China Monetary Policy Report

Q2 2020

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Monetary Policy Analysis Group of

the People’s Bank of China

Executive Summary

Since the beginning of 2020, the COVID-19 pandemic has dealt a heavy blow to China's economic and social development. Under the strong leadership of the CPC Central Committee, the entire nation has made concerted efforts and has achieved significant results in coordinating pandemic containment with economic and social development. China's economic growth has shown strong resilience. In H1 2020, the gross domestic product (GDP) fell slightly by 1.6 percent year on year, but Q2 witnessed year-on-year growth of 3.2 percent, which was much better than expected. The consumer price index (CPI) rose 3.8 percent year on year in H1. Employment was generally stable, and import and export trade was better than expected.

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. Pursuing a sound monetary policy that was more flexible and appropriate, the PBC flexibly managed the intensity, pace and focus of adjustments based on the characteristics of pandemic containment and work and production resumption at different stages. To address the great uncertainties, the PBC remained committed to the specific goals of maintaining an appropriate aggregate policy, notably lowering financing costs and supporting the real economy, and promoted the economy to return to its potential growth level, hence cultivating a proper monetary and financial environment for achieving success in ensuring stability on six fronts, namely employment, the financial sector, foreign trade, foreign investment, domestic investment and expectations, and maintaining security in six areas, namely, employment, people's basic livelihood, operations of market entities, food and energy security, stable industrial and supply chains, and the normal functioning of primary-level governments.

First, work was done to keep liquidity adequate at a reasonable level. By flexibly employing tools such as required reserve ratio (RRR) cuts, the Medium-term Lending Facility (MLF), open market operations (OMOs), central bank lending and central bank discounts, the PBC guided market rates to move smoothly around policy rates, thus stabilizing market expectations. **Second,** reform bonuses were unleashed in succession and social financing costs were lowered. The rates for MLFs and OMOs were guided to drop 30 basis points, which brought down the loan prime rate (LPR). The PBC pushed ahead with the shift in the pricing benchmark for outstanding floating-rate loans so as to reduce interest payments for outstanding loans. **Third,** structural monetary policy tools were improved and liquidity was provided in a well-targeted way. The policies of RMB300 billion special central bank lending and of RMB500 billion central bank lending and central bank discounts have been fully implemented, following which the policy of RMB1 trillion central bank lending and central bank discounts was soon in place. The PBC introduced two innovative policy tools, which provided direct support for the real economy, so as to strengthen support for inclusive micro and small businesses (MSBs) and to facilitate economic recovery and development. **Fourth,** efforts were made to strike a balance between internal and external equilibria, with attention mainly focused on domestic conditions. The RMB exchange rate remained basically stable and moved in both directions with more flexibility. **Fifth,** work was done to safeguard the bottom line that no systemic risk should occur. In line with market-oriented and law-based principles, the PBC steadily proceeded with financial risk resolution and made intensified efforts with respect to write-offs of non-performing loans (NPLs).

Overall, the sound monetary policy produced remarkable results with transmission efficiency further enhanced, and it proved to be forward-looking, precise, proactive, and effective. The financial sector extended much more vigorous support to the real economy. At end-June 2020, broad money (M2) and aggregate financing to the real economy (AFRE) grew 11.1 percent and 12.8 percent year on year, respectively, significantly higher than the growth in 2019. In June, the weighted average rate of corporate loans registered 4.64 percent, 0.48 percentage points lower than that in December 2019. The structure of money and credit was further improved. At end-June, inclusive MSB loans and medium and long-term (MLT) loans to the manufacturing sector grew by 26.5 percent and 24.7 percent year on year, respectively. The RMB exchange rate moved in both directions, and market expectations were stable. At end-June, the China Foreign Exchange Trade System (CFETS) RMB Index registered 92.05, 0.72 percent higher than that at end-2019.

In the long run, the fundamentals of steady growth, long-term sound development and high-quality growth of the Chinese economy remain unchanged. However, it should be noted that the world economy is in recession with great instability and uncertainty. There are still some structural, institutional and cyclical problems with China's economy, and the problem of unbalanced and inadequate development remains prominent. Therefore, it is necessary to have an objective understanding and a rational view of the situation, strengthen confidence, maintain focus, and continue to ensure solid work in promoting economic and social development. In the next stage, firmly upholding the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era and resolutely implementing the decisions and arrangements of the CPC Central Committee and the State Council, the PBC will coordinate pandemic containment with economic and social development. It will adhere to the guiding principle of pursuing progress while ensuring stability, uphold the new development philosophy, and remain committed to the main task of supply-side structural reform. Solid steps will be taken to ensure stability on six fronts and maintain security in six areas, to secure a decisive victory in the tough 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 and better targeted, maintain appropriate growth of money supply and AFRE, improve cross-cyclical design and adjustment, properly handle the relationship among stabilizing growth, securing employment, adjusting structure, preventing risks and controlling inflation, so as to achieve an equilibrium between stabilizing growth and preventing risks in the long run. Measures will be taken in a more targeted and timely way to properly manage the intensity, pace and focus of monetary policy in line with pandemic containment as well as the economic and financial situations. While giving higher priority to supporting recovery of the real economy and sustainable development, the PBC will employ and innovate a mix of monetary policy tools to keep liquidity adequate at a reasonable level. Efforts will be made to smooth the transmission mechanism of monetary policy, bring into full play the role of structural monetary policy tools in ensuring precise liquidity provision, and enable the policies to provide more direct support for the real economy, so as to help the real economy, especially the micro, small, and medium-sized enterprises (MSMEs), to tide over the difficulties and enjoy stable development. Expectations will be guided through multiple channels, so as to keep prices basically stable. The PBC will make continued efforts on the LPR reform and proceed with the shift in the pricing benchmark for outstanding floating-rate loans, aiming at a remarkable reduction of overall financing costs, and thus create favorable conditions for developing the economy, stabilizing businesses and securing employment. It will support banks, especially small and medium-sized banks, in multiple-channel capital replenishment and governance improvements, and it will intensify efforts to resolve non-performing loans (NPLs), and thus enhance the capabilities of banks to serve the real economy and to forestall and defuse financial risks. Efforts will be made to deepen the supply-side structural reform in the financial sector and to foster virtuous cycles and interactions among the financial sector, the sci-tech sector, and industries. The PBC will coordinate RMB and foreign exchange policies, and balance domestic and external economic dynamics, in a bid to accelerate the establishment of a new development pattern, where domestic and international circulation boost each other, with domestic circulation as the mainstay.

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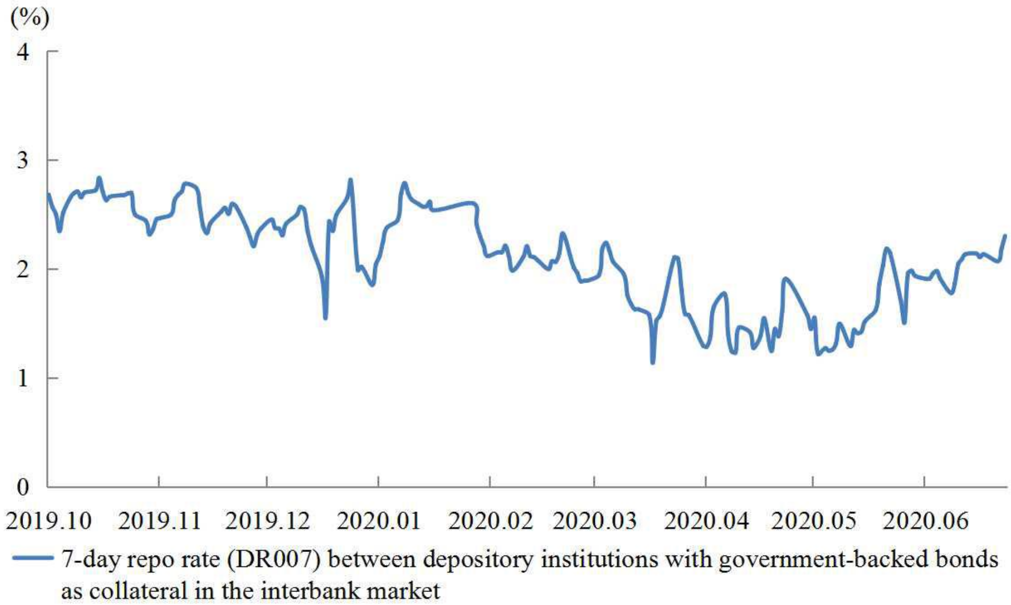
Part 1. Money and Credit Analysis

Since the beginning of 2020, the People's Bank of China (PBC) has resolutely implemented the decisions and arrangements of the CPC Central Committee and the State Council. With the sound monetary policy more flexible and appropriate, and countercyclical adjustments yielding significant results, financing costs continuously declined, the credit structure was further improved, and the quality and efficiency of financial services for the real economy were increasingly higher. The PBC has effectively supported pandemic containment, work and production resumption, and development of the real economy.

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

In H1 2020, facing complicated and grave domestic and international situations, in accordance with the requirement that sound monetary policies should be more flexible and appropriate, the PBC employed a monetary policy toolkit that included required reserve ratio (RRR) cuts, the medium-term lending facility (MLF), central bank lending and central bank discounts to release medium and long-term liquidity. It also had a flexible grasp of the intensity and pace of open market operations (OMOs) to keep liquidity adequate at a reasonable level. In addition, with strengthened expectation management, money market interest rates were guided to move smoothly around OMO rates.

Figure 1 Movement of Money Market Interest Rates



Source: www.chinamoney.com.cn.

II. Lending by financial institutions grew relatively rapidly, with the credit structure optimized and lending rates moving downwards

The PBC guided credit supply toward the needs of enterprises to resume work and production. It continued to push down financing costs and promote lending in favor of micro, small, and medium-sized enterprises (MSMEs), thus providing targeted support for pandemic containment, work and production resumption, and development of the real economy. Outstanding loans issued by financial institutions in domestic and foreign currencies grew 13.0 percent year on year to RMB171.3 trillion at the end of June, up RMB12.7 trillion from the beginning of the year and an acceleration of RMB2.9 trillion from the corresponding period of 2019. Outstanding RMB-denominated loans grew 13.2 percent year on year to RMB165.2 trillion, up RMB12.1 trillion from the beginning of the year and an acceleration of RMB2.4 trillion from the corresponding period of 2019.

The improvement in the credit structure and stronger support for the financing of micro and small business (MSB) met enterprises' liquidity needs and the entire society's demands for funds to contain the pandemic. Loans to enterprises and public entities grew by RMB8.8 trillion from the beginning of the year, a year-on-year increase of RMB2.5 trillion. Medium and long-term loans to the manufacturing sector gained 24.7 percent, hitting a record high within a decade. Outstanding inclusive loans to MSBs grew by 26.5 percent year on year to RMB13.5 trillion at the end of June, recording a growth increase of 3.4 percentage points from the end of the previous year and supporting 29.64 million MSBs, which was a year-on-year increase of 21.8 percent. The growth of loans to the household sector slowed down to 14.0 percent at end-June, 1.5 percentage points lower than that at end-2019.

Table 1 The Structure of RMB Loans in H1 2020

Unit: RMB100 million

	Outstanding amount at end-June	YOY growth (%)	Increase from the beginning of the year	YOY acceleration
RMB loans to:	1,651,999	13.2	120,887	24,175
Households	588,751	14.0	35,561	-2,001
Enterprises and public entities	1,050,420	12.8	87,705	25,058
Non-banking financial institutions	7,052	-2.0	-2,775	790
Overseas	5,776	12.3	397	327

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 H1 2020

Unit: RMB100 million

	Increase from the beginning of the year	YOY acceleration
Chinese-funded large-sized banks [1]	55,497	14,914
Chinese-funded small and medium-sized banks[2]	64,761	9,459
Small-sized rural financial institutions[3]	17,530	4,000
Foreign-funded financial institutions	406	-402

Notes: 1. Chinese-funded large-sized banks refer to banks with assets (in both domestic and foreign currencies) of RMB2 trillion or more (according to the amount of total assets in both domestic and foreign currencies at end-2008).
2. Chinese-funded small and medium-sized banks refer to banks with total assets (both in domestic and foreign currencies) of less than RMB2 trillion (according to the amount of total assets in both domestic and foreign currencies at end-2008).
3. Small-sized rural financial institutions include rural commercial banks, rural cooperative banks, and rural credit cooperatives.
Source: The People's Bank of China.

The weighted average interest rates on loans declined and corporate lending rates continued to move downwards. In June, the one-year loan prime rate (LPR) fell by 0.3 percentage points from December 2019 to 3.85 percent, and the over-five-year LPR fell by 0.15 percentage points to 4.65 percent. In June, the weighted average lending rate recorded 5.06 percent, down 0.38 percentage points from December 2019 and 0.6 percentage points year on year. In particular, the weighted average interest rate on ordinary loans registered 5.26 percent, down 0.48 percentage points from December 2019 and 0.68 percentage points year on year; the weighted average corporate lending rate dropped 0.48 percentage points from December 2019 to 4.64 percent in June, a drop clearly exceeding that of the LPR, which is conducive to lowering the financing costs of enterprises.

Table 3 Weighted Average Interest Rates on New Loans Issued in June 2020

Unit: %

	June	Change from December 2019	YOY change
Weighted average interest rate on all new	5.06	-0.38	-0.60

loans			
On ordinary loans	5.26	-0.48	-0.68
Of which: on corporate loans	4.64	-0.48	-0.64
On bill financing	2.85	-0.41	-0.79
On mortgage loans	5.42	-0.20	-0.11

Source: The People's Bank of China.

In June, the share of ordinary loans with rates above, at, or below the LPR registered 70.03 percent, 5.97 percent, and 24 percent, respectively. In general, the upward and downward float of the loan rates around the LPR moved downward as a whole compared with that in March.

Table 4 Shares of RMB Lending Rates at Different Levels from January to June 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
April	20.72	3.72	75.56	17.40	25.35	14.91	9.88	8.01
May	22.36	5.24	72.41	14.76	25.31	14.10	9.88	8.36
June	24.00	5.97	70.03	14.95	25.63	13.21	8.84	7.40

Source: The People's Bank of China.

The sustained easy monetary policies of the developed economies prompted a decrease in the interest rates on foreign-currency deposits and loans. In June, the weighted average interest rates on demand and large-value USD-denominated deposits with maturities within 3 months registered 0.20 percent and 0.75 percent respectively, down 0.01 percentage points and 0.68 percentage points respectively from March. 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 1.57 percent and 1.47 percent respectively, down 0.62 percentage points and 0.45 percentage points respectively from March

Table 5 Average Interest Rates of Large-value USD-denominated Deposits and Loans from January to June 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
April	0.21	1.06	1.90	2.02	2.08	1.88	2.15	2.26	1.97	1.82	2.43
May	0.21	0.95	1.32	1.38	1.61	1.74	1.71	1.73	1.59	1.62	2.27
June	0.20	0.75	1.32	1.30	1.41	1.45	1.57	1.47	1.41	1.46	2.42

Source: The People's Bank of China.

Growth of deposits picked up. At the end of June, outstanding deposits in domestic and foreign currencies in all financial institutions posted RMB213.0 trillion, up 10.5 percent year on year, 1.9 percentage points higher than that at the end of the previous year. Outstanding RMB deposits registered RMB207.5 trillion, up 10.6 percent year on year, 1.9 percentage points higher than that at the end of the previous year. Outstanding deposits in foreign currencies stood at USD778.4 billion, an increase of USD20.6 billion from the beginning of the year and a deceleration of USD11.9 billion year on year. Fiscal revenues declined, while expenditures on pandemic containment increased. Fiscal deposits decreased by 4.5 percent year on year.

Table 6 The Structure of RMB Deposits in H1 2020

Unit: RMB100 million

	Deposits at end-June	YOY growth (%)	Increase from the beginning of the year	YOY acceleration
RMB deposits:	2,074,780	10.6	145,517	45,004
Households	896,318	14.3	83,286	15,089
Non-financial enterprises	647,213	11.4	52,773	34,360
Public entities	308,246	1.6	11,077	-6,757
Fiscal entities	45,224	-4.5	4,384	-2,442
Non-banking financial institutions	165,017	11.1	-7,446	3,887
Overseas	12,763	11.3	1,443	868

Source: The People's Bank of China.

III. Broad money supply and aggregate financing to the real economy grew at a much higher rate than that in 2019

At the end of June, outstanding M2 recorded RMB213.5 trillion, up 11.1 percent year on year, an acceleration of 2.4 percentage points from the end of 2019. Outstanding M1 registered RMB60.4 trillion, a year-on-year growth of 6.5 percent and 2.1 percentage points higher than that at the end of the previous year. Outstanding M0 reached RMB7.9 trillion, up 9.5 percent year on year, a growth increase of 4.1 percentage points from the end of 2019. The first half of 2020 witnessed a net cash injection of RMB227 billion into the economy, a rise of RMB289.8 billion year on year.

According to preliminary statistics, outstanding aggregate financing to the real economy (AFRE) reached RMB271.8 trillion at the end of June, up 12.8 percent year on year and an acceleration of 2.1 percentage points over the end of the previous year. In H1 2020, the incremental AFRE reached RMB20.83 trillion on a cumulative basis, an increase of RMB6.22 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 the year-on-year growth in undiscounted bankers' acceptances expanded. Third, both corporate bonds and equity financing increased considerably compared with the previous year. Fourth, government bonds saw a significantly larger year-on-year increase. Fifth, the decline of asset-backed securities of depository financial institutions accelerated from the previous year, while the growth of written-off loans accelerated.

Table 7 Aggregate Financing to the Real Economy in H1 2020

	At end-June 2020		In H1 2020	
	Stock (RMB1 trillion)	YOY growth (%)	Flow (RMB100 million)	YOY change (RMB100 million)
AFRE	271.80	12.8	208,328	62,193
Of which：RMB loans	163.90	13.3	123,287	23,068
Foreign-currency loans (RMB equivalents)	2.49	12.6	3,482	3,385
Entrusted loans	11.22	-5.6	-2,306	2,627
Trust loans	7.32	-7.2	-1,295	-2,223
Undiscounted bankers' acceptances	3.72	-1.3	3,862	4,250
Corporate bonds	26.80	21.5	33,274	17,603
Government bonds	41.52	17.1	37,950	13,335
Domestic equity financing by non-financial enterprises	7.60	6.6	2,461	1,256

	At end-June 2020		In H1 2020	
Other financing	7.03	22.5	3,671	-1,229
Of which：Asset-backed securities of depository financial institutions	1.63	18.0	-538	-1,552
Loans written off	4.51	31.6	4,463	272

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.

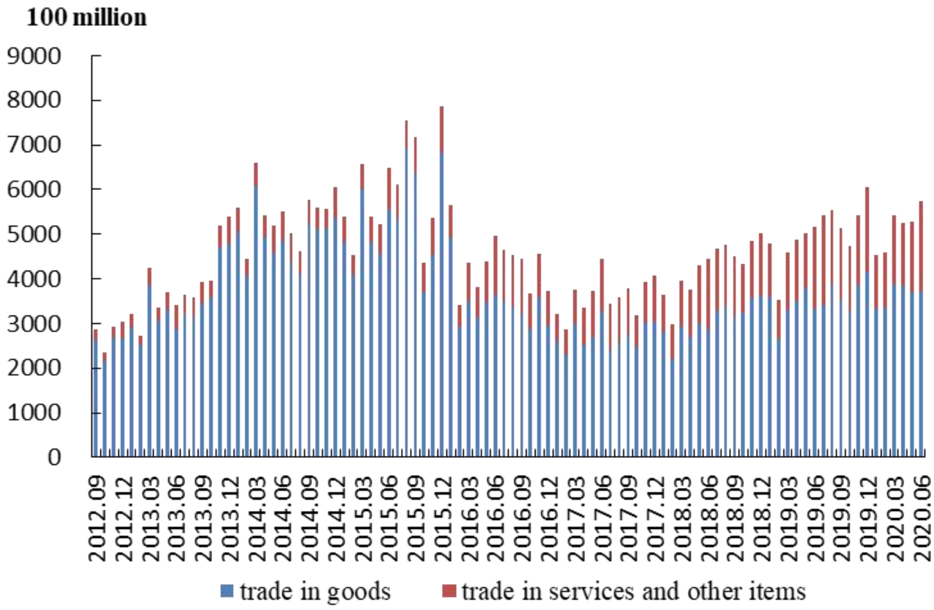
Sources: The People's Bank of China, China Banking and Insurance Regulatory Commission, China Securities Regulatory Commission, China Central Depository & Clearing Co., Ltd., National Association of Financial Market Institutional Investors, etc.

IV. The RMB exchange rate remained basically stable, and cross-border RMB transactions continued to grow

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 an adaptive and equilibrium level. In H1, the RMB exchange rate generally held steady against a basket of currencies. At the end of June, 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 92.05 and 90.78, up 0.72 percent and down 1.12 percent from end-2019, respectively. According to calculations by the Bank for International Settlements (BIS), as of the end of June, the nominal effective exchange rate (NEER) and the real effective exchange rate (REER) of the RMB appreciated 0.50 percent and depreciated 0.43 percent, respectively. From 2005 when reform of the exchange rate formation regime commenced to end-June 2020, the NEER and REER of the RMB appreciated by 32.97 percent and 45.82 percent, respectively. In H1, the RMB depreciated modestly against the USD. At the end of June, the central parity of the RMB against the USD was 7.0795, a depreciation of 1.46 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 16.91 percent on a cumulative basis. In H1, the annualized volatility rate of the RMB exchange rate against the USD was 4.6 percent.

Cross-border RMB transactions continued to grow with roughly balanced receipts and payments. In H1 2020, cross-border receipts and payments in RMB totaled RMB12.7 trillion, up 36 percent year on year. In particular, RMB receipts and payments registered RMB6.3 trillion and RMB6.4 trillion, respectively. RMB cross-border receipts and payments under the current account grew 10 percent over the previous year to RMB3.1 trillion. Specifically, settlement of trade in goods registered RMB2.2 trillion, whereas settlement of trade in services and other items registered a cumulative RMB0.9 trillion. RMB cross-border receipts and payments under the capital account posted RMB9.6 trillion, up 47 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

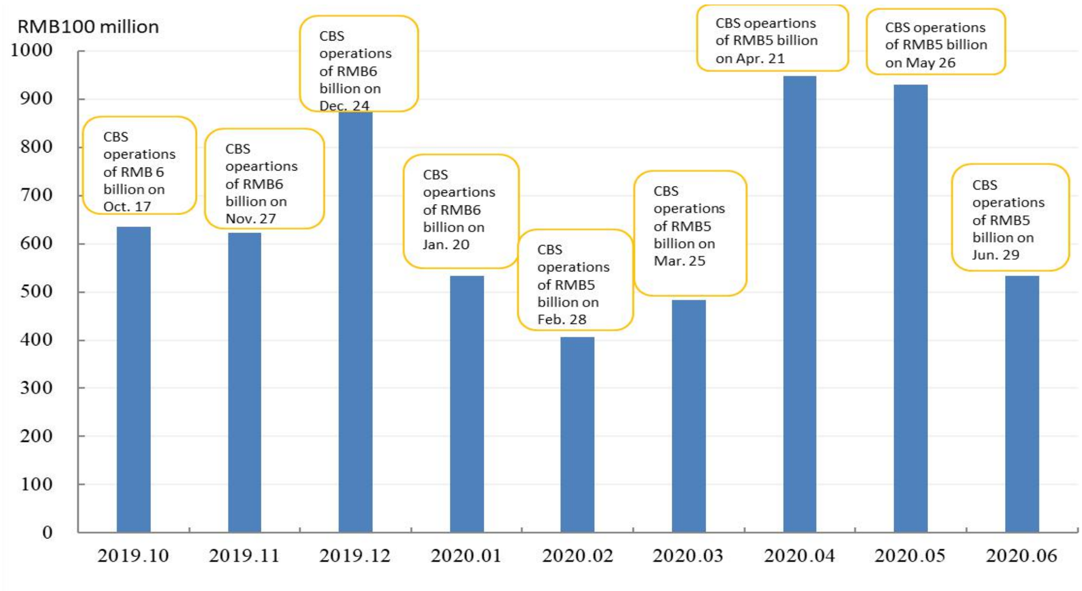
Since the beginning of 2020, amid the daunting challenges posed by the COVID-19 pandemic, the PBC has adhered to the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, resolutely implemented the decisions and arrangements made by the CPC Central Committee and the State Council, and adopted a sound monetary policy in a more flexible and appropriate manner. Based on the current situation highlighted by pandemic containment and work and production resumption, the PBC flexibly managed the intensity, pace, and focus of adjustments, remained committed to the specific goals of maintaining an appropriate aggregate policy, substantially lowering financing costs and supporting the real economy in response to the highly uncertain situation, and shore up the economy to tap into its potential so as to create a favorable environment for ensuring stability on six fronts, namely, employment, the financial sector, foreign trade, foreign investment, domestic investment and expectations, and maintaining security in six areas, namely, employment, people' s basic livelihood, operations of market entities, food and energy security, stable industrial and supply chains, as well as the normal functioning of primary-level governments.

I. Conducting open market operations in a flexible manner

Flexibly conducting open market operations (OMOs) and maintaining liquidity adequate at a reasonable level. In the first half of 2020, in addition to cutting the required reserve ratio (RRR) three times, conducting the medium-term lending facility (MLF) operations, and providing central bank lending and central bank discounts, the PBC conducted OMOs in a flexible manner and maintained adequate liquidity at a reasonable level in the banking system, which was neither loosened nor tightened, with the excess reserve ratio of the system approximating 1.5–2 percent. Since the beginning of Q2, to cushion the impact of short-term factors such as intensive government bond issuances as well as the annual settlement and payment of the corporate income tax, the PBC has managed well the strength and pace of OMOs and has ironed out short-term liquidity fluctuations in a timely manner. A series of 14-day repo operations has been conducted since mid-June, preemptively meeting the heightened liquidity demand at mid-year, stabilizing market expectations, and thus providing a favorable liquidity environment for government bond issuances.

The OMO rates remained stable. Since the beginning of Q2, the 7-day repo rate has remained unchanged at 2.20 percent, which has neither declined due to monetary easing adopted by the developed economies nor increased, sending a clear signal of stability. In the meanwhile, various means were taken to strengthen expectations management and to guide money market rates to move smoothly around the OMO rates, hence bringing into play the role of OMO rates as the center of short-term market rates. In Q2, money market rates witnessed stable movement in general. In April, due to the zero interest rate policy and the quantitative easing adopted by the central banks of the developed economies, participants in the interbank market pushed down money market rates, which once even deviated from the OMO rates. In late May, with market expectations returning to rationality, money market rates rebounded and stayed close to the OMO rates. In Q2, the 7-day rate (DR007), which is a funding rate between depository institutions in the interbank market, averaged 1.66 percent, 45 basis points lower than that in Q1. At end-June, the DR007 stood at 2.30 percent, 26 basis points lower than that at the same time last year.

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



Source: The People's Bank of China.

Continuously conducting central bank bill swap (CBS) operations. In order to support banks to replenish capital through perpetual bond issuances and to further improve the market liquidity of perpetual bonds issued by banks, the PBC conducted CBS operations three times in Q2, with the total amount registering RMB15 billion. The maturity of each operation was three months, at a fixed rate of 0.1 percent. Since the beginning of 2020, the PBC has conducted CBS operations once in each month, totaling RMB31 billion. The perpetual bonds swapped with the PBC included not only those issued by large-sized commercial banks and joint-stock commercial banks but also those issued by urban commercial banks and rural commercial banks. The CBS operations played a positive role in improving liquidity on the secondary market of bank-issued perpetual bonds and supporting the issuance of perpetual bonds to replenish capital by banks, especially small and medium-sized banks.

Issuing central bank bills in Hong Kong on a regular basis. In Q2, 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. In H1 2020, the PBC issued in Hong Kong six batches of RMB-denominated central bank bills in a total amount of RMB80 billion, with the outstanding balance standing at RMB80 billion as of end-June. The regular issuance of RMB-denominated central bank bills in Hong Kong not only enriched RMB investment products with high credit ratings and RMB liquidity management tools on the Hong Kong market but also fostered the offshore issues of RMB bonds by other entities, thus promoting the use of RMB as an international currency.

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

Well-timed Medium-term Lending Facility (MLF) operations were conducted. The supply of monetary base was ensured and MLF rates declined. In the first half of 2020, the PBC conducted a total of RMB1 trillion of MLF operations, all with a maturity of one year. Specifically, the amount of MLF operations posted RMB400 billion in Q2. At end-June, the outstanding MLF registered RMB3.55 trillion, RMB140 billion less than that at the beginning of the year. The one-year MLF rate declined by 20 basis points from the previous operation to 2.95 percent on April 15 and levelled off in May and June. The MLF rate, as the mid-term policy rate, is the center of the mid-term market rates. Market interest rates, such as the government bond yield curve and interbank certificates of deposit, fluctuate around the MLF rate. As the MLF rate represents the banks' average marginal mid-term funding cost, its decline meant the latter dropped, which was helpful to bring down the corporate lending rates through the LPR and to foster lower social financing costs.

Standing Lending Facility (SLF) operations were conducted in a timely manner. The demand for short-term liquidity of locally incorporated financial institutions was met in the full amount, with the SLF playing the role as the ceiling of the interest rate corridor, thus promoting the smooth operation of the money market. In the first half of 2020, the PBC conducted a total of RMB151.4 billion SLF operations, of which RMB48.7 billion of operations were conducted in Q2. The balance of SLF operations registered RMB7.3 billion at end-June. On April 10, the overnight, 7-day, and 1-month SLF rates were lowered by 30 basis points to reach 3.05 percent, 3.2 percent, and 3.55 percent, respectively.

III. Enhancing monetary and credit support to offset the impact of the

In accordance with the decisions and arrangements of the CPC Central Committee and the State Council, the PBC coordinated pandemic containment with economic and social development, rolled out a series of monetary and credit policies, and strived to stabilize businesses and secure employment, in an aim to ensure stability on six fronts and to maintain security in six areas.

First, liquidity remained adequate at a reasonable level. RMB1.7 trillion of short-term liquidity was pumped into the financial market when it reopened after the Spring Festival vacation, which effectively stabilized market expectations. The three reductions of the RRR released RMB1.75 trillion of long-term funds.

Second, RMB1.8 trillion of central bank lending and central bank discounts was provided in three steps, and coordinated efforts were made to promote pandemic containment and economic and social development. In the first half of 2020, the PBC provided RMB300 billion of special central bank lending, RMB500 billion of central bank lending and central bank discounts, and RMB1 trillion of central bank lending and central bank discounts in three steps, with a combined quota of RMB1.8 trillion, to support containment of the pandemic, provision of medical supplies and daily necessities, resumption of work and production, and development of the real economy, especially the micro, small, and medium-sized enterprises (MSMEs). As of end-June, the policy of RMB300 billion of special central bank lending and RMB500 billion of central bank lending and central bank discounts had been fully implemented. As of July 27, central bank lending and central bank discounts in the amount of RMB1 trillion had supported locally incorporated banks to issue a total of RMB457.3 billion in loans at preferential interest rates, thus playing a vital role in supporting pandemic containment as well as work and production resumption.

Third, two monetary policy instruments that directly support the real economy were launched to bolster the development of small and medium-sized enterprises (SMEs) and to stabilize businesses and secure employment. On June 1, 2020, the PBC, jointly with the China Banking and Insurance Regulatory Commission (CBIRC), Ministry of Finance (MOF), the National Development and Reform Commission (NDRC), and Ministry of Industry and Information Technology (MIIT), issued the *Notice on Extending the Policy of Provisional Deferred Repayments of Loan Principal and Interest for Micro, Small and Medium-sized Enterprises* (Yinfa No.122 [2020]), stipulating that, for the principal of inclusive micro and small business (MSB) loans that were to mature within the year and for the accrued interest of inclusive MSB loans outstanding at end-2020, banking financial institutions shall grant deferred repayments of the principal and interest for a certain period of time to enterprises upon application, extending the repayment deadline up to March 31, 2021, with the penalty interest waived. On the same day, the *Notice of the PBC on Issues Regarding Instruments Supporting Deferred Repayments of Inclusive Loans for Micro and Small Businesses* (Yinfa No.124 [2020]) was issued, which stipulated that the PBC launched an instrument in support of deferred repayments of inclusive MSB loans, set up RMB40 billion of central bank lending, and provided an incentive equivalent to approximately 1 percent of the deferred loan principal to locally incorporated banks, so as to ease the MSBs' pressure of deferring the repayment of the loan principal and interest. In addition, the *Notice of the PBC on Issues Regarding the Support Scheme for Inclusive Unsecured Loans for Micro and Small Businesses* (Yinfa No.125 [2020]) was issued on the same day, stating that the PBC launched a support scheme for unsecured inclusive MSB loans, in which RMB400 billion of central bank lending would be set up and banks would be provided with favorable funding equivalent to 40 percent of the unsecured loans that they had actually issued, thus substantively easing the financing strains on the MSBs. The two new instruments directly link monetary policy operations with financial institutions' support for inclusive MSBs, which ensures targeted adjustments and provides vigorous support for stabilizing businesses and securing employment.

Fourth, synergy in the financial system was forged. 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 inclusive MSBs, special credit support from policy banks was put in place, and locally incorporated banks were guided to serve local communities effectively.

IV. Lowering the required reserve ratio for small and medium-sized banks

The RRR for small and medium-sized banks and the interest rate on excess reserves were cut to support the development of the real economy. On April 3, the PBC announced an RRR cut of 1 percentage point for rural credit cooperatives, rural commercial banks, rural cooperative banks, village banks, and city commercial banks that operate solely within their own provincial-level administrative regions. This cut took effect 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 was freed up by the cut. Meanwhile, starting from April 7, the interest rate on excess reserves deposited in the central bank by financial institutions was cut from 0.72 percent to 0.35 percent. At end-June, the excess reserve ratio for financial institutions stood at 1.6 percent, representing a year-on-year reduction of 0.4 percentage points and a reduction of 0.5 percentage points from end-March when the cut had not been announced. All the above-mentioned policies have contributed to boosting the banks' credit support for MSMEs, enhancing the financial institutions' efficiency in capital use, 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 Q2 2020, in line with the requirement of the central economic work conference that medium and long-term funding be increased for the manufacturing sector and the difficulties faced by private firms and MSMEs be alleviated in terms of accessing affordable funding, the PBC further strengthened the assessment of financing for MSBs, private firms, and the manufacturing sector in the MPA, and guided financial institutions to ramp up credit support for them. Improvements were made in the assessment on the use of the loan prime rate (LPR), and the LPR reform continued to play its part in pushing down the loan rates.

The supervisory framework for systemically important financial institutions (SIFIs) was improved. In line with the *Guiding Opinions on Improving the Supervision of Systemically Important Financial Institutions*, the PBC took the lead in the formulation of *Assessment Measures on Systemically Important Banks*, clarifying assessment indicators, process, and the division of work, which helped improve the supervisory framework for systemically important banks in China.

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

The PBC actively used central bank lending in support of agriculture and MSBs, central bank discounts, pledged supplementary lending (PSL), and other policy tools to guide financial institutions to step up support for key areas and weak links in the national economy, such as MSBs, private firms, agriculture, rural areas, and rural residents, as well as poverty alleviation. Central bank lending to support special poverty alleviation projects was made good use of 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, to cut down on the financing costs in these areas as well as to achieve targeted poverty alleviation. In Q2, RMB8 billion of central bank lending for special poverty alleviation projects was provided, with the nationwide balance standing at RMB21.9 billion at end-June. Starting from July 1, 2020, the interest rates on central bank lending to support agriculture and MSBs and the central bank discount rate were reduced by 25 basis points. After this reduction, the three-month, six-month, and one-year central bank lending to support agriculture and MSBs posted 1.95 percent, 2.15 percent, and 2.25 percent, respectively, while the central bank discount rate was 2 percent. At end-June, outstanding central bank lending to support agriculture stood at RMB337.2 billion. Outstanding central bank lending for MSBs and for poverty alleviation posted RMB621.4 billion and RMB153.7 billion, respectively. Outstanding central bank discounts registered RMB433.6 billion. In the first half of 2020, the PBC made a net withdrawal of PSLs in the amount of RMB28.3 billion from policy and development banks, with the net withdrawal in Q2 totaling RMB48.5 billion and the outstanding PSL registering RMB3.509 trillion at end-June.

A targeted medium-term lending facility (TMLF) operation 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 April, the PBC conducted one-year TMLF operations at an interest rate of 2.95 percent, totaling RMB56.1 billion. The interest rate was 20 basis points lower than that in the previous operation, and it was at the same level as the latest MLF rate. At the end of June, the outstanding TMLF stood at RMB594.3 billion.

Box 1 Improving the Structural Monetary Policy Toolkit

In 2020, acting on the fundamental requirement of the financial sector serving the real economy, the PBC continued to improve the structural monetary policy toolkit, deployed structural monetary policy instruments in an innovative manner, provided precise and targeted financial support, effectively supported pandemic containment and economic and social development, and ramped up support for key areas and weak links in the national economy, all of which have achieved good results.

Monetary policy can both play the role of an aggregate policy and be an important force in support of economic structure adjustments, transformation, and upgrading. Frictions exist in the macroeconomic operation, the market system faces the risk of market failure, and micro-market entities are heterogeneous in the real world. If aggregate indicators are the only focus of monetary policy, greater structural distortions will arise, making aggregate targets difficult to attain. Therefore, the introduction of an incentive compatibility mechanism helps structural monetary policies to achieve the following goals, i.e., enhancing efficiency of capital use, promoting the flow of credit resources into key areas and weak links that have greater demand and vitality, leveraging the social and economic efficiency of financial resources, boosting social welfare, and contributing to better aggregate adjustment effects. The PBC has long been successful in implementing structural monetary policy instruments. In wake of the global financial crisis in 2008, the central banks in the advanced economies came to realize that financial markets were flawed, and many began to adopt structural monetary policies, including the Targeted Longer-term Refinancing Operations (TLTRO) of the ECB, and the Funding for Lending Scheme

(FLS) of the Bank of England.

The PBC has increased the intensity of structural monetary policy since the beginning of this year. **First**, the required reserve framework featuring “three tranches and two preferential treatments” was further improved. The targeted RRR cut for inclusive finance on March 16 released about RMB550 billion of long-term funds to support the issuance of loans for inclusive finance. On April 3, the RRR cut for small and medium-sized financial institutions, including rural commercial banks, and for city commercial banks that operate solely within their own provincial-level administrative regions was announced, releasing about RMB400 billion of long-term funds. **Second**, to cushion the impact of the pandemic, special central bank lending with a quota of RMR300 billion as well as inclusive central bank lending and central bank discounts with a quota of RMB500 billion and RMB1 trillion respectively were rolled out successively. By end-June, the policy of RMB300 billion special central bank lending and of the RMB500 billion central bank lending and central bank discounts had been fully implemented. Specifically, the RMB300 billion quota of central bank lending supported banks in issuing a cumulative RMB283.4 billion of preferential loans to a total of 7,597 nationwide and local key enterprises. The RMB500 billion quota of central bank lending and central bank discounts supported locally incorporated banks to issue a cumulative RMB498.3 billion of preferential loans to a total of 590,000 enterprises. Central bank lending and central bank discounts with a quota of RMB1 trillion were put in place to make an orderly continuation. By July 27, a cumulative RMB457.3 billion of preferential loans had been issued to a total of 780,000 businesses and rural households, with each borrower receiving an average of RMB590,000. **Third**, two monetary policy instruments that can provide more direct support for the real economy have been developed. In order to encourage banks to ease MSMEs’ pressures to repay loans, a supportive instrument to defer the repayment of inclusive loans for MSBs was set up, and RMB40 billion of central bank lending was provided. This move is estimated to support locally incorporated banks to extend inclusive MSB loan principal approximating RMB3.7 trillion. Another supportive scheme to provide unsecured inclusive loans for MSBs was created to alleviate the pain of MSBs with no guarantees in accessing loans, in an attempt to raise the share of unsecured MSB loans. Under this scheme, the RMB400 billion of central bank lending is expected to drive locally incorporated banks to issue about RMB1trillion of unsecured loans for inclusive MSBs. Recently, the PBC, for the first time, conducted operations under this supportive scheme for eligible unsecured loans issued by locally incorporated banks from March 1 to May 31, 2020, covering 1,170 locally incorporated banks and 390,000 MSBs nationwide. The principal of eligible unsecured loans reached RMB70.9 billion, with a weighted average maturity of 13.6 months and a weighted average interest rate of 6.76 percent. This first operation to support unsecured inclusive loans provided RMB27 billion to locally incorporated bank and the first interest rate swap operation of the supportive instrument for deferred repayments of inclusive MSB loans will be conducted in the near future.

It has been proved that structural monetary policy functions effectively in following three respects. **First**, a positive incentive mechanism for financial institutions has been set up. The design of the incentive compatibility mechanism enables liquidity injections to play the function of enhancing structural adjustments of bank credit, to effectively guide the behavior of financial institutions, to respond to emergency shocks such as the pandemic, and to ramp up the support of finance to key areas in the real economy. **Second**, a reimbursement-based mechanism to optimize financial institutions' credit has been set up. Through the provision of low-cost funds to financial institutions with partial or total refunding, financial institutions are guided to step up credit support for the key areas and weak links in the national economy. **Third**, the interest rate plays a guiding role. By bringing into play the role of structural monetary policy in guiding the movement of the interest rate, the central bank has strengthened effective guidance of the interest rate and lowered social financing costs. Since the beginning of 2020, financing for MSMEs grew in both volume and coverage and was offered at lower prices. At end-June, outstanding inclusive loans for MSBs grew by 26.5 percent year on year, 3.4 percentage points higher than the growth at the end of the previous year. The interest rate of corporate loans averaged 4.64 percent, 0.48 percentage points lower than that in last December. Inclusive loans for MSBs supported 29.64 million MSB entities, a year-on-year increase of 21.8 percent.

Going forward, the PBC will continue to leverage the role of structural monetary policy instruments in providing precise and targeted financial support, enable the policies to provide more direct support for the real economy, guide financial institutions to ramp up support for MSBs and private firms, earnestly fulfill its duties to ensure stability on six fronts and comprehensively implement the task of maintaining security in six areas, so as to promote a virtuous cycle between finance and the real economy.

VII. Leveraging the structural guidance role of credit policies

With an orientation toward high-quality development, the PBC further optimized the financial structure, guided financial institutions to continuously enhance their support to key areas of the national economy and to weak links, and intensified efforts to stabilize businesses and secure employment in an attempt to ensure success in the battle of poverty elimination and in the building of a moderately prosperous society in all respects. **First, comprehensive mobilization and deployment were carried out to provide support for stabilizing businesses and securing employment by the financial sector.** Based on special research on the subject of "securing market entities", the PBC published *the Guidelines on the Work of Stabilizing Businesses and Securing Employment by the Financial Sector*. Monetary policy tools were innovated to provide more direct support for the real economy. The PBC enhanced credit support for market entities and released guiding opinions on further strengthening financial services to MSMEs, jointly with other authorities, in a bid to raise the scale, reduce the costs, improve the quality, and expand the coverage of these services. The PBC enhanced support for medium and long-term financing of the manufacturing industry and established a coordination and negotiation mechanism among ministries for medium and long-term loans for the manufacturing industry. The PBC published a notice on enhancing interest support to secured loans for start-ups and stepped up financial support for the employment and entrepreneurship of special social groups, such as veterans, college graduates, and migrant workers returning home to start businesses. **Second, financial services were provided to effectively promote targeted poverty alleviation.** The PBC strengthened the application of policy tools and its corresponding guidance, allocated more financial resources to extremely poor areas as well as to counties that were still labeled as poverty-stricken, enhanced management of potential risks with respect to poverty alleviation by the financial sector, and promoted the establishment of a long-term mechanism for providing high-quality and sustainable financial support for poverty alleviation. **Third, financial services were further strengthened to support rural revitalization.** Measures were taken to provide financial support for safeguarding spring farming, tillage preparation, and hog production, and for securing the effective supply of essential agricultural products. Financial institutions were guided to reinforce support for agricultural fixed-asset investments and the construction of high-standard farmland. Efforts were made to enhance financial support for warehouse logistics enterprises in a bid to boost the quality and efficiency of circulation businesses. Financial services for new-type agricultural business entities were stepped up to facilitate the integration of small farmers into the agricultural industry chain. **Fourth, coordinated regional development was promoted.** Focused on the planning, construction, reforms and development of Xiongan New Area, efforts were made to improve the system of financial supportive policies and guide financial institutions to provide more financial resources for key areas and major projects through multiple channels. Continuous efforts were made to provide better financial services for major regional development strategies, such as the coordinated development of Beijing-Tianjin-Hebei, the development of the Yangtze River Economic Belt, the construction of the Guangdong-Hong Kong-Macao Greater Bay Area, the development of regional integration of the Yangtze River Delta, and the construction of Hainan Pilot Free Trade Zone and Free Trade Port.

VIII. Deepening the market-oriented interest rate reform

The PBC advanced the LPR reform and lowered the loan rates for enterprises. The application of the LPR was further promoted. The one-year and above-five-year

LPR reported in June were 3.85 percent and 4.65 percent, respectively, down 20 basis points and 10 basis points from March, respectively. Following the LPR trending downward, loan rates were notably reduced, with a decline larger than that of the LPR. 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. By the end of June, 55 percent of outstanding loans had completed the shift in the pricing benchmark, including 76 percent of the outstanding corporate loans. During the transition, the interest rates on loans were somewhat lowered, which could directly reduce the enterprises' interest expenses. From the beginning of the next price-setting period, enterprises can enjoy additional policy benefits brought about by the lowered LPR, which will further notably reduce their financing costs. A market-based LPR can better reflect changes in market supply and demand, which will significantly improve the efficiency of the transmission of monetary policy to loan interest rates. Meanwhile, the LPR reform plays an important role in the market-based reform of deposit interest rates.

Box 2 Improvements in the Interest Rate Transmission Mechanism

In August 2019, in accordance with the arrangements of the State Council, the PBC reformed and improved the formation mechanism for the LPR which allowed panel banks to make quotes by adding some basis points to the MLF rate. The number of basis points added was mainly determined by factors such as the funding costs of banks, market demand and supply, and the risk premium.

As the central bank's medium-term policy interest rate, the MLF rate represents the marginal funding cost of the banking system to obtain medium-term base money from the central bank. Since the central bank is in charge of supplying base money, its policy interest rates undoubtedly constitute the basis of market interest rate pricing and serve as the pivot of market interest rate movements. Although the proportion of funds provided by the MLF and other monetary policy instruments is not high among the banks' liabilities, it is the marginal amount rather than the total amount that plays a decisive role in affecting market interest rates. Under the credit money system of banks, the entities of money creation are banks. After creating deposits by expanding assets, banks need more base money to satisfy the reserve requirements. Therefore, there exists a continuous demand for base money. As the central bank takes charge of base money supply, it only needs a few necessary operations to exert a decisive marginal impact on the market interest rates rather than operations in huge amount to make central bank funds the main liabilities of the banks. The MLF rate as the medium-term policy interest rate, together with the OMO rate as the short-term policy interest rate, forms the system of policy interest rates of the central bank, which conveys signals of central bank's interest rate adjustments. In addition, as its maturity matches that of the LPR, the MLF is suitable to be used by banks as an important reference for loan pricing, i.e., the price of the funds provided by the banking system for the real economy. Taking into account their respective funding costs and other factors, panel banks can make quotes by adding some basis points to the MLF rate. In fact, the spread between the LPR and the MLF rate is not totally fixed, which reflects the market-oriented feature of the panel banks' quotation. Affected by various factors, the interest rates of interbank CDs, repos, interbank lending, and other interbank financing instruments, as well as the yield curve of treasury bonds, fluctuate in the short-term. However, in the medium and long-term run, they will mainly fluctuate around the central bank's policy interest rates.

Since the reform, the LPR quotation has gradually trended downward, which has reflected well the direction of the central bank's monetary policy and the demand and supply of market funds. It has not only become a key reference for loan interest rate price-setting by banks but also has been internalized into the funds transfer pricing (FTP) of the banks' internal funds. The original implicit floor for loan interest rates has been completely removed, with the transmission channel for monetary policy effectively smoothed. An interest rate transmission mechanism featuring "MLF rates→LPR→loan interest rates" has been fully demonstrated.

Meanwhile, the LPR reform has effectively promoted the market-oriented reform of deposit interest rates. Although no adjustment has been made to the benchmark deposit interest rates since October 2015, the caps and floors of deposit interest rates have both been removed, so the actual deposit interest rates executed by banks can be set on a discretionary and floating-rate basis. With the deepening of the LPR reform, loan interest rates have become more market-oriented and connected to the markets. Due to the remarkable decrease in loan interest rates after the reform, banks will reasonably lower the costs of their liabilities in an attempt to match asset incomes. Subsequently, there will be fewer incentives for banks to attract deposits at high interest rates, thus guiding the decline of deposit interest rates. In fact, against the backdrop of unchanged benchmark deposit interest rates, banks' deposit interest rates of all maturities have recently decreased. In June, a number of large-scale banks voluntarily lowered the issuance interest rates on 3-year and 5-year negotiable CDs, followed by the downward adjustments by joint-stock banks accordingly and the decline of deposit interest rates in some local incorporated banks. In June 2020, the average weighted interest rate of negotiable CDs of large-scale state-owned banks and joint-stock banks registered 2.64 percent and 2.71 percent, respectively, 30 basis points and 34 basis points lower than those of December 2019. The yield of representative money market funds has fallen below 1.5 percent, lower than the 1-year benchmark deposit interest rate. The yields of banks' structural deposits and wealth management products have also declined. This has fully illustrated the effectiveness of the market mechanism in reducing deposit interest rates through the LPR reform, the improved efficiency of monetary policy transmission to deposit interest rates, and the significant progress made in the market-oriented deposit interest rate reform.

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 H1, the highest and lowest CNY central parities were 6.8606 and 7.1316 against the USD, respectively. During the 117 trading days, the RMB appreciated on 60 days and depreciated on 57 days. The biggest intraday appreciation and depreciation were 0.65 percent (456 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-June, the central parities of the RMB against the dollar, the euro, and the Japanese yen had depreciated 1.46 percent, 1.83 percent, and 2.62 percent respectively from end-2019, while the RMB had appreciated 5.00 percent against the pound. From the RMB exchange rate regime reform in 2005 to end-June 2020, the RMB against the dollar, the euro, and the Japanese yen appreciated by a cumulative total of 16.91 percent, 25.79 percent, and 11.02 percent respectively. Direct RMB trading was buoyant on the interbank foreign exchange market with steady liquidity, which helped lower the exchange costs of micro economic entities and facilitate bilateral trade and investment.

Table 8 Trading Volume of the RMB Against Other Currencies in the Interbank Foreign Exchange Spot Market in H1 2020

Unit: RMB100 million

Currency	USD	EUR	JPY	HKD	GBP	AUD	NZD
Trading volume	232663.83	6027.54	1010.54	579.85	125.64	228.14	27.14
Currency	SGD	CHF	CAD	MYR	RUB	ZAR	KRW
Trading volume	330.57	14.58	46.65	2.53	72.71	0.94	29.03
Currency	AED	SAR	HUF	PLN	DKK	SEK	NOK
Trading volume	6.31	8.02	0.40	2.29	1.66	8.80	0.91

Currency	TRY	MXN	THB	KHR	KZT	MNT	
Trading volume	0.35	0.13	172.81	0.02	0.02	0	

Source: China Foreign Exchange Trade System.

As of end-June, under the bilateral currency-swap agreements between the PBC and foreign monetary authorities, the latter utilized a total of RMB32.736 billion, and the former utilized an equivalent of USD431 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

Disposal of high-risk small and medium-sized financial institutions was successfully implemented. The PBC actively defused hidden risks in some city commercial banks, rural commercial banks, and rural credit cooperatives over the years, and maximally protected 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 plans of Jinzhou Bank and Hengfeng Bank were carried out smoothly.

Reform of development and policy financial institutions was continuously deepened. The PBC comprehensively promoted implementation of the reform plans for development and policy financial institutions in terms of redefining the scope of business, promoting the improvement of corporate governance, and strengthening capital constraints. The PBC will continue to guide policy financial institutions to stick to their responsibilities and business scope and to give full play to their role in supporting key areas and weak links in the national economy during the critical period, while strengthening risk prevention and control so as to better serve national development strategies.

Plans were made in advance and efforts were made to properly deal with the risks of a prospective rise in non-performing loans in the banking industry due to the impact of COVID-19. COVID-19 has impacted China's economic and social development, and has put some downward pressures on the quality of banks' credit assets. As there is a time lag in the reflection of non-performing loans, it is estimated that non-performing loans will successively emerge and increase over the upcoming period. The PBC and the CBIRC, together with relevant departments, guided the commercial banks to conduct stress tests and actively made response plans with regard to the rise of non-performing loans due to the impact of COVID-19. Commercial banks were supported and encouraged to consider changes in the situation on a dynamic basis, to adopt forward-looking measures, and to reasonably utilize financial resources. In addition, loss provisions on and write-offs of non-performing loans were enhanced in a bid to properly cope with the risks of a prospective rise in non-performing loans due to the impact of COVID-19 and to enhance the capability to withstand risks and serve the real economy.

Box 3 Review of the Risk Resolution of Baoshang Bank

On May 24, 2019, Baoshang Bank (BSB) was taken over by the PBC and the CBIRC due to serious credit risks. The working group for the takeover fully executed the business management rights on the BSB and entrusted the China Construction Bank Corporation (CCB) to handle its business operations. The risk resolution of the BSB was steadily promoted for more than one year, and it is now reaching a conclusion.

1. Efforts have been made to appropriately guarantee the creditors' rights

On the day of the takeover, the BSB had a total of about 4,731,600 clients. Specifically, its personal clients totaled 4,667,700, while enterprises and interbank institutional clients amounted to 63,600. The number of clients the BSB serves is quite large, with corporate and interbank clients spreading across the country. Once it is unable to repay its debts on time, a series of chain reactions such as bank runs and financial market fluctuations are likely to occur. In order to ensure maximum protection of the legitimate rights and interests of depositors and other creditors, and to safeguard financial and social stability, after a thorough study, the PBC and the CBIRC decided to have the Deposit Insurance Fund and the PBC provide funds, guaranteeing the principal and interest of personal deposits and the creditor's rights of most of the institutions to the full amount. Meanwhile, to strengthen market discipline and gradually break the expectation of rigid repayment while taking into account the acceptability of market entities, 90 percent of large-denomination creditor's rights has been guaranteed on average. Overall, the extent to which the principal and interest of individuals and institutions is guaranteed is appropriate, which is not only higher than that during the comprehensive management of securities companies in 2004 but also relatively high concerning the risk resolution of the same type of international institutions.

2. Assets and capital verification have been comprehensively conducted

In June 2019, to get a clear picture of the BSB, the working group hired an intermediary in a market-based manner to verify the corporate and interbank businesses of the BSB on a deal-by-deal basis. Checkups on the assets and liabilities, account clarification, re-evaluation, and capital verification were conducted, in a bid to fully understand the asset conditions, financial position, and business operations of the BSB. On the one hand, the results of the assets and capital verification confirmed that the BSB was faced with huge risks of insolvency and serious credit risks had already emerged during the takeover. Without the injection of public funds, the ratio of ordinary guaranteed creditors' rights would be theoretically less than 60 percent. On the other hand, the results have established a solid foundation for subsequently promoting the reform and restructuring of the BSB by the working group.

3. Reforms and restructuring of the BSB have been promoted

In October 2019, the reforms and restructuring of the BSB officially began. In order to minimize the disposal costs, the working group originally hoped that by introducing strategic investors, and under the precondition of the government departments not providing public funds for sharing losses, the fund shortages incurred by the BSB's insolvency would be compensated for only by the premium of equity acquisition. However, due to the huge loss gap, no strategic investors were willing to participate in the restructuring of the BSB unless public funds covered the losses. To ensure the uninterrupted provision of financial services during the reform and restructuring of the BSB, with the international experience and practices of financial risk resolution drawn upon, the PBC and the CBIRC finally decided to establish a new bank under the current framework of laws and regulations at home to acquire the BSB so as to promote its reform and restructuring. In the meantime, to guarantee the liquidity safety of the BSB, the PBC provided liquidity support totaling RMB23.5 billion to the BSB through a standing lending facility since the takeover, upon acceptance of high-quality collaterals in full amount.

In January 2020, the working group entrusted the Beijing Financial Assets Exchange, in accordance with the market-based principle, chose Huishang Bank to acquire the four BSB branches outside the Inner Mongolia Autonomous Region, and ascertained the subscription quota and share price for the shareholders of the newly-established bank, namely, Mengshang Bank.

On April 30, 2020, Mengshang Bank was officially established and started its business operations. On the same day, the *Announcement on the Transfer of Relevant Businesses, Assets, and Liabilities of Baoshang Bank Co., Ltd.* was issued by the working group on the BSB's takeover, clarifying that businesses, assets, and liabilities of the BSB will be transferred to Mengshang Bank and Huishang Bank, respectively. According to the eighteenth clause of the *Deposit Insurance Regulations,* the Deposit

Insurance Fund will provide fund support for the above-mentioned two banks and will share responsibility for covering the asset impairment losses of the former BSB, so as to promote the successful acquisition of the BSB by the two banks and to ensure their smooth transition to normal operations.

4. Work plan for the next period

According to the asset and capital verification results that the former BSB faces severe insolvency, a bankruptcy petition will be filed for the BSB, and liquidation on the equities of the former shareholders and unguaranteed claims will be conducted in a law-based manner. In addition, the relevant departments are in the process of holding people concerned accountable based on laws and regulations.

XI. Deepening the reforms of foreign exchange administration

Foreign exchange administration for trade in goods was further improved. First, measures were taken to guarantee that supplies necessary for battling COVID-19 and donation funds were put in place in a timely manner. From January 27 to end-Q2 2020, a total of 14,000 foreign exchange receipts and payments under trade in goods were expedited across the country through the green channel, totaling USD4.9 billion. Second, the pilot program for facilitating foreign exchange receipts and payments under trade in goods was expanded. By end-Q2 2020, a total of 117,000 foreign exchange receipts and payments were processed under all the pilot programs for 248 pilot enterprises in 12 places across the nation, amounting to USD80.9 billion. Third, financial support for the real economy was stepped up. Registration for returned foreign exchange remittances below USD50,000 was canceled. By end-Q2 2020, a total of 1,304 cases of returned remittances had been exempt from registration, worth USD31.2 million. Fourth, innovative development of new forms of trade was boosted. The *Circular of the State Administration of Foreign Exchange on Supporting the Development of New Forms of Trade* (Huifa No.11 [2020]) was issued, optimizing foreign exchange receipts and payments for comprehensive foreign trade service providers and enterprises engaged in cross-border e-commerce.By end-Q2 2020, four banks witnessing completed transactions had cumulatively received foreign exchange worth USD8.07 million, involving 242,000 small orders of 1,498 small and micro businesses.

Cross-border financing and investment were further facilitated. First, cross-border trade and investment facilitation was enhanced. In April 2020, the *Circular of the State Administration of Foreign Exchange on Optimizing Foreign Exchange Administration to Support Foreign-related Business Growth* (Huifa No.8 [2020]) was released. It simplified operational procedures for foreign exchange businesses, improved foreign exchange services, and promoted the high-quality growth of the foreign-related economy. Second, the limits on the investment quota of foreign institutional investors were lifted. In May 2020, the *Regulations on Managing Funds of Securities and Futures Investments by Foreign Institutional Investors* (PBC & SAFE Announcement No.2 [2020]) were issued. They standardized and simplified the administrative requirements for managing funds of securities and futures investments by foreign institutional investors so as to better facilitate the participation of foreign investors in China's financial market.

Stability in the foreign exchange market was maintained. With regular pandemic containment measures remaining in place, efforts were made to coordinate pandemic containment with prevention and resolution of financial risks. Monitoring and analysis of potential risks incurred by cross-border capital flows were strengthened. Emphasis was placed on cracking down on illegal financial activities, such as underground banks, cross-border gambling, and illegal online foreign exchange trading. These measures were all aimed at earnestly maintaining order in the foreign exchange market and forestalling and defusing risks of cross-border capital flows so as to ensure stability on six fronts and to maintain security in six areas. In H1 2020, a total of 714 cases violating the laws and regulations of foreign exchange administration were handled, with the total fines amounting to RMB239 million.

Part 3. Financial Market Conditions

In H1 2020, the financial market operated generally smoothly. Money market transactions were active. The coupon rates of all types of bonds declined, and the volume of cash bond transactions and issuances expanded. The stock market indices rebounded from Q1 2020, and the turnover witnessed a year-on-year rise.

I. Financial market overview

1. Money market transactions were active

Money market interest rates went down in March and April, followed by a rally in May. Interest rates generally remained stable within a reasonable range. In June 2020, the monthly weighted average interest rate for interbank lending and pledged repos posted 1.85 percent and 1.89 percent respectively, both up 45 basis points from March 2020. The monthly weighted average interest rate for government-backed bond repos among depository institutions posted 1.75 percent, 14 basis points lower than the monthly weighted average interest rate of pledged repos. At end-June, the overnight and 7-day Shibor posted 1.79 percent and 2.23 percent respectively, up 17 and 8 basis points from end-March, respectively.

The market saw active repo transactions and interbank lending. In H1 2020, the trading volume of bond repos on the interbank market reached RMB471.2 trillion, representing an average daily turnover of RMB3.9 trillion and a year-on-year increase of 18.9 percent. The volume of cumulative trading of interbank lending registered RMB78.4 trillion, with an average daily turnover of RMB648.3 billion and a year-on-year decrease of 5.2 percent. In terms of the maturity structure, overnight repos and overnight lending accounted for 84.8 percent and 90.6 percent, respectively, of the total turnover in bond repos and interbank lending, decreasing 0.1 percentage points and 1.5 percentage points year on year. The volume of bond repos traded on the exchange markets increased 11.5 percent year on year to RMB128.5 trillion.

Table 9 Fund Flows among Financial Institutions in H1 2020

Unit: RMB100 million

	Repos		Interbank lending	
	H1 2020	H1 2019	H1 2020	H1 2019
Chinese-funded large banks①	–1,452,030	–963,223	–230,389	–155,482
Chinese-funded medium-sized banks②	-427,545	-402,336	-42,523	-86,641
Chinese-funded small-sized banks③	23,779	95,271	60,861	60,513
Securities institutions④	511,590	393,100	155,881	137,803
Insurance institutions⑤	57,105	36,578	267	272
Foreign-funded banks	39,158	50,268	-12,065	-10,731
Other financial institutions and vehicles⑥	1,247,944	790,342	67,968	54,266

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.

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

⑤Insurance institutions include insurance firms and corporate annuities.

⑥ Other 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 H1 2020, a total of 13,000 interbank CDs were issued on the interbank market, raising RMB7.8 trillion. The trading volume on the secondary market totaled RMB85.9 trillion. At end-June, outstanding interbank CDs reached RMB10.3 trillion. In H1 2020, the average weighted interest rate of 3-month interbank CDs was 2.21 percent, 16 basis points higher than that of the 3-month Shibor. A total of 31,000 negotiable CDs were issued by financial institutions, raising RMB6.0 trillion, with a decrease of RMB1.2 trillion year on year.

Interest rate swaps were active. In H1 2020, the RMB interest rate swap market witnessed 144,363 transactions, increasing 26.7 percent year on year, with the volume of the notional principal totaling RMB9.9 trillion, an increase of 19.1 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 RMB6.0 trillion, accounting for 60.9 percent of the principal of all maturities. The 7-day fixing repo rate and the Shibor served as the main reference rates for the floating leg of the RMB interest rate swaps, accounting for 80.3 percent and 16.9 percent, respectively, of the total notional principal of the interest rate swaps. In H1 2020, interest rate swaps anchored to the LPR further increased to 995 transactions with RMB169.47 billion of the notional principal.

Table 10 Transactions of Interest Rate Swaps in H1 2020

	Transactions	Notional principal (RMB100 million)
H1 2020	144,363	98,646
H1 2019	115,102	83,319

Source: China Foreign Exchange Trade System.

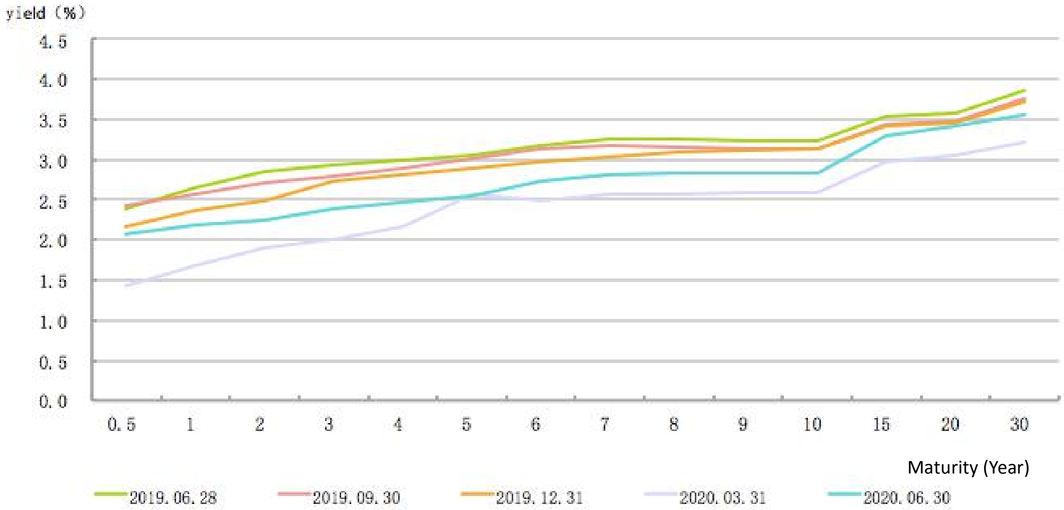
The LPR interest rate option business developed steadily. Since the LPR interest rate option business made its debut on the interbank market on March 23, it attracted active participation of market players, covering large commercial banks, joint-stock commercial banks, city commercial banks, rural commercial banks, foreign-funded banks, securities companies, and so forth. From March to June 2020, a total of 266 interest rate option transactions were concluded, adding up to RMB44.66 billion. Specifically, 110 LPR interest rate swaption transactions were concluded, adding up to RMB10.33 billion of the notional principal, and 156 were LPR interest rate cap/floor transactions, amounting to RMB34.33 billion of the notional principal.

2. The coupon rate of bonds retreated remarkably, while the transactions and issuance of cash bonds expanded

The government bond yields picked up in Q2. At end-June, the yields of 10-year and 1-year government bonds posted 2.82 percent and 2.18 percent, respectively, increasing by 23 basis points and 49 basis points, respectively, from end-March.

The coupon rates of bonds retreated remarkably. The coupon rate of 10-year government bonds issued in June 2020 was 2.68 percent, 61 basis points lower than the rate in June 2019. The coupon rate of 10-year financial bonds issued by China Development Bank was 3.08 percent, 51 basis points lower than the rate in June 2019. The average rate of 1-year short-term financing bills (bond rating A-1) issued by AAA-rated non-financial enterprises was 2.36 percent, 136 basis points lower than the rate in June 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 H1 2020, the value of cash bond trading on the bond market posted RMB127.76 trillion, registering an increase of 28.8 percent year on year. Specifically, the value of cash bond trading on the interbank market was RMB119.67 trillion, representing an average daily turnover of RMB989.0 billion and an increase of 25.7 percent year on year. The value of cash bond transactions on the stock exchanges totaled RMB8.08 trillion, registering an average daily turnover of RMB69.1 billion, with an increase of 103.9 percent year on year. The value of bond lending transactions stood at RMB3.16 trillion, with an increase of 50.1 percent year on year.

The volume of bond issuances has seen year-on-year growth. In H1 2020, the cumulative volume of bond issuances totaled RMB26 trillion, RMB4.6 trillion more than that in H1 2019. Specifically, the issuance of corporate debenture bonds exceeded RMB1.6 trillion in March as well as in April, and the increase in net financing of H1 2020 was RMB1.5 trillion more than that in H1 2019. At end-June, outstanding bonds held in custody amounted to RMB107.8 trillion.

Table 11 Bond Issuances in H1 2020

Unit: RMB100 million

Type of bond	Issuances	YOY change
Government securities	25,338	7,360
Local government bonds	34,864	6,492

Central bank bills	0	0
Financial bonds①	127,798	4,828
Of which: Financial bonds issued by China Development Bank and policy financial bonds	27,815	7,778
Interbank certificates of deposit	78,275	-5,286
Corporate debenture bonds②	72,076	27,083
Of which: Debt-financing instruments of non-financial enterprises	49,132	16,243
Enterprise bonds	2,316	758
Corporate bonds	14,983	5,219
Bonds issued by international institutions	395	215
Total	260,471	45,978

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 offered SME 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 H1 2020, commercial drafts issued by enterprises totaled RMB11.7 trillion, rising 16.6 percent year on year. At end-June, outstanding commercial drafts stood at RMB14.2 trillion, increasing 15.3 percent year on year. Outstanding commercial draft acceptances continued to expand steadily by RMB1.5 trillion from the beginning of the year and by RMB767.5 billion from end-March. At end-June, 71.2 percent of the outstanding bankers' acceptances were issued by MSMEs.

Bill financing continued to expand. In H1 2020, total discounts by financial institutions amounted to RMB22.1 trillion, growing 19.0 percent year on year. At end-June, the balance of bill financing was RMB8.6 trillion, up 23.3 percent year on year. The balance accounted for 5.2 percent of the total outstanding loans, 0.4 percentage points higher than the percentage during the same period of the previous year. In Q2 2020, interest rates in the bill market rebounded after a decline.

4. The stock market continued to rally, with turnover increasing year on year

Stock indices rebounded. At end-June, the Shanghai Stock Exchange Composite Index closed at 2,985 points, increasing 8.5 percent from end-March. The Shenzhen Stock Exchange Component Index closed at 11,992 points, increasing 20.4 percent from end-March. Turnover on the stock markets rose significantly. In H1 2020, the combined turnover of Shanghai Stock Exchange and Shenzhen Stock Exchange reached RMB89 trillion and the average daily turnover was RMB760.3 billion, with an increase of 29 percent year on year. The amount of funds raised on the stock markets declined year on year. In H1 2020, a cumulative RMB333.9 billion was raised, decreasing 8.7 percent year on year.

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

In H1 2020, total premium income in the insurance sector amounted to RMB2.7 trillion, with a year-on-year increase of 6.5 percent, 5.7 percentage points lower than the growth rate in 2019. Claim and benefit payments totaled RMB630.8 billion, with a year-on-year increase of 1.2 percent. Specifically, total property insurance claim and benefit payments increased 2.3 percent year on year, and total life insurance claim and benefit payments grew 0.3 percent year on year.

Table 12 Asset Allocations in the Insurance Sector at End-June 2020

Unit: RMB100 million, %

	Balance		As a share of total assets	
	End-June 2020	End-June 2019	End-June 2020	End-June 2019
Total assets	219,792	195,026	100.0	100.0
Of which: Bank deposits	28,152	26,335	12.8	13.5
Investments	173,099	147,337	78.7	75.5

Source: China Banking and Insurance Regulatory Commission.

The growth of assets in the insurance sector accelerated. At end-June, total assets in the insurance industry increased 12.7 percent year on year to RMB22 trillion, an acceleration of 0.5 percentage points from end-2019. Specifically, bank deposits increased 6.9 percent year on year and investment-linked assets expanded 17.5 percent year on year.

6. Foreign exchange transactions fell year on year

In H1 2020, the cumulative turnover of spot RMB/foreign exchange transactions registered USD3.4 trillion, a decrease of 14.3 percent year on year. The cumulative turnover of RMB/foreign exchange swap transactions totaled USD7.3 trillion, a decrease of 17.4 percent year on year. Specifically, cumulative overnight RMB/USD swap transactions posted USD4.1 trillion, accounting for 55.9 percent of the total swap turnover. Turnover of the RMB/foreign exchange forward transactions totaled USD51.3 billion, rising 19.9 percent year on year. Turnover in foreign currency pair transactions totaled USD308.5 billion, rising 34.4 percent year on year. In particular, the EUR/USD pair registered the largest trading volume, accounting for 61.7 percent of the total market share.

Participants in the foreign exchange market expanded further. At end-June, there were 722 members in the foreign exchange spot market, 256 members in the foreign exchange forward market, 250 members in the foreign exchange swap market, 207 members in the currency swap market, and 156 members in the foreign exchange options market. There were 30 market makers in the spot market and 27 market makers in the forward and swap markets.

7. The gold market operated steadily with an overall rise in prices

Gold prices witnessed an overall increase. At end-June, international gold prices closed at USD1,768.1 per ounce, representing a gain of 16.09 percent from end-2019. The Au99.99 on Shanghai Gold Exchange closed at RMB397.76 per gram, increasing 16.71 percent from end-2019. In H1 2020, the volume of gold traded on Shanghai Gold Exchange was 33,800 tons, representing a rise of 13.28 percent year on year. The turnover posted RMB12.43 trillion, increasing 44.03 percent year on year.

II. Development of institutional arrangements in the financial markets

1. Institutional arrangements in the bond market and the bill market

On June 24, 2020, the PBC, together with other relevant departments, issued the

Notice of the People's Bank of China, the National Development and Reform Commission, and the China Securities Regulatory Commission on Issues Concerning Disposal of Defaults on Corporate Debenture Bonds, in order to promote market-oriented and law-based disposal of defaults on the bond market.

On June 28, 2020, the PBC released the *Administrative Measures on Depository Paper*, for the purposes of regulating the financing mechanism of depository papers and improving services to SMEs and supply chain financing. Depository papers connect the bill market with the bond market, and the professional pricing and investing capacity of the bond market can be fully leveraged in a way that improves the standardization of bill transactions and enhances the financing function of bills.

2. Institutional arrangements in the capital market and the securities and futures industry

Capital market reform was further deepened. First, in June, the CSRC released three sets of institutional rules on the reforms and the pilot registration-based system for the ChiNext market, which specified the qualifications, registration procedures, and information disclosure requirements for the IPO on the ChiNext market. Specifically, the issuance verification and listing procedure were improved with stricter information disclosure requirements. It was also clarified that when a ChiNext-listed company engages in a M&A and reorganization that involves stock issuances, it shall be carried out in a registration-based approach. Second, in June, the CSRC released the *Guiding Opinions on the Transfer of Companies Listed on the National Equities and Exchange Quotations (NEEQ) for Listing on Other Boards,* which stipulates that if a company has been listed on the NEEQ Select for at least one consecutive year, it can apply for a transfer of listing board to the ChiNext market or the STAR market. Third, in April, the CSRC released the *Announcement on the Relevant Arrangements for the Innovative Pilot Program of Domestic Listing of Red-chip Enterprises*, which relaxed the market value requirements for red-chip enterprises to be listed domestically.

The businesses of securities institutions were further regularized. First, in April, the CSRC released the *Guidelines for Public Offerings of Securities Investment Funds to Invest in Stocks Listed on the NEEQ*, allowing equity funds, hybrid funds, and other approved publicly offered funds to invest in the stocks listed on the NEEQ Select. Second, in May, the CSRC released the *Decision on Revising the Provisions on the Administration of Subordinated Debts of Securities Companies*, which allowed securities companies to publicly issue subordinated debts, supported securities companies in issuing write-down bonds, contingent convertible bonds, and other innovative instruments, and unified the scope of institutional investors. Third, in June, the CSRC released the *Administrative Measures on the Sponsor Business of Securities*

Issuances and Listings, which revised the contents related to the underwriting and sponsoring business of securities companies and clarified the self-regulatory responsibilities of stock exchanges.

3. Institutional arrangements in the insurance market

The requirements for insurance funds to invest in bank capital replenishment bonds were relaxed. On May 20, 2020, the CBIRC released the *Notice on Issues Concerning Insurance Fund Investments in Bank Capital Replenishment Bonds*, which relaxed the requirements for the issuers of capital replenishment bonds that insurance funds can invest in and lifted the requirements of external credit ratings for the bonds to invest in.

Insurance funds were supported to participate in treasury bond futures trading. On June 23, 2020, the CBIRC released the *Provisions on Insurance Funds Participating in Treasury Bond Futures Trading* and, in the meantime, it revised the *Measures for Insurance Funds to Participate in Financial Derivatives Trading* and the *Provisions on Insurance Funds to Participate in Stock Index Futures Trading*. It was specified that risk hedging shall be the the purpose of insurance funds to participate in the trading of treasury bond futures and stock index futures.

"Looking back" actions were taken to rectify market disorder in the insurance industry. On June 23, 2020, the CBIRC released the *Notice on Carrying Out "Looking Back" Actions to Rectify Market Disorder in the Banking and Insurance Industries*, which clearly stated the priorities of the work to rectify market disorder.

Part 4. Macroeconomic Overview

I. Global economic and financial developments

1. Economic and financial market performance in the major economies

The COVID-19 took a toll on the global economy in the first half of 2020. With progress in reopening, economic indicators in some economies improved gradually. The International Monetary Fund (IMF) further revised down its global growth forecast for 2020 to –4.9 percent in June, down 1.9 percentage points from the April forecast. Due to the fallout from the pandemic, the major economies saw slower growth in Q1. The quarter-on-quarter GDP growth fell into negative territory in the US, the euro area, Japan, and the U.K., while year-on-year GDP growth in Brazil, India, Russia, and South Africa posted –0.25 percent, 3.09 percent, 1.6 percent, and –0.1 percent, respectively. In mid-April, the economy showed signs of improvement as a number of countries announced a phased and gradual approach in relaxing lockdown measures and promoted reopening. The Purchasing Managers' Index (PMI) rose across the board toward the middle of this year. The manufacturing PMI in the US, Turkey, and Brazil all rebounded to above 50 and unemployment pressures eased.

International financial market volatility increased. The stock market saw a V-shaped rally, and the US dollar liquidity strains moderated. From March to April, the US Dow Jones Industrial Average Index and other stock indexes plunged amid the spread of COVID-19. However, major stock indexes in the US, Germany, Japan, and the U.K. had rebounded swiftly since May, with the Nasdaq hitting a record high this year. In Q2, global dollar liquidity strains eased, as the US Federal Reserve (Fed) expanded its balance sheet significantly. As of June 30, the 1-year US dollar Libor was 0.55 percent, shedding 45 basis points (bps) from end-March, while the 1-year Euribor was –0.23 percent, dipping 6 bps from end-March.

Table 13 Macroeconomic and Financial Indicators in the Major Advanced Economies

Economy	Indicator	Q2 2019			Q3 2019			Q4 2019			Q1 2020			Q2 2020		
		Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.
United States	Real GDP Growth (annualized quarterly rate, %)	1.5			2.6			2.4			-5.0			-32.9		
	Unemployment Rate (%)	3.6	3.6	3.7	3.7	3.7	3.5	3.6	3.5	3.5	3.6	3.5	4.4	14.7	13.3	11.1
	CPI (year-on-year, %)	2.0	1.8	1.6	1.8	1.7	1.7	1.8	2.1	2.3	2.5	2.3	1.5	0.3	0.1	0.6
	DJ Industrial Average (end of the period)	26593	24815	26600	26864	26403	26917	27046	28051	28538	28256	25409	21917	24346	25383	25813
Euro Area	Real GDP Growth (year-on-year, %)	1.3			1.4			1.0			-3.1			-15.0		
	Unemployment Rate (%)	7.6	7.6	7.5	7.5	7.5	7.5	7.4	7.4	7.4	7.4	7.2	7.2	7.5	7.7	7.8
	HICP (year-on-year, %)	1.7	1.2	1.3	1.0	1.0	0.8	0.7	1.0	1.3	1.4	1.2	0.7	0.3	0.1	0.3
	EURO STOXX 50 (end of the period)	3515	3280	3474	3467	3427	3569	3604	3704	3745	3641	3329	2787	2928	3059	2989
United Kingdom	Real GDP growth (year-on year, %)	1.4			1.3			1.1			-1.7			...		
	Unemployment Rate (%)	3.8	3.8	3.9	3.8	3.9	3.8	3.8	3.8	3.8	3.9	4.0	3.9	3.9	3.9	...
	CPI (year-on-year, %)	2.1	2.0	2.0	2.1	1.7	1.7	1.5	1.5	1.3	1.8	1.7	1.5	0.8	0.5	0.6
	FTSE 100 (end of the period)	7418	7162	7426	7587	7207	7408	7248	7347	7542	7286	6581	5672	5901	6077	6170

Japan	Real GDP Growth (annualized quarterly rate, %)	2.1			0.0			-7.2			-2.2			...		
	Unemployment Rate (%)	2.4	2.4	2.3	2.3	2.3	2.4	2.4	2.2	2.2	2.4	2.4	2.5	2.6	2.9	2.8
	CPI (year-on-year, %)	0.9	0.7	0.7	0.5	0.3	0.2	0.2	0.5	0.8	0.7	0.4	0.4	0.1	0.1	0.1
	NIKKEI 225 (end of the period)	22259	20601	21276	21522	20704	21756	22927	23294	23657	23205	21143	18917	20194	21878	22288

Sources: Statistical Bureaus and Central Banks of the Relevant Economies.

2. Monetary policy of major economies

Central banks in the major economies maintained interest rates at low levels and scaled up asset purchases. Central banks in the advanced economies, such as the US Fed, the European Central Bank (ECB), the Bank of England (BOE), and the Bank of Japan (BOJ), kept their low interest rates unchanged since Q2. The balance sheets of the US Fed, ECB, and BOE expanded quickly as they substantially increased the size of their asset purchase programs.

The US Fed, ECB, and the central banks in other major advanced economies introduced structural emergency liquidity facilities. The US Fed created a number of structural tools, such as the Paycheck Protection Program Liquidity Facility since April, and adjusted these tools several times to better support pandemic-hit businesses and local governments. The ECB announced pandemic emergency longer-term refinancing operations and further expanded the pandemic emergency purchase program.

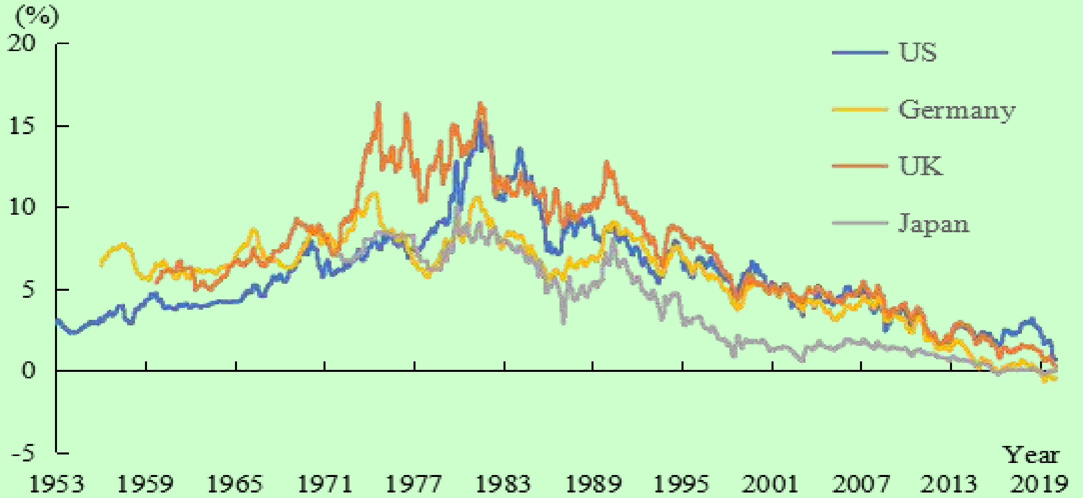
Central banks in the emerging market economies continued their rate cuts. In Q2, the central banks in Brazil, Russia, Turkey, and South Africa cut rates by a total of 150 bps respectively on two occasions, while the Mexican central bank reduced rates three times by a total of 150 bps. The Reserve Bank of India, Bank of Korea, and Bank Indonesia lowered the benchmark rate by 40 bps, 25 bps, and 25 bps, respectively.

Box 4 How to Look at Low Global Interest Rate

Global interest rates have been declining since the 1980s. In the wake of the 2008 global financial crisis, the major economies implemented large-scale quantitative easing (QE), and some economies also adopted a negative interest rate policy, which further reduced the interest rates. Since the second half of 2019, given the increasing economic downside risks and the impact of the COVID-19 pandemic, central banks around the world have returned to the easing mode, starting a wave of policy rate cuts. The low interest rate policy has again been transmitted to the financial market where bond rates have fallen sharply, bonds carrying negative interest rates have expanded rapidly in size, and deposit and lending interest rates have also been impacted. At the end of June 2020, the 10-year government bond yields in the US, Germany, UK, and Japan were 0.66, –0.5, 0.21, and 0.04 percent respectively, which were down by about

340, 500, 430, and 150 basis points from end-2007, significantly lower than the level before the 2008 global financial crisis and a sharp drop of about 10 percentage points from the 1981 high.

Figure 5 10-Year Government Bond Yields in the US, Germany, UK, and Japan



Sources: Federal Reserve, Eurostat, Bank of England, Bank of Japan, and Wind.

Apart from policy factors, long-term structural factors, such as the decline in potential economic growth, are the main drivers behind the low global interest rates. From the perspective of real interest rates, the equilibrium interest rate level is mainly related to potential economic growth. Due to the slowing technological progress, the uneven distribution of wealth worldwide, the widening income gap, aging, and the imbalanced industrial structure, the willingness of the advanced economies to consume and invest has weakened and the potential economic growth rate has declined. The corresponding equilibrium interest rates, namely the actual neutral interest rates, have come down as well. According to World Bank statistics, in 2019 the proportion of the population over 65 years old in the US, the European Union, and Japan was 16.2, 20.5, and 28 percent respectively, an increase of 3.7, 3.3, and 7.3 percentage points from 2007. From the perspective of nominal interest rates, long-term inflation and inflation expectation volatility have decreased since the 1980s, which also led nominal interest rates to decline significantly at a pace even greater than the real interest rates.

Given the lower actual neutral interest rates and the subdued inflation, some advanced economies have adopted zero or even a negative interest rate policy. However, the low interest rate policy has not worked as expected, and its effects remain to be seen. Neutral interest rates are an important yardstick in formulating monetary policy. In the long run, the interest rate level should remain near the sum of the actual neutral interest rates and the inflation targets. Even with the low interest rate policy, inflation in the advanced economies has long been lower than the inflation targets of the central banks. This can be attributed to three main reasons. **First,** the low interest rate policy has a limited effect on long-term structural factors, and it is difficult to change the long-term downward trend of potential economic growth and neutral interest rates. **Second,** considering that deposit interest rates cannot effectively break through a zero interest rate, the low interest rate policy increases the downward pressure on the banks' profits and consequently monetary policy cannot be smoothly transmitted through the banking system in some economies. Studies have shown that if the policy rate declines and hits the "reversal interest rate," the critical interest rate at which the effects of an accommodative monetary policy will reverse, the excessive narrowing of interest margins, and the decline in profits may lead commercial banks to cut credits, causing a tightening effect instead. **Third,** in a low interest rate environment, if the policy rate is cut too quickly, it may trigger a Neo-Fisherian effect. Interest rates will fall simultaneously with inflation expectations, while real interest rates will remain unchanged, which will converge toward the liquidity trap and monetary easing will become ineffective.

Excessively low interest rates will also have many negative impacts, such as resource misallocations and funds flowing out of the real economy to the virtual economy. First, excessively low interest rates will reduce the efficiency of financial resource allocations and aggravate structural distortions. Interest rates are the touchstone of market capital allocations. If interest rates are too low, massive funds may flow to zombie companies, which will intensify the problem of rising corporate debt and overcapacity and will hinder technological innovation as well as industrial upgrading and transformation. **Second,** interest rates that are too low tend to encourage risk-taking behavior and excessive leveraging of financial institutions, which will increase the vulnerability of the financial system. **Third,** interest rates that are too low will divert funds from the real economy to the virtual economy. Funds released by a loose monetary policy will increasingly flow to the asset market. With the deepening of global economic and financial integration, the spillover and spillback effects of monetary policy have become increasingly notable. The low interest rates and the QE in the major economies may increase risks associated with cross-border capital flows and foreign exchange markets to other economies, and heighten the volatility of financial market prices and exchange rates. At present, the limitations of low interest rates have caused the monetary authorities in the advanced economies to reflect on and reassess their monetary policy framework. In the medium term, the major economies will continue with their low interest rate policy, but there is limited room for policy rates to fall further.

Since the beginning of 2020, the People's Bank of China (PBC) has been implementing a normal monetary policy and has maintained interest rates at levels commensurate with China's development stage and economic situation. As a result, the interest rate spread between domestic and foreign currencies has remained at an appropriate range and the attractiveness of RMB assets has increased.

3. Issues and trends that merit attention

First, the pandemic containment and the economic reopening should be balanced better. Some economies may see a resurge in infections when they reopen their economies on a large scale before effectively containing the virus. Second, the rising risk of insolvency in the corporate sector may trigger a wave of bankruptcy and credit downgrading. The pandemic has pushed up the number of bankrupt businesses in the US A number of big names have filed for bankruptcy. Companies in aviation and tourism-related industries are struggling. Third, the global leverage ratio has continued to rise. Lockdowns brought the economy to a halt, resulting in lower incomes and higher debts in the household and corporate sectors. In the meantime, massive containment and bailout measures pushed up the short-term fiscal deficit and government debt levels. The already-high global leverage ratio rose further. Fourth, risks are lurking in the financial markets. Investors are sensitive to expected movements in volatile financial markets. Any surprise may unnerve the market. The emerging market economies need to remain alert to cross-border capital flows and exchange rate risks. According to the Institute of International Finance, the emerging markets saw an inflow of USD 32.9 billion into their capital markets in June. Fifth, external instabilities and uncertainties have increased markedly. Geopolitical tensions have resurfaced and trade frictions among some countries are intensifying.

II. Macroeconomic developments in China

In H1 2020, facing the unexpected outbreak of COVID-19 and the complex domestic and international situations, China's economy showed great resilience and witnessed a gradual recovery, with work and production resumption improving month by month and economic growth in Q2 remarkably outperforming expectations. According to preliminary statistics, the GDP in H1 dropped by 1.6 percent year on year on a comparable basis to RMB45.7 trillion, whereas the GDP in Q2 grew by 3.2 percent year on year. In H1, the CPI rose by 3.8 percent year on year.

1. Consumption gradually improved, the decline of investment decelerated remarkably, and imports and exports outperformed expectations

Residents' income in nominal terms grew marginally and their willingness to consume gradually improved. In H1, per capita disposable income registered RMB15,666, up 2.4 percent year on year in nominal terms. It dropped by 1.3 percent in real terms year on year—a decline that was slower than that of GDP. The income distribution structure continued to improve, with the ratio of the per capita income of urban residents to that of rural residents narrowing. According to the Urban Depositors' Survey conducted by the PBC in Q2, the Income Sentiment Index reached 46.1 percent, up 4.5 percentage points from the previous quarter; 23.4 percent of residents were inclined to "consume more," up 1.3 percentage points from the previous quarter. In H1, total retail sales of consumer goods registered RMB17.2 trillion, down 11.4 percent year on year, decelerating by 7.6 percentage points from the previous quarter. Retail sales of consumer goods in the rural areas witnessed a faster recovery than those in the urban areas, and sales of upgraded consumer goods grew rapidly. Online retail sales showed sound growth momentum. In H1, national online retail sales grew by 7.3 percent year on year to RMB5.2 trillion.

The decline of fixed-asset investments decelerated remarkably, while investments in the high-tech industry and social areas rallied. In H1, fixed-asset investments (excluding those by rural households) decreased by 3.1 percent year on year to RMB28.2 trillion, decelerating by 3.2 percentage points and 13.0 percentage points compared with that from January to May and that in Q1 respectively. Current investments have exhibited the following characteristics. First, investments in real estate development rebounded rapidly, while those in the manufacturing industry picked up slowly. In H1, the year-on-year growth of investments in real estate development and the manufacturing industry registered 1.9 percent and –11.7 percent respectively, up 2.2 percentage points and 3.1 percentage points respectively compared with that from January to May. Second, investments in the high-tech industry rebounded rapidly. Investments in the high-tech manufacturing industry grew by 6.3 percent year on year in H1, while those in Q1 dropped by 12.1 percent. Third, investments in the social areas rallied, increasing by 5.3 percent year on year in H1 and dropping by 8.8 percent in Q1. Specifically, investments in the health industry grew by 15.2 percent year on year in H1, while those in Q1 edged down by 0.9 percent. Investments in the education industry grew by 10.8 percent year on year, while those in Q1 dropped by 4.0 percent.

Imports and exports outperformed expectations and the trade structure continued to improve. In H1, imports and exports dropped by 3.2 percent year on year, decelerating by 3.3 percentage points from Q1. In H1, RMB-denominated exports dropped by 3.0 percent year on year to RMB7.7 trillion, while RMB-denominated imports dropped by 3.3 percent to RMB6.5 trillion, leading to a trade surplus of RMB1.2 trillion. China’s foreign trade gradually stabilized and picked up after fluctuations in Q1. Specifically, exports maintained positive growth for three consecutive months from April to June, and the growth of imports turned positive in June. In terms of trade modes, the trade structure continued to improve, with the share of general trade in total imports and exports increasing. In terms of the commodity structure, the proportion of exports of machinery and electronics increased, and exports of supplies related to the pandemic containment as well as products related to the “stay-at-home economy” grew rapidly, driving the stabilization and recovery of foreign trade in Q2. In terms of trade partners, ASEAN became China’s largest trade partner, accounting for 14.7 percent of the total foreign trade volume in China.

Foreign direct investment (FDI) continued to concentrate in the high-tech industry. In H1, actually utilized FDI decreased by 1.3 percent year on year to RMB472.18 billion, decelerating by 9.5 percentage points from Q1, thus demonstrating a steady upturn in foreign investors’ expectations and confidence. In terms of the industrial distribution, the concentration of FDI in the high-tech industry accelerated. In H1, actually utilized foreign investment in the high-tech service industry grew by 19.2 percent year on year.

In H1, non-financial outward direct investments by domestic investors edged down by 0.7 percent year on year to RMB362.14 billion (equivalent to USD51.5 billion). Specifically, investments worth USD8.12 billion went to the countries along the Belt and Road, up 19.4 percent year on year. The industrial structure of outward investments continued to improve. Outward investments mainly flowed to the leasing/commercial services industry, manufacturing industry, wholesale/retail industry, mining industry, construction industry, and other industries.

2. Agricultural production was fairly satisfactory, industrial production recovered rapidly, and the decline of the service industry decelerated

In H1, primary industry grew by 0.9 percent year on year, accounting for 5.7 percent of GDP. The secondary and tertiary industries dropped by 1.9 percent and 1.6 percent respectively, accounting for 37.8 percent and 56.5 percent of GDP. Specifically, in Q2, the primary, secondary, and tertiary industries grew by 3.3 percent, 4.7 percent, and 1.9 percent year on year, with secondary industry rebounding at a faster pace than tertiary industry.

Agricultural production was fairly satisfactory. The total output of summer crops grew by 0.9 percent year on year to 142.81 million tons, registering an increase of 1.21 million tons from the previous year. The agricultural planting structure continued to improve, with the sowing areas of rape seeds and other cash crops increasing. Hog production capacity continued to rebound. At end-Q2, hogs in stock grew by 5.8 percent to 339.96 million from end-Q1.

Industrial production recovered rapidly. In H1, the value-added of Industrial Enterprises above a Designated Size (IEDS) decreased by 1.3 percent year on year, decelerating by 7.1 percentage points from Q1. Specifically, IEDS grew by 4.4 percent in Q2, and fell by 8.4 percent in Q1. In H1, total profits of IEDS dropped by 12.8 percent year on year, with the decline continuing to decelerate. Specifically, total profits of IEDS grew by 11.5 percent year on year in June, accelerating by 5.5 percentage points from May. According to a survey conducted in Q2 by the PBC on 5,000 entrepreneurs, the Business Climate Index posted 42.7 percent, up 12.4 percentage points from Q1. The Profitability Index registered 49.6 percent, up 27.3 percentage points from Q1.

The decline in the service industry decelerated, and the modern service industry showed sound growth momentum. In H1, the year-on-year decline of the value-added of tertiary industry decelerated by 3.6 percentage points from Q1. Specifically, the value-added of tertiary industry grew by 1.9 percent year on year in Q2 and dropped by 5.2 percent in Q1. In H1, the Index of Service Production (ISP) fell by 6.1 percent year on year, decelerating by 5.6 percentage points from Q1. Specifically, the index grew by 2.3 percent in June, accelerating by 1.3 percentage points from May. In June, the Commercial Activities Index for the service industry registered 53.4 percent, up 1.1 percentage points from May. In terms of market expectations, the Expected Business Activities Index for the service industry reached 59.0 percent.

3. The growth of consumer prices decelerated, whereas the decline in producer prices accelerated compared with those in the previous quarter

The growth of consumer prices decelerated. In Q2, the CPI rose by 2.7 percent year on year, decelerating by 2.2 percentage points from the previous quarter, with CPI growth in April, May, and June registering 3.3 percent, 2.4 percent, and 2.5 percent respectively. In Q2, food prices grew by 12.2 percent year on year, decelerating by 8.1 percentage points from the previous quarter. The growth of non-food prices decelerated slightly. Growth of consumer goods prices decelerated, while that of service prices remained stable.

The decline of producer prices accelerated compared with the previous quarter. Due to its relatively higher base in the previous year, the Producer Price Index (PPI) in Q2 2020 dropped by 3.3 percent year on year, accelerating by 2.7 percentage points compared with the previous quarter. Specifically, the PPI in April, May, and June dropped by 3.1 percent, 3.7 percent, and 3.0 percent year on year respectively, with the decline in June decelerating. The Purchasing Price Index for Industrial Products (PPIRM) fell by 4.4 percent year on year, accelerating by 3.6 percentage points from the previous quarter. In H1, the Corporate Goods Price Index (CGPI) monitored by the PBC decreased by 1.4 percent year on year, decelerating by 1.3 percentage points from the previous quarter.

4. The decline of fiscal revenue decelerated, and the employment situation was generally stable

In H1, revenue in the national general public budget dropped by 10.8 percent year on year to RMB9.6 trillion, decelerating by 3.5 percentage points compared with Q1. Expenditures in the national general budget saw a decline of 5.8 percent year on year to RMB11.6 trillion, basically on par with those in Q1. Fiscal expenditures surpassed revenue, leading to a deficit of RMB2.0 trillion, up RMB454.2 billion year on year.

In terms of the revenue structure, tax revenue amounted to RMB8.2 trillion, down 11.3 percent year on year. Non-tax revenue reached RMB1.4186 trillion, down 8.0 percent year on year. Specifically, the domestic value-added tax, domestic consumption tax, and business income tax dropped by 19.1 percent, 9.0 percent, and 7.2 percent year on year respectively, while the personal income tax and the stamp tax on securities trading increased by 2.5 percent and 16.0 percent year on year respectively. In terms of the expenditure structure, expenditures on disaster prevention and treatment/emergency management, resources exploration/industrial information and other areas, and debt servicing grew rapidly, registering year-on-year growth of 13.6 percent, 9.9 percent, and 9.8 percent respectively.

In H1, budgetary revenue from nationwide government-managed funds decreased 1 percent year on year. Specifically, revenue from land sales rose by 5.2 percent year on year. Budgetary expenditures from nationwide government-managed funds increased by 21.7 percent year on year.

The employment situation was generally stable. At end-June, the surveyed unemployment rate in the urban areas was 5.7 percent, down 0.2 percentage points from the previous month, which was the second lowest rate in 2020. Specifically, the surveyed unemployment rate among employees aged from 25 to 59 years old reached 5.2 percent, 0.5 percentage points lower than that in the urban areas and 0.2 percentage points lower than that in the previous month respectively. In H1, 5.64 million people were newly employed, accomplishing 62.7 percent of the annual target. At end-Q2, the number of rural immigrants reached 177.52 million. According to the Survey of Urban Depositors conducted by the PBC in Q2, residents' employment expectations improved remarkably, with the Employment Expectation Index for Q2 reaching 50.1 percent, up 2.8 percentage points from the previous quarter.

5. The balance of payments and external debt

A basic equilibrium was maintained in the balance of payments. China's current account deficit stood at USD33.7 billion in Q1 2020. To be specific, the surplus in trade in goods was USD23.1 billion, whereas the deficit in trade in services was USD47 billion. Under the capital and financial account, the surplus in direct investments reached USD16.3 billion. At end-June, foreign exchange reserves registered USD3.1123 trillion, an increase of USD4.4 billion, or 0.14 percent, from end-2019. At end-March, the balance of full-caliber foreign debt (denominated in both domestic and foreign currencies) posted USD2.0946 trillion. Among this, the short-term external debt balance was USD1.2159 trillion, accounting for 58 percent of the total external debt balance.

6. Analysis by sector

6.1 The real estate sector

In H1 2020, nationwide housing prices overall remained stable. Housing sales and investments in real estate development recovered gradually from March. In June, among the 70 medium and large-sized cities nationwide, newly built and second-hand residential housing prices increased by 4.9 percent and 2.2 percent year on year, both 0.5 percentage points less than the growth rates at end-March. In H1 2020, the total floor area of sold units and housing sales decreased by 8.4 percent and 5.4 percent year on year respectively. Investments in real estate development stood at RMB6.3 trillion, up 1.9 percent year on year and an acceleration of 9.6 percentage points from Q1. Specifically, investments in residential housing development reached RMB4.6 trillion, up 2.6 percent year on year and an acceleration of 9.8 percentage points from Q1, which accounted for 73.8 percent of total investments in real estate development.

Table 14 Floor Area of Real Estate Projects that were Newly Started, Under Construction, and Completed in H1 2020

	Floor area (100 million square meters)	YOY growth (%)	YOY acceleration from Q1(percentage points)
Floor area of newly-started real estate projects	9.8	-7.6	19.6
Floor area of real estate projects under construction	79.3	2.6	0
Floor area of completed real estate projects	2.9	-10.5	5.3

Source: National Bureau of Statistics.

Growth of real estate loans was stable but with a weaker momentum. At end-June, outstanding real estate loans by major financial institutions (including foreign-funded financial institutions) stood at RMB47.4 trillion, up 13.1 percent year on year and a deceleration of 0.8 percentage points from end-March. Outstanding real estate loans made up 28.7 percent of the total lending balance at end-June. Specifically, outstanding individual housing loans amounted to RMB32.5 trillion, up 15.7 percent year on year, representing a deceleration of 0.2 percentage points from end-March. Outstanding housing development loans posted RMB9.1 trillion, rising by 12.0 percent year on year and a deceleration of 1.6 percentage points from end-March.

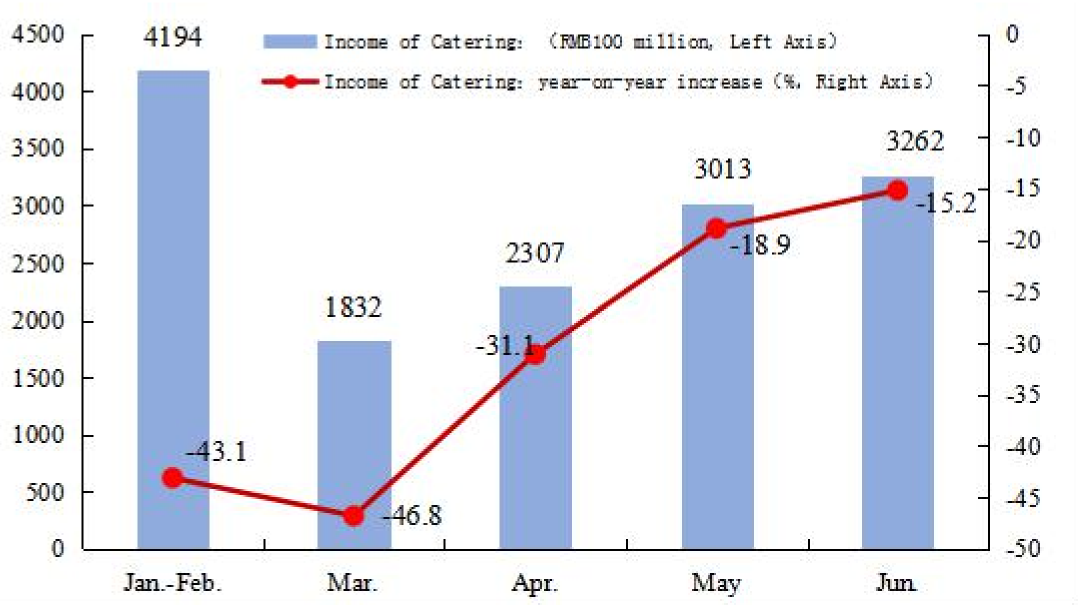
6.2 The catering sector

With the increasing personal income, the accelerating pace of life, and the changing consumption concepts, the demand for dining out grew and promoted the rapid development of the catering industry in China. **First**, the catering industry continued to expand in size. In 2019, income in the catering industry totaled RMB4.67 trillion, up 9.4 percent year on year, which was 1.5 percentage points higher than that in retailing. **Second**, the job-creating capacity of the catering industry was further enhanced. According to the *Communiqué on China's 4th Economic Census*, incorporated enterprises in the catering industry employed 4.234 million staff at end-2018, an increase by 8.8 percent from end-2013. **Third**, development of the catering industry is increasingly integrated with information and smart technologies, with new business models emerging in succession, such as takeout and delivery services, smart restaurants, and unmanned restaurants. **Fourth,** food safety in the catering industry showed an overall good momentum, with an initial atmosphere of co-governance by government regulation, industry discipline, and public supervision.

Nonetheless, the catering industry still faces some challenges and constraints in achieving sustainable and sound development. **First**, the catering industry is lacking chain store operations and operations of scale. In 2019, the income of catering enterprises above a designated scale accounted for 20.2 percent of the entire catering industry nationwide, which had been declining for seven consecutive years since 2013. **Second**, the rising cost pressures of rent, labor, and raw materials, plus the fierce market competition due to the low entry threshold, squeeze the profit margins of catering enterprises. **Third**, service and management of the catering industry need to be improved.

The COVID-19 pandemic hit the catering industry significantly. With major strategic achievements in pandemic containment, China's economy has been normalizing, which will promote the gradual recovery of the catering industry. In H1 2020, income in the catering industry totaled RMB1.4609 trillion, down 32.8 percent year on year. In particular, the year-on-year decrease of income in Q2 was 23 percentage points lower than that in Q1, which had improved for three consecutive months.

Figure 6 Income of Catering and Its Year-on-Year Increase in H1 2020



Source: National Bureau of Statistics.

Going forward, driven by the goal of meeting people's aspirations for a better life, efforts should be made to improve the adaptability and flexibility of catering supply to changes in demand on the basis of inheritance and innovation, and to promote the quality and efficiency of the catering industry. On the one hand, support policies in credit, rent, taxes, and fees should be enhanced to stimulate the vitality of catering enterprises and to allow them to play a better role in ensuring job security and to safeguard market entities. On the other hand, efforts should also be made to promote the intensive use of information and smart technologies in the catering industry, to cultivate more large-scale chain brands, to improve service and management, and to enhance the competitiveness of catering enterprises.

Part 5. Monetary Policy Outlook

I. Outlook for the Chinese economy

Since the beginning of 2020, the COVID-19 pandemic has dealt a heavy blow to China's economic and social development. Under the strong leadership of the CPC Central Committee, the entire nation worked as one and achieved significant results in coordinating pandemic containment with economic and social development. China's GDP recorded an annual growth of 3.2 percent in Q2, representing a rebound of 10 percentage points from Q1, which was much higher than expected. Looking beyond the near term, the fundamentals of steady economic growth in the long run and high-quality development remain unchanged.

The Chinese economy has demonstrated strong resilience. With pandemic containment measures remaining in place, economic and social activities have basically returned to normal, thereby accelerating economic growth and recovery. Currently, the pandemic containment and economic recovery in China is among the fastest in the world, and the economic conditions have evolved from "inflicted supply and demand" by the pandemic in Q1 to "rapidly recovering supply and gradually improving demand" in Q2. Market expectations are generally stable, and the economy is likely to resume its potential growth level in H2 2020. China's development is still and will continue to be for a long time at an important stage of strategic opportunities. The recent years have seen solid progress in fighting the "three tough battles" against major risks, poverty and pollution, along with deepened supply-side structural reforms, generally stable labor market conditions, steady growth of personal income, and continuous improvement in people's livelihood. New infrastructure and new urbanization initiatives as well as major projects, such as transportation and water infrastructure, have been vigorously carried out, and new industries, business models and growth drivers are taking shape and rapidly developing. The proactive fiscal policy has been more impactful and the sound monetary policy has been more flexible and appropriate. The financial sector has continuously enhanced its support for the real economy, especially for micro and small businesses (MSBs) and private enterprises. With prudent and decisive measures to prevent and control financial risks, the financial system has been generally sound and capable of defusing various risks. The RMB exchange rate has been basically stable at an adaptive and equilibrium level, and the economy has strengthened its capability to address external shocks.

The world economy has fallen into a recession, and the domestic economy still faces many challenges. The global pandemic remains in a prolonged plateau phase, geopolitical tensions have started to rise, and trade frictions between some countries are intensifying, causing major instabilities and uncertainties. According to forecasts by the IMF and the World Bank, the global economy will contract by 4.9 percent or 5.2 percent in 2020. The World Bank projects that the global economy may sink into the worst recession since World War II. As pressures are still great in terms of imported pandemic case prevention and world economic risks, and the pandemic still has an impact on domestic economic conditions, the service sector, including catering, tourism and cultural entertainment, is facing a relatively slow recovery. To offset the impact of the pandemic, countercyclical adjustments in H1 have increased, and the macro leverage ratio has revealed a temporary rise. But with the economic growth resuming its potential levels, the macro leverage ratio will gradually return to reasonable levels. With regard to structural, institutional and cyclical concerns in the economy, as well as prominent issues of uneven development and underdevelopment, it is necessary to take an objective and rational perspective, to remain confident and focused and to enhance opportunity and risk awareness. The PBC will manage its own affairs well by combining reforms and macro-management and accommodating both short-term and long-term considerations as well as internal and external equilibria, so as to build an economy that is more competitive, innovative and risk-proof. The PBC will firmly grasp the strategic basis of expanding domestic demand, vigorously protect and stimulate the vitality of market entities, and ensure solid implementation of tasks regarding economic and social development.

Consumer prices exhibit a smaller overall increase, and there are no grounds for persistent inflation or deflation. The CPI's year-on-year increase of above 5 percent at the beginning of 2020 was mainly due to the rapid rise in pork prices, added by the impact of the pandemic on supply, and therefore possessed both structural and time-specific characteristics. With multiple measures taken by government departments to guarantee supply and stabilize prices, monetary policy remained sound and the price increase steadily dropped to below 3 percent since February. According to preliminary estimates, the average growth of the CPI in 2020 will fall into a reasonable range. In addition, various commodity prices recovered to varying degrees in Q2. The PPI's month-on-month growth turned positive, and the year-on-year growth drop narrowed, which reflected the rebound in demand. However, the recent floods in some provinces may affect the manufacture and transportation of agricultural products, and the rapid increase in money supply in the advanced economies may push up commodity prices in the future. Furthermore, as the global pandemic unfolds, in light of the uncertain impact of containment measures on supply chains and industry chains, it is necessary to pay close attention to the short-term price fluctuations caused by various factors. From medium and long-term perspectives, China's economic performance is generally stable, aggregate supply and demand are basically in equilibrium, the supply-side structural reforms are being further carried out, the market mechanism is playing a better role, monetary policies remain sound, and monetary conditions are reasonable and adequate, 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, the PBC will adhere to the guiding principle of pursuing progress while ensuring stability and will uphold the new development philosophy. Solid efforts will be made to ensure stability on six fronts, namely, employment, the financial sector, foreign trade, foreign investment, domestic investment, and expectations, and to fully implement the tasks of maintaining security in six areas, namely, employment, people's basic livelihoods, operations of market entities, food and energy security, stable industrial and supply chains, and the normal functioning of primary-level governments, 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, appropriate, and targeted, maintain the rational growth of money supply and aggregate financing to the real economy (AFRE), and improve cross-cyclical policy design and adjustments. The relationship among stabilizing growth, safeguarding employment, adjusting the structure, preventing risks, and controlling inflation will be properly handled to achieve a long-term balance between stabilizing growth and preventing risks. The PBC will take measures in a more targeted and timely way to manage the intensity, pace, and focus of monetary policy operations in line with pandemic containment as well as economic and financial situations. It will continue to attach higher priority to supporting the recovery of the real economy and its sustainable development by using and launching a mix of monetary tools to keep liquidity adequate at a reasonable level and to smooth the mechanism of monetary policy transmission. While the role of structural monetary policy tools in ensuring targeted liquidity provision will be effectively brought into play, efforts will be made to enable policy measures to provide more direct support for the real economy, so as to help the real economy, particularly micro, small, and medium-sized enterprises (MSMEs), pull through the difficulties and achieve stable development. Work will be done to guide expectations through multiple channels and keep prices basically stable. Moreover, the PBC will deepen financial supply-side structural reforms, help foster a virtuous cycle and triangular interactions among the financial sector, the sci-tech sector, and industries, coordinate RMB and foreign exchange policies, and properly balance internal and external economic dynamics, so that a new development pattern will be formed at a faster pace, where domestic and international circulations boost each other, with domestic circulation as the mainstay.

First, the PBC will pursue a sound monetary policy that is more flexible, appropriate, and targeted. Based on the status of pandemic control and economic development, it will employ a mix of monetary policy tools to keep liquidity adequate at a reasonable level, guide the stable movement of market rates around open market operation rates and medium-term lending facility rates, and maintain the rational growth of money supply and AFRE. Work will be done to match credit supply with the financing needs of market entities, channel the stable flow of funds to the real economy, and support the economy to return to its potential growth rate. The capital replenishment mechanism will be improved to be sustainable so that banks will be better able to serve the real economy and to forestall and defuse financial risks. By reducing overall financing costs, extending loans at preferential rates, and adopting policies such as deferring principal and interest repayments for MSME loans, the PBC will encourage the financial system to give up a reasonable part of its profits to enterprises. Additionally, the PBC will strengthen the synergy with the fiscal sector to facilitate the issuance of government bonds and will join efforts with employment, industry, investment, and consumption policies.

Second, to stabilize businesses and secure employment, the PBC will actively explore the propelling force of central bank lending and central bank discounts as well as the monetary policy tools that provide direct support for the real economy. Continued efforts will be made to effectively implement the central bank lending and central bank discount policy with a quota of RMB1 trillion. After winding up the RMB300 billion of special central bank lending and the RMB500 billion of central bank lending and central bank discount quotas, the PBC will maintain policy stability by providing inclusive and sustained financing support for agro-linked enterprises, MSBs, private enterprises, and industries severely affected by the pandemic. Active steps will be taken to promote the two monetary policy tools that provide direct support for the real economy and to guide locally incorporated financial institutions to step up credit support for inclusive MSBs that keep their employment basically stable, so as to ensure that targeted adjustments will be more effective in serving the purpose of stabilizing businesses and securing employment. The support tool for the deferral of inclusive MSB loan repayments will be used to substantially ease the pressures on MSBs caused by principal and interest repayments and to tide them over the difficulties. The support scheme for unsecured inclusive MSB loans will be used to address the lack of collaterals and guaranties for MSBs and to increase the share of unsecured MSB loans in a move to ease their financing strains.

Third, the PBC will give play to the role of monetary and credit policies in promoting economic structural adjustments so as to better serve the real

economy. The required reserve policy framework featuring "three tranches and two preferential treatments" will be further enhanced so that a long-term mechanism of increasing bank loans to MSBs will be put in place and improved. By balancing short-term and long-term goals and adopting a combination of policies, the PBC will push forward with the project of enhancing the capacity of commercial banks to provide financial services for MSMEs, and it will also take steps to improve the banks' internal credit resource allocations as well as assessments and incentives. Research will be conducted on the linkup between financial support for poverty eradication and rural revitalization policies to consolidate the achievements made in the battle against poverty. Work will be accelerated to roll out measures for the assessment of commercial banks' services for rural revitalization so as to guide the flow of financial resources accordingly. Measures will be taken to facilitate connections between banks and manufacturing enterprises in a move to ramp up medium and long-term financing support for the manufacturing sector. Firmly adhering to the principle that housing is for living in, not for speculation, and that the real estate market shall not be used to provide a short-term stimulus to the economy, as well as remaining committed to stabilizing land prices, housing prices as well as expectations, the PBC will maintain the continuity, consistency, and stability of real estate finance policies, and effectively implement the rules on prudential management of real estate finance.

Fourth, the PBC will deepen the market-oriented interest rate reform and exchange rate reform to increase the efficiency of financial resource allocations. The loan prime rate (LPR) reform will move ahead. In line with market-oriented and law-based principles, the PBC will basically complete the shift in the pricing benchmark for outstanding floating-rate loans by the end of August so as to smooth the transmission mechanism of monetary policy and further bring down overall 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, maintain the fairness of pricing, and urge financial institutions to strictly implement the requirement for explicit indications of annualized loan rates so as to protect the rights and interests of consumers. Taking steps to deepen the market-oriented exchange rate reform, the PBC will 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. Work will be done 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. The PBC will 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 free 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. More efforts will be made to build a market-oriented, law-based, and internationalized bond market and to enhance the capacity of the bond market to serve the real economy through innovations driven by development. Measures will be taken to strengthen institution building by improving the bond market management system and pushing for the unification of standards so as to improve bond market efficiency. Support will be provided for bond financing by private enterprises. 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 regulatory 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 the 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 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 pushed ahead. Work will continue to be done to deepen the reform of development financial institutions and policy financial institutions by setting strict boundaries for their businesses and strengthening prudential supervision so that development finance and policy finance can fully play their role in supporting economic structural transformation and high-quality economic development. Focusing on strengthening the mechanisms of corporate governance, reforms of commercial banks and other financial enterprises will go deeper continuously so as to regulate the relationship between the general meeting of shareholders, the board of directors, the board of supervisors, and management, and to 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. 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 and properly handle the relationship between fighting the pandemic, reviving the economy, and preventing and controlling risks, while acting prudently to defuse risks and firmly defending the bottom line that no systemic risk should occur. Moreover, the PBC will support banks, particularly small and medium-sized banks, to replenish capital through multiple channels and to improve their governance, and will resolve non-performing loans with more efforts so as to enhance the soundness of financial institutions.