China Monetary Policy Report

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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 achieved significant strategic results in coordinating pandemic containment and economic and social development. Economic growth has been better than expected, with the relationship between supply and demand gradually improving and market vitality being enhanced. In the first three quarters, economic growth turned from negative to positive, with the year-on-year gross domestic product (GDP) growth registering 4.9 percent in Q3. In the first three quarters, the consumer price index (CPI) rose 3.3 percent year on year, employment was generally stable, and import and export trade was stable with promising signs.

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, and responded quickly and forcefully with intensified macro policies. The sound monetary policy was more flexible, appropriate and targeted. The PBC remained committed to the specific goals of maintaining an appropriate aggregate policy, notably lowering financing costs and supporting the real economy in addressing the great uncertainties, and flexibly managed the intensity, pace and focus of policy adjustments based on the characteristics of pandemic containment, and work and production resumption at different stages, hence cultivating a proper monetary and financial environment for achieving success in supporting market entities and securing employment, and providing strong support for pandemic containment and economic recovery. The monetary policies introduced by the PBC in response to the pandemic released RMB9 trillion worth of funds in 2020, and the profits waived by the financial sector in support of the real economy approximated RMB1.25 trillion in the first ten months of the year.

First, liquidity was kept adequate at a reasonable level. By effectively managing the intensity and pace of monetary policy tools, including the Medium-term Lending Facility (MLF) and open market operations (OMOs), the PBC managed to keep a supply-demand balance for short, medium and long-term liquidity, and thus stabilized market expectations and guided market rates to move smoothly around the policy rates. **Second,** the reform of the loan prime rate (LPR) was carried forward. The work of shifting the pricing benchmark for outstanding floating-rate loans collectively was completed on schedule, and the implicit floor of loan rates was removed. **Third,** the set of structural monetary policy tools was improved. The differentiated policy design was highlighted and its directness and accuracy in supporting the real economy were enhanced. **Fourth,** efforts were made to strike a balance between internal and external equilibria, with attention mainly focused on domestic conditions. The RMB exchange rate moved in both directions based on market supply and demand with more flexibility amid stable market expectations. Cross-border capital flowed in an orderly way as the market equilibrium was maintained. **Fifth,** work was done to safeguard the bottom line that no systemic risk should occur. Financial risks were effectively managed.

Overall, the sound monetary policy proved to be forward-looking, proactive, precise and effective. It produced remarkable results, with the transmission efficiency further enhanced and the financial sector extending solid support to the real economy. At end-September 2020, broad money (M2) and aggregate financing to the real economy (AFRE) grew 10.9 percent and 13.5 percent year on year, respectively, significantly higher than the growth in 2019. The weighted average rate on corporate loans registered 4.63 percent in September, down 0.49 percentage points from December 2019. The structure of money and credit continued to improve. At end-September, the inclusive loans to micro and small businesses (MSBs) and the medium and long-term (MLT) loans to the manufacturing sector grew by 29.6 percent and 30.5 percent year on year, respectively. The RMB exchange rate moved in both directions and remained basically stable at an adaptive and equilibrium level. The China Foreign Exchange Trade System (CFETS) RMB Index registered 94.40 at end-September, 3.29 percent higher than that at end-2019.

Having entered the stage of high-quality development, China boasts advantages and favorable conditions in multiple respects for future development. However, it should also be noted that the international environment is becoming increasingly complicated, with a noticeable increase of instabilities and uncertainties, and the domestic economy is facing many challenges. 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 in-depth knowledge and a dialectical view of the situation, and to strengthen the awareness of opportunities and risks. By taking into consideration the reform and adjustments, short-term and long-term development, as well as internal and external equilibria as a whole, the PBC will manage its own affairs well and strive to achieve high-quality development. In the next stage, the PBC will firmly uphold the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era and resolutely implement the decisions and arrangements of the CPC Central Committee and the State Council. Coordinating pandemic containment and economic and social development, the PBC will make all-out efforts to ensure stability on six fronts, namely employment, the financial sector, foreign trade, foreign investment, domestic investment and expectations, to maintain 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, as well as to wrap up 13th Five-year Plan smoothly, in a bid to give utmost support to achieving the goal of building a moderately prosperous society in all respects. At the same time, the PBC will further focus its efforts on thoroughly implementing the guidelines of the Fifth Plenary Session of the 19th CPC Central Committee. In understanding the new development stage, applying the new development philosophy, and building the new development paradigm, the PBC will improve macroeconomic governance, conduct cross-cyclical policy designs, foster an aggregate balance, optimize the economic structure, and strike a balance between internal and external dynamics. The PBC will make efforts to build a modern central banking system by upgrading the mechanism of money supply management, improving the formation and transmission mechanism of market-oriented interest rates, and developing institutional mechanisms to provide effective financial support for the real economy.

The sound monetary policy will be more flexible, appropriate and targeted, and it will be better adapted to the needs of high-quality economic development and more focused on the quality and efficiency of the financial sector in serving the real economy. The mechanism of money supply management will be improved so as to ensure a proper control of the aggregates. Based on the macro situation and market needs, the PBC will scientifically manage the intensity, pace and focus of monetary policy operations to keep liquidity adequate at a reasonable level and the growth of M2 and AFRE basically in line with that of nominal GDP, which reflects the potential output. The PBC will improve the formation and transmission mechanism of market-oriented interest rates, deepen the LPR reform, and continue to unleash the potential of reform in lowering lending rates. It will adopt a mix of policies to significantly reduce the overall financing costs and enable the market to play a decisive role in the formation of the RMB exchange rate. The role of structural monetary policy tools in targeted liquidity provision will be enhanced so that policy measures will provide more direct support for the real economy. Importance will be attached to expectation management to keep prices stable. The PBC will balance domestic and external dynamics as well as short-term and long-term goals, maintain a normal monetary policy for as long as possible, and keep the macro leverage ratio basically stable. To ensure success in the tough battle of forestalling and defusing major financial risks, efforts will be made to reinforce the institutional system for financial risk prevention, early warnings, resolution and accountability, to safeguard financial security, and to firmly defend the bottom line that no systemic risk should occur. With innovation and high-quality supply guiding and creating new demands, the PBC will make its contribution to accelerating the establishment of a new development paradigm with domestic circulation as the mainstay and domestic and international circulation reinforcing each other.

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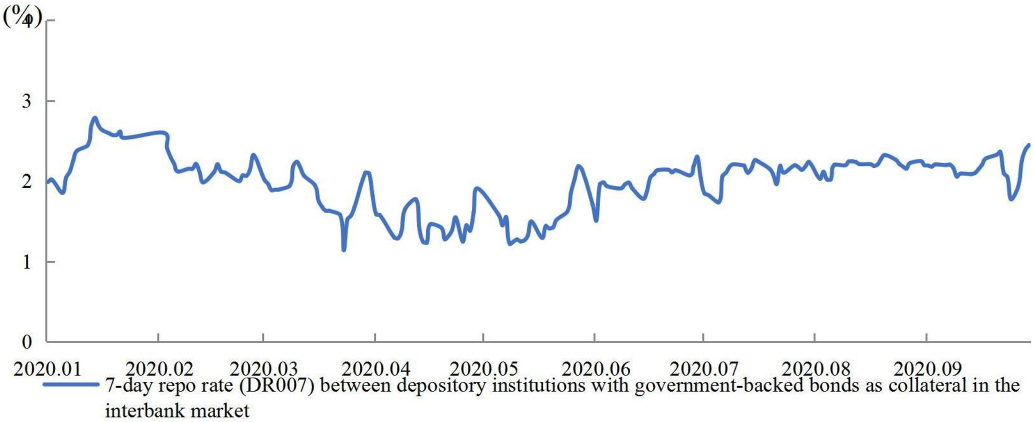
Part 1. Money and Credit Analysis

Since the beginning of 2020, the People's Bank of China (PBC) has resolutely implemented the decisions and arrangements made by the CPC Central Committee and the State Council. With the sound monetary policy more flexible, appropriate, and targeted, money and credit and aggregate financing witnessed a reasonable growth in scale, the credit structure was further improved, and the quality and efficiency of financial services for the real economy were increasingly higher, thus driving the steady recovery of the macro-economy and yielding positive results for stabilizing businesses and securing employment.

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

From the third quarter of 2020, amid the changes in economic and financial conditions, the PBC had a rational grasp of the intensity and pace of monetary policy tools, such as the Medium-term Lending Facility (MLF) and open market operations (OMOs) to promptly satisfy reasonable demands for liquidity in financial institutions. Liquidity in the banking system was constantly kept adequate at a reasonable level, and an equilibrium was maintained between liquidity supply and demand in the short, medium, and long terms. Capacity to adjust liquidity has been further improved. In the meanwhile, the PBC strengthened expectation management by announcing monetary policy arrangements in advance and it ironed out short-term fluctuations in the market in a timely manner. With the system of policy interest rates further refined, money market interest rates were guided to move smoothly around the OMO rates, and the volatility of interest rates was further reduced. Stable market expectations enabled financial institutions to trim down their preventive demands for liquidity. At the end of September, the excess reserve ratio of financial institutions registered 1.6 percent, down 0.2 percentage points from the previous year.

Figure 1 Movement of Money Market Interest Rates



Source: www.chinamoney.com.cn.

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

Loans grew at a reasonable rate and the financial sector continued to support the recovery of the real economy. Pursuing a sound monetary policy, the PBC properly managed the intensity, pace, and focus of adjustments in line with the requirement of being flexible, appropriate, and targeted, and it constantly released the potential of the loan prime rate (LPR) reform to lower financing costs. The role of a targeted structural monetary policy was brought into play to promote lending in favor of micro and small businesses (MSBs) and private enterprises. Outstanding loans issued by financial institutions in domestic and foreign currencies grew 12.8 percent year on year to RMB175.5 trillion at end-September, increasing RMB16.9 trillion from the beginning of the year and RMB3.1 trillion more than the increase in the corresponding period of 2019. Outstanding RMB-denominated loans grew 13.0 percent year on year to RMB169.4 trillion, up RMB16.3 trillion from the beginning of the year and a larger increase of RMB2.6 trillion compared with the corresponding period of the previous year.

The credit structure was remarkably optimized. Medium and long-term loans to the manufacturing sector and loans to MSBs recorded a rapid growth. At end-September, loans to enterprises and public entities grew by RMB10.6 trillion from the beginning of the year, a year-on-year acceleration of RMB2.3 trillion. Medium and long-term loans to the manufacturing sector gained 30.5 percent, an acceleration for eleven consecutive months. Outstanding inclusive loans to MSBs grew by 29.6 percent year on year to RMB14.6 trillion at end-September and their growth rates hit new records from March to September. These loans supported 31.28 million MSBs, increasing 21.8 percent year on year. In the first three quarters, inclusive loans to MSBs increased by RMB3 trillion, a year-on-year acceleration of RMB1.2 trillion.

Table 1 The Structure of RMB Loans in the First Three Quarters of 2020

Unit: RMB100 million

	Outstanding amount at end-September	YOY growth (%)	Increase from the beginning of the year	YOY acceleration
RMB loans to:	1693665	13.0%	162554	26286
Households	614431	14.7%	61241	4464
Enterprises and public entities	1068347	12.4%	105632	23464
Non-banking financial institutions	5107	-35.5%	-4720	-1879
Overseas	5780	10.3%	401	238

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 Institutions in the First Three Quarters of 2020

Unit: RMB100 million

	Increase from the beginning of the year	YOY acceleration
Chinese-funded large-sized banks [1]	74344	16449

Chinese-funded small and medium-sized banks[2]	88053	10770
Small-sized rural financial institutions[3]	22833	4585
Foreign-funded financial institutions	545	-196

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 stood at a relatively low level and corporate lending rates continued to move downwards. In September, the one-year 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 September, the weighted average lending rate recorded 5.12 percent, down 0.32 percentage points from December 2019 and 0.5 percentage points year on year. In particular, the weighted average interest rate on ordinary loans registered 5.31 percent, down 0.43 percentage points from December 2019 and 0.65 percentage points year on year; the weighted average corporate lending rate fell by 0.49 percentage points from December 2019 to 4.63 percent, 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 September 2020

Unit: %

	September	Change from December of the previous year	YOY change
Weighted average interest rate on new loans	5.12	-0.32	-0.50
On ordinary loans	5.31	-0.43	-0.65
Of which: On corporate loans	4.63	-0.49	-0.61

On bill financing	3.23	-0.03	-0.10
On mortgage loans	5.36	-0.26	-0.19

Source: The People's Bank of China.

In September, the share of ordinary loans with rates above, at, or below the LPR registered 67.7 percent, 7.41 percent, and 24.89 percent, respectively. In general, the upward and downward float of the loan rates around the LPR as a whole moved downward compared with that in June.

Table 4 Shares of RMB Lending Rates at Different Levels from January to September 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
July	21.69	5.86	72.45	13.63	26.19	14.17	9.48	8.97
August	24.48	6.29	69.23	13.26	23.77	13.62	9.41	9.15
September	24.89	7.41	67.70	13.31	23.74	14.09	8.78	7.79

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 September, the weighted average interest rates on demand and large-value USD-denominated deposits with maturities within 3 months registered 0.21 percent and 0.72 percent, respectively, up 0.01 percentage points and down 0.03 percentage points, respectively, from June. 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 1.37 percent and 1.24 percent, respectively, down 0.20 percentage points and 0.23 percentage points, respectively, from June.

Table 5 Average Interest Rates of Large-value USD-denominated Deposits and Loans from January to September 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
July	0.21	0.70	1.07	1.16	1.39	1.46	1.53	1.43	1.32	1.32	2.17
August	0.23	0.73	0.96	1.24	1.36	1.43	1.46	1.40	1.28	1.30	1.95
September	0.21	0.72	0.92	1.16	1.18	1.39	1.37	1.24	1.35	1.29	2.46

Source: The People's Bank of China.

Growth of deposits picked up. At end-September, outstanding deposits in domestic and foreign currencies in all financial institutions posted RMB216.9 trillion, up 10.7 percent year on year, 2.1 percentage points higher than that at the end of the previous year. Outstanding RMB deposits registered RMB211.1 trillion, up 10.7 percent year on year, 2 percentage points higher than those at the end of the previous year.

Outstanding deposits in foreign currencies stood at USD848.7 billion, an increase of USD90.9 billion from the beginning of the year and an acceleration of USD86.2 billion year on year. Fiscal revenues declined, expenditures for pandemic containment increased, and the distribution of funds for special bonds accelerated. Fiscal deposits decreased by 2.9 percent year on year.

Table 6 The Structure of RMB Deposits in the First Three Quarters of 2020

Unit: RMB100 million

	Deposits at end-September	YOY growth (%)	Increase from the beginning of the year	YOY acceleration
RMB deposits:	2110774	10.7%	181511	49337
Households	912537	13.9%	99505	14182
Non-financial enterprises	649315	12.4%	54875	39646
Public entities	311944	1.5%	14775	-6988
Fiscal entities	47118	-2.9%	6278	-1709
Non-banking financial institutions	177228	10.0%	4765	3537
Overseas	12632	9.5%	1312	669

Source: The People's Bank of China.

III. Broad money supply and aggregate financing to the real economy grew at a reasonable rate

At end-September, outstanding M2 recorded RMB216.4 trillion, up 10.9 percent year on year, an acceleration of 2.2 percentage points from the end of 2019. Outstanding M1 registered RMB60.2 trillion, a year-on-year growth of 8.1 percent and 3.7 percentage points higher than that at the end of the previous year. Outstanding M0 reached RMB8.2 trillion, up 11.1 percent year on year and an increase of 5.7 percentage points from the end of 2019. The first three quarters of 2020 witnessed a net cash injection into the economy of RMB518.1 billion, a rise of RMB426.0 billion year on year.

According to preliminary statistics, outstanding aggregate financing to the real economy (AFRE) reached RMB280.07 trillion at end-September, up 13.5 percent year on year and an acceleration of 2.8 percentage points over the end of the previous year. In the first three quarters of 2020, the incremental AFRE reached RMB29.62 trillion on a cumulative basis, an increase of RMB9.01 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 in asset-backed securities of depository financial institutions accelerated from the previous year, while the growth in written-off loans accelerated.

Table 7 Aggregate Financing to the Real Economy in the First Three Quarters of 2020

	At end-September 2020		In the First Three Quarters of 2020	
	Stock (RMB1 trillion)	YOY growth (%)	Flow (RMB100 million)	YOY change (RMB100 million)
AFRE	280.07	13.5	296200	90095
Of which：RMB loans	168.26	13.2	166881	27919
Foreign-currency loans (RMB equivalents)	2.35	7.7	3052	3863
Entrusted loans	11.13	-5.1	-3190	3264
Trust loans	7.03	-8.5	-4137	-3059
Undiscounted bankers' acceptances	3.90	18.7	5676	10900

	At end-September 2020		In the First Three Quarters of 2020	
Corporate bonds	27.39	20.6	40966	16537
Government bonds	44.46	20.2	67313	27434
Domestic equity financing by non-financial enterprises	7.97	10.0	6099	3756
Other financing	7.36	21.6	7036	-1037
Of which：Asset-backed securities of depository financial institutions	1.63	11.3	-532	-2385
Loans written off	4.83	32.0	7644	1166

Notes: ①The 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 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 of “government bonds.” The value of this indicator is the face value of the bonds under custody. Since 2019, the PBC has further improved the “corporate bonds” statistics contained in the AFRE by incorporating “exchange-traded asset-backed corporate securities.” into it. To improve the AFRE statistical method, the PBC has incorporated “local government special bonds” into the AFRE since September 2018 and has incorporated “asset-backed securities by depository financial institutions” and “loans written off” into the AFRE statistics under the item of “other financing” since July 2018. ③Year-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.

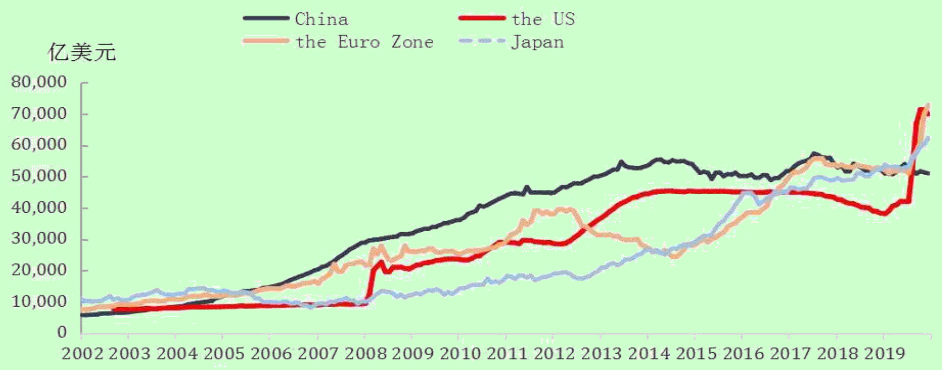
Box 1 The Correct Approach to Understanding the Relationship Between the Central Bank Balance Sheet and Money Supply

In the traditional view, a change in broad money (M2) results from a change in base money, which is amplified by the money multiplier. As base money mainly consists of currency in circulation, required reserves, and excess reserves, it constitutes the major liabilities of the central bank, reflects implementation of the monetary policy, and is close to the size of the central bank’s balance sheet numerically. Therefore, a change in the size of the central bank's balance sheet is easily regarded as a change in the monetary policy stance. As a matter of fact, there is no constant correlation between the growth of M2 and the change in the size of the central bank's balance sheet and base money.

Commercial banks, rather than the central bank, are the direct broad money creators. In reality, M2 is created by banks through credit expansion, such as bank lending, which is an independent behavior by banks and has nothing to do with base money. The central bank both provides support for and puts constraints on bank money creation by adjusting base money. When creating money through bank lending, the banks transfer the excess reserves, which are equal to a certain proportion of the new deposits, into the required reserves according to the requirements of the central bank. The central bank itself is not the money creator.

It should be noted that excess reserves are the liquidity in the banking system that can support money creation by banks, while the required reserves are the "frozen" liquidity in the banking system that cannot support money creation. As the central bank's balance sheet and base money include the sum of the above two items, it is of little significance to simply use them to analyze the monetary policy stance. For example, prior to the global financial crisis in 2008, the size of the US Fed's balance sheet remained basically unchanged, and its monetary policy stance was tightened or loosened mainly through adjustments of the policy rate. Another example is that the size of the balance sheet of China's central bank expanded cumulatively eight times from early 2000 to end-2013, along with which there were also changes in China's monetary policy stance.

Figure 2 Size of the Balance Sheets of the Central Banks of China, the US, the Euro Zone and Japan



Source: Wind.

Over a broader time span, the balance sheet expansion of China's central bank has been roughly the same as that of the central banks of the major developed economies. From the beginning of 2000 to end-September 2020, the balance sheet of China's central bank expanded 9.6 times, which was roughly the same as that of the US Fed (9.5 times), the European Central Bank (7.1 times), and the Bank of Japan (5.2 times) over the same period (see Figure 2). The balance sheet expansion of China's central bank, starting from the beginning of this century, is a passive scale-up resulting from the growth of funds outstanding for foreign exchange, while the corresponding growth of base money mainly comes from the "frozen" required reserves, some of which will be "unfrozen" and become excess reserves when the central bank cuts the required reserve ratio (RRR). A RRR cut can also increase the liquidity in the banking system and support money creation, but the size of the central bank's balance sheet and base money will remain unchanged, or may even decrease in the short term, as the banks repay their loans to the central bank with the funds unleashed from the RRR cut. In contrast, the central banks in the major developed economies started their large-scale balance sheet expansion in the wake of the global financial crisis in 2008, which was aimed at further injecting liquidity through quantitative easing to stimulate the economy when the normal monetary policy space was depleted. The balance sheet expansion of the central banks in the developed economies basically corresponds to an increase in excess reserves, which is essentially different from that of China.

In recent years, breaking away from the passive balance sheet expansion caused by the growth of funds outstanding for foreign exchange, China's central bank has significantly enhanced its independence in monetary policy implementation, and the role of banks as the center of money creation has been brought into full play. Since the beginning of 2020, the PBC has mainly employed the two monetary policy instruments of RRR cuts and central bank lending to cushion the impact of the COVID-19 pandemic, both of which have had an effect on the central bank's balance sheet. As the balance sheet scale-down resulting from the RRR cuts counteracts the scale-up brought about by central bank lending, the size of the central bank's balance sheet remains basically stable while the growth rates of M2 and aggregate financing to the real economy (AFRE) are significantly higher than those in 2019. Compared with the ballooning size of the central bank balance sheets in the major developed economies, China's central bank has maintained a normal monetary policy with a smooth transmission.

One point that needs to be emphasized is that the money multiplier is the identity ratio between M2 and base money. The creation of M2 is the behavior of banks. Banks' demand for required reserve payments after creating deposits through bank lending can be offset by the central bank's RRR cuts, which shrink the central bank's balance sheet, or be met by central bank lending, which expands the balance sheet. This means the money multiplier is actually an ex-post identity result and there is no direct logical relationship between the numerator and the denominator. The traditional view on the money multiplier is a mechanical observation of money creation, without a full awareness that it is commercial banks that create the money. Hence, it cannot be used to realistically analyze the money.

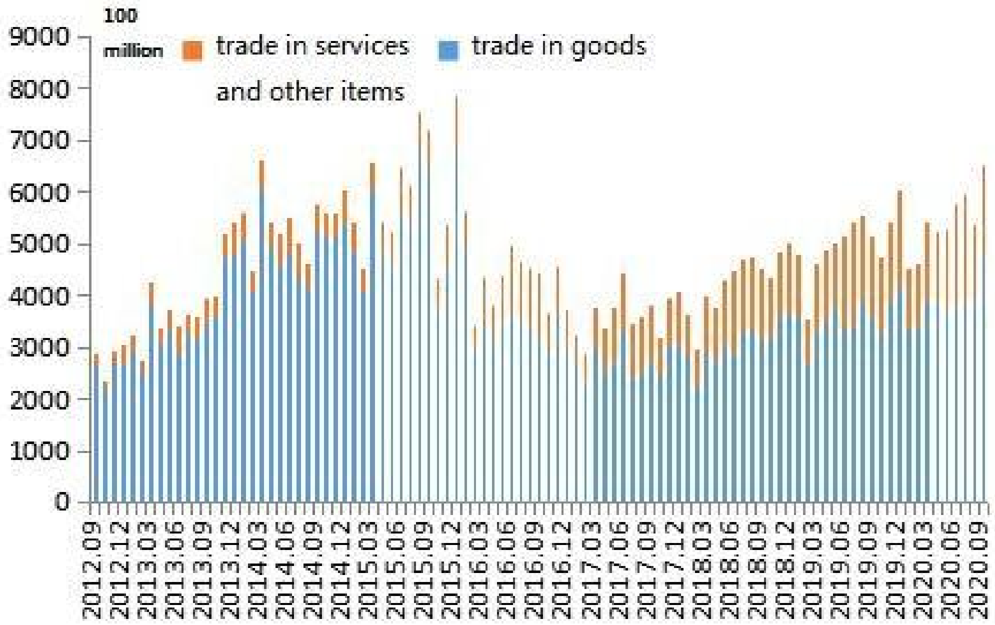
In general, there is no intrinsic logic underlying the relationship among the size of the central bank's balance sheet, the money multiplier, and the growth of M2. Moreover, as one of the few large economies that stick to a normal monetary policy, China does not need to inject liquidity through a large-scale expansion of its central bank's balance sheet. Therefore, it is inappropriate to measure the effects of monetary policy simply by gauging the expansion of the central bank's balance sheet or by the money multiplier. The key to observing the looseness or tightness of the monetary policy is to observe the money supply or the AFRE, both of which are the intermediate targets of the monetary policy. A reasonable growth of money and credit indicates that the banks' market-based role in money creation functions well and the central bank provides a moderate amount of base money. Going forward, in line with the decisions and arrangements made by the CPC Central Committee and the State Council, the PBC will continue to adopt a sound monetary policy in a more flexible, more appropriate, and better targeted manner, do a good job in designing cross-cyclical policies, improve the mechanism of money supply management, and bring into full play the positive role of the supply of base money in promoting high-quality development of the economy.

IV. The RMB exchange rate appreciated slightly, 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 the first three quarters, the RMB exchange rate appreciated slightly against a basket of currencies. At end-September, the China Foreign Exchange Trade System (CFETS) RMB exchange rate index and the RMB exchange rate index based on the special drawing rights (SDRs) basket closed at 94.40 and 92.45, respectively, up 3.29 percent and 0.70 percent from end-2019, respectively. According to calculations by the Bank for International Settlements (BIS), at end-September, the nominal effective exchange rate (NEER) and the real effective exchange rate (REER) of the RMB appreciated 2.67 percent and 2.19 percent from end-2019, respectively. From 2005 when reform of the exchange rate formation mechanism commenced to end-September 2020, the NEER and REER of the RMB appreciated by 35.85 percent and 49.66 percent, respectively. In the first three quarters of 2020, the RMB exchange rate against the USD became more flexible and appreciated slightly. At end-September, the central parity of the RMB against the USD was 6.8101, up 2.44 percent from end-2019, and it appreciated by 21.53 percent on a cumulative basis from the launch of the reform of the exchange rate formation mechanism in 2005. In the first three quarters of 2020, the annualized volatility rate of the RMB exchange rate against the USD was 4.25 percent. On October 27, 2020, the Secretariat of the China Foreign Exchange Market Self-Regulatory Framework announced that some quoting banks of the RMB's central parity against the USD took the initiative to phase out in succession the use of a "counter-cyclical factor" in the quotation model of the RMB's central parity against the USD based on their judgment of the economic fundamentals and market situations. The adjusted model was conducive to enhancing the transparency, benchmark role, and effectiveness of the central parity quotations made by the quoting banks, and it demonstrated the role of market entities in the Foreign Exchange Market Self-Regulatory Framework.

Cross-border RMB transactions continued to grow with roughly balanced receipts and payments. In the first three quarters of 2020, cross-border RMB settlements totaled RMB20.8 trillion, up 44 percent year on year. In particular, RMB receipts and payments registered RMB10.3 trillion and RMB10.5 trillion, respectively. Cross-border RMB settlements under the current account grew by 11 percent year on year to RMB4.9 trillion, among which RMB settlements of trade in goods registered RMB3.4 trillion whereas RMB settlements of trade in services and other items registered RMB1.5 trillion. Cross-border RMB settlements under the capital account posted RMB15.9 trillion, up 58 percent year on year.

Figure 3 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, made prompt and effective responses, and adopted a sound monetary policy in a more flexible, more appropriate, and better targeted manner. The PBC flexibly managed the intensity, pace, and focus of adjustments, remained committed to the already set combined goals of maintaining an appropriate aggregate policy, substantially lowering financing costs, and supporting the real economy in response to the great uncertainties in the environment, and went all out to ensure stability on six fronts, namely, employment, the financial sector, foreign trade, foreign investment, domestic investment, and expectations, and maintain security in six areas, namely, employment, the people' s basic livelihood, the operations of market entities, food and energy security, stable industrial and supply chains, as well as the normal functioning of primary-level governments, so as to create a favorable monetary and financial environment for stabilizing businesses and securing employment and to provide strong support for pandemic containment and economic recovery.

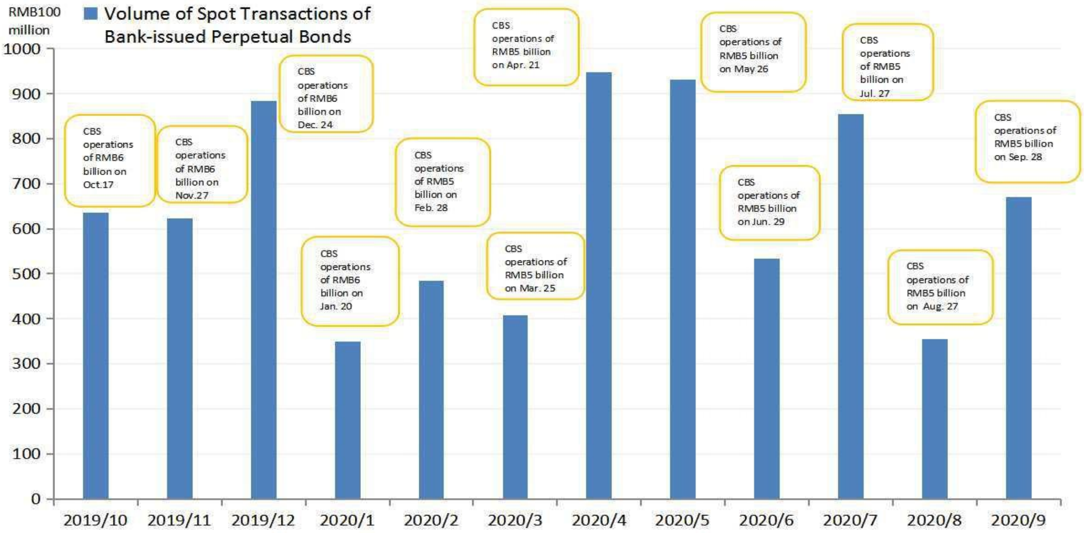
I. Conducting open market operations in a flexible manner

Maintaining adequate liquidity at a reasonable level in the banking system. Since the beginning of Q3 2020, in light of the current liquidity level in the banking system, financial institutions' demand for liquidity, intensive government bond issuances, and other factors, the PBC conducted open market operations (OMOs) in a flexible manner, strengthened coordination of OMOs with mid and long-term monetary policy instruments, and maintained adequate liquidity at a reasonable level in the banking system as always, which was neither loosened nor tightened, with liquidity supply in the short, medium and long terms maintaining an equilibrium level that matched market demand. In the meanwhile, the PBC strengthened market communications, improved the transparency of monetary policy, and effectively stabilized market expectations by disclosing the plan of the month for Medium-term Lending Facility (MLF) operations in advance in the *Announcement of Open Market Operations*.

Guiding money market rates to move smoothly around the OMO rates. Since the beginning of Q3， the 7-day repo rate has remained unchanged at 2.20 percent on the open market, unaffected by the continuously easing monetary policies adopted by the developed economies, which steadily sends policy rate signals and demonstrates a sound monetary policy stance. In the meanwhile, the 7-day and 14-day open market operations were reasonably matched so as to iron out the short-term liquidity fluctuations caused by tax peaks, intensive government bond issuances, seasonal factors, etc., and to guide money market rates to move smoothly within a reasonable range around the OMO rates, hence reducing interest rate volatility and bringing into play the increasingly important role of OMO rates as pivotal short-term market rates. In Q3, the 7-day rate (DR007), which is the weighted average funding rate between depository institutions on the interbank market, averaged 2.15 percent, 44 basis points lower than that in Q3 2019. At end-September, the DR007 stood at 2.45 percent, 40 basis points lower than that at the same time of the previous year.

Continuously conducting central bank bill swap (CBS) operations. In Q3, the PBC conducted CBS operations three times, with a 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 RMB46 billion. The CBS operations played a positive role in improving liquidity on the secondary market of bank-issued perpetual bonds and in supporting the issuance of perpetual bonds to replenish capital by banks, especially small and medium-sized banks.

Figure 4 Volume of Spot Transactions of Bank-issued Perpetual Bonds



Source: The People’s Bank of China.

Issuing central bank bills in Hong Kong on a regular basis. In Q3, 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 Q1–Q3 2020, the PBC issued in Hong Kong nine batches of RMB-denominated central bank bills in a total amount of RMB120 billion. The regular issuance of RMB-denominated central bank bills in Hong Kong not only enriched RMB investment products and RMB liquidity management tools on the Hong Kong market but also fostered the offshore issues of RMB-denominated bonds by both domestic and overseas financial institutions and enterprises, thus promoting the sustainable and sound development of the offshore RMB market. According to statistics, from January to September 2020, various bond issuers other than the PBC issued over RMB99 billion of offshore RMB-denominated bonds, a year-on-year growth of 25 percent. The market would have been more willing to issue bonds without the disruption of the COVID-19 pandemic. With sustained growth in issuances, the how and where to issue RMB-denominated bonds offshore have become increasingly diversified and market vitality has improved substantially.

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

Well-timed MLF operations were conducted. The reasonable supply of medium- and long-term liquidity was ensured, giving full play to the signaling and guiding functions of the mid-term policy rate. From January to September, the PBC conducted a total of RMB2.7 trillion of MLF operations, all with a maturity of one year. Specifically, the amount of MLF operations posted RMB1.7 trillion in Q3, with a net injection of medium- and long-term liquidity of RMB550 billion. At end-September, the outstanding MLF registered RMB4.1 trillion, RMB410 billion more than that at the beginning of the year. The rate of the latest one-year MLF operation posted 2.95 percent, the same as that at end-June.

Standing Lending Facility (SLF) operations were conducted in a timely manner. The demand for short-term liquidity by 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. From January to September, the PBC conducted a total of RMB157.4 billion SLF operations, of which RMB6 billion of the operations were conducted in Q3. At end-September, the balance of SLF operations registered RMB2.5 billion, and the overnight, 7-day, and 1-month SLF rates were 3.05 percent, 3.2 percent, and 3.55 percent, respectively, leveling off as compared with those at end-June.

III. Enhancing monetary and credit support to offset the impact of the COVID-19 pandemic

To coordinate on-going pandemic containment and economic and social development, the intensity, pace, and focus of monetary policy adjustments were properly managed based on the different features of each stage. Policy measures were implemented in a more direct manner with enhanced financial support for stabilizing businesses and securing employment, with the aim of ensuring stability on six fronts and maintaining security in six areas.

First, liquidity remained adequate at a reasonable level. By means of required reserve ratio (RRR) cuts, MLF operations, and open market operations, liquidity was kept adequate at a reasonable level, thereby safeguarding the stable movement of market rates and creating a favorable liquidity environment for the issue of special central government bonds and local government special bonds. RMB1.7 trillion of short-term liquidity was provided to the financial market when it reopened after the Spring Festival vacation, which effectively stabilized market expectations. The three rounds of RRR cuts in the first nine months of the year released RMB1.75 trillion of long-term funds.

Second, the policies of RMB1.8 trillion of central bank lending and central bank discounts were rolled out and put into place, with a multi-level and multi-tier approach. At the early stage of the pandemic outbreak, on January 31, the PBC arranged a first round of special central bank lending in the amount of RMB300 billion so as to facilitate the issuance of loans for key medical and daily-necessity enterprises at preferential interest rates. The actual financing costs for enterprises dropped to below 1.6 percent after a 50-percent fiscal subsidy on the loan interest, which vigorously supported the provision of medical supplies and daily necessities. When China entered the stage of work and production resumption with preliminary containment of the pandemic, as a second step the PBC rolled out RMB500 billion of central bank lending and central bank discounts on February 26. Commercial banks issued loans at rates no higher than the one-year LPR plus 50 basis points, which forcefully supported the resumption of work and production. With remarkable achievements in pandemic control during the previous stage and at the stage of accelerated resumption of production and order, the PBC rolled out a third round of RMB1 trillion of inclusive central bank lending and central bank discounts on April 20, in an attempt to facilitate bank issuances of more loans to rural-development businesses, micro and small businesses (MSBs), and private enterprises. By keeping the average financing costs below 5.5 percent, the PBC expended all-out efforts to secure market entities. The policies of RMB300 billion of special central bank lending and RMB500 billion of central bank lending and central bank discounts were fully implemented by end-June. Over 80 percent of the RMB1 trillion of central bank lending and central bank discounts had been put into place by end-September, which played a vital role in supporting pandemic containment as well as supporting the resumption of work and production.

Third, with highlighted characteristics of directness and precision, two monetary-policy instruments directly supporting the real economy were proactively promoted, with the aim of stabilizing businesses, securing employment, and bolstering the development of small and medium-sized enterprises (SMEs). On June 1, 2020, the PBC created two monetary-policy instruments directly supporting the real economy. The instrument in support of deferred repayments of inclusive MSB loans was operated on a monthly basis, providing a cumulative RMB4.7 billion of incentive funds to locally incorporated banks, and supporting a total of RMB469.5 billion of deferred principal of inclusive MSB loans from June to September. The weighted average time extension registered 12.6 months, easing the MSBs' temporary pressures to repay the loan principal and interest. The support scheme for inclusive unsecured loans for MSBs was operated on a quarterly basis, providing a cumulative RMB93.2 billion of preferential funding to locally incorporated banks and supporting a total of RMB264.6 billion of unsecured loans for MSBs from March to September, effectively alleviating the financing strains on the MSBs.

Fourth, the roles of financial institutions were brought into full play. Measures were taken to strengthen financial support for regions that were hard hit by the pandemic. Major state-owned banks were urged to ramp up support for inclusive MSBs, special credit support from policy banks was put into place, and locally incorporated banks were guided to effectively serve local communities. The financial regulatory authorities guided the financial sector to waive a part of its profits to the real economy by reducing loan interest rates through a deepened LPR reform, by implementing two monetary-policy instruments directly supporting the real economy, and by cutting charges and fees, etc. According to an estimation, a total of RMB1.25 trillion of benefits had been waived by the financial sector in favor of the real economy by end-October. With the policy effects further unfolding, the RMB1.5 trillion goal for the whole year is expected to be achieved.

IV. Further improving the macroprudential policy framework

The role of the macroprudential assessment (MPA) was effectively brought into play to optimize the credit structure and to promote the supply-side structural reform of the financial sector. In Q3 2020, the PBC further improved the assessment requirements for the financing for MSBs, private firms, and the manufacturing sector in the MPA in an attempt to secure incremental financing flows to the manufacturing sector and micro, small and medium-sized enterprises (MSMEs). The PBC improved the assessment for the use of the LPR, promoted banks to accelerate the shift in the pricing benchmark for outstanding floating-rate loans, and pushed ahead with a further decline in the overall financing costs for the real sector.

The foreign exchange risk reserve ratio was adjusted when appropriate. Since the beginning of 2020, the RMB exchange rate witnessed two-direction floating based on market supply and demand amid strengthened flexibility, stable market expectations, orderly cross-border capital flows, stable performance of the foreign exchange market, and balanced market demand and supply. As a result, the PBC decided to reduce the foreign exchange risk reserve ratio for forward foreign exchange sales from 20 percent to zero, effective from October 12, 2020, in a bid to keep the RMB exchange rate basically stable at an adaptive and equilibrium level.

The mechanism of countercyclical capital buffer was established. In September 2020, the PBC and CBIRC jointly issued th*e Notice of the PBC and CBIRC on Establishing Mechanism of Countercyclical Capital Buffer* (Yinfa No. 233 [2020]), stipulating the establishment of the mechanism of countercyclical capital buffer and setting the initial countercyclical capital buffer ratio at zero. Looking forward, the PBC and CBIRC will assess and adjust the countercyclical capital buffer ratio as needed, taking into account in a comprehensive manner the macroeconomic and financial conditions, the macro leverage level, the soundness of the banking system, exposure to systemic financial risks, and other factors.

The development of financial holding companies was promoted with strengthened regulation. In September 2020, the State Council issued the *Decisions on Implementing the Access Management of Financial Holding Companies* (Guofa No. 12 [2020], hereinafter referred to as the *Decisions*), and the PBC promulgated the *Trial Measures on Regulation of Financial Holding Companies* (Order No. 4 [2020] of the People's Bank of China, hereinafter referred to as the *Measures*). In line with the idea of macroprudential management and the principle of all-round, continuous, and look-through regulation, law-based market access and regulation is carried out on the basis of consolidated management of financial holding companies (FHCs), which are formed via investments by non-financial enterprises as controlling shareholders, so as to strengthen regulation of the business activities of the financial holding companies (FHC). Adhering to the principle that separate operation is the mainstream of the financial sector, the *Decisions* and the *Measures* institutionally isolated the real sector from the financial sector, which contributed to the sustainable and healthy development of the FHCs, to the prevention of risk contagion, and to a virtuous circle between the economy and finance.

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

The PBC actively used credit policies to support central bank lending, 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 people, as well as poverty alleviation. Good use was made of central bank lending to support special poverty alleviation projects to increase credit supply to areas of extreme poverty, including the "three autonomous regions," i.e., Tibet, four prefectures in southern Xinjiang, the areas in four provinces with large Tibetan populations, and the "three autonomous prefectures," i.e., Linxia in Gansu, Liangshan in Sichuan, and Nujiang in Yunnan, to lower the financing costs in these areas as well as to achieve targeted poverty alleviation. In Q3, RMB7.2 billion of central bank lending for special poverty alleviation projects was provided, with the nationwide balance recording RMB29.1 billion at end-September. At end-September, outstanding central bank lending to support rural development registered RMB378.4 billion. Outstanding central bank lending for MSBs and for poverty alleviation posted RMB800.8 billion and RMB172.3 billion, respectively. Outstanding central bank discounts registered RMB482.2 billion. In the first nine months of 2020, the PBC made a net withdrawal of PSLs in the amount of RMB103.1 billion from policy and development banks, with the net withdrawal in Q3 totaling RMB74.7 billion and the outstanding PSL registering RMB3.4343 trillion at end-September.

Targeted Medium-term Lending Facilities (TMLFs) maturing in Q3 were rolled over in the form of MLF. The TMLFs provided a stable and long-term funding source for financial institutions to expand credit supply to MSBs and private firms at low costs. On July 15, 2020, the PBC conducted one-year MLF operations totaling RMB400 billion with a rate of 2.95 percent, which included the rollover of the TMLFs maturing in July. The instrument can roll over up to 3 years. At the end of September, the outstanding TMLFs totaled RMB296.6 billion.

Box 2 Fully Implementing Monetary Policy Instruments to Enable Direct Support to the Real Economy

To implement the policy arrangements of the CPC Central Committee and the State Council on ensuring stability on six fronts and maintaining security in six areas, the PBC, in line with the requirements of the *Report on the Work of the Government (2020)*, unveiled on June 1, 2020 two instruments that can directly support the real economy, namely a support instrument to defer the repayment of inclusive loans for micro and small businesses (MSBs), and a support scheme for inclusive unsecured loans to MSBs. The instruments are aimed at further improving the system of structural monetary policy instruments and beefing up financial support to keep businesses and employment stable.

I. A support instrument allowing MSBs to defer repayments of inclusive loans has been introduced to effectively ease repayment pressures

Amid the COVID-19 fallout, most MSMEs faced cash flow problems. To ease their pressure to repay the loan principal and interest, the PBC and the China Banking and Insurance Regulatory Commission (CBIRC) promptly introduced policies to defer principal and interest repayments of the loans for MSMEs, with the repayment deadline extended until March 31, 2021. Specifically, repayments of inclusive loans for MSBs eligible for this policy should all be deferred, and other businesses facing financial difficulties can negotiate with their creditors about deferred repayments. According to this policy, all inclusive loans for MSBs that are due to mature before end-2020 are eligible to apply to defer the principal and interest repayments. Banks shall approve of the MSBs' deferred repayments as long as that in their applications they promise to keep their employment basically stable. As of end-September, 2020, principal repayments of 1.89 million market entities and interest repayments of 910 thousand market entities have been deferred by banking institutions across the country, involving RMB4.7 trillion of principal and interest of matured loans.

To encourage locally incorporated banks to ensure maximum coverage of the deferred repayments policy on inclusive loans of MSBs, the PBC has launched a support instrument with the provision of funds totaling RMB40 billion. The PBC, through interest rate swap agreements signed between special purpose vehicles (SPVs) and locally incorporated banks, provides the banks with incentive funds equal to 1 percent of the total principal of inclusive MSB loans under deferred repayment. This instrument is conducted on a monthly basis, and incentives totaling RMB4.7 billion have been channeled to locally incorporated banks, with inclusive MSB loan principal worth RMB469.5 billion having been deferred in repayments from June to September, covering 500 thousand MSBs.

II. A support scheme for unsecured inclusive MSB loans has been launched to effectively enhance their share

In light of the MSBs' high operational risks, banks normally require them to provide collateral guarantees before issuing them loans. Currently, unsecured loans issued by locally incorporated banks to MSBs account for only around 8 percent of their total loans. To alleviate the pains and difficulties arising from the MSBs' lack of such guarantees and to raise the share of the unsecured MSB loans, the PBC has launched a support scheme for unsecured inclusive MSB loans, with the provision of funds totaling RMB400 billion. The PBC provides favorable funding support for locally incorporated banks through support scheme agreements for unsecured loans signed between the SPVs and the banks.

This support scheme is mainly targeted at locally incorporated banks with sound performance, and only those rated between level 1 and 5 in the PBC's rating of financial institutions in the previous quarter can qualify as applicants. For unsecured inclusive MSB loans with a maturity of no less than 6 months that are newly issued by eligible locally incorporated banks from March 1, 2020 to December 31, 2020, the PBC provides the banks with favorable funding through the support scheme. The funding equals 40 percent of the principal of the actually issued loans, with a maturity of one year. The MSBs covered by the plan must promise to keep employment basically stable.

From March to September 2020, banking institutions across the country cumulatively issued RMB2.3 trillion of inclusive unsecured loans to MSBs, a year-on-year increase of RMB796.1 billion. Specifically, loans issued by locally incorporated banks with a rate between level 1 and 5 registered RMB973.3 billion, a year-on-year increase of RMB349.9 billion. This instrument is conducted on a quarterly basis, and RMB93.2 billion of favorable funding has been provided to locally incorporated banks rated between level 1 and 5. They were supported to issue RMB264.6 billion of unsecured loans to MSBs from March to September, covering 2.33 million MSBs.

III. Following market-based principles to enable targeted and direct financial support to the real economy

First, they are market-based. The PBC followed the commercial principle that commercial banks are provided with autonomy in their business operations and they can undertake credit risks by themselves. Through innovations in the operational arrangements of monetary policy instruments and the design of an incentive compatibility mechanism, financial institutions are fully motivated to take the initiative to enhance financial services to MSBs.

Second, they provide direct support to the real economy. Direct support does not mean the PBC directly provides funds to businesses. Instead, funding support provided by these two instruments is channeled to the real economy through financial institutions. These two instruments directly link monetary policy operations with financial support to financial institutions for MSBs. As long as MSBs commit themselves to keeping employment basically stable, and locally incorporated banks follow the rules in arranging loan deferments or in issuing unsecured loans to MSBs, these banks are eligible for PBC support, thus ensuring efficient and direct flows of funds to the real economy.

Third, they are targeted. These two instruments specify the eligible targets and scope of policy support. Locally incorporated banks with MSBs as their major clients are eligible for policy support, and the scope includes deferred principal and interest repayments of the inclusive loans of MSBs and newly-issued inclusive unsecured loans to MSBs, thus ensuring precise and targeted funding support to MSBs through locally incorporated banks.

Going forward, the PBC will continue to put in place these two monetary policy instruments step by step, effectively ease the MSBs' pressures to repay loan principal and interest, increase the share of unsecured loans, and bolster financial support to keep businesses and employment stable.

VI. Bringing into full play the role of credit policy in guiding structural reform

By focusing its efforts on promoting high-quality development, the PBC guided financial institutions to continue to step up support to key areas and weak links in the national economy,and kept businesses and employment stable, thus ensuring that the targets and tasks for winning the battle against poverty can be met, and bringing to completion the building of a moderately prosperous society in all respects. **First, the PBC accelerated financial support to keep businesses and employment stable.** A series of meetings was held to promote financial support to keep businesses and employment stable, sustained efforts were made to strengthen credit support to MSMEs, and funding for MSMEs was promoted to achieve "an increase in quantity, a decrease in price, an improvement in quality, and an expansion in coverage." The PBC made innovations in monetary policy instruments that can directly support the real economy, issued the *Notice on Extending the Policy of Provisional Deferred Repayments of Loan Principal and Interest for Micro, Small and Medium-sized Enterprises and Stepping up Support for Unsecured Loans of Micro and Small Businesses* , clarified and improved policies, regularly monitored and issued reports, boosted media coverage and communications, and ensured policy implementation and transmission. By focusing on key support groups and key businesses, the PBC made innovations in many types of activities connecting government agencies, banks, and businesses to enable more effective and better-targeted connections. **Second, the PBC made solid progress in targeted financial poverty alleviation**. Areas in extreme poverty and counties that have not been lifted out of poverty were provided with stronger financial support, more financial support was channeled to industries for poverty alleviation, basic financial services in poverty-stricken areas were consolidated and enhanced, the establishment of supporting mechanisms for financial poverty alleviation was advanced, risks in financial poverty alleviation were well prevented, and the establishment of a long-term mechanism to reduce poverty by financial support was promoted. **Third, the PBC continued to increase financial inputs to boost rural revitalization.** Sustained financial guarantees were provided for the production of hogs and other areas, credit support to increase the area of high-standard cropland and to consolidate rural lands was promoted, the *Opinions on Expanding Effective Investments in Agriculture and Rural Areas and on Accelerating the Strengthening of Prominent Weaknesses in Agriculture, Rural Areas, and Farmers* were launched by the Office of the Central Leading Group for Rural Affairs with the cooperation of the PBC, financial support for effective investment in agriculture and rural areas was boosted, and financial services for new-type rural business entities and small rural households were enhanced to effectively meet their financing needs for business development.

VII. Deepening the market-based interest rate reform

The PBC advanced completion of the LPR reform and promoted the reduction of loan rates. First, the shift in the pricing benchmark for outstanding floating-rate loans was successfully achieved. As of end-August, 92.4 percent of outstanding loans had completed the shift in the pricing benchmark. Specifically, 90 percent of the outstanding corporate loans and 99 percent of individual housing mortgage loans had completed the shift; 91 percent of the aforementioned outstanding loans were shifted to be priced with the LPR for reference. With the completion of the shift in the pricing benchmark for outstanding floating-rate loans, the movements of the LPR can have an impact on most of the loans. Accordingly, the implicit floor of the loan rates was completely removed and the efficiency of the transmission of monetary policy was further enhanced, with the financing costs lowered more notably.

Second, the pricing of internal funds of financial institutions became notably more market-based. With the deepening of the LPR reform, the market-based LPR has gradually replaced the benchmark loan rates as a key reference for the internal funds transfer pricing (FTP) of the commercial banks. Up to now, all the national banks have established the FTP system and have realized the linkage between the FTP and the LPR. Most of the locally incorporated financial institutions have also set up the FTP mechanism and have included the LPR in the FTP.

Third, derivatives of the LPR witnessed fairly rapid development. As the pricing benchmark for outstanding loans was shifted to the LPR, basic assets pegged to the LPR will increase. There will be a rise in demand of financial institutions and enterprises for hedging against the risks brought about by LPR assets or the negative debt interest rate, with the LPR derivative transactions growing rapidly.

Fourth, the LPR reform also played an important role in promoting the market-based reform of deposit rates. In September 2019, the weighted average interest rates of three-year and five-year deposits stood at 3.67 percent and 3.8 percent, respectively, down by 5 basis points and 26 basis points from last December.

VIII. Improving the market-based RMB exchange rate regime

The PBC continued to advance the market-based exchange rate regime 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. Meanwhile, the PBC attached importance to guiding expectations and kept the RMB exchange rate basically stable at an adaptive and equilibrium level.

In Q3, the highest and lowest CNY central parities were 6.7591 and 7.0710, respectively against the USD. During the 66 trading days, the RMB appreciated on 42 days and depreciated on 24 days. The biggest intraday appreciation and depreciation were 0.59 percent (397 bps) and 0.41 percent (277 bps), respectively. The RMB exchange rate against other major international currencies floated in two ways. At end-September, the central parities of the RMB against the dollar and the pound had appreciated 2.44 percent and 4.48 percent, respectively, from end-2019, while the RMB had depreciated 2.23 percent and 0.53 percent against the euro and the Japanese yen. From the RMB exchange rate regime reform in 2005 to end-September 2020, the RMB against the dollar, the euro, and the Japanese yen appreciated by a cumulative total of 21.53 percent, 25.27 percent, and 13.39 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 Q3 2020

Unit: RMB100 million

Currency	USD	EUR	JPY	HKD	GBP	AUD	NZD
Trading volume	149659.58	4186.93	697.75	576.87	153.82	59.43	29.84

Currency	SGD	CHF	CAD	MYR	RUB	ZAR	KRW
Trading volume	251.08	13.06	36.03	1.01	6.03	0.81	15.65
Currency	AED	SAR	HUF	PLN	DKK	SEK	NOK
Trading volume	0.33	0.30	2.86	2.84	4.64	4.07	0.03
Currency	TRY	MXN	THB	KHR	KZT	MNT	
Trading volume	0.20	0	128.15	0.04	0.01	0	

Source: China Foreign Exchange Trade System.

As of end-September, under the bilateral currency-swap agreements between the PBC and foreign monetary authorities, the latter utilized a total of RMB32.826 billion, and the former utilized an equivalent of USD447 million denominated in foreign currencies. These operations played an active role in promoting bilateral trade and investment.

Box 3 Advancing Toward a More Market-Based RMB Exchange Rate Formation Mechanism

Since 1994, the RMB exchange rate formation mechanism has undergone continuous reforms so as to be more market-based. It has gradually evolved into a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. The extent to which the exchange rate is market-based has been continuously enhanced, with the market playing a decisive role in its formation. In recent years, this type of exchange rate regime has managed to withstand the test of several rounds of shocks. Efforts will be made to stick to the market-based reform of the RMB exchange rate formation mechanism, to optimize allocation of financial resources, to enhance the flexibility of the exchange rate, and to place an emphasis on guiding expectations, in a bid to keep the RMB exchange rate basically stable at an adaptive and equilibrium level under the framework of a general equilibrium.

1. Current features of the RMB exchange rate formation mechanism

First, the PBC has exited from regular intervention, with the RMB exchange rate mainly determined by the market. During the recent two years, the PBC has greatly reduced foreign exchange interventions by enhancing the role of market forces. While giving full play to the exchange rate as a price signal, the PBC has improved the efficiency of resource allocations.

Second, the RMB exchange rate has floated in two ways. From 2019 to Q3 of 2020, the RMB appreciated on 216 days and depreciated on 211 days during the 427 trading days. Recently, the RMB has appreciated, which largely reflects China's sound economic fundamentals. As China took the lead in containing the pandemic, it became the first country to resume work and production and to return to positive economic growth. With rapid growth of exports, overseas entities have continuously increased their RMB asset holdings. Overall, the RMB exchange rate continues to move in both directions.

Third, the RMB exchange rate formation mechanism has managed to withstand the test of several rounds of shocks. It has maintained flexibility in the exchange rate and has given full play to the role of the exchange rate as an automatic stabilizer in adjusting the macro economy and the balance of payments. During the first nine months of 2020, the annual volatility rate of the RMB against the USD posted 4.25 percent, virtually the same as those of the other major international currencies. As of end-September, the central parity of the RMB against the USD appreciated 2.4 percent from the beginning of 2020, and the China Foreign Exchange Trade System (CFETS) RMB Index against a basket of currencies appreciated 3.3 percent, registering a fairly moderate appreciation. Over the same period, the euro and Japanese yen appreciated against the USD by approximately 4.5 percent and 3 percent, respectively.

Fourth, as social expectations are stable, the foreign exchange market operates in an orderly manner. In recent years, the external environment has been getting more and more complicated. However, with strengthened expectation guidance by the PBC, expectations about the foreign exchange market remain stable. The "convergence of three prices," namely, the central parity, the onshore price, and the offshore price, has been achieved, avoiding the impact of the exchange rate overshooting on the macro economy. The depth of the foreign exchange market has gradually been improved, and its capacity to withstand shocks has been notably enhanced. The settlement and sale of foreign exchange by banks are basically balanced, and market supply and demand remain stable.

Fifth, the market-based RMB exchange rate has promoted a balance between an internal and external equilibrium. As the flexibility of the RMB exchange rate increases, the autonomy of monetary policy is enhanced. The PBC has pursued a sound monetary policy based on the domestic economic situation, avoiding a conflict in goals between an internal and external equilibrium. In this context, the RMB exchange rate has undergone orderly adjustments, reasonably reflecting changes in the supply and demand of the foreign exchange market. An automatic equilibrium in the balance of payments has been achieved, helping to strike a balance between an internal and external equilibrium. During the first half of 2020, the current account ran a surplus, while the capital account saw a deficit, exhibiting a notable pattern of two-way capital flows. On the one hand, capital inflows have increased, improving the structure of domestic asset holders. On the other hand, spontaneous capital outflows have increased. The major reason is that domestic banks have voluntarily increased their holdings of overseas assets and domestic institutions have raised the proportion of their overseas assets. This is a healthy pattern.

2. Adhering to a more market-based RMB exchange rate formation mechanism

In terms of the RMB exchange rate formation mechanism reform, the market will continue to play a decisive role in the formation of the RMB exchange rate, thereby optimizing the allocation of financial resources.

First, the PBC will stick to the managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies, as this regime is currently the most appropriate institutional arrangement for an emerging economy like China. It will continue to let the market play a role in determining the exchange rate and will avoid regular intervention in the foreign exchange market. Meanwhile, China's trade and investment structure is becoming more diversified. Changes in the exchange rates of its major trade and investment partners are all likely to have an impact on its balance of payments and its internal and external equilibrium. With continuous reference to a basket of currencies, the role of the exchange rate in adjusting the macro economy and serving as a signal can be effectively enhanced.

Second, work will be done to continuously increase the flexibility of the RMB exchange rate so as to give full play to the role of the exchange rate as an automatic stabilizer in adjusting the macro economy and the balance of payments. At present, the international environment is becoming more complicated, with notable fluctuations in the international financial market. As investors are sensitive to any expectation changes, some news may trigger sharp market fluctuations. Only through enhancing flexibility of the RMB exchange rate can China withstand the impact of the external destabilizing factors and uncertainties, thereby maintaining the autonomy of its monetary policy. Meanwhile, importance must be attached to guiding expectations so as to create conditions for the orderly operation of the foreign exchange market and for the RMB exchange rate to be kept at an adaptive and equilibrium level.

Third, efforts will be made to strengthen management of the foreign exchange market. As the foreign exchange market exhibits a notable feature of heterogeneous expectations, changes in the expectations are more likely to cause a herd effect and have a substantial impact on the movements of the exchange rate. The PBC will give full play to the self-discipline mechanism of the foreign exchange market. Financial institutions are required to remain “risk neutral” and to intensify the authenticity verification of enterprises’ foreign exchange derivative transactions so as to prevent the credit risks of financial institutions brought about by enterprises conducting transactions without a real need, leveraged illegal foreign exchange trading, and speculation and arbitrage.

Fourth, work will be done to strike a balance between an internal and external equilibrium and to keep the RMB exchange rate basically stable at an adaptive and equilibrium level under the framework of a general equilibrium. The RMB exchange rate is an important link connecting the real economy with the financial sector, the domestic economy with the overseas economy, and the domestic financial market with the international financial market. It is also a key pivot for coordinating RMB and foreign exchange policies and for handling an internal and external equilibrium. As China is a super-sized emerging economy, attention must be mainly focused on domestic conditions during the formulation and implementation of monetary policy. The market-based exchange rate is conducive to enhancing the autonomy of monetary policy and to striking a balance between an internal and external equilibrium so as to keep the RMB exchange rate basically stable at an adaptive and equilibrium level under the framework of a general equilibrium.

IX. Promoting resolution of financial risks in a prudent and orderly manner and deepening the reform of financial institutions

Disposal of high-risk small and medium-sized financial institutions was successfully implemented. The PBC worked closely with other relevant departments and regional governments to mitigate the impact of the pandemic and delivered crucial progress and important results in the disposal of high-risk small and medium-sized financial institutions. The reform and restructuring plans of key financial institutions, including Baoshang Bank (BSB) and Jinzhou Bank, were carried out smoothly so as to ensure the smooth operation of the financial system during the critical and sensitive period and to firmly defend the bottom line so that no systemic risks should occur.

Risk resolution of BSB was promoted steadily and orderly. The takeover of BSB is a key campaign in the crucial battle of preventing and defusing financial risks. It is also the first case of disposal of a distressed bank through purchase and assumption (P&A) since the establishment of the deposit insurance system in 2015. At present, the relevant business, acquired by Mengshang Bank and Huishang Bank, is operating smoothly. According to the asset and capital verification results that BSB has become seriously insolvent, a bankruptcy petition will be filed for BSB, and liquidation of the equity 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 the people concerned accountable based on laws and regulations. This shows that the takeover of BSB is a decisive action and it has produced notable results, orderly eliminated the risks of BSB, successfully achieved the dual policy goals of preventing systemic risks and safeguarding financial stability, as well as preventing moral hazards and strengthening market discipline.

The reform of development and policy financial institutions was continuously deepened. The PBC fully promoted implementation of the reform plans for development and policy financial institutions to redefine their responsibilities and the scope of their business, improving corporate governance and constraint and incentive mechanisms, and preventing financial risks. The PBC guided development and policy financial institutions to fulfill their responsibilities, focus on their main business, and, with strengthened risk prevention and control, give full play to their role in supporting key areas and weak links in the national economy during the critical period so as to better serve national development strategies.

X. Deepening the reform of foreign exchange arrangements

Foreign exchange arrangements for trade in goods were further improved. First, the pilot program for facilitating foreign exchange receipts and payments under trade in goods was expanded to more areas. By end-September 2020, the pilot program covered 56 banks and 374 enterprises in 19 places across China. Second, redundant regulations on the current account were sorted out and removed. In August 2020, with the release of the *Circular of the State Administration of Foreign Exchange on Issuing Guidance for Current Account Activities (2020 Edition)* (Huifa No.11 [2020]), relevant rules and regulations were brought together in this all-in-one guidebook, while regulations and redundant provisions were significantly trimmed, including the rescinding of 29 regulations.

Innovative development of new forms of trade was boosted. First, individuals are now able to make trade settlement through personal foreign exchange savings accounts. Second, six banks including China CITIC Bank have been approved to conduct cross-border foreign exchange activities based on electronic transaction information. Third, companies engaged in cross-border e-commerce are allowed to make net settlement payments according to the netting between expenses on overseas warehouses, logistics, and taxes and proceeds from export sales. Fourth, domestic companies engaged in international delivery services, logistics providers, and cross-border e-commerce platforms can pay the charges in advance for overseas warehousing and logistics for their customers. Fifth, the settlement of funds for market procurement trade in 31 pilot markets across China was facilitated. Sixth, comprehensive foreign trade service providers were encouraged to collect foreign exchange receipts on behalf of their clients, which benefited over 300 providers and nearly 100,000 foreign trade MSBs. Seventh, companies can submit summary declarations of small-value foreign-related receipts and payments in their own names so as to help MSBs accumulate good credit and lower trade costs.

The promotion of personal foreign exchange business was more regulated and innovative. First, facilitation of foreign exchange sales of compensation was enhanced for overseas employees of Chinese companies. As of end-September 2020, there was a total of 12,000 simplified transactions, covering USD139 million. Second, off-counter processing of foreign exchange sales and purchases for overseas studies was introduced in some commercial banks, which are not part of the annual quota for foreign exchange purchases by individuals. As of end-September, there were 1,189 relevant transactions or the equivalent of USD26.12 million. Third, the pilot program for facilitating foreign exchange sales and purchases of the compensation for foreign professionals in China was approved in five places including Beijing and Chongqing. Fourth, the plan of some banks to facilitate small-value consumption under the current account by foreign individuals in China was approved.

Order in the foreign exchange market was maintained. Monitoring and analysis of potential risks incurred by cross-border fund 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, so as to ensure stability on six fronts and maintain security in six areas.

Part 3. Financial Market Conditions

In Q3 2020, the financial market operated generally smoothly. Money market transactions were active with stable interest rates. Amid the steady recovery of the economy, the coupon rates of all types of bonds rebounded and the volume of cash bond issuances and transactions expanded remarkably. The stock market continued to pick up and it witnessed year-on-year rises in both turnover and the size of funds raised.

I. Financial market overview

1. Money market transactions were active, with stable interest rates

Money market interest rates went up in July and August, followed by a fall in September. In September 2020, the monthly weighted average interest rate for interbank lending and pledged repos posted 1.8 percent and 1.93 percent, respectively, down 5 basis points and up 4 basis points, respectively, from June 2020. The monthly weighted average interest rate of government-backed bond repos among depository institutions posted 1.73 percent, 20 basis points lower than the monthly weighted average interest rate of pledged repos. At end-September, the overnight and 7-day Shibor posted 2.36 percent and 2.33 percent, respectively, up 58 and 10 basis points from end-June, respectively.

The market saw active repo transactions and interbank lending. In the first three quarters of 2020, the volume of trading of bond repos on the interbank market reached RMB733.3 trillion, representing an average daily turnover of RMB3.9 trillion and a year-on-year increase of 19.4 percent. The volume of cumulative trading of interbank lending registered RMB116.4 trillion, with an average daily turnover of RMB619.1 billion and a year-on-year decrease of 2.7 percent. In terms of the maturity structure, overnight repos and overnight lending accounted for 84.8 percent and 90.5 percent, respectively, of the total turnover in bond repos and interbank lending, decreasing 0.4 percentage points and 1.2 percentage points year on year. The volume of bond repos traded on the exchange markets increased 15.1 percent year on year to RMB206.9 trillion.

Table 9 Fund Flows among Financial Institutions, Q1–Q3 2020

Unit: RMB100 million

	Repos		Interbank lending	
	Q1–Q3 2020	Q1–Q3 2019	Q1–Q3 2020	Q1–Q3 2019
Chinese-funded large banks①	–2,088,769	–1,459,948	–319,064	–219,620
Chinese-funded medium-sized banks②	-654,137	-557,039	-45,958	-106,491
Chinese-funded small-sized banks③	-1,119	138,117	94,169	82,008
Securities institutions④	820,183	633,339	205,936	195,045
Insurance institutions⑤	90,597	61,983	650	189
Foreign-funded banks	58,785	70,940	-18,575	-17,989
Other financial institutions	1,774,460	1,112,608	82,841	66,859

and vehicles⑥				

Notes： ① Chinese-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. ② Chinese-funded medium-sized banks refer to policy banks, China Merchants Bank and the eight other joint-equity commercial banks, Bank of Beijing, Bank of Shanghai, and Bank of Jiangsu. ③ Chinese-funded small-sized banks refer to Hengfeng Bank, China Zheshang Bank, China Bohai Bank, other city commercial banks, rural commercial banks, rural cooperative banks, private banks, and village and township banks. ④Securities institutions include securities firms, fund management companies, and futures companies. ⑤ Insurance 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 operated steadily. In Q3 2020, a total of 7,147 interbank CDs were issued on the interbank market, raising RMB5.4 trillion. The volume of trading on the secondary market totaled RMB44.3 trillion. At end-September, outstanding interbank CDs reached RMB11.2 trillion. In Q3 2020, the average weighted interest rate of 3-month interbank CDs was 2.61 percent, 8 basis points higher than that of the 3-month Shibor. A total of 10,407 negotiable CDs was issued by financial institutions in Q3 2020, raising RMB2.0 trillion, with a decrease of RMB625.3 billion year on year.

The interest rate swap market witnessed orderly development. In Q3 2020, the RMB interest rate swap market witnessed 72,300 transactions, increasing 14.94 percent year on year, with the volume of the notional principal totaling RMB4.66 trillion, a decrease of 7.36 percent year on year. In terms of the maturity structure, contracts with maturities of up to one year traded most briskly and the volume of the notional principal posted RMB2.83 trillion, accounting for 60.8 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 83.09 percent and 14.29 percent, respectively, of the total notional principal of the interest rate swaps. In Q3 2020, interest rate swaps anchored to the LPR witnessed 380 transactions, with RMB56.663 billion of the notional principal.

Table 10 Transactions of Interest Rate Swaps in Q3 2020

	Transactions	Notional principal (RMB100 million)
Q3 2020	72,310	46,568.5
Q3 2019	62,876	50,304.7

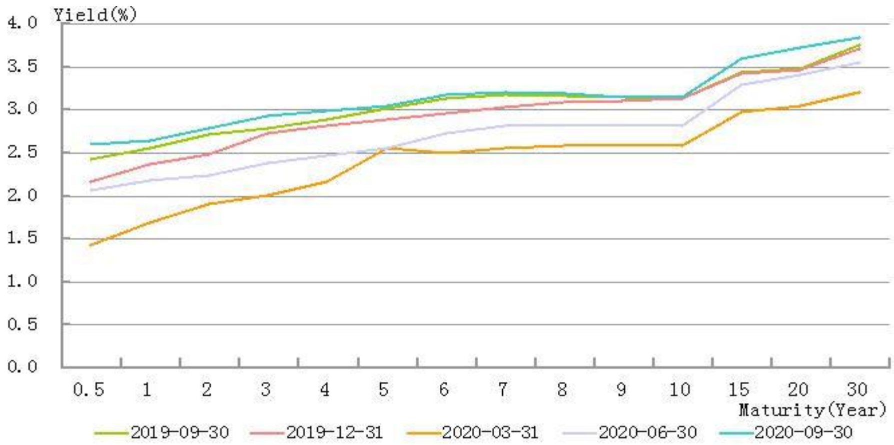
Source: China Foreign Exchange Trade System.

The LPR interest rate option business developed steadily. Since the LPR interest rate option business made its debut on the interbank market in March, it has attracted participation by a variety 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. In Q3 2020, a total of 154 interest rate option transactions were concluded, totaling RMB36.65 billion. Specifically, 6 LPR interest rate swap transactions were concluded, amounting to RMB620 million of the notional principal, and 148 were LPR interest rate cap/floor transactions, amounting to RMB36.03 billion of the notional principal.

2. The coupon rate of bonds rebounded, and transactions and issuances of cash bonds expanded

Government bond yields generally experienced a choppy rise. In Q3, due to the continuous improvement of economic fundamentals, the easing of risk aversion on the market, and the impact of the stock-bond seesaw effect, at end-September the yields of 1-year and 10-year government bonds posted 2.65 percent and 3.15 percent, respectively, increasing by 47 basis points and 33 basis points, respectively, from end-June. The yield curve went upward in a flattening trend.

Figure 5 Yield Curves of Government Securities on the Interbank Market



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

The coupon rates of bonds rallied. The coupon rate of 10-year government bonds rolled over in September 2020 was 3.08 percent, 23 basis points higher than the rate in June 2020. The coupon rate of 10-year financial bonds issued by China Development Bank was 3.64 percent, 56 basis points higher than the rate in June 2020. The average rate of 1-year short-term financing bills (bond rating A-1) issued by AAA-rated non-financial enterprises was 3.71 percent, 135 basis points higher than the rate in June 2020.

The volume of cash bond transactions on the interbank market saw year-on-year growth and that on the stock exchanges witnessed a significant increase. In the first three quarters of 2020, the value of cash bonds trading on the bond market posted RMB205.66 trillion, registering an increase of 29.03 percent year on year. Specifically, the value of cash bond trading on the interbank market was RMB192.07 trillion, representing an average daily turnover of RMB1.02 trillion and an increase of 25.4 percent year on year. The value of cash bond transactions on the stock exchanges totaled RMB13.59 trillion, with an increase of 119.3 percent year on year. The value of bond lending transactions stood at RMB5.66 trillion, with an increase of 74.2 percent year on year.

Bond issuances saw year-on-year growth. In the first three quarters of 2020, the cumulative value of bond issuances totaled RMB42.44 trillion, with an increase of 25.2 percent year on year. At end-September, outstanding bonds held in custody amounted to RMB113.76 trillion, with an increase of 18.6 percent year on year. In the first three quarters of 2020, the cumulative value of corporate debenture bonds registered RMB10.71 trillion, increasing 38.9 percent year on year.

Table 11 Bond Issuances, Q1–Q3 2020

Unit: RMB100 million

Type of bond	Issuances	YOY change
Government securities	47,869	18,081
Local government bonds	56,789	14,967
Central bank bills	0	0
Financial bonds①	212,108	21,757
Of which: Financial bonds issued by China Development Bank and policy financial bonds	43,783	14,873
Interbank certificates of deposit	132,666	3,160
Corporate debenture bonds②	107,139	30,013
Of which: Debt-financing instruments of non-financial enterprises	71,099	20,848
Enterprise bonds	4,150	544
Corporate bonds	23,293	6,512
Bonds issued by international institutions	505	175
Total	424,410	84,993

Notes: ①Including 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 the Shanghai Stock Exchange and the 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 edged up, and interest rates on the bill market remained relatively stable

The bill acceptance business developed steadily. From January to September 2020, commercial drafts issued by enterprises totaled RMB16.5 trillion, rising 10.1 percent year on year. At end-September, outstanding commercial drafts stood at RMB13.9 trillion, increasing 11.9 percent year on year. Outstanding commercial draft acceptances dropped slightly, an increase by RMB1.2 trillion from the beginning of the year and a decrease by RMB278.5 billion from end-June; 70.3 percent of the outstanding bankers' acceptances were issued by MSMEs.

Bill financing continued to expand, with interest rates moving upward. From January to September 2020, total discounts by financial institutions amounted to RMB30.6 trillion, growing 13.5 percent year on year. At end-September, the balance of bill financing was RMB8.1 trillion, up 7.3 percent year on year. The balance accounted for 4.8 percent of the total outstanding loans, 0.3 percentage points lower year on year. In Q3 2020, interest rates on the bill market moved upward.

4. The stock market continued to grow after a rebound, with turnover and the amount of funds raised increasing year on year

The stock indices continued to climb after a rebound. At end-September, the Shanghai Stock Exchange Composite Index closed at 3,218 points, increasing 7.8 percent from end-June. The Shenzhen Stock Exchange Component Index closed at 12,907 points, increasing 7.6 percent from end-June. Turnover on the stock markets expanded significantly. In the first three quarters of 2020, the combined turnover of the Shanghai Stock Exchange and the Shenzhen Stock Exchange reached RMB158.4 trillion and the average daily turnover was RMB865.8 billion, with an increase of 58.6 percent year on year. The amount of funds raised on the stock markets surged year on year. In the first three quarters of 2020, a cumulative RMB803.8 billion was raised, increasing 63.6 percent year on year.

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

In the first three quarters of 2020, total premium income in the insurance sector amounted to RMB3.7 trillion, with a year-on-year increase of 7.2 percent, 5 percentage points lower than the annual growth rate in 2019. Claim and benefit payments totaled RMB998.9 billion, with a year-on-year increase of 6.1 percent. Specifically, total property insurance claim and benefit payments increased 7.7 percent year on year, and total life insurance claim and benefit payments went up by

4.7 percent year on year.

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

Unit: RMB100 million, %

	Balance		As a share of total assets	
	End-September 2020	End-September 2019	End-September 2020	End-September 2019
Total assets	224,386	199,601	100.0	100.0
Of which: Bank deposits	25,796	25,213	11.5	12.6
Investments	181,266	152,558	80.8	76.4

Source: China Banking and Insurance Regulatory Commission.

The growth of assets in the insurance sector accelerated. At end-September, total assets in the insurance sector increased 12.4 percent year on year to RMB22.4 trillion, an acceleration of 0.2 percentage points from end-2019. Specifically, bank deposits increased 2.3 percent year on year and investment-linked assets expanded 18.8 percent year on year.

6. Foreign exchange transactions fell year on year

In the first three quarters of 2020, the cumulative turnover of spot RMB/foreign exchange transactions registered USD5.7 trillion, a decrease of 5.3 percent year on year. The cumulative turnover of RMB/foreign exchange swap transactions totaled USD12.1 trillion, a decrease of 6 percent year on year. Specifically, cumulative overnight RMB/USD swap transactions posted USD6.9 trillion, accounting for 57.3 percent of the total swap turnover. Turnover of RMB/foreign exchange forward transactions totaled USD75.4 billion, rising 26.6 percent year on year. Turnover in foreign currency pair transactions totaled USD514.9 billion, rising 51.2 percent year on year. In particular, the EUR/USD pair registered the largest trading volume, accounting for 61.2 percent of the total market share.

Participants on the foreign exchange market expanded continuously. At end-September, there were 726 members on the foreign exchange spot market, 258 members on the foreign exchange forward market, 252 members on the foreign exchange swap market, 208 members on the currency swap market, and 159 members on the foreign exchange options market. There were 30 market makers on the spot market and 27 market makers on the forward and swap markets.

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

Gold prices increased before declining. At end-September, international gold prices closed at USD1,886.90 per ounce, representing a gain of 6.72 percent from end-June. The Au99.99 on the Shanghai Gold Exchange closed at RMB402.97 per gram, increasing 1.31 percent from end-June. In the first three quarters of 2020, the volume of gold traded on the Shanghai Gold Exchange was 49,500 tons, representing a decrease of 9.87 percent year on year. The turnover posted RMB18.94 trillion, increasing 12 percent year on year.

II. Development of institutional arrangements in the financial markets

1. Institutional arrangements in the bond market

With the implementation of the *Guiding Opinions of the PBC, CBIRC, CSRC, and SAFE on Regulating the Asset Management Business of Financial Institutions,* the institutional arrangements in the bond market were constantly improved. In July 2020, the PBC, CBIRC, CSRC, and SAFE jointly released the *Rules for Recognition of Standard Debt-Based Assets* (Announcement No. 5 [2020] of the PBC, CBIRC, CSRC and SAFE), which specified the boundaries, identification criteria, and regulatory arrangements for standard debt-based assets and non-standard debt-based assets so as to guide well-regulated market development.

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

The system for securities investor protection was further enhanced. In July 2020, the Supreme People's Court released the *Provisions on Several Issues Concerning Representative Actions Arising from Securities Disputes.* The *Provisions* make detailed stipulations on the representative action rules in the *Civil Procedure Law* and the *Securities Law* and clarify the standardized legal proceedings for both ordinary representative actions and special representative actions. Release of the said judicial interpretation marked the official introduction of the securities class action system.

Risk disposal mechanisms of securities institutions were further improved. In July 2020, the CBIRC released the *Guidelines for the Side Pocket Mechanism of Publicly Offered Securities Investment Funds (for Trial Implementation)*, which added a side pocket mechanism[1] as a liquidity risk management tool for publicly-offered funds. Also stipulated in the *Guidelines* were the triggering conditions and the implementing procedures for the side pocket mechanism as well as the primary responsibilities of fund managers and the supervisory duties of custodians.

3. Institutional arrangements in the insurance market

Regulation of the allocation of equity assets of insurance companies was improved. In July 2020, the CSRC released the *Notice on Matters Concerning Improving the Regulation of the Allocation of Equity Assets of Insurance Companies*, which set differentiated regulatory proportions for equity asset investments, thus guiding insurance companies to conduct investments in a prudent and sound manner.

The property insurance industry was propelled to shift toward high-quality development. In July 2020, the CBIRC released the *Notice on Issuing the Three-Year Action Plan (2020–2022) of Promoting High-Quality Development of the Property Insurance Industry*, which put forward elaborate planning for the property insurance market during the following three years, including such aspects as the transformation and development of the industry, the capability to serve the national economy, society, and the people's livelihood, the level of opening-up and international influence, as well as regulatory policies, systems, and mechanisms.

Regulation was strengthened for the development of insurance asset management product businesses. In September 2020, the CBIRC released a series of supporting

[1] A side pocket mechanism refers to the liquidity risk management tool that, when all legal conditions are met, separates hard-to-value risky assets from other fund portfolio assets, and then disposes or liquidates them for the purpose of ensuring the normal functioning of the rest of the fund assets.

provisions of the *Interim Measures for the Administration of Insurance Asset Management Products*, which specify time limits for product registration and extend the scope of investment assets.

Regulation of the investment management capabilities of insurance institutions was improved. In September 2020, the CBIRC released the *Notice on Issues Concerning Improving the Regulation of the Investment Management Capabilities of Insurance Institutions* and designed in detail the concrete standards for insurance institutions to build various investment management capabilities.

4. Enhancing coordinated supervision of the financial infrastructure

In July 2020, the PBC and CSRC jointly released *Announcement No. 7 [2020] of PBC and CSRC* and approved interconnectivity cooperation between the relevant infrastructure institutions in the interbank bond market and the exchange bond market. The PBC and CSRC will strengthen regulatory cooperation and coordination to boost the free flow of factors in the bond market.

5. Promoting the opening-up of the bond market

In September 2020, the PBC, CSRC and SAFE jointly drafted the *Announcement on Issues Concerning Investment in China's Bond Market by Overseas Institutional Investors (Exposure Draft)*, which clarifies the overall institutional arrangements for the opening-up of China's bond market and solicits market opinions on the arrangements facilitating overseas institutional investors to allocate RMB bond assets.

In September 2020, FTSE Russell announced that it would add Chinese government bonds to its World Government Bond Index (WGBI) in October 2021. So far, all of the three global major bond index providers have or are planning to include China's bonds in their relevant indexes, which fully reflects international investors' confidence in the long-term sound development of China's economy and the continuous opening-up of China's financial sector.

Part 4. Macroeconomic Overview

I. Global economic and financial developments

1. Economic and financial market performance in the major economies

Overall, the global economy continued to recover, with the economic indicators improving marginally in some economies, but uncertainties remained for the future given the recent resurgence of COVID-19. In October the International Monetary Fund (IMF) revised its global growth forecast to –4.4 percent for 2020 and 5.2 percent for 2021, up 0.8 percentage points and down 0.2 percentage points from its June forecast, respectively. In Q3, the annualized quarter-on-quarter real GDP growth rate bounced back to 33.1 percent in the US, while the year-on-year real GDP growth in the euro area and the U.K. posted –4.4 percent and –9.6 percent, with the drop declining by 10.4 and 11.9 percentage points, respectively. The emerging market economies also showed signs of recovery. The Purchasing Managers' Index (PMI) rose in the major economies, with the manufacturing PMI in the US and the euro area both rebounding to above 50. Meanwhile, as global COVID-19 cases have recently resurged and the effectiveness of a vaccine still remains to be seen, we cannot ignore the risk of a new wave of the pandemic and its impact on the stability and development of the global economy in the future.

Improvements in the labor market slowed, as more and more temporary unemployment is likely to become permanent. From April to September, the US unemployment rate dropped from 14.7 percent to 7.9 percent, but research shows that, although the temporary unemployment rate declined from 11.5 percent to 2.9 percent, the permanent unemployment rate rose from 3.2 percent to 5 percent. In the meantime, the unemployment rate rose from 7.4 percent to 8.3 percent in the euro area, from 2.6 percent to 3.0 percent in Japan, and from 4.0 percent to 4.8 percent in the U.K.

A differentiation in the impact of the pandemic led to a divergence in price movements. The major developed economies continued to experience low inflation, and even deflation. In September, the year-on-year growth rate of the CPI posted 1.4, 0.5, 0 percent for the US, U.K., and Japan, respectively, while the year-on-year growth rate of the HICP in the euro area was reported to be –0.3 percent. Most emerging economies still have a positive inflation, while some countries' inflation continues to run high.

The global stock market continued to bounce back, but volatility also became larger. In the US, the Nasdaq and the S&P 500 recovered to their pre-pandemic level in early June and late August, respectively, with the Nasdaq hitting a current-year high in September. Major stock indexes in Germany, Japan, and the U.K. all rebounded significantly from the market low in March. Emerging market stocks have improved considerably, but most countries still have not recovered to their pre-pandemic level.

Table 13 Macroeconomic and Financial Indicators in the Major Advanced Economies

Economy	Indicator	Q3 2019			Q4 2019			Q1 2020			Q2 2020			Q3 2020		
		Jul.	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.
United States	Real GDP Growth (annualized quarterly rate, %)	2.6			2.4			-5.0			-31.4			33.1		
	Unemployment Rate (%)	3.7	3.7	3.5	3.6	3.5	3.5	3.6	3.5	4.4	14.7	13.3	11.1	10.2	8.4	7.9
	CPI (year-on-year, %)	1.8	1.7	1.7	1.8	2.1	2.3	2.5	2.3	1.5	0.3	0.1	0.6	1.0	1.3	1.4
	DJ Industrial Average (end of the period)	26864	26403	26917	27046	28051	28538	28256	25409	21917	24346	25383	25813	26428	28430	27782
Euro Area	Real GDP Growth (year-on-year, %)	1.4			1			-3.3			-14.8			-4.4		
	Unemployment Rate (%)	7.5	7.5	7.5	7.4	7.4	7.4	7.4	7.3	7.2	7.4	7.6	7.9	8.1	8.3	8.3
	HICP (year-on-year, %)	1.0	1.0	0.8	0.7	1.0	1.3	1.4	1.2	0.7	0.3	0.1	0.3	0.4	-0.2	-0.3
	EURO STOXX 50 (end of the period)	3467	3427	3569	3604	3704	3745	3641	3329	2787	2928	3050	3234	3274	3273	3294
United Kingdom	Real GDP growth (year-on year, %)	1.0			1.0			-2.1			-21.5			-9.6		
	Unemployment Rate (%)	3.8	3.9	3.8	3.8	3.8	3.8	3.9	4.0	4.0	4.0	4.1	4.1	4.3	4.5	4.8
	CPI (year-on-year, %)	2.1	1.7	1.7	1.5	1.5	1.3	1.8	1.7	1.5	0.8	0.5	0.6	1.0	0.2	0.5
	FTSE 100 (end of the period)	7587	7207	7408	7248	7347	7542	7286	6581	5672	5901	6077	6170	5898	5964	5866

Japan	Real GDP Growth (annualized quarterly rate, %)	0.2			-7.1			-2.3			-28.8			21.4		
	Unemployment Rate (%)	2.3	2.3	2.4	2.4	2.2	2.2	2.4	2.4	2.5	2.6	2.9	2.8	2.9	3.0	3.0
	CPI (year-on-year, %)	0.5	0.3	0.2	0.2	0.5	0.8	0.7	0.4	0.4	0.1	0.1	0.1	0.3	0.2	0
	NIKKEI 225 (end of the period)	21522	20704	21756	22927	23294	23657	23205	21143	18917	20194	21878	22288	21710	23140	23185

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

2. Monetary policies of the major economies

The central banks in the major economies maintained the intensity of their accommodative monetary policies. In Q3, the US Fed, the European Central Bank (ECB), the Bank of England (BOE), and the Bank of Japan (BOJ) kept their ultra-low interest rates and the size of their asset purchases remained unchanged, while the size of their balance sheets remained at a high level. The US Fed and the BOE continued to revise their pandemic emergency liquidity facilities, including loosening the application requirements, expanding the terms, and enhancing the coverage and strength of the facilities.

Trapped by the “low growth, low inflation, and low interest rate” deadlock, the central banks in the developed economies conducted assessments of their monetary policy framework in succession. After completing its new assessment, the US Fed declared it would revise its monetary policy framework in August, aiming to achieve an inflation rate that averages 2 percent, and it stated that the response of its monetary policy to real employment would depend on the shortfalls, instead of the deviations, from the maximum employment level, and employment judgments would be made based on multiple dimensions. In addition, the ECB and the Bank of Canada began their assessments of the monetary policy framework in January and August, respectively, which are expected to be completed in 2021.

The central banks in the emerging market economies continued their rate cuts. In Q3, the Mexican central bank reduced its benchmark interest rates twice by a total of 75 bps. The central banks in Brazil, Russia, South Africa, Malaysia, and Indonesia cut their rates by 25 bps.

3. Issues and trends that merit attention

First, the duration of the global pandemic may exceed expectations. Recently, the newly confirmed cases climbed sharply across the globe. With a rebound in the US and Europe, and the expansion accelerating in some of the developing economies, the global pandemic might continue for a rather long time and might impact the global economic recovery.

Second, the risks of fiscal sustainability are worth noting. In 2020, the US fiscal deficit budget hit a record high of USD3.1 trillion, more than twice that in 2009. According to the IMF, by September the global fiscal measures responding to the pandemic were about 12 percent of global GDP, and the global public debt ratio will approach 100 percent in 2020 and might continue to rise. The IMF called on governments to improve the efficiency of their fiscal expenditures and to solve the problems of huge fiscal deficits and public debts while promoting an economic recovery.

Third, hidden financial risks are rising. The performance of financial markets has deviated from the economic fundamentals. Despite the fragilities in the recovery of the real economy and the shaky outlook for company earnings, the global stock market enjoyed a strong rebound, hence the risk of a reversal in the future. Non-banking financial institutions have prominent fragilities, with a noticeable liquidity mismatch. Once the financial markets experience dramatic fluctuations, they may face huge pressures to sell and such pressures may spread to the banking system.

Box 4 China's Macro Policy Vigorously Supported its Economic Recovery

In 2020, a series of monetary and fiscal policies were adopted throughout the world to cushion the impact of the COVID-19 pandemic, and they have played a positive role in global economic stability and recovery. To effectively support pandemic containment and to promote economic and social development, China adopted various monetary and fiscal policy measures. Overall, China's macro policies have maintained an appropriate intensity, which provide vigorous support for shoring up the real economy, effectively filling the supply gap of medical essentials and daily necessities for global pandemic containment and other industrial products due to the impact of COVID-19, and making an important contribution to the economic recovery both at home and abroad. In responding to the pandemic and supporting the economic recovery, the debt scale and the leverage ratio will inevitably go up in stages, after which the gradual recovery of the economy will make possible a reasonable macro leverage ratio for the long term.

After the outbreak of COVID-19, the PBC decisively launched RMB9 trillion of monetary policy response measures, which mainly include guiding the MLF rates and the OMO rates to move downward, releasing the dividends of a market-based interest rate system through the LPR reform, freeing up RMB1.75 trillion of long-term funds with three reductions of the RRR, providing RMB1.8 trillion of central bank lending and central bank discounts, and launching two monetary policy tools that directly support the real economy to bolster RMB4.7 trillion for the financing of micro and small businesses (MSBs). By adopting policies such as lowering interest rates, reducing fees, and deferring principal and interest repayments, the financial system has cut RMB1.25 trillion of its profits in favor of the real economy, expecting to realize the goal of RMB1.5 trillion for the entire year. Liquidity has been maintained at an adequate and reasonable level with implementation of the monetary policy. It is expected that RMB loans will increase by approximately RMB20 trillion and the AFRE will increase by over RMB30 trillion in 2020. Broad money and the AFRE outgrew those of 2019, representing the strong support of the financial sector to the real economy.

Fiscal policy continued to take effect, which alleviated the impact of the pandemic on the real economy. The fiscal deficit in 2020 went up by RMB1 trillion over the previous year, RMB1 trillion of special government bonds for pandemic containment were issued, and RMB3.75 trillion of special local government bonds were also issued, with a year-on-year increase of RMB1.6 trillion. Albeit on a large base of fiscal policy in 2019, RMB3.6 trillion of additional fiscal support was provided through the above three measures. In addition, efforts were made to provide endogenous momentum for the overall recovery of the economy and society through tax cuts and fee reductions, increased expenditures in key areas, as well as enhanced guarantees and support for major projects.

In terms of the domestic situation, the intensity of China’s macro policy responses has been appropriate. Measures have been taken precisely to deliver solid outcomes, and all the announced policies have been implemented promptly and thoroughly, yielding remarkable results. First, the pandemic has been brought under control, which is the basic premise for an economic recovery. China took the lead in containment of the pandemic among the major economies, cutting the daily increase in domestic coronavirus cases to single digits within about two months. The adoption of appropriate and reasonable macro policy measures is expected to vigorously bolster the economic recovery. In contrast, if the pandemic had not been effectively contained, an even stronger macro policy would not have fundamentally cushioned its devastating impact on the economy. Second, in accordance with the pace of the pandemic containment efforts, macro policy measures have been rolled out gradually at different levels based on the characteristics of pandemic containment and recovery of the economy and society at different stages. The macro policy took different focuses in the various stages of pandemic containment, which secured the provision of medical supplies and daily necessities, fostered the resumption of work and production, and speedily restored normal production and life. Third, as for policy implementation, China's macro policies have been targeted precisely instead of indiscriminately injecting large amounts of liquidity. The PBC launched two monetary policy instruments that provide direct support for the real economy, i.e., an instrument supporting deferred repayments of inclusive MSB loans, and a support scheme for unsecured inclusive MSB loans. The fiscal sector set up a new transfer payment mechanism to ensure that funds go straight to prefecture- and county-level governments, and it issued special government bonds for COVID-19 control to support pandemic containment and local infrastructure construction. Fourth, from the perspective of policy effects, China's economic and social development has been restored in a comprehensive manner. China's GDP dropped by 6.8 percent in Q1, but grew by 3.2 percent and 4.9 percent in Q2 and Q3, respectively. China's economy resumed positive growth during the first three quarters, with economic indicators, including consumption, investment, export, etc., picking up.

From a global perspective, China's macro policy responses have also maintained an appropriate intensity, which support a swift recovery of the economy and make an important contribution to the world economy. First, they have forestalled further contraction of the world economy. According to the IMF forecast, the world economy has been witnessing the worst recession since World War II, and it is expected to contract by 4.4 percent in 2020. China is the only one among the major economies to maintain a positive growth rate. It would not be possible to realize positive growth for the world economy in 2020 and 2021 as a whole without the positive growth of the Chinese economy. Second, China's economic growth will have positive spillover effects in the world, especially in fostering an economic recovery of its neighboring countries and its major trade partners. Third, amid the impact of the pandemic, China, to some extent, has played the role of global supplier of the last resort, and it has established a foundation for pandemic containment as well as for an economic recovery throughout the world. China's rapid resumption of production has filled the global supply gap of medical essentials and daily necessities for battling COVID-19 and other industrial production that has been impacted by the pandemic. It has provided massive essential supplies and intermediate goods necessary for a resumption of production to the world, and it has made a critical contribution to global pandemic containment and restoration of global industrial chains.

II. Macroeconomic developments in China

In the first three quarters of 2020, facing the severe shocks from COVID-19 and the complex situations at home and abroad, departments in all regions coordinated regular containment of the pandemic and economic and social development in a scientific way and vigorously and effectively promoted a resumption of production and order. As a result, the national economy continued to recover steadily. According to preliminary statistics, GDP in the first three quarters grew by 0.7 percent year on year on a comparable basis to RMB72.3 trillion, the growth of which turned positive. Specifically, GDP in Q3 grew by 4.9 percent year on year. In the first three quarters, CPI rose by 3.3 percent year on year.

1. Consumption gradually improved, and the growth of investments and foreign trade turned positive

The growth of residents' income in real terms turned positive and there was a gradually improving willingness to consume gradually. In the first three quarters, per capita disposable income registered RMB23,781, up 3.9 percent year on year in nominal terms. It grew by 0.6 percent in real terms year on year, registering positive growth for the first time in 2020. Residents' income from wages and salaries remained stable, and growth of the per capita income of rural residents outpaced that of urban residents. According to the Urban Depositors' Survey conducted by the PBC in Q3, 23.5 percent of residents were inclined to "consume more," up 0.2 percentage points from the previous quarter. In the first three quarters, total retail sales of consumer goods registered RMB27.3 trillion, down 7.2 percent year on year and a deceleration of 4.2 percentage points from H1 of 2020. In particular, growth in Q3 grew by 0.9 percent, registering positive quarterly growth for the first time in 2020. Sales of upgraded consumer goods and online retail sales continued to grow rapidly.

The growth of fixed-asset investments turned positive, and investments in the high-tech industry and social areas continued to rebound. In the first three quarters, total fixed-asset investments (excluding those by rural households) increased by 0.8 percent year on year to RMB43.7 trillion, registering positive growth for the first time in 2020. Current investments have exhibited the following characteristics. First, investments in the manufacturing sector and the infrastructure rebounded remarkably. The growth of investments in infrastructure turned positive for the first time in 2020, registering 0.2 percent in the first three quarters. In the first three quarters, investments in the manufacturing sector declined by 6.5 percent, a deceleration of 5.2 percentage points from H1, while private investments decreased by 1.5 percent to RMB24.4 trillion, a deceleration of 5.8 percentage points from H1. Second, the growth of investments in the high-tech industry accelerated. In the first three quarters, investments in the high-tech industry grew by 9.1 percent, an acceleration of 2.8 percentage points from H1. Third, investments in social areas rebounded. In the first three quarters, investments in social areas increased by 9.2 percent, an acceleration of 3.9 percentage points from H1. Specifically, investments in the areas of health care and education grew by 20.3 percent and 12.7 percent, respectively.

Imports and exports outperformed expectations, and the trade structure continued to improve. In the first three quarters, imports and exports grew by 0.7 percent year on year, an acceleration of 3.9 percentage points from H1. Specifically, imports and exports in Q3 grew by 7.5 percent year on year. In the first three quarters, the growth of exports registered 1.8 percent, 4.8 percentage points higher than that in H1, while imports decreased by 0.6 percent, a deceleration of 2.7 percentage points from H1. As a result, there was a trade surplus of RMB2.3 trillion. The trade structure continued to improve, and the share of imports and exports under general trade and in the private sector increased. In terms of the commodities structure, the share of exports of machinery and electronics in total exports increased somewhat, and exports of medical equipment and supplies related to pandemic containment grew rapidly. In terms of trade partners, ASEAN became China's largest trade partner. In the first three quarters, China's trading volume with ASEAN grew by 7.7 percent to RMB3.38 trillion, accounting for 14.6 percent of the total volume of China's foreign trade, up 0.9 percentage points from the same period of 2019.

The concentration of foreign direct investment (FDI) in the high-tech industry accelerated. In the first three quarters, actually utilized FDI increased by 5.2 percent year on year to RMB718.81 billion, the growth of which turned positive. Specifically, the growth of actually utilized FDI in Q3 posted 20.4 percent, far outpacing the –10.8 percent in Q1 and the 8.4 percent in Q2. In terms of the industrial distribution, the concentration of FDI in the high-tech industry accelerated. In the first three quarters, actually utilized foreign investment in the high-tech service industry grew by 26.4 percent year on year.

In the first three quarters, non-financial outward direct investments by domestic investors edged down by 0.6 percent year on year to RMB551.51 billion, registering a slight deceleration. Specifically, non-financial outward direct investments in the countries along the Belt and Road reached USD13.02 billion, up 29.7 percent year on year. In particular, outward investments in the leasing/commercial services industry and the wholesale/retail industry witnessed year-on-year growth of 18.6 percent and 41.1 percent, respectively.

2. Agricultural production was fairly satisfactory, industrial production accelerated, and the service industry recovered steadily

The share of tertiary industry in total industry continued to increase. In the first three quarters, the primary, secondary, and tertiary industries grew by 2.3 percent, 0.9 percent, and 0.4 percent year on year, respectively, accounting for 6.7 percent, 37.9 percent, and 55.4 percent of GDP. The share of the tertiary industry in total industry surpassed that of the secondary industry by 17.5 percentage points, up 1.2 percentage points from the same period of 2019.

Agricultural production was fairly satisfactory. In the first three quarters, the value-added of agriculture grew by 3.8 percent year on year, which was on par with that in H1. Specifically, the value-added of agriculture in Q3 grew by 3.9 percent. As the sowing areas of autumn crops increased amidst stability and the major autumn crops on the whole grew well, it was expected that there would be another bumper autumn crop harvest . Hog production capacity gradually rebounded. At end-Q3, hogs in stock grew by 20.7 percent year on year to total 370.39 million.

Industrial production accelerated. The value-added of Industrial Enterprises above a Designated Size (IEDS) in the first three quarters increased by 1.2 percent year on year, while that in H1 decreased by 1.3 percent. Specifically, IEDS grew by 5.8

percent in Q3, accelerating by 1.4 percentage points from Q2. According to a survey of 5,000 entrepreneurs, conducted in Q3 by the PBC, the Business Climate Index and the Profitability Index posted 49.4 percent and 57.0 percent, respectively, up 6.6 percentage points and 7.3 percentage points from Q2.

The service industry recovered steadily, and the modern service industry showed sound growth momentum. In Q3, the value-added of the service industry grew by 4.3 percent year on year, accelerating by 2.4 percentage points from Q2. In the first three quarters, the Index of Service Production (ISP) fell by 2.6 percent year on year, decelerating by 3.5 percentage points from H1. In September, the Commercial Activities Indexes for transportation, telecommunications/Internet software, and the accommodations/catering industries remained above 60 percent. The Expected Business Activities Index for the service industry reached 62.2 percent, up 0.9 percentage points from that in August, demonstrating the stronger confidence of enterprises in the development of the market.

3. The growth of consumer prices decelerated slightly, and the decline in producer prices narrowed

The growth of consumer prices decelerated slightly. In Q3, the CPI rose by 2.3 percent year on year, witnessing a deceleration of 0.4 percentage points from the previous quarter. Specifically, CPI growth registered 2.7 percent, 2.4 percent, and 1.7 percent in July, August, and September, respectively. Due to factors such as the stabilization of pork prices and the base figure effect, the growth of food prices decelerated by 1.4 percentage points from Q2, registering year-on-year growth of 10.8 percent in Q3. The growth of non-food prices decelerated slightly, with the prices of consumer goods and services both decelerating.

The decline in producer prices decelerated. In Q3, the Producer Price Index (PPI) dropped by 2.2 percent year on year, decelerating by 1.1 percentage points compared with Q2. Specifically, the year-on-year decline of producer prices in July, August, and September dropped by 2.4 percent, 2.0 percent, and 2.1 percent, respectively. The Purchasing Price Index for Industrial Products (PPIRM) dropped by 2.7 percent year on year, decelerating by 1.7 percentage points from the previous quarter. In the first three quarters, the Corporate Goods Price Index (CGPI) monitored by the PBC decreased by 1.4 percent year on year, which was on par with that in H1.

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

The decline of fiscal revenue decelerated. In the first three quarters, revenue in the national general public budget dropped by 6.4 percent year on year to RMB14.1 trillion, decelerating by 4.4 percentage points compared with H1. Specifically, tax revenue amounted to RMB11.9 trillion, down 6.4 percent year on year. Non-tax revenue reached RMB2.2 trillion, down 6.7 percent year on year. The domestic value-added tax, domestic consumption tax, and business income tax dropped by 13.5 percent, 5 percent, and 4.9 percent year on year, respectively, while the personal income tax increased by 7.3 percent year on year.

Fiscal expenditures rebounded gradually. In the first three quarters, expenditures in the national general budget saw a decline of 1.9 percent year on year to RMB17.5 trillion. Growth accelerated by 3.9 percentage points compared with H1 and decelerated by 11.3 percentage points from the same period of 2019. In terms of the expenditure structure, expenditures related to health care and social security/employment grew steadily, registering year-on-year growth of 4 percent and 8.2 percent, respectively. Expenditures in the business/services industry and resource exploration/industrial information and other areas rose substantially, registering year-on-year growth of 24.5 percent and 20.9 percent, respectively.

In the first three quarters, budgetary revenue from nationwide government-managed funds totaled RMB5.5 trillion, up 3.8 percent year on year. Specifically, revenue from land sales rose by 10.3 percent year on year. Budgetary expenditures from nationwide government-managed funds increased by 26.6 percent year on year to RMB7.8 trillion.

Employment was generally stable. In the first three quarters, 8.98 million people were newly employed, accomplishing 99.8 percent of the annual target. In September, the surveyed unemployment rate in urban areas was 5.4 percent, down 0.2 percentage points from August. Specifically, the unemployment rate of the surveyed employees between the ages of 25 and 59 years old posted 4.8 percent, 0.6 percentage points lower than that in the urban areas, on par with that in August. The average weekly working hours of employees of enterprises were 46.8 hours, increasing by 0.1 hour year on year. As of end-Q3, the number of rural migrants decreased by 2.1 percent year on year to 179.52 million, down 3.84 million from the same period of 2019.

5. The balance of payments and external debt

A basic equilibrium was maintained in the balance of payments. According to preliminary statistics, China's current account surplus stood at USD170.7 billion in the first three quarters. To be specific, the surplus in trade in goods was USD339.8 billion, whereas the deficit in trade in services was USD116.9 billion. Under the capital and financial account, the surplus in direct investments reached USD44.9 billion. At end-September, foreign exchange reserves registered USD3.1426 trillion, increasing by USD34.6 billion from end-2019. At end-June, the balance of full-caliber foreign debt (denominated in both domestic and foreign currencies) posted USD2.1324 trillion. In particular, the short-term external debt balance was USD1.2234 trillion, accounting for 57 percent of the total external debt balance.

6. Analysis by sector

6.1 The real estate sector

In Q3 2020, nationwide housing prices remained generally stable. Housing sales and investments in real estate development gradually recovered. In September, among the 70 medium and large-sized cities nationwide, newly built housing prices increased by 4.5 percent year on year, decelerating 0.4 percentage points from those in June. Second-hand residential housing prices increased by 2.2 percent year on year, basically on par with those in June. In the first three quarters, the total floor area of sold units decreased by 1.8 percent year on year, while housing sales increased by 3.7 percent year on year. Investments in real estate development gradually recovered. In the first three quarters, investments in real estate development grew by 5.6 percent year on year, accelerating by 3.7 percentage points from H1. Specifically, investments in residential housing development rose by 6.1 percent year on year, registering an acceleration of 3.5 percentage points from H1, accounting for 74.0 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 the First Three Quarters of 2020

	Floor area (100 million square meters)	YOY growth (%)	YOY acceleration from H1(percentage

			points)
Floor area of newly started real estate projects	16.0	-3.4	4.2
Floor area of real estate projects under construction	86.0	3.1	0.5
Floor area of completed real estate projects	4.1	-11.6	-1.1

Source: National Bureau of Statistics.

The growth of real estate loans continued to decelerate. At end-September, outstanding real estate loans by major financial institutions (including foreign-funded financial institutions) stood at RMB48.8 trillion, up 12.8 percent year on year and a deceleration of 0.3 percentage points from end-June. Outstanding real estate loans made up 28.8 percent of the total lending balance. Specifically, outstanding individual housing loans amounted to RMB33.7 trillion, up 15.6 percent year on year, representing a deceleration of 0.1 percentage points from end-June. Outstanding housing development loans posted RMB9.3 trillion, a rise of 11.4 percent year on year and a deceleration of 0.6 percentage points from end-June.

6.2 The civil aviation sector

In recent years, the civil aviation industry in China has seen rapid growth with an expanding industrial scale. There has been marked improvement in aviation safety, steady enhancement in the quality of development, and continuous enhancement of transport efficiency and the security capability of this industry, and it is playing a more important role in society. The outbreak of the COVID-19 pandemic hit the civil aviation industry severely. The CBRC, jointly with the PBC and the Civil Aviation Administration of China (CAAC), introduced a special support policy of emergency loans for aviation enterprises locked in difficulties. In line with the principle of adopting differentiated measures and providing a credit supply with precision, the PBC provided special central bank lending, and the development banks and large banks issued preferential loans to bail out some of the troubled civil aviation enterprises. These measures effectively cushioned the impact of the pandemic and helped enterprises tide over the difficulties. As significant strategic results were achieved in coordinating pandemic containment with economic and social development, the civil aviation industry showed an overall rebounding trend. **First**, the transport and operation of the civil aviation industry recovered steadily. In Q3, total transport turnover of the civil aviation industry decreased by 32.4 percent year on year, decelerating by 14.2 percentage points and 19.3 percentage points from Q1 and Q2, respectively. **Second**, passenger traffic and cargo/mail traffic continued to rebound. Passenger traffic decreased by 24.0 percent year on year, decelerating by 30.0 percentage points and 30.5 percentage points from Q1 and Q2, respectively. Cargo and mail traffic decreased by 8.8 percent year on year, decelerating by 8.6 percentage points and 3.6 percentage points from Q1 and Q2, respectively. **Third**, transport efficiency continuously increased. In the first three quarters, with the gradual recovery of demand in the civil aviation market, the passenger load factor for scheduled flights, the weight load factor for scheduled flights, and the average daily use rate of aircraft decreased by 11.6 percent, 5.5 percent, and 3.4 percent, respectively, decelerating by 3.2 percentage points, 1.6 percentage points, and 0.7 percentage points from H1, respectively.

Figure 6 Transport Turnover of Civil Aviation and Its Year-on-Year Increase in the First Three Quarters of 2020

Source: National Bureau of Statistics.

Meanwhile, the development of China's civil aviation industry still faces multiple challenges. **First**, factors such as the improper distribution of airspace resources, fairly slow development of infrastructure construction, a shortage of professionals, uncompetitive enterprises, and an inefficient management system have restricted the sustainable development of the civil aviation industry. **Second,** pressures of energy savings and environmental protection on the civil aviation industry are increasing, and the tasks of changing the development mode and realizing green and low-carbon development are becoming more arduous. **Third**, the surging growth of e-commerce, delivery, and modern logistics has put forward higher requirements on air cargo. **Fourth,** due to the lack of a growth momentum in the global economy and trade, rising protectionism, and geopolitical tensions, plus the fallout from COVID-19, competition in terms of transport services in the civil aviation industry is becoming fiercer around the world.

Going forward, efforts should be made to build a safe, convenient, efficient and green modern civil aviation system while continuing to contain the pandemic. On the one hand, efforts should be made to strengthen the planning and construction of airports, to reasonably utilize airspace and other resources, to scientifically plan and arrange domestic route networks, to promote the development of air cargo facilities, and to continuously enhance the quality of transport services and aviation safety. On the other hand, efforts should also be made to deepen the reform of the civil aviation industry, to enhance its ability to innovate, to strengthen personnel training, to accelerate construction of a green civil aviation, and to enhance international competitiveness.

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 has worked as one and has achieved significant results in coordinating pandemic containment and economic and social development. Economic growth has been better than expected, the balance between supply and demand has gradually improved, and the market has seen more vitality and stronger growth drivers. Economic growth in Q1–Q3 turned from negative to positive, with growth in Q3 recording 4.9 percent, making it highly probable that the economy will see positive growth for 2020. Looking beyond the near term, the fundamentals of steady economic growth in the long run and high-quality development remain unchanged.

At present, China has entered a stage of high-quality development, and there are numerous advantages and conditions sustaining its future development. The pandemic containment and economic recovery in China are among the fastest in the world. With demand mostly having recovered and supply growing at a faster pace, employment and the people's well-being are secured, and market expectations are generally stable. According to forecasts by the IMF, China will be the only major economy to record positive growth in 2020. In the current and next period, China's development is still at an important stage of strategic opportunities. The economy still has great potential, strong resilience and vitality, and ample room for maneuver. With the deepening of the supply-side structural reforms as well as the full implementation of the innovation-driven development strategy and the strategy of expanding domestic demand, various new industries, business models and growth drivers are taking shape and rapidly developing. The numerous advantages and conditions supporting long-term growth remain unchanged. The financial sector has continuously enhanced its support for the real economy, especially for micro, small and medium-sized enterprises (MSMEs) and private businesses. 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 foreign exchange reserves remained above USD3 trillion. The economy has strengthened its capability to address external shocks.

As the global environment becomes more complex, instabilities and uncertainties have increased significantly, posing numerous challenges for the domestic economy. Since Q3, recovery has been weak in the major economies. As the pandemic has resurged in some economies, the public sectors and industries have been exposed to rising debt, which seriously undermined the sustainability of fiscal policies. Capital market prices are detached from economic fundamentals, and excessively loose monetary policies have led to spillovers. Meanwhile, with protectionism and unilateralism gaining ground, geopolitical tensions have resurfaced and trade frictions among some countries are intensifying. Global industrial and supply chains are suffering from the severe impact of non-economic factors, causing major instabilities and uncertainties in economic recovery. As such, China is still under great pressures in preventing imported infection and risks related to the global economy and financial markets. To offset the impact of the pandemic, countercyclical adjustments increased in H1, and the macro leverage ratio displayed a temporary rise. Looking forward, however, the macro leverage ratio is likely to stabilize as economic growth gradually returns to its potential levels. In addition, the time lag between the pandemic outbreak and the attendant financial risks places upward pressures on future nonperforming loans. 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 develop a deep understanding and dialectical view, and to enhance opportunity and risk awareness. The PBC will focus on taking care of its own matters by properly handling the relationship between reforms and macro-management, short-term and long-term considerations as well as internal and external equilibrium, so as to achieve high-quality development.

Consumer price growth continued its overall downward trend, and there are no grounds for persistent inflation or deflation. In July and August 2020, due to the impact of floods in some provinces, the prices of meat and vegetables saw a rebound. But as multiple measures were taken by government departments to guarantee supply and stabilize prices and monetary policy remained sound, prices have recently declined. CPI growth in September fell to below 2 percent. According to preliminary estimates, the average growth of the CPI in 2020 will fall within a reasonable range. Industrial production continued to recover, with domestic and external demand gradually regaining ground. The PPI recorded positive monthly growth throughout Q3, while its negative year-on-year growth exhibited an overall narrowing trend. However, as the global pandemic unfolds, in light of the uncertain impact of the containment measures on supply chains, as well as the base effect and holiday disruptions on the CPI, it is necessary to pay close attention to short-term price movements. 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 advanced, 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

In the next stage, the PBC will continue to follow the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era and resolutely implement the decisions and arrangements of the CPC Central Committee and the State Council. It will coordinate ongoing pandemic control with economic and social development, and it will make every effort to ensure stability on six fronts, namely, employment, the financial sector, foreign trade, foreign investment, domestic investment and expectations, to maintain 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, and to successfully wrap up the 13th Five-Year Plan, thereby giving utmost support to achieving the target of completing the building of a moderately prosperous society in all respects. At the same time, the PBC will focus on thoroughly implementing the guidelines of the Fifth Plenary Session of the 19th CPC Central Committee by understanding the new development stage, applying the new development philosophy, establishing the new development paradigm, improving macroeconomic governance, conducting cross-cyclical policy design, and promoting a balance of economic aggregates, structural optimization as well as both internal and external equilibria. Moreover, work will be done to build a modern central banking system, to improve the mechanism of money supply management, to enhance the market-oriented interest rate formation and transmission mechanism, and to build the systems and mechanisms needed to provide effective financial support for the economy.

The sound monetary policy will be more flexible, appropriate and targeted, better adapted to the needs of high-quality economic development, and more focused on the quality and efficiency of the provision of financial services for the real economy. The PBC will improve the mechanism of money supply management to manage scientifically the intensity, pace and focus of monetary policy operations in line with the macro situation and market needs. By so doing, it will keep liquidity adequate at a reasonable level to avoid a liquidity crunch in the market while firmly refraining from adopting broad and indiscriminate stimulus measures so that a liquidity spillover will not occur. The PBC will work to enhance the market-oriented interest rate formation and transmission mechanism, deepen the loan prime rate (LPR) reform, continue to unleash the potential of reform in lowering lending rates, adopt a combination of policies to significantly reduce social financing costs, and give play to the decisive role of the market in the RMB exchange rate formation. The role of structural monetary policy tools in targeted liquidity provision will be enhanced so that policy measures can provide more direct support for the real economy. The PBC will attach importance to managing expectations and keeping prices stable. It will properly handle the relationship between internal and external equilibria and that between short-term and long-term goals, conduct a normal monetary policy as long as possible, and keep the macro leverage ratio basically stable. Efforts will be made to fight the tough battle of forestalling and defusing major financial risks, to improve the systems of financial risk prevention, early warnings, resolution and accountability, and to safeguard financial security by firmly defending the bottom line that no systemic risk should occur. Work will be done to guide and create new demand with innovations and high-quality supply and to accelerate the establishment of a new development paradigm with domestic circulation as the mainstay and domestic and international circulation reinforcing each other.

First, the PBC will pursue a sound monetary policy that is more flexible, appropriate and targeted. It will improve the mechanism of money supply management and employ a mix of monetary policy tools, such as the Medium-term Lending Facility (MLF), open market operations (OMOs), central bank lending, and central bank discounts to keep liquidity adequate at a reasonable level and to properly control the general valve of money supply, so that the growth rates of M2 and aggregate financing to the real economy (AFRE) will be basically in line with that of nominal GDP which reflects potential output, thereby supporting the return of the economy to its potential growth rate. Work will be done to guide the market rates to move smoothly around OMO rates and MLF rates. Moreover, the mechanism for sustainable capital replenishment will be improved, with increased support for the issuance by small and medium-sized banks of capital replenishment instruments, such as perpetual bonds, so that banks will be better able to serve the real economy and to forestall and defuse financial risks. Measures will be taken to improve macroeconomic governance, to optimize monetary policy objectives as well as fiscal, employment, industry, investment, consumption, environmental protection, regional and other policy objectives, and to promote a reasonable division of duties and an efficient synergy.

Second, to strengthen financial support for stabilizing businesses and securing employment, the PBC will move further ahead with the implementation of central bank lending, central bank discounts, as well as the monetary policy tools that provide direct support for the real economy, and will effectively bring into play their propelling force. It will maintain the stability of central bank lending and central bank discount policies while providing inclusive and sustained financing support for agro-linked enterprises, micro and small businesses (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, to improve the effectiveness of targeted adjustments, and to guide locally incorporated financial institutions to step up credit support for inclusive MSBs that keep their employment basically stable. Concrete efforts will be made to alleviate the pressures on MSBs caused by principal and interest repayments and to ease their financing difficulties. The financial sector will be guided to meet the target of giving up RMB1.5 trillion of its profits to the real economy.

Third, the PBC will build the systems and mechanisms needed to provide effective financial support for the real economy. It will innovate and improve the system of structural monetary policy tools, design the incentive compatibility mechanism in a targeted way, and guide financial institutions to ramp up support for those fields in conformity with the new development philosophy. Work will be done to improve the system for providing financial support for innovation, to promote the industrialization and large-scale application of new technologies, and to develop fund chains for innovation chains and industrial chains, thereby giving rise to a virtuous cycle and triangular interactions among the financial sector, the sci-tech sector, and industries. The PBC will push ahead with the regulated development and innovation of supply chain finance by implementing supporting policies step by step in collaboration with the relevant agencies and providing targeted services to support the completeness and stability of supply chains and industrial chains. The rural financial services system will be improved. Research will be conducted on the linkup between financial support for poverty eradication and rural revitalization policies. Work will be accelerated to roll out measures for the assessment of the services of commercial banks for rural revitalization. The PBC will urge commercial banks to improve their internal resource allocations as well as their performance assessments. Measures will be taken to establish and improve the long-term mechanism for increasing bank lending to MSBs, to guide financial institutions to step up credit support for MSBs, private enterprises, the agricultural sector, rural areas, farmers as well as the manufacturing sector, to enhance Fintech, and to reinforce financial inclusion. 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, the PBC will remain committed to stabilizing land prices, housing prices as well as expectations, maintain the continuity, consistency and stability of real estate finance policies, and effectively implement rules for the prudential management of real estate finance.

Fourth, the PBC will deepen the market-oriented interest rate reform and the exchange rate reform to increase the efficiency of financial resource allocations. It will improve the market-oriented interest rate formation and transmission mechanism, with the LPR reform continuing to go deeper. The market-oriented LPR pricing mechanism will be consolidated. The PBC will urge financial institutions to better incorporate the LPR into the funds transfer pricing (FTP) of loans and to strengthen the interconnections between the LPR and both the internal and external pricing of loans, thereby further bringing down the financing costs by means of reform and increasing the efficiency of monetary policy transmission. The self-regulatory mechanism for market rate pricing will play its part in regulating the conduct of deposit rate pricing and in reinforcing the requirement that lending entities of all types give explicit indications of annualized loan rates, in a move to maintain the fairness of pricing, safeguard a level playing field in the market, and protect the rights and interests of consumers. Taking steady 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. Development of the foreign exchange market will pick up pace. Enterprises will be guided to be neutral in financial management and manage exchange rate risks with foreign exchange derivatives, while financial institutions will be guided to always be risk neutral and to provide services of exchange rate risk management for import and export companies with authentic needs. 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 further facilitate the use of the RMB in cross-border trade and investment.

Fifth, the PBC will strengthen fundamental institution building in financial markets so that they can play an effective role in stabilizing growth, promoting structural adjustments, advancing reform, and guarding against risks. Active steps will be taken to improve the bond market management system and push for the unification of standards for information disclosures regarding corporate debenture bonds. 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 coordinated regulation over financial market infrastructures, put into practice the arrangements for interconnectivity between bond market infrastructures, and continue to push forward with the building of custodian banks and trade repositories so as to ensure that financial markets are generally safe and stable while performing efficiently. Active but prudent steps will be taken to promote the opening-up of the bond market. In terms of bond market access, channels will be integrated and procedures will be optimized so that the environment for overseas investors will be more friendly and convenient.

Sixth, the PBC will push further ahead with the reform of financial institutions and make continued efforts to improve corporate governance and optimize financial supply. Focusing on strengthening corporate governance, the reform of state-owned commercial banks will go deeper, and a modern financial enterprise system with Chinese characteristics will be established to increase efficiency and provide better services for MSBs and private enterprises. Work will be done to support the sustainable and sound development of small and medium-sized banks and rural credit cooperatives by improving monetary, regulatory and tax rules so that they can reassume their roles in serving local needs and their original purposes. An effective mechanism of checks and balances in governance will be established, and the long-term mechanism for capital replenishment will be improved. Measures will be taken to reform and optimize the policy financial sector by carrying out separate account management of businesses as well as classified accounting in a move to enhance their capacity to support the national strategy.

Seventh, the PBC will improve the systems of financial risk prevention, early warnings, resolution and accountability. It will safeguard financial security and fight the tough battle of forestalling and defusing major financial risks to firmly defend the bottom line that no systemic risk should occur. The system of financial risk prevention and early warnings will be improved, and stress tests fully covering the banking system will be conducted. To improve the soundness of financial institutions and their sustainable management capacity, the PBC will support banks, particularly small and medium-sized banks, to replenish capital through multiple channels and improve their governance, and to step up efforts to set aside loss provisions for non-performing loans and carry out write-offs. Work will be done vigorously to develop regulatory technologies and enhance the professionalism, effectiveness and seriousness of regulation. While the endeavors to defuse risks will be advanced prudently, under no circumstances will local risks be allowed to evolve into systemic risks, nor will regional risks be allowed to evolve into national risks. Meanwhile, the PBC will accelerate steps to improve the system of accountability for financial risk resolution so as to ensure that shareholders, creditors of different types, local governments and financial regulatory agencies assume their respective responsibilities.