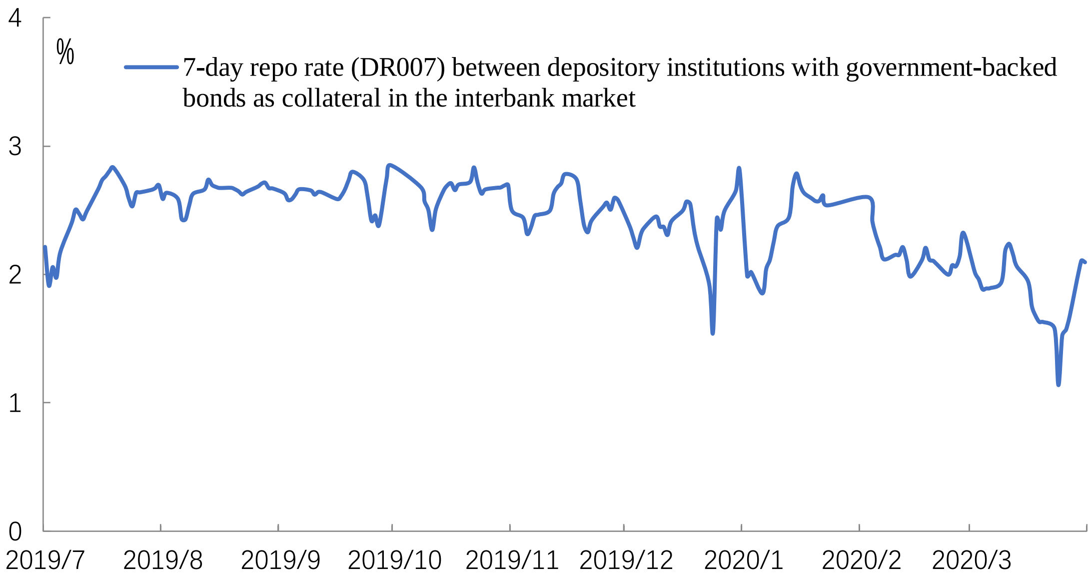
I. Liquidity in the banking system was adequate at a reasonable level

In Q1 2020, in accordance with the requirement that sound monetary policies should be more flexible and appropriate, the PBC intensified countercyclical adjustments and employed a monetary policy toolkit that included RRR cuts and the medium-term lending facility (MLF) to release medium and long-term liquidity. Open market operations were conducted flexibly to maintain adequate liquidity in the banking system at a reasonable level. The PBC also guided a steady decline in money market interest rates and smoothed operations in the financial market. At the end of March, the excess reserve ratio for financial institutions registered 2.1 percent, up 0.8 percentage points from the previous year.

Figure 1 Movement of Money Market Interest Rates



Source: www.chinamoney.com.cn.

II. Lending by financial institutions grew relatively rapidly, with lending rates moving downwards

Lending grew relatively rapidly, providing stronger support for the real economy. Multiple measures were taken to encourage financial institutions to enhance credit support for pandemic containment and resumption of work and production. In particular, the role of the loan prime rate (LPR) was brought into play in guiding an overall decline in market interest rates, to stimulate effective demands for credit, and to promote the rapid growth of loans. At the end of March, outstanding loans by financial institutions in domestic and foreign currencies grew 12.3 percent year on year to RMB166 trillion, up RMB7.4 trillion from the beginning of the year and an acceleration of RMB1.3 trillion from the corresponding period of the previous year. Outstanding RMB-denominated loans grew 12.7 percent year on year to RMB160.2 trillion, up RMB7.1 trillion from the beginning of the year and an acceleration of RMB1.3 trillion from the corresponding period of 2019.

The credit structure was optimized, and loans to micro and small businesses (MSBs) increased rapidly. Loans to enterprises and public entities grew by RMB6 trillion from the beginning of the year, a year-on-year increase of RMB1.6 trillion. Industries engaged in pandemic containment or heavily hit by the pandemic received strong credit support. The growth of loans to public health and social services reached 17.1 percent, rising 7.2 percentage points year on year. Medium and long-term loans to the manufacturing sector gained 16.7 percent, hitting a new record since April 2011. In particular, loans to the high-tech manufacturing sector rose by 39.2 percent over the same period of the previous year. At the end of March, outstanding inclusive loans to MSBs grew by 23.6 percent year on year to RMB12.4 trillion, up 4.5 percentage points from the same period of the previous year, thus supporting 27.87 million MSBs, a year-on-year increase of 22.2 percent. The growth of loans to the household sector slowed down to 13.7 percent at the end of March, 1.8 percentage points lower than that at end-2019.

Table 1 The Structure of RMB Loans in Q1 2020

Unit: RMB100 million

	Outstanding amount at end-March	YOY growth (%)	Increase from the beginning of the year	YOY acceleration
RMB loans to:	1602089	12.7	70978	12899
Households	565264	13.7	12074	-6022

Enterprises and public entities	1023144	12.1	60429	15636
Non-banking financial institutions	8098	37.7	-1729	3149
Overseas	5583	8.6	204	136

Note: Loans to enterprises and public entities refer to loans to non-financial enterprises, government departments and organizations.

Source: The People's Bank of China.

Table 2 New RMB Loans by Financial Institution in Q1 2020

Unit: RMB100 million

	Increase from the beginning of the year	YOY acceleration
Chinese-funded large-sized banks [1]	35274	9881
Chinese-funded small and medium-sized banks[2]	36235	3865
Small-sized rural financial institutions[3]	9645	1062
Foreign-funded financial institutions	388	-147

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.

Box 1 Smoother Transmission of Monetary Policy to the Real Economy in China

In recent years, following the decisions and arrangements of the CPC Central Committee and the State Council, the People's Bank of China (PBC) has used banks as the crux of monetary policy transmission. It has flexibly adopted various measures to alleviate the "three constraints" faced by banks in creation of money, namely, liquidity, capital, and interest rates, in an attempt to straighten out the monetary policy transmission mechanism. From 2018 to April 2020, the PBC cut the required reserve ratio (RRR) ten times, releasing long-term funds in the amount of RMB8.4 trillion. The average RRR fell from 14.9 percent from early 2018 to 9.4 percent. During the first two working days after this year's Spring Festival, beyond expectations the PBC injected RMB1.7 trillion of short-term liquidity, keeping liquidity adequate at a reasonable level. From 2019 to April 2020, banks issued perpetual bonds totaling RMB718.6 billion, effectively replenishing their tier-one capital. Since August 2019, the LPR reform has been successfully promoted, which has removed the implicit floor for loan rates and has activated the demand for loans. With the "three constraints" eased remarkably, the transmission mechanism of China's monetary policy is much smoother and transmission efficiency has obviously improved.

Since the COVID-19 outbreak, the PBC has rolled out a series of monetary policy measures in accordance with the periodic features of pandemic containment and the resumption of work and production. As the transmission efficiency of monetary policy is obviously enhanced, the transmission of various kinds of monetary policy measures to the real economy has been straightened out, which has effectively supported pandemic containment and resumption of work and production, and has alleviated the real difficulties in the real economy. In terms of guiding credit supply, in Q1 the PBC released long-term liquidity in the amount of about RMB2 trillion through RRR cuts and central bank lending. New RMB loans totaled RMB7.1 trillion. For liquidity injection per yuan, there is a corresponding credit growth of 3.5 yuan, which means the amplification ratio is 1:3.5. Deposits are a major component of the broad money (M2), created by credit expansion. The increase in credit supply is accompanied by an increase in deposits by enterprises and residents, which can effectively ease their cash flow pressures and help enterprises alleviate their urgent difficulties in terms of debt repayment, capital turnover, and fund-raising. In terms of reducing the lending rates, enterprise loan rate in March was 4.82 percent, down by 0.3 percentage points from end-2019 and 0.78 percentage points from the peak in 2018 respectively. This drop apparently surpasses those of the one-year MLF and the LPR during the same period. The effect of the policy rate decline is amplified and then transmitted to the real economy, and the LPR reform has effectively played a role in bringing down the lending rates.

Since March, in order to offset the impact of COVID-19, central banks in the US and the Eurozone have swiftly cut their interest rates to zero, put forward large-scale asset purchase plans, and even carried out unlimited quantitative easing. In terms of guiding the credit supply, the Federal Reserve released liquidity in the amount of USD1.6 trillion, with loans increasing by USD500 billion. One dollar's worth of liquidity injection corresponds to credit growth of USD0.3. In Q1, the European Central Bank released liquidity of about EUR540 billion, with loans increasing by EUR230 billion. One euro's worth of liquidity injection corresponds to credit growth of EUR0.4, which means the reduction ratio is 2.5:1. In terms of reducing lending rates, since 2020 the Federal Reserve has cut interest rates by 1.5 percentage points. The average lending rate for the four major US banks, namely, Citibank, Bank of America, Wells Fargo, and JP Morgan, was 4.96 percent in Q1, decreasing 0.17 percentage points from Q4 2019, and obviously lower than the drop in the policy rate. Interest rates for loans granted through the Federal Reserve's lending facility to small and medium-sized enterprises ranged from 4.8 percent to 6.5 percent and are guaranteed by the government. The European Central Bank cut the policy rate to zero and reduced the targeted longer-term refinancing operations rate by a total of 0.5 percentage points in March and April. The lowest rate may reach −1 percent. However, the interest rate for loans issued by commercial banks to small and micro businesses is 2.17 percent, down by 0.11 percentage points from end-2019.

In general, when evaluating policy effectiveness, it is crucial to determine whether aggregate financing support for the real economy has been increased and whether financing costs have been reduced. In comparison, transmission of monetary policy to the real economy is much smoother in China, both in terms of guiding credit supply and reducing lending rates. Banks have fully played their principal role and the market mechanism runs fairly well. Going forward, emphasis will be placed on making the sound monetary policy more flexible and appropriate. Continuous efforts will be made to put forward targeted measures in line with the periodic features of pandemic prevention and control and resumption of work and production and to maintain the transmission efficiency of monetary policy. This will further alleviate the real difficulties facing the real economy and offset the impact of COVID-19.

The weighted average interest rates on loans declined, and the corporate lending rates continued to move downwards. In March, the one-year LPR fell by 10 bps from last December to 4.05 percent and the over-five-year LPR fell by 5 bps to 4.75 percent. In March, the weighted average lending rate stood at 5.08 percent, down 0.36 percentage points from last December and 0.61 percentage points year on year. In particular, the weighted average interest rate on ordinary loans reached 5.48 percent, down 0.26 percentage points from last December and 0.56 percentage points year on year; the weighted average bill financing rate posted 2.94 percent, down 0.32 percentage points from last December and 0.70 percentage points year on year; the weighted average individual mortgage rate was 5.60 percent, down 0.02 percentage points from last December and 0.08 percentage points year on year. The corporate lending rate in March was reduced by 0.3 percentage points from end-2019, a drop clearly exceeding that of the LPR, which shows that the LPR reform has had remarkable effects. It has begun to act on strengthening the independent pricing capacities of financial institutions, improving the competitiveness of loan markets, and smoothing the market rate transmission. In mid-April, among ordinary loans, loans with rates lower than 90 percent of the benchmark accounted for 28.9 percent, 3 times that in July 2019 when the LPR reform had not yet kicked off. The implicit floor on loan rates was completely removed and pricing became increasingly market-based.

In March, the share of ordinary loans with rates above, at, or below the LPR registered 72.83 percent, 2.75 percent, and 24.42 percent, respectively. In general, the LPR premium decreased compared with that in last December.

Table 3 Shares of RMB Lending Rates at Different Levels in Q1 2020

Unit: %

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
January	20.63	1.75	77.62	19.95	24.70	16.83	8.95	7.17
February	31.41	2.12	66.47	17.72	21.02	12.29	6.91	8.53
March	24.42	2.75	72.83	19.39	22.81	14.35	8.87	7.42

Source: The People's Bank of China.

Sharp interest rate cuts by the Federal Reserve prompted a dip in interest rates on foreign-currency deposits and loans. In March, the weighted average interest rates on demand and large-value USD-denominated deposits with maturities within 3 months registered 0.21 percent and 1.43 percent respectively, down 0.09 percentage points and 0.5 percentage points from last December respectively. The weighted average interest rates of USD-denominated loans with maturities within 3 months and with maturities between 3 months (including 3 months) and 6 months registered 2.19 percent and 1.92 percent respectively, down 0.82 percentage points and 1.09 percentage points respectively from last December.

Table 4 Average Interest Rates of Large-value USD-denominated Deposits and Loans in Q1 2020

Unit: %

Month	Large-value deposits						Loans				
	Demand deposits	Within 3 months	3–6 months (including 3 months)	6–12 months (including 6 months)	1 year	Over 1 year	Within 3 months	3–6 months (including 3 months)	6–12 months (including 6 months)	1 year	Over 1 year
January	0.31	1.94	2.46	2.61	2.61	2.62	2.88	2.78	2.58	2.52	3.71
February	0.28	1.97	2.47	2.48	2.52	2.47	2.76	2.76	2.43	2.58	3.49
March	0.21	1.43	1.84	1.72	1.77	1.68	2.19	1.92	1.80	1.57	2.85

Source: The People's Bank of China.

Growth of deposits remained stable. At the end of March, outstanding deposits in domestic and foreign currencies in all financial institutions posted RMB206.4 trillion, up 9.2 percent year on year, 0.6 percentage points higher than that at the end of the previous year. Outstanding RMB deposits registered RMB201 trillion, up 9.3 percent year on year, 0.6 percentage points higher than that at the end of the previous year. Outstanding deposits in foreign currencies stood at USD765.4 billion, an increase of USD7.6 billion from the beginning of the year and a deceleration of USD33.7 billion year on year. Fiscal revenues tapered off, while expenditures on public health, such as pandemic containment, were higher. Fiscal deposits decreased by 10.7 percent year on year.

Table 5 The Structure of RMB Deposits in Q1 2020

Unit: RMB100 million

	Deposits at end-March	YOY growth (%)	Increase from the beginning of the year	YOY acceleration
RMB deposits:	2009933	9.3	80669	17610
Households	877723	13.0	64691	4012
Non-financial enterprises	613040	8.4	18600	15273
Public entities	299203	2.4	2034	-4629

Fiscal entities	37697	-10.7	-3143	-4795
Non-banking financial institutions	168750	12.3	-3713	5957
Overseas	13520	19.6	2200	1792

Source: The People's Bank of China.

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

At the end of March, outstanding M2 stood at RMB208.1 trillion, up 10.1 percent year on year, an acceleration of 1.4 percentage points from the end of 2019. Outstanding M1 stood at RMB57.5 trillion, a year-on-year growth of 5 percent and 0.6 percentage points higher than that at the end of the previous year. Outstanding M0 reached RMB8.3 trillion, up 10.8 percent year on year, an increase of 5.4 percentage points from the end of 2019. In Q1 2020, RMB583.3 billion of net cash was injected into the economy, a rise of RMB410 billion year on year.

According to preliminary statistics, the outstanding aggregate financing to the real economy (AFRE) reached RMB262.24 trillion at the end of March, up 11.5 percent year on year and an acceleration of 0.8 percentage points over the end of the previous year. In Q1 2020, the incremental AFRE reached RMB11.08 trillion, an increase of RMB2.47 trillion year on year. Growth of the AFRE was characterized by the following features. First, RMB loans saw a substantially larger year-on-year increase. Second, the drop in entrusted loans narrowed, and undiscounted bankers' acceptances registered larger month-on-month growth. Third, growth of both corporate bonds and equity financing accelerated. Fourth, government bonds saw a larger year-on-year increase. Fifth, the decline of asset-backed securities by depository financial institutions accelerated from the previous year, while the growth of loans that were written off decelerated.

Table 6 Aggregate Financing to the Real Economy in Q1 2020

	At end-March 2020		In Q1 2020	
	Stock (RMB 1 trillion)	Year-on-year change (%)	Flow (RMB100 million)	YOY change (RMB100 million)

AFRE	262.24	11.5	110767	24708
Of which：RMB loans	158.82	12.7	72501	9608
Foreign-currency loans (RMB equivalents)	2.34	7	1910	1669
Entrusted loans	11.35	-6.6	-970	1308
Trust loans	7.43	-5.6	-130	-966
Undiscounted bankers’ acceptances	3.36	-16.3	260	-1789
Corporate bonds	25.21	17.4	17657	8407
Government bonds	39.31	15.8	15781	6322
Domestic equity financing by non-financial enterprises	7.48	6	1255	724
Other financing	6.74	25.7	812	-371
Of which：Asset-backed securities of depository financial institutions	1.66	32	-232	-12
Loans written off	4.22	32.8	1546	-130

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

2. Since December 2019, the PBC has further improved the AFRE statistics by incorporating “treasury bonds” and “local government general bonds” into the AFRE and combining them with the existing “local government special bonds” under the item “government bonds.” The value of this indicator is the face value of the bonds under custody.

3. The PBC has further improved the “corporate bonds” statistics contained in the AFRE since September 2019 by incorporating them into the “exchange-traded asset-backed corporate securities.” The PBC has incorporated “local government special bonds” into the AFRE since September 2018 and incorporated “asset-backed securities by depository financial institutions” and “loans written off” into the AFRE statistics under the item “other financing” since July 2018 to improve the statistical AFRE method.

4. Year-on-year statistics in the table are on a comparable basis.
Sources: The 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.

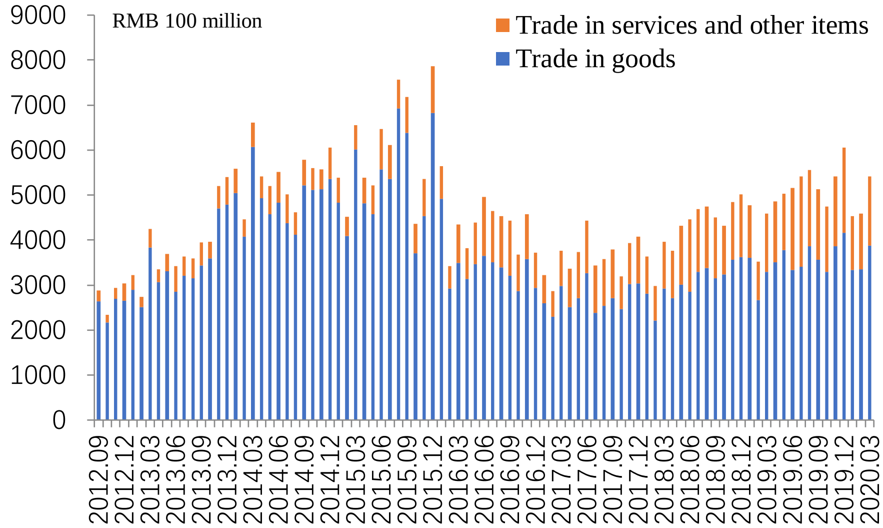
IV. The RMB exchange rate remained basically stable, and cross-border RMB transactions grew rapidly

Since the beginning of 2020, cross-border capital flows and foreign exchange supply and demand have been basically in equilibrium, with market expectations generally stable. Based on market supply and demand, the RMB exchange rate moved in both directions and remained basically stable at a reasonable equilibrium level. With the world economy struck by the pandemic, volatility in the international foreign exchange market swelled dramatically. The RMB exchange rate also fluctuated somewhat, but it showed relatively strong resilience while remaining flexible. The RMB exchange rate against the USD depreciated marginally and the rate against a basket of currencies appreciated. At the end of March, the China Foreign Exchange Trade System (CFETS) RMB exchange-rate index and the RMB exchange rate index based on the special drawing rights (SDRs) basket closed at 94.06 and 91.35, up 2.92 percent and down 0.5 percent from end-2019, respectively. According to calculations by the Bank for International Settlements (BIS), from end-2019 to the end of March, the nominal effective exchange rate (NEER) and the real effective exchange rate (REER) of the RMB appreciated by 2.46 percent and 3.13 percent, respectively. From 2005 when reform of the exchange rate formation regime commenced to end-March, the NEER and REER of the RMB appreciated by 35.56 percent and 51.04 percent, respectively. At the end of March, the central parity of the RMB against the USD was 7.0851, a depreciation of 1.54 percent from end-2019. From the launch of the reform of the exchange rate formation regime in 2005, the central parity of the RMB against the USD appreciated by 16.82 percent on a cumulative basis. In Q1 2020, the annualized volatility rate of the RMB exchange rate against the USD was 5.7 percent, which was greater than the average in 2019, but less than those of the major international currencies and the emerging market currencies in the midst of the global financial market turmoil.

In Q1 2020, cross-border receipts and payments in RMB totaled RMB6.1 trillion, up 39 percent year on year. In particular, RMB receipts and payments registered RMB3 trillion and RMB3.1 trillion, respectively. RMB cross-border receipts and payments under the current account grew 15 percent over the previous year to RMB1.5 trillion. Specifically, settlement of trade in goods registered RMB1.1 trillion, whereas settlement of trade in services and other items registered a cumulative RMB0.4 trillion. RMB cross-border receipts and payments under the capital account posted RMB4.6

trillion, up 48 percent year on year.

Figure 2 Monthly RMB Payments and Receipts Under the Current Account



Source: The People's Bank of China.

Part 2. Monetary Policy Operations

In Q1 2020, amid the complicated situations such as the mounting downward economic pressures both in and out of China caused by the COVID-19 outbreak and the massive volatility in international financial market, the PBC adhered to the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, implemented the decisions of the CPC Central Committee and the State Council, coordinated pandemic containment with economic and social development, implemented a sound monetary policy in a more flexible and appropriate manner, and adopted preemptive forceful measures. During different phases of battling COVID-19, the PBC innovated policy tools and rolled out measures as needed. By stabilizing expectations, expanding the aggregate amount, adopting targeted measures, emphasizing loan extensions, innovating measures, and focusing on implementation, the PBC effectively supported pandemic control and work and production resumption and cushioned the impact of the outbreak on the economy. All these efforts helped to foster a proper monetary and financial environment for winning the battle against the outbreak and for maintaining stability of employment, the financial sector, foreign trade, foreign and domestic investment, and expectations.

I. Conducting open market operations in a flexible manner

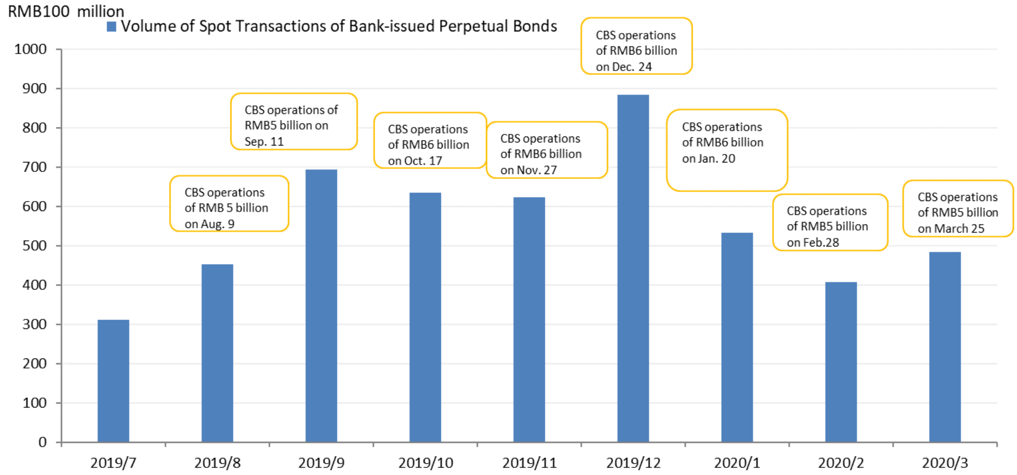
Effectively responding to the COVID-19 disruptions by acting decisively to inject short-term liquidity. In light of the possible large short-term disruptions to the financial market when it reopened after the Spring Festival, on February 2, the final day of the Spring Festival vacation, the PBC announced stronger-than-expected liquidity injection measures to stabilize market expectations. From February 3 to 4, RMB1.7 trillion of short-term repos were conducted through open market operations (OMOs), thus supporting the stable operation of the financial market.

Maintaining adequate liquidity at a reasonable level with an appropriate amount and tempo of OMOs. As domestic market sentiments gradually stabilized, the PBC suspended OMOs in succession beginning in mid-February and properly withdrew liquidity when repos matured, guiding liquidity aggregates to return to a normal level. With the approach of end-March, due to a strong demand for funds at the end of the quarter, and somewhat unstable market sentiments caused by the continued liquidity strain of the US dollar in the overseas market, the PBC conducted 7-day repos at the end of the first quarter to shore up market confidence and to guarantee the smooth performance of all types of financial institutions entering the new quarter.

The OMO rates moved downward. From the beginning of the year to end-April, the 7-day repo rate dropped 30 basis points to 2.2 percent, and the MLF rate dropped 30 basis points, signaling a strengthened countercyclical adjustment of monetary policy and guiding money market interest rates to move downward. Meanwhile, the financing cost for the real economy was reduced through LPR transmissions. In Q1 2020, money market rates moved steadily with less volatility, remaining within a reasonable range. In Q1 2020, the 7-day repo rate (DR007), which is a funding rate between depository institutions and pledged by government-backed bonds in the interbank market, averaged 2.11 percent, 39 basis points lower than that in Q4 2019. At end-Q1, the DR007 stood at 2.09 percent, 64 and 72 basis points lower than that in the same period of the previous year and end-2019, respectively.

Conducting central bank bill swap (CBS) operations successively. In order to improve the market liquidity of perpetual bonds issued by banks and to support banks to replenish capital through perpetual bond issuances, the PBC conducted CBS operations three times in Q1, once in each month, totaling RMB16 billion. The maturities of all these operations were three months at a fixed rate of 0.1 percent. The bonds swapped with the PBC included not only perpetual bonds issued by large-sized commercial banks and joint-stock commercial banks but also those issued by urban commercial banks, reflecting support by the central bank to small and medium-sized banks to replenish capital through perpetual bond issuances.

Figure 3 Volume of Spot Transactions of Bank-issued Perpetual Bonds



Source: The People's Bank of China.

Issuing central bank bills in Hong Kong on a regular basis. On February 13 and March 26, the PBC issued three batches of RMB-denominated central bank bills in Hong Kong, totaling RMB40 billion. Specifically, the 3-month, 6-month, and 1-year bills registered RMB20 billion, RMB10 billion, and RMB10 billion, respectively, with the balance standing at RMB80 billion as of end-March. The issuance enriched RMB assets with high credit ratings in the offshore market, fostered the sound development of the offshore RMB money market as well as the offshore issues of RMB bonds by other entities, and further promoted the use of RMB as an international currency.

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

Standing Lending Facility (SLF) operations were conducted to provide short-term liquidity in a timely manner. The demand of locally incorporated financial institutions was met in full amount, with the SLF playing the role of the ceiling of the interest rate corridor, thus promoting the smooth operation of the money market. In Q1 2020, the PBC conducted a total of RMB102.7 billion SLF operations, with the balance registering RMB30.6 billion at end-March. The overnight, 7-day, and 1-month SLF rates registered 3.35 percent, 3.50 percent, and 3.85 percent respectively at end-March, basically at the same level as those in the previous quarter. On April 10, the above-mentioned SLF rates were lowered by 30 basis points, after which the overnight, 7-day, and 1-month SLF rates registered 3.05 percent, 3.2 percent, and 3.55 percent, respectively.

The PBC conducted timely MLF operations to guarantee the supply of base money, with a declining rate. In Q1 2020, the PBC conducted a total of RMB600 billion of MLF operations, all with a maturity of one year. At end-March, the outstanding MLF registered RMB4290 billion, an increase of RMB600 billion from the beginning of the year. On February 17, the rate of the MLF declined by 10 basis points from the previous operation to 3.15 percent, and on April 15, the rate declined by 20 basis points to 2.95 percent, hence improving the risk appetite and boosting market confidence. The decline of the rate reflected the lower average marginal funding cost of financial institutions, which helps reduce the actual corporate lending rate through the LPR and to promote lower social funding costs.

III. Enhancing monetary and credit support to offset the effects of the COVID-19 outbreak

To offset the effects of the COVID-19 outbreak, the PBC resolutely followed the decisions and arrangements of the CPC Central Committee and the State Council, acted promptly and proactively, and adopted a series of monetary and credit policies to boost domestic demand, to contribute to work and production resumption, and to stabilize employment.

First, liquidity remained adequate at a reasonable level. A total amount of RMB1.7 trillion was injected into the market when it reopened after the Spring Festival vacation. In addition to the release of over RMB800 billion through the across-the-board RRR cut of 0.5 percentage points at the beginning of the year, a further RMB550 billion was released in March through the targeted RRR cuts, hence supporting loans of financial institutions in the inclusive finance area.

Second, special central bank lending was launched to provide targeted support to key areas and to enterprises in battling COVID-19. In support of winning the fight against the outbreak, the PBC released the *Notice on Providing Special Central Bank Lending to Support the Prevention and Control of COVID-19* (Yinfa No.28 [2020]) on January 31, 2020. The aim was to provide low-cost special central bank lending in a total amount of RMB300 billion to major national banks and some locally incorporated banks in 10 key provinces (municipalities), such as Hubei, to support the provision of credit by financial institutions at favorable rates to key enterprises directly engaged in the production, transportation, and sale of key medical supplies and daily necessities in the fight against the virus.

Third, an additional RMB500 billion of central bank lending and central bank discount quotas was introduced to support work and production resumption in an

orderly manner. The PBC released the *Notice of the People's Bank of China on Ramping up Central Bank Lending and Central Bank Discounts to Support Orderly Work and Production Resumption* (Yinfa No.53 [2020]) on February 26, 2020, increasing central bank lending and central bank discount quotas by RMB500 billion, and at the same time reducing the interest rate of central bank lending designated for agricultural sector and small businesses by 0.25 percentage points to 2.5 percent. Therefore, low-cost and inclusive funding support was provided for the orderly resumption of work and production, and debt repayment, capital turnover, the expansion of the funding scale, and other urgent issues confronting enterprises were also addressed.

Fourth, another RMB1 trillion of central bank lending and central bank discounts quotas were introduced to support the economic recovery and development. The PBC released the *Notice of the People's Bank of China on Ramping Up Central Bank Lending and Central Bank Discounts for Small and Medium-sized Banks to Extend Credit Supply Designated for Agricultural Entities, MSBs, and Private Businesses* (Yinfa No.93 [2020]) on April 20, 2020. The quotas of central bank lending and central bank discounts were raised by RMB1 trillion, thus enabling the issue of loans at favorable rates to MSMEs in a wider scale and with a wider coverage and supporting a larger credit supply to agriculture, foreign trade, and other sectors that were heavily affected by the outbreak.

Fifth, synergy in the financial system was forged and counter-cyclical adjustments were strengthened. Financial institutions were guided to provide differentiated financial services to areas with different COVID-19 alert levels. Major state-owned banks were urged to ramp up support for MSBs in inclusive finance areas, special credit support from policy banks was put in place, and locally incorporated banks were guided to serve local communities effectively Five ministries, with active cooperation between the PBC and the CBIRC, released the *Notice on Temporary Loan Deferments of Principal and Interest for Micro, Small, and Medium-sized Enterprises* (Yinbaojianfa No.6 [2020]) on March 1, 2020, encouraging financial institutions to allow temporary loan deferments in both principal and interest to qualified MSMEs with temporary liquidity difficulties on the basis of their applications. The repayment date may be extended to June 30.

Box 2 The Precise Role of Central Bank Lending and Central Bank Discounts in Combating COVID-19 and Promoting Economic and Social Development

In order to coordinate pandemic containment with economic and social development, the PBC has taken the initiative in introducing policy measures. Based on the progress of pandemic containment, the PBC has provided RMB300 billion worth of special central bank lending, RMB500 billion worth of central bank lending and central bank discounts, and RMB1 trillion worth of central bank lending and central bank discounts in succession, with a combined quota of RMB1.8 trillion. The role of central bank lending and central bank discounts in providing targeted liquidity has been brought into full play, vigorously supporting containment of the pandemic, the provision of medical supplies and daily necessities, resumption of work and production, and development of the real economy, especially the MSMEs.

1. **The PBC has reasonably mastered the pace and strength of central bank lending and central bank discounts.** In response to the pandemic containment and economic and social development, this round of central bank lending and central bank discounts has been employed sequentially with increased policy strength on three occasions since the beginning of this year. In order to win the battle against the pandemic and ensure the provision of medical supplies and daily necessities, on January 31 the PBC provided special central bank lending amounting to RMB300 billion, which was intended to provide low-cost funds to major national banks and selected locally incorporated banks in key provinces including Hubei. These banks were expected to provide credit support at preferential interest rates to major enterprises that participated in the production, transportation, and sales of medical supplies and daily necessities for pandemic containment. With the pandemic preliminarily under control at home, in order to support the orderly resumption of work and production, on February 26 the PBC raised the quota for central bank lending and central bank discounts by a total of RMB500 billion and cut the central bank lending rate on loans supporting the agricultural sector and small businesses by 0.25 percentage points to 2.5 percent. This expanded the coverage and inclusiveness of credit support and made low-cost inclusive funding accessible to more enterprises, thus solving their urgent difficulties in work and production resumption, repayment of debts, turnover of capital, and expansion of funding. In an attempt to shore up the real economy and mitigate the impact of the global COVID-19 outbreak, on April 20 the PBC again increased the quota for central banking lending and central bank discounts by RMB1 trillion, which was to be used to issue preferential loans to the vast number of MSMEs. Financial institutions were encouraged to increase their credit supply to the agro-linked sector, foreign trade, as well as sectors severely hit by the pandemic. This policy has boosted credit support with more strength, wider coverage, and enhanced inclusiveness.

2. **Characteristics of central bank lending and central bank discounts since the beginning of this year.** The three-time implementation of central bank lending and central bank discounts was featured by broadened coverage, growing inclusiveness, preferential interest rates, and precise requirements on the use of funds.

First, the policy coverage was broadened gradually with growing inclusiveness.

The RMB300 billion worth of special central bank lending was provided to 9 national banks and 31 locally incorporated banks in 10 provinces (municipalities). List-based management was adopted for major enterprises, which were selected by the National Development and Reform Commission (NDRC), the Ministry of Industry and Information Technology, and the provincial governments of key provinces. It was required that the funds be used for the production and business operations of industries related to pandemic containment. The RMB500 billion and RMB1 trillion worth of central bank lending was provided to over 4,000 locally incorporated financial institutions nationwide. To be specific, RMB500 billion was expected to be provided to more than 500,000 economic entities including enterprises, and RMB1 trillion was to support over 2 million economic entities.

Second, preferential interest rates helped bring down the financing costs of the real economy. The interest rate on the RMB300 billion worth of special central bank lending was the one-year loan prime rate (LPR) of the previous month minus 250 basis points (bps), or 1.35 percent at the time. Financial institutions were required to issue loans with the funds from the special central bank lending at an interest rate no higher than the latest one-year LPR minus 100 bps, or 2.85 percent at the time. With a 50 percent discount subsidized by public financing, the actual financing cost of enterprises was ensured to be lower than 1.6 percent. The interest rate on the RMB500 billion worth of central bank lending stood at 2.5 percent, and financial institutions were required to use the funds from the central bank lending and central bank discounts to issue loans at an interest rate no higher than the latest LPR plus 50 bps, or 4.35 percent at the time. In terms of the central bank lending and central bank discounts in the amount of RMB1 trillion, small and medium-sized banks were guided to issue loans with the corresponding funds at a preferential interest rate at about 5.5 percent to the vast number of MSMEs, with the financing cost averaging below 5.5 percent.

Third, a reimbursement-based management mode was adopted to guide the use of funds, i.e., issuing loans first and applying for funding later, so as to prevent the misuse of funds. Financial institutions were required to issue loans to enterprises that meet the requirements in the first place, and then to apply to the PBC for central bank lending in the same amount. Therefore, use of funds from central bank lending could be precisely managed. The PBC also required financial institutions to set up an electronic file to closely track and monitor the use of funds in a bid to prevent the misuse of funds.

3. Implementation of the policy has achieved results. The three-time implementation of central bank lending and central bank discounts played a positive role in supporting pandemic containment, resumption of work and production, and economic and social development. The provision of special central bank lending in the amount of RMB300 billion is coming to an end. As of May 5, 9 national banks and locally incorporated banks in 10 provinces (municipalities) had cumulatively issued RMB269.3 billion worth of preferential loans to a total of 7,037 key enterprises, with each enterprise granted preferential loans worth no more than RMB40 million. The weighted average interest rate on the preferential loans posted 2.50 percent, bringing down the actual financing costs of enterprises to approximately 1.25 percent after deducting the subsidy from the public financing, i.e., a 50-percent discount on the interest. At present, the scarcity of medical supplies has been substantially eased and the supply of daily necessities has returned to normal. Of the RMB500 billion worth of central bank lending and central bank discounts, 80 percent have been used to issue loans. As of May 5, preferential loans (including discounts) cumulatively issued by locally incorporated banks amounted to RMB399.6 billion, benefiting 524,000 enterprises (including rural households). To be specific, agro-linked loans, MSB loans for inclusive finance, and bank discounts posted RMB72.6 billion, RMB258.3 billion, and RMB68.7 billion, with the weighted average interest rates standing at 4.38 percent, 4.43 percent, and 3.05 percent respectively. All the above-mentioned interest rates were below the latest one-year LPR plus 50 bps, thus meeting the regulatory requirements. The policy of the RMB1 trillion worth of central bank lending and central bank discounts has been put in place. The PBC branches and sub-branches have been carrying out the credit supply in an orderly manner. As a continuation of the previous two phases of policy implementation, the third provision of RMB1 trillion is expected to take effect, providing credit support for the real economy and guiding the downward trend of social financing costs.

IV. Lowering the required reserve ratio for financial institutions

The RRR and excess reserve ratio for financial institutions were cut to support development of the real economy. First, on January 6, 2020, the PBC lowered the RRR for financial institutions (excluding finance companies, financial leasing companies, and auto finance companies) by 0.5 percentage points, releasing over RMB800 billion of long-term funds. Second, on March 16, the PBC implemented a targeted RRR cut for inclusive finance. Based on the assessment on the issuance of loans for inclusive finance in 2019, it granted a preferential RRR cut of 0.5–1.5 percentage points to eligible institutions, and thereby released approximately RMB400 billion in net long-term funds. Moreover, joint-stock commercial banks that received a 0.5-percentage-point RRR cut according to this assessment will enjoy an additional RRR cut of 1 percentage point. The cut was expected to release long-term funds of about RMB150 billion, all of which are required to be used to issue inclusive finance loans. Third, the RRR cut of 1 percentage point for rural commercial banks, rural cooperative banks, village banks, and city commercial banks operating solely within provincial-level administrative regions was carried out in two phases, with a cut of 0.5 percentage points each time, on April 15 and May 15 respectively. About RMB400 billion of long-term funds were freed up by the cuts. Fourth, starting from April 7, the interest rate on excess reserve deposited in the central bank by financial institutions was cut from 0.72 percent to 0.35 percent. All the above-mentioned policies have contributed to boosting financial institutions' support for MSMEs, bringing down social financing costs, and shoring up the real economy.

V. Further improving the macroprudential policy framework

The role of the macroprudential assessment (MPA) was effectively brought into play to optimize the credit structure and promote the financial supply-side structural reform. In Q1 2020, the central economic work conference required that medium and long-term funding be increased for the manufacturing sector and the difficulties faced by private enterprises and MSMEs be alleviated in terms of accessing affordable funding. In line with these requirements, the PBC further increased the weight of financing for MSBs, private enterprises, and the manufacturing sector in the MPA, in order to guide financial institutions to enhance credit support for related enterprises. A new assessment index, i.e., use of central bank lending, was introduced to encourage locally incorporated banks to better use the newly-added RMB500 billion worth of central bank lending and the central bank discounts quota in issuing preferential MSME loans. The use of funds released from the targeted RRR cuts by joint-stock banks was also incorporated into the MPA, requiring joint-stock banks to further increase credit supply for inclusive finance.

The parameter for overall cross-border financing was adjusted in the MPA, bringing down financing costs for the real economy. In a bid to expand the use of foreign capital, facilitate cross-border financing for domestic institutions, and reduce financing costs for the real economy, on March 11 the PBC and the State Administration of Foreign Exchange (SAFE), based on the current macroeconomic conditions and the balance of payments, released the *Notice on Adjusting the Parameter for Overall Cross-border Financing in the MPA* (Yinfa No. 64 [2020]), increasing the parameter from 1 to 1.25. After the policy adjustment, the upper limit on the risk-weighted balance of cross-border financing was raised accordingly. This policy is intended to help domestic institutions, particularly small and medium-sized enterprises (SMEs) and private enterprises, make full use of resources and markets at home and abroad, broaden financing channels, alleviate their difficulties in accessing affordable funding, and promote the resumption of work and production, so as to better serve the development of the real economy.

VI. Giving full play to the role of structural monetary policy instruments

The PBC actively leveraged credit policy to support central bank lending, central bank discounts, pledged supplementary lending (PSL), and other policy tools, and to guide financial institutions to enhance support for key areas in the national economy and weak links, such as MSBs, private firms, agriculture, rural areas,

and rural residents, as well as poverty alleviation. The *Notice of the People's Bank of China on Leveraging the Special Quota of Central Bank Lending in Support of Agriculture, Rural Areas, and Rural Residents to Facilitate the Expansion of Credit to the Hog Breeding Sector* (Yinfa No.56 [2020]) was issued on February 28. The PBC provided RMB20 billion of the special central bank lending quota targeting agriculture, rural areas, and rural residents in an attempt to support credit expansion to the hog breeding sector. Central bank lending to support special poverty alleviation projects was leveraged in a bid to increase credit supply to areas of extreme poverty, including the "three autonomous regions," i.e., Tibet, four prefectures in southern Xinjiang, and the Tibetan areas in four provinces, and the "three autonomous prefectures," i.e., Linxia in Gansu, Liangshan in Sichuan, and Nujiang in Yunnan, and to cut down on the financing costs in these areas as well as to promote realization of the goals of targeted poverty alleviation and elimination. In Q1, RMB6.3 billion of central bank lending to support special poverty alleviation projects was issued, with the nationwide outstanding amount of such lending reaching RMB13.9 billion at the end of March. Outstanding central bank lending to support agriculture, rural areas, and rural residents stood at RMB278.4 billion at the end of March. Outstanding central bank lending for MSBs and for poverty alleviation posted RMB370.4 billion and RMB158.2 billion, respectively. Outstanding central bank discounts registered RMB508.2 billion. In Q1, the PBC provided RMB20.2 billion of PSLs to policy and development banks, with the outstanding volume registering RMB3.5576 trillion at the end of March

The targeted medium-term lending facility (TMLF) was conducted. The TMLF provided a stable and long-term funding source for financial institutions to expand credit supply to private firms and MSBs at preferential interest rates. In January, the PBC conducted one-year TMLF operations at an interest rate of 3.15 percent, totaling RMB240.5 billion. At the end of March, the outstanding TMLF stood at RMB805.6 billion.

VII. Leveraging the structural guidance role of credit policies

The PBC fully implemented the decisions and arrangements of the CPC Central Committee and the State Council, upheld the supply-side structural reform as the main task, and guided financial institutions to enhance their support to key areas of the national economy and to weak links. By channeling funds to back the real economy, especially the MSMEs, and focusing on employment in key industries and key population, it aimed to be successful in the battle of poverty elimination and in the building of a moderately prosperous society in all respects.

First, financial services were provided to effectively promote targeted poverty alleviation. Efforts were made to reinforce the application of and guidance on policy tools, to provide more financial resources to extremely poor areas, and to maintain rapid expansion in loans and central bank lending to areas of extreme poverty, including the three autonomous regions, i.e., Tibet, the four prefectures in southern Xinjiang, and the Tibetan areas in four provinces and the three autonomous prefectures, i.e., Linxia in Gansu, Liangshan in Sichuan, and Nujiang in Yunnan.

Second, financial services were further strengthened to support rural revitalization. Measures were taken to financially safeguard spring farming, tillage preparation, and hog production, to support financial institutions' expansion of the scope of collateral, to explore innovation in pledging livestock and poultry and in collateralizing collective assets and shares, in a bid to actively meet the financing needs of a new-type agricultural business entities.

Third, financial services were actively provided to support resumption of the work and production of MSMEs. The PBC guided financial institutions to enhance their credit support for MSMEs by using funds from central bank lending and discounts so as to lower comprehensive financing costs. Enterprises with short-term difficulties due to COVID-19 are allowed to temporarily defer payments of principal and interest. Guidelines were given for no irrational recalling, discontinuing, or cutting of loans. Financial institutions were encouraged to increase the credit supply to MSBs with funds collected by issuing special financial bonds to support MSBs. A total of RMB131.5 billion of such bonds was issued in Q1.

Fourth, continued efforts were made to enhance financial support for the high-quality development of manufacturing. Commercial banks were guided to provide personalized credit products and financial services based on the features of manufacturing enterprises and to strengthen their financing support for high-tech manufacturing.

Fifth, financial support for employment and entrepreneurship was strengthened. With communication and cooperation enhanced among agencies, the PBC studied and improved policies for secured loans, eased criteria for loan applicants, improved loan approval efficiency, and stepped up financial support for the employment and entrepreneurship of special social groups, including veterans, college graduates, and migrant workers returning home for business start-ups.

VIII. Deepening the market-oriented interest rate reform

The PBC continued to put in place reform measures to lower the real interest rates

on corporate loans. Since 2020, application of the LPR was further promoted. The one-year and above-five-year LPR were reported at 4.05 percent and 4.75 percent, respectively in March, and reduced to 3.85 percent and 4.65 percent in April, respectively, 30 basis points and 15 basis points lower than those in December 2019, respectively. Given its indication in direction and guidance, the LPR helps to further lower the real interest rates on loans. In line with market-oriented and law-based principles, the PBC promoted a shift in the pricing benchmark for outstanding floating-rate loans in an orderly manner, which started from March 1 as scheduled. After basic completion of the shift, the LPR is expected to have a more significant effect on transmitting the lowered LPR to loan interest rates, so that the difficulties and high costs of financing for MSBs will be further alleviated.

Box 3 Significant Achievements in the Loan Prime Rate Reform

In accordance with the decisions and arrangements of the State Council, on August 17, 2019, the PBC released an announcement on reforming and improving the formation mechanism for the LPR, with the aim of deepening the market-oriented reform of loan interest rates. After a period of continued efforts, significant achievements were made in the LPR reform.

First, the market-based LPR better reflects changes in market demand and supply. After the introduction of the LPR in 2013, due to the banks' inertia in pricing loans and other factors, the spread between the LPR and the benchmark loan interest rate remained relatively constant, with a low degree of market orientation. The LPR reform allowed panel banks to make quotes based on their own actual loan interest rates for prime clients by adding some basis points to the interest rate of the MLF. Determined by market bidding, the interest rate of the MLF reflects the average marginal funding cost of banks. The LPR is more market-based given its formation by adding some basis points to the MLF interest rate. With the gradual decline of the LPR since August 2019, the one-year LPR was reduced by a cumulative 0.4 percentage points, fully reflecting the changes in demand and supply of market funds.

Second, the PBC promoted the application of the LPR in the order of "new loans first, outstanding loans second." Banks' application of the LPR to the price-setting of new loans was incorporated into the assessment of the MPA, thus propelling banks to use the LPR in setting loan prices in an orderly manner. New loans using the LPR in price-setting accounted for 90 percent of all such loans by the end of December 2019. From January 1, 2020, banks are not allowed to sign new contracts of floating-rate loans with reference to the benchmark loan interest rates. On this basis, replacement of the pricing benchmark for outstanding floating-rate loans was launched on March 1, 2020 as scheduled, and was orderly advanced in line with market-oriented and law-based principles. Affected by COVID-19, banks, in an attempt to allow clients to process replacements and to avoid the gathering of people, during the early stages handled the business via internet banks and mobile banks, among other online methods. As progress has been achieved in this respect, with the stabilization of COVID-19 containment and future acceleration in the resumption of work and production, replacement of the pricing benchmark for outstanding floating-rate loans will be stepped up.

Third, efficiency of the transmission from monetary policy to loan interest rates was strengthened remarkably. During April 11–20, 2020, new loans with interest rates lower than 0.9 times the original benchmark loan interest rate accounted for 28.9 percent of all new loans, and this proportion more than tripled from its level in July 2019 when the reform has yet started. The implicit floor on loan rates was completely removed. The internal pricing mechanism of banks was further improved, and the market-determined LPR gradually replaced the loan benchmark interest rate as the main reference for internal funds transfer pricing (FTP) of commercial banks. According to statistics, most national banks have embedded the LPR in the FTP curve. Owing to the higher correlation between the FTP and the LPR, the FTP in commercial banks became more market-oriented.

Fourth, significant achievements have been made with reform measures to facilitate a reduction of the real loan interest rate. After the LPR reform was launched, with strengthened awareness and capability of price negotiations with enterprises, the loan market became more competitive. Some banks actively provided services for grassroots clients and ramped up their loan support for MSBs, thus notably pushing downward the overall interest rates of corporate loans. In March 2020, the interest rate of general loans (personal mortgage loans excluded) stood at 5.48 percent, 0.62 percentage points lower than that in July 2019 when the reform has yet kicked off and 0.26 percentage points lower than that at the beginning of this year, a remarkably sharper decrease than the fall of the LPR over the same period.

Fifth, the LPR reform played an important role in promoting the market-oriented reform of deposit interest rates. As the LPR reform deepened, loan interest rates were aligned with market interest rates and became more market-based. Due to the overall decrease in interest rates in the loan market, bank income from loans declined. To match the income from assets, banks cut the costs of the liabilities as needed, with lower incentives to attract deposits at high interest rates, thus guiding the decline of deposit rates. In fact, changes have taken place in the deposit rates as some banks have actively lowered the rates and rates on market-priced money market funds as well as other quasi-deposit products trended downwards. Hence, the deposit rates and market interest rates became increasingly aligned, i.e., shifting away from the existing two-track interest rate system into a unified system. The reform of interest rates in the loan market enabled the deposit rates to effectively become more market-oriented.

Going forward, the PBC will continue to deepen the LPR reform and release its potentials. Further efforts will be made to smooth the transmission channel from market interest rates to loan interest rates, facilitate the reduction of real loan interest rates, and support work and production resumption and economic and social development. Meanwhile, the PBC will promote the shift in the pricing benchmark for outstanding floating-rate loans in an orderly manner, strengthen its monitoring of the progress of the shift, and integrate the shift of outstanding corporate loans in financial institutions into the MPA and the eligibility prudential assessments, which is expected to be basically completed by the end of August.

IX. Improving the market-oriented RMB exchange rate regime

The PBC continued to advance the market-oriented exchange rate reform and to improve the managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. It maintained the flexibility of the exchange rate and gave play to the role of the exchange rate as an automatic stabilizer in adjusting the macro economy and the balance of payments. In the meantime, the PBC attached importance to guiding expectations and keeping the RMB exchange rate basically stable at an adaptive and equilibrium level. In Q1 2020, the highest and lowest CNY central parities were 6.8606 and 7.1052 against the USD, respectively. During the 58 trading days, the RMB appreciated on 27 days and depreciated on 31 days. The biggest intraday appreciation and depreciation were 0.45 percent (309 bps) and 0.76 percent (530 bps), respectively. The RMB exchange rate against other major international currencies floated two-ways with both appreciations and depreciations. At end-March, the central parities of the RMB against the dollar and the Japanese yen had depreciated 1.54 percent and 2.22 percent respectively from end-2019, while the RMB had appreciated 0.09 percent and 4.46 percent respectively against the euro and the pound. From the RMB exchange rate regime reform in 2005 to end-March 2020, the RMB against the dollar, the euro, and the Japanese yen appreciated by a cumulative total of 16.82 percent, 28.24 percent, and 11.47 percent respectively. Direct RMB trading was buoyant on the interbank foreign exchange market with steady liquidity, which helped lower the exchange costs for market participants and facilitate bilateral trade and investment.

Table 7 Trading Volume of the RMB Against Other Currencies in the Interbank Foreign Exchange Spot Market in Q1 2020

Unit: RMB100 million

Currency	USD	EUR	JPY	HKD	GBP	AUD	NZD
Trading volume	112114.73	3529.67	486.59	354.33	56.25	135.84	19.24
Currency	SGD	CHF	CAD	MYR	RUB	ZAR	KRW
Trading volume	228.38	8.60	35.27	1.53	15.93	0.69	10.28
Currency	AED	SAR	HUF	PLN	DKK	SEK	NOK
Trading volume	3.62	6.46	0.20	0.29	0.54	8.25	0.67
Currency	TRY	MXN	THB	KHR	KZT	MNT	
Trading volume	0.28	0.13	76.75	0.01	0.02	0	

Source: China Foreign Exchange Trade System.

As of end-March, under the bilateral currency-swap agreements between the PBC and foreign monetary authorities, the latter utilized a total of RMB32.66 billion, and the former utilized an equivalent of USD418 million denominated in foreign currencies. These operations played an active role in promoting bilateral trade and investment.

X. Promoting resolution of financial risks in a prudent and orderly manner and deepening the reforms of financial institutions

Risk resolution of Baoshang Bank (BSB) was promoted in a prudent and orderly manner. Since the takeover of BSB due to its severe credit risk, steady progress has been made by the joint efforts of all relevant parties. On April 30, BSB issued an announcement that part of its businesses, assets, and liabilities would be transferred to Mengshang Bank (MSB) and Huishang Bank. MSB was scheduled to open for business on May 6. On balance, this swift and decisive action has avoided further deterioration of the bank’s risks, ensured maximum protection of the legitimate rights and interests of its depositors and clients, and maintained overall social stability. Meanwhile, in line with the laws and regulations, it has put an end to the practice of de facto guaranteed repayments. During this entire process, the PBC has fully played its role as "lender of last resort", which has effectively contained the risks of contagion from BSB to other small and medium-sized banks and thus has succeeded in defending the bottom line of no systemic risks.

Phased achievements were made in disposing of high-risk small and medium-sized financial institutions. The PBC actively defused hidden risks in some city commercial banks, rural commercial banks, and rural credit cooperatives over the years, and ensured maximum protection of the legitimate rights and interests of creditors. It promoted provincial-level governments to formulate risk disposal plans for small and medium-sized financial institutions, according to the principle of "one province, one policy." The reform and restructuring plan of Hengfeng Bank was successfully put in place and phased progress was made in the reform and restructuring of Bank of Jinzhou.

Steady progress was made in the reform of development and policy financial institutions. Implementation of the reform plans for development and policy financial institutions was comprehensively promoted. The PBC, together with members of the Reform Working Group, promoted implementation of the reform measures in an orderly manner, such as establishing and enhancing the boards of directors, improving the governance structure, and redefining the scope of business. Currently, boards of directors of development and policy financial institutions have been established and are functioning effectively. The PBC will continue to guide policy financial institutions to stick to their responsibilities and business scope and to strengthen support for key areas and weak links, while strengthening risk prevention and control so as to better serve national development strategies.

XI. Deepening the reforms of foreign exchange administration

Foreign-exchange administration for trade in goods was further optimized. First, business processes of foreign exchange receipts and payments for imports of supplies necessary for battling COVID-19 were simplified. From January 27 to March 31, a total of 4,551 foreign exchange receipts and payments under trade in goods were expedited across the country through the green channel, totaling USD1.03 billion. Second, the pilot program of facilitating foreign exchange receipts and payments under trade in goods was expanded. By end-Q1 2020, the pilot programs of facilitating foreign exchange receipts and payments under trade in goods and in services were carried out in eight and two provinces (municipalities) across the nation, respectively. There were 41 pilot banks and 206 enterprises. A total of 73,000 foreign exchange receipts and payments were processed under trade in goods and services, worth a total USD57.2

billion. Third, enterprises across the nation succeeded in reporting online 852,000 foreign exchange transactions under trade in goods. Fourth, requirements on foreign exchange receipts and payments under trade in goods were simplified for small and micro businesses engaged in cross-border e-commerce. Meanwhile, these enterprises were exempt from directory registration. Fifth, electronic filing of taxation was continuously promoted in the area of foreign exchange payments for trade in services. At end-Q1 2020, 32,000 electronic taxation forms were filed, involving foreign exchange payments worth USD55.7 billion and bringing benefits to 12,600 enterprises.

Cross-border financing and investment were further facilitated. First, requirements on presenting in advance authenticity-verifying documents were temporarily eased for settlements and payments of foreign exchange receipts under the capital account with respect to disease containment. From January 27 to March 27, a total of 4,895 facilitated payments of foreign exchange receipts under the capital account were processed across the nation, worth about USD900 million. Second, cross-border financing related to pandemic containment was facilitated and achieved. The external debt quota may be lifted for those enterprises which have genuine demand, and they can apply online for external debt registration. From January 27 to March 27, 742 cases of external debt registration were processed online, amounting to USD37 billion. Third, the pilot program of external debt facilitation was expanded and high-tech companies were supported to raise funds overseas. The scope of the pilot was expanded from Beijing Zhongguancun National Self-dependent Innovation Demonstration Zone to places such as Shanghai, Hubei, Guangdong, and Shenzhen, and eligible high-tech companies have been allowed to borrow funds voluntarily within a certain quota.

Stability in the foreign exchange market was maintained. Priority was given to conducting monitoring and analysis of potential risks of cross-border capital flows incurred by COVID-19. Emphasis was placed on clue screening of illegal financial activities, such as underground banks, cross-border gambling, and illegal online foreign exchange trading. Forward-looking research was actively promoted on a cross-border anti-money-laundering mechanism, macro and micro regulation on banks, and on the foreign exchange wholesale market. In Q1, a total of 176 cases violating the laws and regulations of foreign exchange administration were handled, with the total fines amounting to RMB140 million.

Part 3. Financial Market Conditions

In Q1 2020, affected by the COVID-19 pandemic, the financial market experienced increased volatility. Capital prices in the money market dropped significantly with an overall easing of the supply of liquidity. The total volume of bond issuances saw year-on-year growth, with a rapid fall in bond yields. The stock market generally went up prior declining, with the major indexes sliding.

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 adequate at a reasonable level, and money market interest rates remained at a low level. In March 2020, the monthly weighted average interest rate for interbank lending and pledged repos posted 1.40 percent and 1.44 percent, respectively. The monthly weighted average interest rate for government-backed bond repos among depository institutions posted 1.29 percent, 15 basis points lower than the monthly weighted average interest rate of pledged repos. At end-March, the overnight and 7-day Shibor posted 1.61 percent and 2.15 percent, respectively.

The market saw active repo transactions and interbank lending. In Q1 2020, the trading volume of bond repos on the interbank market reached RMB202.3 trillion, representing an average daily turnover of RMB3.4 trillion and a year-on-year increase of 4.6 percent. The volume of cumulative trading of interbank lending reached RMB32.4 trillion, with an average daily turnover of RMB548.6 billion and a year-on-year decrease of 19.7 percent. In terms of the maturity structure, overnight repos and overnight lending accounted for 82.8 percent and 89 percent, respectively, of the total turnover in bond repos and interbank lending, decreasing 1.4 percentage points and 2.7 percentage points year on year. The volume of bond repos traded on the exchange markets increased 11.1 percent year on year to RMB62.9 trillion.

Table 8 Fund Flows Among Financial Institutions in Q1 2020

Unit: RMB100 million

	Repos		Interbank lending	
	Q1 2020	Q1 2019	Q1 2020	Q1 2019
Chinese-funded large banks①	–625,803	–516,915	–96,936	–83,417
Chinese-funded medium-sized banks②	-219,725	-212,088	-26,027	-39,830
Chinese-funded small-sized banks③	3,900	52,584	24,252	37,387
Securities institutions④	224,001	190,239	69,209	66,229
Insurance institutions⑤	25,677	19,818	44	93
Foreign-funded banks	23,081	26,569	-1,620	-6,838
Other financial institutions and vehicles⑥	568,869	439,794	31,078	26,376

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, fund management companies 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 Q1

2020, a total of 6,930 interbank CDs were issued on the interbank market, raising RMB4.1 trillion. The trading volume on the secondary market totaled RMB40.4 trillion. By end-March, outstanding interbank CDs reached RMB10.6 trillion. In Q1 2020, the average weighted interest rate of 3-month interbank CDs was 2.53 percent, 1 basis point higher than that of the 3-month Shibor. A total of 18,000 negotiable CDs were issued by financial institutions, raising RMB3.6 trillion and with a decrease of RMB0.9 trillion year on year.

Interest rate swaps were active. In Q1 2020, the RMB interest rate swap market witnessed 61,000 transactions, increasing 23 percent year on year, with the volume of the notional principal totaling RMB4.3 trillion, an increase of 12 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 RMB2.5 trillion, accounting for 59 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 79.3 percent and 18.7 percent, respectively, of the total notional principal of the interest rate swaps. In Q1 2020, interest rate swaps anchored to the LPR amounted to 466 transactions with RMB75.5 billion of the notional principal.

Table 9 Transactions of Interest Rate Swaps in Q1 2020

	Transactions	Notional principal (RMB100 million)
Q1 2020	61,357	42,955
Q1 2019	49,703	38,205

Source: China Foreign Exchange Trade System.

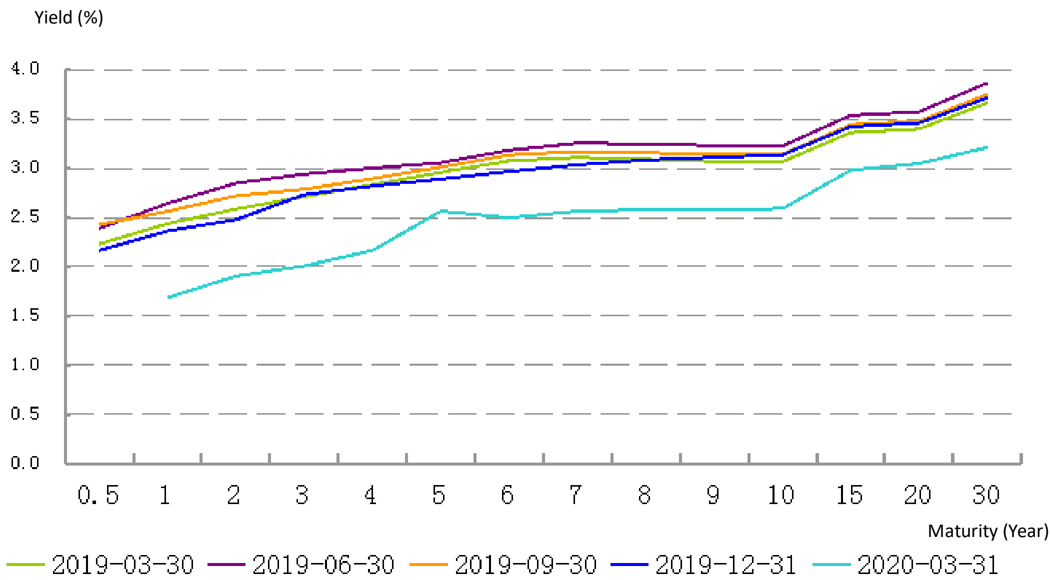
The LPR interest rate option business was officially launched. On March 23, the LPR interest rate option business on the interbank market made its debut and attracted active participation by market players, covering large commercial banks, joint-stock commercial banks, city commercial banks, rural commercial banks, foreign-funded banks, securities companies, and so forth. At end-March, a total of 172 interest rate option transactions were concluded, adding up to RMB15.53 billion. Specifically, 89 were LPR interest rate swap transactions and 83 were LPR interest rate cap/floor transactions, amounting to RMB7.34 billion and RMB8.19 billion, respectively.

2. The coupon rate of bonds generally declined, while transactions and the issuance of cash bonds expanded

The government bond yield curve moved downward. At end-March, the yields of 10-year and 1-year government bonds posted 2.55 percent and 1.69 percent, respectively, decreasing by 60 basis points and 73 basis points, respectively, from the beginning of 2020.

The coupon rates of all types of bonds fell. The coupon rate of 10-year government bonds issued in March 2020 was 3.13 percent, 12 basis points lower than the rate in March 2019. The coupon rate of 10-year financial bonds issued by China Development Bank was 2.89 percent, 76 basis points lower than the rate in March 2019. The average rate of 1-year short-term financing bills (bond rating A-1) issued by AAA-rated non-financial enterprises was 2.89 percent, 53 basis points lower than the rate in March 2019.

Figure 4 Yield Curves of Government Securities on the Interbank Market



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

The volume of cash bond transactions continued to grow. In Q1 2020, the volume of cash bond trading on the interbank market posted RMB48.8 trillion, representing an average daily turnover of RMB827.0 billion and an increase of 14.6 percent year on year. The volume of cash bond transactions on the stock exchanges totaled RMB3.4 trillion, registering an increase of 78.1 percent year on year.

The volume of bond issuances has seen year-on-year growth and the share of short-term debenture bond issuances has hit a record high in recent years. In Q1 2020, the cumulative volume of bond issuances totaled RMB12.1 trillion, RMB1.8 trillion more than that in Q1 2019. The issuance of debenture bonds surged remarkably, among which RMB1485.3 billion with a maturity of less than one year was issued, accounting for 43 percent of all debenture bond issuances. At end-March, outstanding bonds held in custody amounted to RMB102.9 trillion, an increase of 4 percent compared to end-2019.

Table 10 Bond Issuances in Q1 2020

Unit: RMB100 million

Type of bond	Issuances	YOY change
Government securities	7,350	2,260
Local government bonds	16,105	2,039
Central bank bills	0	0
Financial bonds①	62,837	3,036
Of which: Financial bonds issued by China Development Bank and policy financial bonds	11,819	2,167
Interbank certificates of deposit	40,628	146
Corporate debenture bonds②	34,352	10,913
Of which: Debt-financing instruments of non-financial enterprises	23,319	5,172
Enterprise bonds	836	16
Corporate bonds	7,205	2,927
Bonds issued by international institutions	138	53
Total	120,782	18,300

Notes: ① Including financial bonds issued by 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 MSB bonds, and asset-backed securities on Shanghai Stock Exchange and Shenzhen Stock Exchange issued by non-financial enterprises.

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

3. Bill financing continued to rise, and interest rates in the bill market remained

relatively stable

The bill acceptance business continued to grow. In Q1 2020, commercial drafts issued by enterprises totaled RMB6.0 trillion, rising 12.1 percent year on year. At end-March, outstanding commercial drafts stood at RMB13.4 trillion, increasing 10.6 percent year on year. Outstanding commercial draft acceptances continued to expand steadily by RMB696.2 billion from the beginning of the year. Of the outstanding bankers' acceptances, 70.2 percent were issued by MSMEs.

Bill financing continued to expand, while interest rates moved downwards slightly. In Q1 2020, total discounts by financial institutions amounted to RMB10.9 trillion, growing 3.1 percent year on year. At end-March, the balance of bill financing was RMB8.2 trillion, up 25.6 percent year on year. The balance accounted for 5.1 percent of total outstanding loans, 0.5 percentage points higher than the percentage during the same period of the previous year. In Q1 2020, interest rates in the bill market moved downwards slightly.

4. Stock indices dropped, with turnover and the amount of funds raised increasing year on year

Stock indices declined in a much narrower way compared to other stock markets. At end-March, the Shanghai Stock Exchange Composite Index closed at 2,750 points, decreasing 9.8 percent from end-2019. The Shenzhen Stock Exchange Component Index closed at 9,962 points, decreasing 4.5 percent from end-2019. The turnover on the stock markets increased significantly. In Q1 2020, the combined turnover of Shanghai Stock Exchange and Shenzhen Stock Exchange reached RMB50 trillion and the average daily turnover was RMB862.1 billion, with an increase of 46.7 percent year on year. The amount of funds raised expanded year on year. In Q1 2020, a cumulative RMB140.3 billion was raised on the stock market, increasing 39.6 percent year on year.

5. Growth of premium income slowed down, while growth of assets in the insurance sector accelerated

In Q1 2020, total premium income in the insurance sector amounted to RMB1.7 trillion, with a year-on-year increase of 2.3 percent, 9.9 percentage points lower than the growth rate in 2019. Claim and benefit payments totaled RMB303.1 billion, with a year-on-year decrease of 8.7 percent. Specifically, total property insurance claim and benefit payments decreased 11.7 percent year on year, while total life insurance claim and benefit payments fell 6.4 percent year on year.

Table 11 Asset Allocations in the Insurance Sector at End-March 2020

Unit: RMB100 million, %

	Balance		As a share of total assets	
	End-March 2020	End-March 2019	End-March 2020	End-March 2019
Total assets	217,193	191,082	100.0	100.0
Of which: Bank deposits	28,621	26,189	13.2	13.7
Investments	165,634	144,364	76.3	75.6

Source: China Banking and Insurance Regulatory Commission.

The growth of assets in the insurance sector accelerated. At end-March, total assets in the insurance industry increased 13.7 percent year on year to RMB21.7 trillion, an acceleration of 1.5 percentage points from end-2019. Specifically, bank deposits increased 9.3 percent year on year and investment-linked assets expanded 14.7 percent year on year.

6. Foreign exchange transactions fell year on year

In Q1 2020, turnover of spot RMB/foreign-exchange transactions registered USD1.7 trillion, a decrease of 15.07 percent year on year. Turnover of RMB/foreign exchange swap transactions totaled USD3.3 trillion, a decrease of 27.8 percent year on year. Specifically, overnight RMB/USD swap transactions posted USD1.8 trillion, accounting for 56.2 percent of the total swap turnover. Turnover in the RMB/foreign exchange forward market totaled USD26.9 billion, rising 40.3 percent year on year. Turnover in foreign currency pair transactions totaled USD116.9 billion, rising 47 percent year on year. In particular, the EUR/USD pair registered the largest trading volume, accounting for 52.3 percent of the total market share.

Participants on the foreign exchange market expanded further. At end-March, there were 716 members on the foreign exchange spot market, 249 members on the foreign exchange forward market, 243 members on the foreign exchange swap market, 201 members on the currency swap market, and 151 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. The gold market operated steadily with an overall rise in prices

In Q1 2020, international gold prices closed at USD1,608.95 per ounce, representing a gain of 5.64 percent from end-2019. The Au99.99 on the Shanghai Gold Exchange closed at RMB364.27 per gram, increasing 6.89 percent from end-2019. In Q1 2020, the volume of gold traded on Shanghai Gold Exchange was 18,000 tons, representing a gain of 24 percent year on year. The turnover posted RMB6.4 trillion, increasing 54.08 percent year on year.

II. Development of institutional arrangements in the financial markets

1. Institutional arrangements in the bond market

In February 2020, China Securities Regulatory Commission (CSRC), the Ministry of Finance (MOF), the PBC, and China Banking and Insurance Regulatory Commission (CBIRC) jointly issued a notice enabling eligible pilot commercial banks and insurance institutions capable of investment management, based on the principle of compliance, controllable risk, and sustainable business, to participate in the trade of treasury bond futures on China Financial Futures Exchange (CFFEX). In this way, the structure of treasury bond futures investors will be enriched and the stable and orderly development of the market will be promoted. The first batch of pilot institutions included Industrial and Commercial Bank of China (ICBC), Agricultural Bank of China (ABC), Bank of China (BOC), China Construction Bank (CCB), and Bank of Communications (BOCOM).

2. Improving institutional arrangements in the capital market and the securities and futures industry

The capability of the capital market to serve the real economy was further enhanced. First, in February the CSRC released three refinancing arrangements for listed companies, including the *Decision on Revising the "Measures for the Administration of Securities Issuances by Listed Companies"*. The arrangements relaxed the refinancing limitation of companies listed on the ChiNext Market. Second, in March, the CSRC released the *Special Provisions on Shareholding Reductions by Venture Capital Fund Shareholders of Listed Companies* after revision, which tapped into the potential of venture capital funds to support the entrepreneurship and innovation of enterprises. Third, in March, the CSRC released the *Guidelines for the Evaluation of Science and Technology Innovation Attributes (for Trial Implementation)*, which made it more operable for the Exchange to evaluate the science and technology innovation attributes of companies listed on the STAR market.

Regulation of securities institutions was further improved. For one thing, in January the

SCRC released the *Provisions on the Calculation Basis for Risk Control Indicators of Securities Companies*, which further improved the system of risk control indicators of securities companies. For another, in March the CSRC decided to lower the payment ratio of securities companies in securities investor protection funds in 2019 and 2020, so as to lower their operating costs and strengthen support for the real economy.

3. Improving institutional arrangements in the insurance market

Development of commercial insurance in the field of social services was bolstered. On January 23, the CBIRC, together with 12 other ministries and commissions, issued the *Opinion on Promoting the Development of Commercial Insurance in the Field of Social Services*, which introduced 11 policies and measures in five respects to help commercial insurance play a better role in the field of social services.

The business of insurance asset management products was regulated in an all-round way. On March 18, the CBIRC released the *Interim Measures for the Regulation of Insurance Asset Management Products*, which specified the positioning, form, and issuance mechanism of asset management products, made clear the due responsibilities of the issuers, and implemented active supervision.

Reform of accident insurance was accelerated. On January 17, the CBIRC released the *Opinions on Accelerating the Reform of Accident Insurance*, in order to rectify price distortions in accident insurance.

4. Further opening up the bond market

In March 2020, under the guidance of the PBC, relevant financial infrastructures improved their transaction settlement arrangements and launched services such as rolling settlement and flexible settlement cycles, which met the diversified needs of foreign institutional investors and further facilitated their operations.

5. Enhancing coordinated supervision of the financial infrastructure

After being deliberated and passed at the tenth meeting of the Central Committee for Deepening Overall Reform, the *Work Plan on Coordinating Supervision over Financial Infrastructures* was co-issued by the PBC, NDRC, MOF, CBIRC, CSRC, and SAFE. The work plan aims to further improve the coordinated supervision and construction planning of the financial infrastructure and to enhance capability to serve the real economy and to forestall financial risks.

Part 4. Macroeconomic Overview

I. Global economic and financial developments

1. The global economy is set to enter a recession

As the global pandemic outbreak continues, the International Monetary Fund (IMF) has revised downward its global growth forecast several times since 2020, according to which the per capita income in over 170 countries out of its 189 members will see negative growth. Risks are tilted to the downside in the advanced economies. During the seven weeks ending May 2, more than 33 million Americans filed first-time unemployment claims, and the jobless rate surged to 14.7 percent in April. Since the pandemic broke out in countries such as Italy, France, and Germany in February 2020, the extent of the economic slowdown in the euro area has sparked concerns. Growth in Japan was already on the verge of recession prior to the outbreak of COVID-19, and the pandemic will precipitate an economic downturn.

The emerging market economies could see a fall in growth across the board. Due to the economic fallout of COVID-19, growth in the emerging market economies will probably continue to drop. The IMF projected that the emerging market economies as a whole would grow –1.0 percent in 2020, 4.7 percentage points slower than the growth of 3.7 percent in 2019.

Table 12 Macroeconomic and Financial Indicators in the Major Advanced Economies

Economy	Indicator	Q1 2019			Q2 2019			Q3 2019			Q4 2019			Q1 2020		
		Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
United States	Real GDP Growth (annualized quarterly rate, %)	3.1			2.0			2.1			2.1			-4.8		
	Unemployment Rate (%)	4.0	3.8	3.8	3.6	3.6	3.7	3.7	3.7	3.5	3.6	3.5	3.5	3.6	3.5	4.4
	CPI (YOY, %)	1.6	1.5	1.9	2.0	1.8	1.6	1.8	1.7	1.7	1.8	2.1	2.3	2.5	2.3	1.5
	DJ Industrial Average (end of the period)	25000	25916	25929	26593	24815	26600	26864	26403	26917	27046	28051	28538	28256	25409	21917

Euro Area	Real GDP Growth (YOY, %)	1.4			1.2			1.3			1.0			-3.3		
	Unemployment Rate (%)	7.8	7.8	7.7	7.6	7.6	7.5	7.6	7.5	7.5	7.4	7.4	7.3	7.3	7.3	7.4
	HICP (YOY, %)	1.4	1.5	1.4	1.7	1.2	1.3	1.0	1.0	0.8	0.7	1.0	1.3	1.4	1.2	0.7
	EURO STOXX 50 (end of the period)	3159	3298	3352	3515	3280	3474	3467	3427	3569	3604	3704	3745	3641	3329	2787
United Kingdom	Real GDP growth (YOY, %)	2.0			1.3			1.3			1.1			...		
	Unemployment Rate (%)	3.9	3.9	3.8	3.8	3.8	3.9	3.8	3.9	3.8	3.8	3.8	3.8	3.9	4.0	...
	CPI (YOY, %)	1.8	1.9	1.9	2.1	2.0	2.0	2.1	1.7	1.7	1.5	1.5	1.3	1.8	1.7	1.5
	FTSE 100 (end of the period)	6969	7074	7279	7418	7162	7426	7587	7207	7408	7248	7347	7542	7286	6581	5672
Japan	Real GDP Growth (annualized quarterly rate, %)	2.2			2.3			0.1			-7.1			...		
	Unemployment Rate (%)	2.5	2.4	2.5	2.4	2.4	2.3	2.3	2.3	2.4	2.4	2.2	2.2	2.4	2.4	2.5
	CPI (YOY, %)	0.2	0.2	0.5	0.9	0.7	0.7	0.5	0.3	0.2	0.2	0.5	0.8	0.7	0.4	0.4
	NIKKEI 225 (end of the period)	20773	21385	21206	22259	20601	21276	21522	20704	21756	22927	23294	23657	23205	21143	18917

Sources: Statistical bureaus and central banks of relevant economies.

2. The major central banks began a fresh round of monetary easing

Central banks around the globe cut rates aggressively. Central banks in the advanced economies, such as the US Fed and the Bank of England (BOE), reduced rates substantially to address the financial turbulence caused by COVID-19 and to boost market confidence. In March, the US Fed and the BOE each joined the ranks of zero interest rates as they lowered rates twice by a total of 150 basis points (bps) and 65 bps, respectively.

Central banks in the advanced economies either resumed or scaled up quantitative easing (QE). In Q1, the US Fed expanded its balance sheet considerably as it announced it would buy assets as necessary. The European Central Bank (ECB) first increased QE by EUR120 billion, and then announced that it would buy an additional EUR750 billion in assets by year-end. The Bank of Japan (BOJ) increased the size of asset purchased by nearly JPY8 trillion, and the BOE increased the size of assets purchased by GBP200 billion to GBP645 billion.

Major central banks strengthened liquidity support by adopting a number of targeted facilities. The Fed introduced several emergency liquidity facilities, including the Primary Dealer Credit Facility, the Commercial Paper Funding Facility, and the Secondary Market Corporate Credit Facility. The ECB launched additional longer-term refinancing operations, the BOE created the COVID Corporate Financing Facility to support liquidity among larger firms and the Term Funding Scheme for small and medium-sized enterprises, and the BOJ put in place Special Funds-Supplying Operations for distressed businesses.

3. Issues and trends that merit attention

First, supply and demand shocks resulting from the fast spread of COVID-19 have put the global economy on a recession trajectory for the short term. From the supply side, the pandemic has spread to most key parts of the global value chain, with production coming to a grinding halt and industrial chains disrupted. From the demand side, the pandemic has directly led to diminishing income for households and businesses, while fears and uncertainties over the pandemic have further dented market confidence, resulting in weaker consumption and investment. **Second,** the global economy is fraught with uncertainties as how the pandemic will develop remains unclear and as the intensity of policy responses varies from country to country. Although countries around the world have adopted a slew of measures to address the fallout from COVID-19, their policy intensity and effectiveness are different. A second wave of infection may come given the absence of strong international coordination, which may cause the economies to alternate between pausing and reopening. **Third,** pockets of financial risks accumulated at a faster pace, which warrants attention. The real economy has suffered from the COVID-19 pandemic. The credit risk and market risk have been growing in the corporate sector and financing institutions. If some countries respond late or inappropriately, financial risks may coincide with real economic risks. **Fourth,** the major economies have less room for policy maneuver. The major central banks have already cut policy rates to near zero, while much earlier the ECB and the BOJ had already introduced a negative interest rate policy.

II. Macroeconomic developments in China

In Q1 2020, COVID-19 dealt an unprecedented blow to China’s economic and social development. Despite the pandemic, China’s economy showed great resilience, the sound momentum of pandemic containment further consolidated, and work and production resumption was gradually approaching or had already reached a normal level. The production of livelihood-related fundamental industries and major products grew steadily, people’s basic livelihood was well-guaranteed, and overall economic and social development was stable. According to preliminary statistics, the GDP in Q1 2020 dropped by 6.8 percent year on year, while the CPI rose by 4.9 percent year on year.

Box 4 Analysis of the Economic Impact of the COVID-19 Pandemic on the World and on China and the Policy Responses

Since the beginning of 2020, the COVID-19 has spread across the world with confirmed cases in over 200 countries and regions. As of May 5, the aggregate number of confirmed cases exceeded 3.7 million and the number of deaths exceeded 250,000. Given the impact of the pandemic, the IMF revised its forecast for 2020 global GDP growth down by 6.3 percentage points, from 3.3 percent in January to –3 percent, which would mark the worst economic recession since the Great Depression in the 1930s. The World Bank also predicted that GDP growth in the East Asia-Pacific region would slow down from 5.8 percent in 2019 to 2.1 percent in 2020.

The pandemic has had a great impact on the global economy. First of all, countries have adopted lockdowns, business closures, and isolation measures, putting a halt to economic activities other than the production of essential goods and bringing the economies to a standstill. Second, international trade has shrunk significantly, reducing potential growth of the global economy. The World Trade Organization (WTO) predicted that global trade would shrink by 13 percent to 32 percent this year due to the pandemic and might be worse than that during the 2008 global financial crisis. Meanwhile, the global economic slowdown induced by the pandemic will further undermine external demand and exert large pressures on the trade sector. Third, most industries have gone into a temporary halt, taking a toll on the key links in the global supply chain. In recent decades, integrated global production has become a major source of world economic growth. As a result, the stagnation of economic activities in one country can easily weaken or even disrupt the global supply chain. Fourth, the pandemic has also changed the expectations of global investors, and black swan events in the international financial market have occurred frequently. In March, the US stock market plunged, triggering the circuit breaker four times. On April 20, international crude oil futures settled at a negative price for the first time in history. Financial risks have coincided with sluggishness in the real economy.

The pandemic has also hit China’s economic and social development in an unprecedented manner. First, the production and operation of enterprises have been impacted. The extension of the Spring Festival holiday and the delay in resumption of work have reduced the effective working days. The traffic restrictions in some provinces and cities have also interrupted the flow of personnel and materials necessary for production. The relevant losses have been reflected in GDP growth in Q1 2020.

Second, the demand-side indicators have decelerated year on year. Since the beginning of this year, consumer spending on retail, catering, and tourism has declined significantly. The pandemic has also profoundly influenced the behavior of economic entities. In particular, consumers may reduce consumption in shopping malls, theaters, and other crowded places for a long time. Third, external risks will continue to impact the domestic economy. It is difficult to improve the dampened international trade in the short term, and external demand may continue to decline, which will drag down China's economic growth further. Nonetheless, China’s overall economic fundamentals of stable growth, good long-term momentum, and high-quality development remain intact. According to the decisions and arrangement of the Communist Party of China (CPC) Central Committee and the State Council, all sectors and regions have taken multi-pronged measures to comprehensively promote the resumption of work and production amid routine pandemic containment and to restore normal economic and social order. By the end of Q1 2020, China's industrial enterprises above a designated size had come close to full-scale resumption, restaurants, hotels and other enterprises in many regions had resumed business, and transportation and logistics were gradually returning to normal. Economic data have improved since March.

However, the following risks merit attention. First, the duration and negative impact of the pandemic might exceed expectations. The pandemic is still serious in advanced countries like Europe and the US, and the effect of efforts to restart the economy remains to be seen. The number of newly confirmed cases is rising rapidly in some developing economies and agricultural product–exporting countries, and the future development of the pandemic is highly uncertain. Second, close attention should be paid to the spillovers of the highly accommodative unconventional monetary and fiscal policies in the major economies. Monetary and fiscal policies can only counteract the negative impact of the pandemic. The future global economic recovery and financial development still depend on progress in pandemic containment. Meanwhile, the negative effects of unconventional policies will play out gradually. Third, the domestic economy still faces many challenges. Enterprises, especially small and medium-sized enterprises (SMEs), have been hit hard by the pandemic. There is increasing pressure on employment and social security. More coordination is needed to resume work and production along the industrial chain. Continuous efforts should be made to guarantee supply of the main agricultural byproducts and to stabilize their prices. Fourth, there are also uncertainties in China's balance of payments and cross-border capital flows. On the one hand, given that the major central banks have significantly loosened monetary policy and China has taken the lead in pandemic containment as well as production resumption, RMB assets, which provide higher returns and relative security, may attract capital inflows. On the other hand, the continuous weakening of external demand and the decline in investor risk appetite may also reduce exports and cause capital outflows.

Going forward, the sound monetary policy should be more flexible and appropriate whereby the PBC will keep a good grasp in the intensity, pace, and focus of the new polices, skillfully handle the relationship between stabilizing growth, protecting employment, restructuring the economy, preventing risks, and controlling inflation, ensure that the growth of M2 and aggregate financing to the real economy (AFRE) is basically in line with and slightly higher than nominal GDP growth, and support high-quality economic development with appropriate money growth. The PBC will continue to maintain the two-way floating flexibility of the RMB exchange rate and stabilize expectations through multiple channels. In addition, the PBC will strengthen international policy coordination and effectively contain the impact of the pandemic. Furthermore, the PBC will adhere to bottom-line thinking, remain vigilant against potential external risks, prepare policies proactively, and promote stability in the national economy.

1. Consumption decreased, investment slowed down, and imports and exports declined

Residents' income in nominal terms grew slightly, consumption decreased, and sales of daily necessities and online retail sales of physical goods witnessed fast growth. In Q1 2020, per capita disposable income edged up by 0.8 percent in nominal terms and dropped by 3.9 percent in real terms year on year. The income distribution structure continued to improve, with the per capita income of rural residents continuing to grow at a faster pace than that of urban residents. According to the Urban Depositors' Survey conducted by the PBC, in Q1 2020 22.0 percent of consumers were inclined to "consume more," down 6.0 percentage points and 3.8 percentage points respectively from Q4 2019 and Q1 2019. In Q1 2020, total retail consumer goods declined by 19.0 percent year on year, among which that in March dropped by 15.8 percent year on year, a deceleration of 4.7 percentage points from that in January and February. The retail sales of grain oil and food, beverages, and Chinese and western medicines by enterprises above a designated size grew by 12.6 percent, 4.1 percent, and 2.9 percent respectively. Online retail sales of physical goods witnessed a year-on-year growth of 5.9 percent.

Investment activities slowed down, with a relatively smaller decline of investment in the high-tech and health industries. In Q1 2020, fixed-asset investments throughout China (excluding those by rural households) decreased by 16.1 percent year on year, a deceleration of 8.4 percentage points from those from January to February. Divided by investment areas, investment in the infrastructure, manufacturing, and real estate industries fell by 19.7 percent, 25.2 percent, and 7.7 percent year on year respectively, a deceleration of 10.6 percentage points, 6.3 percentage points, and 8.6 percentage points from those in January and February respectively. Investment in high-tech industry dropped by 12.1 percent, 4.0 percentage points lower than total investment, while investment in the health industry edged down by 0.9 percent, 15.2 percentage points lower than total investment.

Imports and exports shrank, but the trade structure continued to improve. In Q1 2020, imports and exports dropped by 6.4 percent year on year. Specifically, exports declined by 11.4 percent, while imports edged down by 0.7 percent, with the trade surplus at RMB98.3 billion. The trade structure continued to be optimized, and export goods moved further up the value chain. Imports and exports of general trade accounted for 60.0 percent of total imports and exports, 0.4 percentage points higher than that in Q1 2019. The layout of the international market became more diversified. Exports to the US and the EU dropped by 23.6 percent and 14.2 percent respectively, while exports to ASEAN and countries along the Belt and Road grew 2.4 percent and decreased 1.8 percent respectively, 13.8 percentage points and 9.6 percentage points higher than that of total exports.

Foreign direct investment continued to be concentrated in the high-tech services industry. In Q1 2020, actually utilized foreign investment decreased by 10.8 percent year on year to RMB216.2 billion. Actually-utilized foreign investment in the high-tech services industry grew by 15.5 percent year on year, accounting for 29.9 percent of that in the services sector. Specifically, information services, electronic commerce services, and professional technology services rose by 28.5 percent, 62.4 percent, and 95 percent year on year respectively.

2. Agricultural production was generally stable, whereas industrial production declined

In Q1 2020, the value-added of primary, secondary, and tertiary industries decreased by 3.2 percent, 9.6 percent, and 5.2 percent respectively, accounting for 4.9 percent, 35.7 percent, and 59.4 percent of GDP respectively.

Agricultural production was generally stable. In Q1 2020, the value-added of agriculture (the planting industry) grew by 3.5 percent year on year. The output of poultry eggs and milk grew by 4.3 percent and 4.6 percent respectively, and that of pork, beef, mutton, and poultry totaled 18.13 million tons. The hog capacity continued to recover. At end-Q1 2020, hog in stock grew by 3.5 percent from end-Q4 2019 to 321.20 million, among which breeding sows in stock grew by 9.8 percent to 33.81 million.

Industrial production declined. In Q1 2020, the value-added of Industrial Enterprises above a Designated Size (IEDS) decreased by 8.4 percent year on year, among which that in March declined by 1.1 percent year on year, a deceleration of 12.4 percentage points from that in January and February. In March, industrial output was approaching that of March 2019. Year-on-year growth of the high-tech manufacturing industries reached 8.9 percent, 17.3 percentage points higher than that of the IEDS. In Q1 2020, total profits of the IEDS dropped by 36.7 percent year on year, a deceleration of 1.6 percentage points from that in January and February. According to a survey conducted in Q1 2020 by the PBC on 5,000 entrepreneurs, the Business Climate Index posted 30.3 percent, down 25.2 percentage points and 24.5 percentage points from Q4 2019 and Q1 2019 respectively. The Profitability index registered 22.3 percent, down 35 percentage points and 30 percentage points from Q4 2019 and Q1 2019, respectively.

Growth of the services sector slowed down, while that of the emerging services industry showed sound momentum. In Q1 2020, the value-added of information communications, software, and the information technology services industry grew by 13.2 percent year on year, and that of the financial industry increased by 6.0 percent year on year. In March, the Index of Service Production (ISP) dropped by 9.1 percent year on year, a deceleration of 3.9 percentage points from that in January and February. The Commercial Activities Index for the services industry registered 51.8 percent, up 21.7 percentage points from the previous month. In terms of market expectations, the Expected Business Activities Index for the services industry reached 56.8 percent, up 17.1 percentage points from the previous month, demonstrating the enterprises' strengthened confidence in the market.

3. Consumer prices witnessed a structural rise, and producer prices declined amidst stability

Consumer prices went up structurally, with growth witnessing a month-on-month decline. In Q1 2020, the CPI rose by 4.9 percent year on year, an acceleration of 0.7 percentage points from the previous quarter, with growth of the CPI in January, February, and March registering 5.4 percent, 5.2 percent, and 4.3 percent, respectively. Specifically, the price of pork rose rapidly, which drove up food prices to a high level. Food prices grew by 20.3 percent year on year, an acceleration of 3 percentage points from the previous year. Non-food prices edged up steadily by 1.1 percent year on year, which was on par with the previous quarter. The growth of consumer goods prices accelerated, while growth of services decelerated.

Producer prices continued to decrease. In Q1 2020, the Producer Price Index (PPI) edged down by 0.6 percent year on year, decelerating 0.6 percentage points compared with the previous quarter. The PPI increased by 0.1 percent in January, and fell by 0.4 percent and 1.5 percent respectively in February and March. The Purchasing Price Index for Industrial Products (PPIRM) declined by 0.8 percent year on year, a deceleration of 1.1 percentage points from the previous quarter. The Corporate Goods Price Index (CGPI) monitored by the PBC edged down by 0.1 percent year on year, with growth registering 1.0 percent, 0.3 percent, and –1.4 percent respectively in January, February, and March, posting a month-on-month deceleration.

4. Fiscal expenditures decreased, and the employment situation was generally

stable

In Q1 2020, revenue in the national general public budget totaled RMB4.5984 trillion, down 14.3 percent year on year, registering a deceleration of 18.1 percentage points compared with 2019. Specifically, tax revenue dropped by 16.4 percent year on year, while non-tax revenue edged up by 0.1 percent year on year. The domestic value-added and consumption tax fell by 23.6 percent and 16.4 percent year on year respectively. The corporate income tax saw a year-on-year decrease of 12.8 percent, while the personal income tax grew by 3.5 percent year on year.

Fiscal expenditures slowed down. In Q1 2020, expenditures in the national general public budget hit RMB5.5284 trillion, down 5.7 percent year on year, a deceleration of 13.8 percentage points from 2019. In terms of the structure, expenditures related to medical health and social security were stable. Expenditures for the health industry grew by 4.8 percent year on year, whereas those for social security and employment fell by 0.7 percent year on year.

Budgetary revenue from nationwide government-managed funds went down 12 percent year on year. Specifically, revenue from land sales dropped by 7.9 percent year on year. Budgetary expenditures from nationwide government-managed funds increased by 4.6 percent year on year.

The employment situation remained stable. In Q1 2020, a total of 2.29 million new jobs were created in the urban areas. In March, the surveyed unemployment rate in the urban areas was 5.9 percent, up 0.7 percentage points and down 0.3 percentage points compared with that in December 2019 and February 2020 respectively. The surveyed unemployment rate in the urban areas of 31 metropolises stood at 5.7 percent, which was on par with the previous month. In March, the average working time per week of employees in enterprises was 44.8 hours, 4.6 hours more than that in the previous month. Employment sentiment was falling. According to the Survey of Urban Depositors conducted by the PBC in Q1 2020, the Employment Sentiment Index posted 37.7 percent, down 6.8 percentage points and 8.1 percentage points compared with that in Q4 2019 and Q1 2019 respectively, while the Employment Expectation Index for Q2 2020 was 47.3 percent, down 4.6 percentage points and 6.4 percentage points quarter on quarter and year on year, respectively.

5. The balance of payments and external debt

The balance of payments remained basically in equilibrium. According to preliminary data, China's current account deficit stood at USD29.7 billion in Q1. To be specific, the surplus in trade of goods was USD26.4 billion, whereas the deficit in trade of services was USD47 billion. Under the capital and financial account, the surplus in direct investments reached USD14.9 billion. At end-March, foreign-exchange reserves registered USD3.0606 trillion, a decrease of USD47.3 billion, or 1.5 percent, from the beginning of 2020. As of end-2019, the balance of full-caliber foreign debt (denominated in both domestic and foreign currencies) posted USD2.0573 trillion.

Among this, the short-term external debt balance was USD1.2053 trillion, accounting for 59 percent of the total external debt balance.

6. Analysis by sector

6.1 The real estate sector

In Q1 2020, nationwide housing prices were generally stable. Due to the impact of COVID-19, housing sales and investments in real estate development declined, but picked up gradually from March. Growth of real estate loans continued to moderate.

At end-March, among the 70 medium and large-sized cities nationwide, newly built and second-hand residential housing prices increased by 5.4 percent and 2.7 percent year on year, 1.4 percentage points and 1 percentage point less, respectively, than the growth rates at end-2019. In Q1, the total floor area of sold units and housing sales decreased by 26.3 percent and 24.7 percent year on year respectively.

Table 13 Floor Area of Real Estate Projects that were Newly Started, Under Construction, and Completed in Q1 2020

	Floor area (100 million square meters)	YOY growth (%)	YOY acceleration (percentage points)
Floor area of newly-started real estate projects	2.8	-27.2	-35.7
Floor area of real estate projects under construction	71.8	2.6	-6.1
Floor area of completed real estate projects	1.6	-15.8	-18.4

Source: National Bureau of Statistics.

Investments in real estate development and newly-started real estate projects declined. In Q1, real estate investments in China totaled RMB2.2 trillion, down 7.7 percent year on year, a deceleration of 17.6 percentage points compared with the annual growth rate in 2019. Specifically, investments in residential housing development reached RMB1.6 trillion, down 7.2 percent year on year and a deceleration of 21.1 percentage points from the annual growth rate in 2019, which accounted for 72.9 percent of total investments in real estate development.

Growth of real estate loans continued to moderate. At end-March, outstanding real estate loans by major financial institutions (including foreign-funded financial institutions) stood at RMB46.2 trillion, up 13.9 percent year on year and a deceleration of 0.9 percentage points from end-2019. Outstanding real estate loans made up 28.8 percent of the total lending balance. Specifically, outstanding individual housing loans amounted to RMB31.2 trillion, up 15.9 percent year on year, representing a deceleration of 0.8 percentage points from end-2019. Outstanding housing development loans posted RMB9.0 trillion, rising 13.6 percent year on year and a deceleration of 1 percentage point from end-2019. Outstanding land development loans decreased by 7.5 percent year on year to RMB1.29 trillion, a deceleration of 0.4 percentage points from end-2019.

Growth of loans for government-subsidized housing slowed down. At end-March, outstanding loans for government-subsidized housing development totaled RMB4.7 trillion, up 3.9 percent year on year and a deceleration of 2.8 percentage points from end-2019. New loans for government-subsidized housing development reached a cumulative RMB110.8 billion in Q1, a deceleration of RMB117 billion year on year, accounting for 16.9 percent of all incremental real estate development loans.

6.2 The pharmaceutical sector

The pharmaceutical sector is closely bound up with the national economy and the people's livelihood, and the safety of people's lives should always be given first priority. With the living standards improving and the people’s health awareness growing, the pharmaceutical sector in China maintained a momentum of rapid development. **First**, economies of scale grew rapidly. Value added of pharmaceutical enterprises above a designated size witnessed year-on-year growth of 6.6 percent, 0.9 percentage points higher than that of the industrial sector. **Second**, investments in fixed assets saw fast growth. In 2019, investments in fixed assets of the pharmaceutical sector increased by 8.4 percent over the previous year, 5.3 percentage points faster than that of the manufacturing sector as a whole. **Third**, prices in the pharmaceutical sector rose steadily. The PPI of the pharmaceutical sector climbed up by 1.7 percent year on year, whereas the overall PPI dipped by 0.3 percent year on year.

The pharmaceutical sector in China still faces mounting challenges to maintain sound development. **First,** technological research and innovation need to be improved, as pharmaceutical enterprises are still weak in fundamental research and in translating research results into applications. **Second,** upgrading the quality of pharmaceutical products remains a pending task. Competition in the pharmaceutical sector is fierce, coupled with serious product homogeneity and overcapacity of some products in the sector. In 2019, the capacity utilization rate of the pharmaceutical sector was 76.6 percent, down 1 percentage point from 2018. **Third,** the industrial concentration of the entire pharmaceutical sector remains low. At end-2019, the number of pharmaceutical enterprises above a designated size totaled 7,382. The sector, boasting a vast number of enterprises, is still struggling with a lack of scale and a low concentration of enterprises.

Since the outbreak of COVID-19, the CPC Central Committee and the State Council have placed great importance on the development and application of diagnostic reagents and medicines as well as on the provision of medical supplies. As a result, the sector realized an expansion of capacity and an increase in output within a short period of time, effectively meeting the needs of pandemic containment. Going forward, efforts should be made to advance research and development of safe and effective vaccines in a timely manner on the basis of adhering to science and ensuring safety. Meanwhile, efforts should also be made to enhance investments in pharmaceutical enterprises, accelerate the upgrading of product quality, promote industry-wide resource integration, and improve the long-run competitiveness of the pharmaceutical sector. Financial support will be enhanced in a bid to bolster the rapid and high-quality development of the pharmaceutical sector.

Part 5. Monetary Policy Outlook

I. Outlook for the Chinese economy

The first quarter of 2020 witnessed an unprecedented impact of COVID-19 on economic and social development in China. However, the impact is, on the whole, controllable, so the great temporary challenges will not change the fundamentals of steady growth, long-term sound development, and high-quality development of the Chinese economy.

Under the strong leadership of the CPC Central Committee, the Chinese economy has demonstrated great resilience. With pandemic containment measures remaining in place, economic and social activities have gradually returned to normal, and work and production have resumed, approaching or reaching normal levels. The fight against the pandemic has spawned and promoted rapid development of many new industries and business models. The proactive fiscal policy has been more intensified and the sound monetary policy more flexible and appropriate, with higher priority given to supporting recovery of the real economy. Money and credit as well as aggregate financing to the real economy (AFRE) have been growing at a rate consistent with economic development, and the liquidity has been maintained adequate at a reasonable level. With proactive and effective structural monetary policies, financial support for the real economy, especially for micro, small and medium-sized enterprises (MSMEs) and private enterprises, has been continuously intensified. With prudent and decisive measures taken to prevent and control financial risks, the financial system has been generally healthy and capable of defusing various risks. The RMB exchange rate has remained basically stable and exhibited more flexibility in two-way fluctuations, thereby effectively preventing shocks of external financial risks.

The risk of a global recession is intensifying, while the domestic economy is confronted with increasing challenges. Destabilizing factors and uncertainties have increased significantly as the global pandemic continues to spread. According to projections by the IMF, the global economy will experience a growth of –3 percent in 2020, a deceleration of 5.9 percentage points compared to 2019. With frequent breakouts of black swan events in international financial markets, the major countries have collectively adopted zero-rate monetary policies, and the balance sheets of the central banks have seen a sharp expansion. The pressures arising from imported pandemic case prevention and from international economic risks have been building up in China, and the resumption of work and production as well as economic and social development are facing new difficulties, in that structural, institutional, and cyclical concerns are intertwined and thereby pose unprecedented challenges for economic development. The current conditions necessitate work to fully assess the difficulties, risks, and uncertainties, enhance the sense of urgency, and ensure solid implementation of tasks regarding economic and social development. In response to problems caused by COVID-19, such as lack of demand, decline in consumption, difficulties in business operations, and building pressures on employment, cyclical adjustments will be intensified, strategies to increase domestic demand will be firmly implemented, and work concerning pandemic containment as well as economic and social development will be carried forward in a coordinated way.

Inflation is generally under control and expectations are basically stable, with future developments to be watched closely. In the first two months of Q1 2020, the CPI temporarily soared above 5 percent, which was mainly due to the rapid rise in food prices, such as the price of pork, around the Spring Festival and the shrinking supply because of the pandemic. With the orderly resumption of work and production under way, and multiple measures taken by government departments to guarantee supply and stabilize prices, the CPI has shown a decelerating trend as it dropped to 4.3 percent in March, and inflation expectations are generally stable. Due to weak domestic demand and plunging commodity prices, the PPI retreated below zero with a deeper drop after temporarily turning positive in January. Factors such as COVID-19 may cause price disturbances in the short term through both supply and demand, which warrant continued monitoring and analysis. However, judging by the fundamentals, China's economic performance is generally stable, and aggregate supply and demand are basically in equilibrium, providing no grounds for persistent inflation or deflation.

II. Outlook for monetary policy in the next stage

Under the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, the PBC will resolutely implement the decisions and arrangements of the CPC Central Committee and the State Council, remain committed to achieving the target of completing the building of a moderately prosperous society in all respects, and coordinate pandemic containment with economic and social development. With pandemic response measures kept in place, it will adhere to the guiding principle of pursuing progress while ensuring stability, and uphold the new development philosophy. Efforts will be intensified to ensure stability in six key areas, namely, employment, the financial sector, foreign trade, foreign investment, domestic investment, and market expectations, and to safeguard employment, people's basic livelihood, market entities, food and energy security, stability of industrial and supply chains, and the smooth functioning of grassroots administration, with the aim of achieving a decisive victory in the tough battle against poverty and completing the building of a moderately prosperous society in all respects. The PBC will pursue a sound monetary policy that is more flexible and appropriate, while the intensity, focus, and pace of policy conduct will be properly managed to accommodate changes in the pandemic containment situation and economic development at different stages. As countercyclical adjustments will be stressed in monetary policy, the PBC will attach higher priority to supporting the recovery of the real economy by adopting aggregate and structural policies to keep liquidity adequate at a reasonable level and to help the real economy, particularly MSMEs, pull through the difficulties. The role of central bank lending and central bank discount policies as a propelling force will be brought into full play to provide financial services precisely for pandemic containment, the resumption of work and production, and development of the real economy. The relationship among stabilizing growth, safeguarding employment, adjusting structures, preventing risks, and controlling inflation will be properly handled, while work will be done to keep prices basically stable and to guide expectations in various ways. Moreover, the PBC will support banks replenishing capital through multiple channels so as to enhance their capacity to serve the real economy and to forestall and defuse financial risks. It will further the loan prime rate (LPR) reform and move ahead with the shift in the pricing benchmark for outstanding floating-rate loans in an orderly manner so as to smooth the mechanism of monetary policy transmission and guide market lending rates to move downward. The PBC will coordinate RMB and foreign exchange policies, and properly balance the domestic and external economic dynamics. It will deepen financial supply-side structural reforms, improve the modern financial system to make it highly adaptable, competitive, and inclusive, and foster a virtuous cycle in the national economy.

First, the PBC will pursue a sound monetary policy that is more flexible and appropriate, enhance countercyclical adjustments, and keep liquidity adequate at

a reasonable level. It will closely monitor liquidity supply and demand as well as domestic and international markets, and employ a mix of monetary policy tools to keep liquidity adequate at a reasonable level so that the growth of M2 and AFRE are basically in line with and slightly higher than nominal GDP growth. Macro management will be more forward-looking, precise, proactive, and effective, while the intensity and pace of liquidity injections will be better managed to ensure that money market rates perform stably within a reasonable range. The PBC will try to reach a dynamic balance among multiple targets, attach more importance to some targets such as economic growth and employment, and counter the impact of the pandemic with more forceful policies, thereby creating a favorable monetary and financial environment for effective containment of the pandemic and for supporting the recovery of the real economy. It will properly balance an internal equilibrium with an external equilibrium, and maintain China's status as one of the few major economies in the world that is pursuing a normal monetary policy. Work will be done to improve the capital replenishment mechanism to make it sustainable, encourage banks to replenish capital through multiple channels such as the issuance of perpetual bonds, and prioritize support for capital replenishment of small and medium-sized banks so as to enhance their capacity to serve the real economy and to forestall and defuse financial risks.

Second, the PBC will give full play to the role of central bank lending and central bank discount policies as a propelling force and provide financial services precisely for pandemic containment, the resumption of work and production, and the development of the real economy. It will continue giving play to the RMB300 billion of special central bank lending to fight the pandemic and guarantee supply until the quota is used up. Financial institutions will be guided to continue using the RMB 500 billion of central bank lending and central bank discount quotas to support the orderly resumption of work and production. Moreover, central bank lending and central bank discount policies with a total quota of RMB1 trillion will be properly implemented in line with the ongoing recovery of the real economy and will link up seamlessly with the preceding RMB300 billion and RMB500 billion. The PBC will further step up credit support for agro-linked enterprises, micro and small businesses (MSBs), private enterprises, foreign trade enterprises, and industries severely affected by the pandemic and will guide the reduction of social financing costs.

Third, the PBC will explore the role of monetary and credit policies in promoting economic structural adjustments so as to better serve the real economy. It will further improve the required reserve ratio (RRR) policy framework featuring "three tranches and two preferential treatments", and establish and improve a long-term mechanism of increasing bank loans to MSBs. Policy coordination will be enhanced so that financial resources will be channeled to fields that will benefit both the demand and supply sides and produce a multiplier effect, such as advanced manufacturing, livelihood improvements, and weak links in infrastructure development, thereby promoting industrial and consumption upgrading. Research will be conducted on the linkup between financial support for poverty eradication and rural revitalization policies, while work will be accelerated to roll out measures for the assessment of commercial banks' services for rural revitalization. The PBC will guide financial institutions to improve incentives in internal assessments, enhance implementation of the mechanism under which people who have fulfilled their duties will not be held liable for losses, and strengthen cooperation with government-backed guarantee agencies in an effort to facilitate the allocation of more credit resources to MSBs and private enterprises. Work will be done to promote the development of supply chain finance and ramp up financial support for MSMEs based on the creditworthiness of core enterprises. The expiration date for the policy of delayed repayment of principal and interest will be duly extended for enterprises, particularly MSMEs, whose employment remains basically stable. Adhering to the principle that housing is for living in, not for speculation, and the requirement that the real estate market shall not be used to provide a short-term stimulus to the economy, the PBC will maintain the continuity, consistency, and stability of real estate finance policies.

Fourth, the PBC will make more efforts to deepen the market-based interest rate reform and the reform of the RMB exchange rate formation mechanism so as to enhance the efficiency of financial resource allocations. The LPR reform will move steadily deeper. In line with market-oriented and law-based principles, the PBC will move ahead with the shift in the pricing benchmark for outstanding floating-rate loans in an orderly manner so as to smooth the mechanism of monetary policy transmission and to further bring down social financing costs by means of reform. It will make effective use of the self-regulatory mechanism for market rate pricing, regulate deposit rate pricing conduct, and urge banks to strictly implement the requirement for explicit indications of annualized loan rates so as to protect the rights and interests of consumers. Taking steady steps forward to deepen the market-oriented exchange rate reform, the PBC will continue to improve the managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies, maintain the flexibility of the RMB exchange rate, and explore the role of the exchange rate in macroeconomic management and as an automatic stabilizer for the balance of payments. The PBC will strengthen macroprudential management to stabilize market expectations and to keep the RMB exchange rate basically stable at an adaptive and equilibrium level. Steps will be accelerated to develop the foreign exchange market and to provide services of exchange rate risk management for import and export companies with authentic needs. Enterprises will be guided to be risk neutral in financial management and to manage exchange rate risks with foreign exchange derivatives. Efforts will be made to steadily advance the convertibility of the RMB under the capital account, improve the policy framework and the infrastructure for cross-border use of the RMB, and promote the use of the RMB in cross-border trade and investment.

Fifth, the PBC will improve the financial market system and enable financial

markets to play an effective role in stabilizing growth, promoting structural adjustments, advancing reform, and guarding against risks. Institution building in the management of financial bonds will be strengthened to establish a tiered and categorized shelf-like system for the management of financial bond issuances. Measures will be taken to support equity financing and bond financing by private enterprises and to enhance the capacity of the financial sector to serve the real economy. Work will be done to push for uniform standards for information disclosures of corporate debenture bonds and to improve the relevant regulations. The mechanism of bond default risk prevention and resolution will be improved in line with market-oriented and law-based principles. The PBC will enhance coordination and interconnectivity between financial market infrastructures, and push forward with the building of custodian banks and trade repositories to ensure that financial markets are generally stable while performing safely and efficiently. Active but prudent steps will be taken to promote an institutional and systemic opening-up of the bond market and to introduce more medium- and long-term investors into the market.

Sixth, the PBC will deepen the financial supply-side structural reforms and improve the modern financial system to make it highly adaptable, competitive, and inclusive. Reforms of financial institutions will be further promoted. More work will be done to promote full implementation of the reform plans for development financial institutions and policy banks so as to improve their governance system, set strict boundaries for their businesses, and better bring out their role in line with the management practices of financial institutions. Reforms of large commercial banks and other large financial enterprises will deepen so as to improve their corporate governance, regulate the relationship between the general meeting of shareholders, the board of directors, the board of supervisors, and management, and improve authorized management, thereby giving rise to effective decision-making, implementation as well as checks and balances, and enhancing their business management and risk control capabilities.

Seventh, the PBC will make continued efforts to fight the tough battle of forestalling and defusing major financial risks so as to ensure that risks are generally controllable and steadily subsiding, and to firmly defend the bottom line that no systemic risk should occur. Under the leadership of the State Council Financial Stability and Development Committee, while consolidating the success already achieved, the PBC will adhere to the fundamental principles of maintaining overall stability, taking a coordinated approach, adopting differentiated measures, and defusing bombs with precision. It will consider new developments in the macroeconomic situation from a holistic perspective, focus on key issues, and manage the pace of work properly so as to ensure that the tasks of defusing risks set forth in the decisions of the CPC Central Committee will be fulfilled as scheduled, thereby creating a favorable financial environment for completing the building of a moderately prosperous society in all respects in 2020.