China Monetary Policy Report

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Monetary Policy Analysis Group of

the People's Bank of China

Executive Summary

The year 2020 is an extraordinary year. In the complicated and severe environment both at home and abroad, especially in the face of the fallout from COVID-19, the Chinese nation has, under the strong leadership of the CPC Central Committee with Comrade Xi Jinping at its core, made concerted efforts and achieved significant strategic results in coordinating pandemic containment and economic and social development. The 13th Five-Year Plan wrapped up smoothly, and China is on course to finish building a moderately prosperous society in all respects. With its economy recovering steadily, China is the only major economy to register positive growth in 2020 and one of the few major economies staying on a normal monetary policy path. In 2020, China's gross domestic product (GDP) grew by 2.3 percent, with its volume exceeding RMB100 trillion, and the consumer price index (CPI) rose 2.5 percent. Employment was generally stable, and import and export trade increased despite the unfavorable environment.

Following 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, rose to challenges and responded proactively with stronger macro policies. The sound monetary policy was flexible, appropriate and targeted. Remaining committed to the specific goals of maintaining an appropriate aggregate policy, notably lowering financing costs and supporting the real economy in the face of great uncertainties, the PBC flexibly managed the intensity, pace and focus of policy adjustments, ensured stability on six fronts, namely employment, the financial sector, foreign trade, foreign investment, domestic investment and expectations, and maintained 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, hence cultivating a proper monetary and financial environment for achieving decisive success in the building of a moderately prosperous society in all respects.

First, promoting scientific decision-making, the PBC made prompt and effective responses. In terms of the aggregate, support measures totaling more than RMB9 trillion were introduced via a mix of tools, including required reserve ratio cuts, the Medium-term Lending Facility (MLF), central bank lending and central bank discounts. In terms of price, the rates of the MLF and open market operations (OMOs) dropped by 30 basis points guided by the PBC in a forward-looking manner, which brought down market rates. The one-year loan prime rate (LPR) also declined. **Second,** responding creatively, the PBC provided direct and targeted policy support to stabilize businesses and bolster employment. Central bank lending and central bank discounts totaling RMB1.8 trillion were provided in three phases in line with the needs of pandemic containment and economic development. Two innovative tools enabling direct support for the real economy were launched and the set of structural monetary policy tools was improved. **Third,** taking reform and opening-up as the driving force, the PBC deepened the market-based reforms of interest rates and the exchange rate. The work of shifting the pricing benchmark for outstanding floating-rate loans, which began as scheduled, has been completed smoothly. Determined to remove the implicit floor of loan rates, the PBC promoted the LPR and greatly enhanced the transmission efficiency of interest rates. The PBC also improved the RMB exchange rate formation mechanism, enhanced the flexibility of the RMB exchange rate, and intensified macro-prudential management. **Fourth**, remaining proactive, the PBC stabilized market expectations. Attaching importance to expectation management, the PBC improved institutionalized ways of communicating monetary policies and played an active role in international monetary policy coordination. **Fifth,** upholding market-oriented and law-based principles, the PBC well managed financial risks and firmly defended the bottom line that no systemic risk should occur.

Overall, the sound monetary policy proved to be forward-looking, proactive, precise and effective in 2020, and it provided strong support for China to take the lead in containing the pandemic, resuming work and production, and achieving positive economic growth. A mix of measures was introduced to guide the financial sector to waive RMB1.5 trillion of profits in support of the real economy, providing the real sector with significantly more perceivable benefits. The monetary policy target was smoothly achieved. At end-2020, broad money (M2) and aggregate financing to the real economy (AFRE) grew 10.1 percent and 13.3 percent year on year respectively. The overall financing costs for enterprises declined remarkably. The weighted average rate on corporate loans registered 4.61 percent in December 2020, down 0.51 percentage points from December 2019, hitting a new record low. The credit structure continued to improve. At end-2020, the inclusive loans to micro and small businesses (MSBs) and the medium and long-term (MLT) loans to the manufacturing sector grew by 30.3 percent and 35.2 percent year on year respectively. The RMB exchange rate moved in both directions with enhanced flexibility based on market supply and demand and remained basically stable at an adaptive and equilibrium level. The China Foreign Exchange Trade System (CFETS) RMB Index registered 94.84 at end-2020, 3.78 percent higher than that at end-2019.

Now with China's economy returning to normal, the intrinsic momentum for growth is rising and macroeconomic conditions are improving. However, it should also be noted that internationally the economic and financial conditions are still complicated and severe, uncertainties remain concerning the pandemic and the external environment, and domestically the foundation for economic recovery is not yet solid. Therefore, it is necessary to have a deep understanding and a dialectical view of the situation, heighten awareness about potential difficulties, remain confident of reaching goals, and focus on our own affairs, so as to achieve high-quality development. In the next stage, under the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, the PBC will follow the guidelines of the Fifth Plenary Session of the 19th CPC Central Committee and the Central Economic Work Conference, implement the decisions and arrangements of the CPC Central Committee and the State Council, and adhere to the general principle of seeking progress while ensuring stability. Based on the requirements of the new development stage, the PBC will apply the new development philosophy and foster a new development paradigm. It will prioritize stability, focus on key tasks, defend the bottom line, and live up to its responsibilities in a bid to consolidate and further the success achieved in pandemic containment as well as in social and economic development. With the policy maintaining its continuity, stability and sustainability, the PBC will improve macroeconomic governance, build a modern central banking system, conduct cross-cyclical policy designs, foster an aggregate balance, optimize the economic structure, strike a balance between internal and external dynamics, continue the efforts to ensure stability on six fronts and maintain security in six areas, thereby contributing to a good start for the establishment of a new development paradigm and bringing on a new look.

The sound monetary policy will be flexible, targeted, reasonable and appropriate. Prioritizing stability, the PBC will not make an abrupt turn in its policy stance. Instead, it will manage the timing, intensity and effectiveness of its policies, properly handle the relationship between economic recovery and risk prevention, and keep sustainable room for normal monetary policy. By improving the mechanism of money supply management, the PBC will ensure proper control of the aggregates so as to keep liquidity adequate at a reasonable level, the growth of M2 and AFRE basically in line with that of nominal GDP, and the macro leverage ratio basically stable. Meanwhile, flexible adjustments will be made to the intensity, pace and focus of policy to accommodate changes in circumstances. Structural monetary policy tools will play their roles in targeted liquidity provision, and institutional mechanisms will be developed for the financial sector to provide support for the real economy. More financial support will be extended to scientific and technological innovation, MSBs and green development. The PBC will enhance the market-oriented interest rate formation and transmission mechanism by improving the policy rate system and deepening the LPR reform so as to consolidate the achievements made in lowering real lending rates and to stabilize and reduce the overall financial costs for enterprises. By enabling the market to play a decisive role in the formation of the RMB exchange rate and by enhancing macro-prudential management, the PBC will increase the flexibility of the RMB exchange rate and keep the RMB exchange rate basically stable at an adaptive and equilibrium level. More efforts will be put into monitoring and analysis as well as expectation management in order to keep prices basically stable. To safeguard financial security and to firmly defend the bottom line that no systemic risk should occur, the PBC will reinforce the institutional system for financial risk prevention, early warning, resolution and accountability. 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 circulations reinforcing each other.

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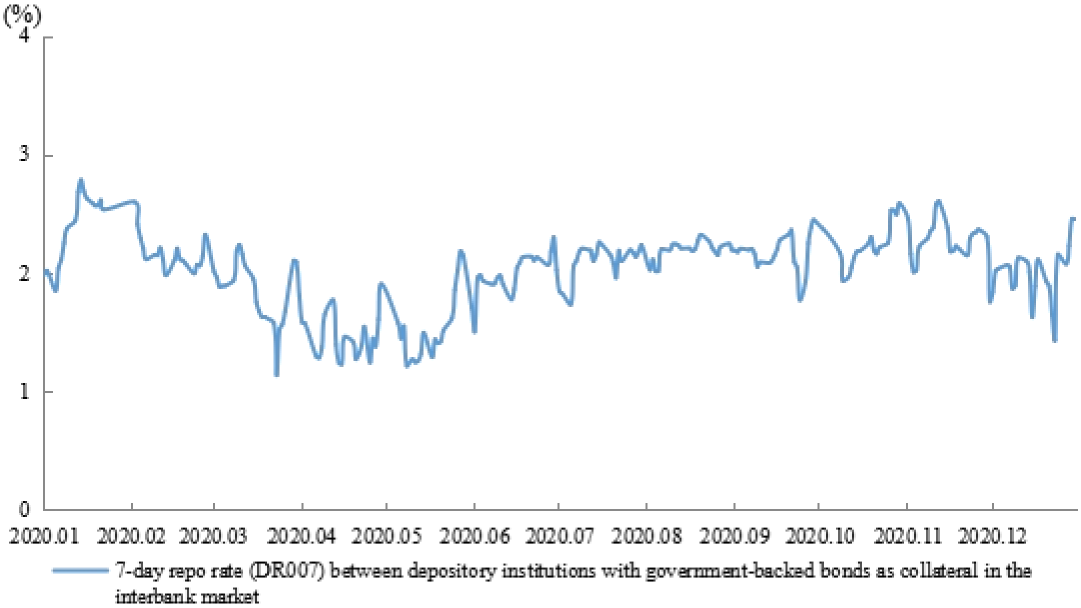
Part 1. Money and Credit Analysis

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. Under a sound monetary policy which is more flexible, appropriate and targeted, this year witnessed a reasonable growth in money and credit and aggregate financing, a further improved structure, and a significant drop in overall financing costs for enterprises. Buttressed by the realization of monetary policy goals, China took the lead in pandemic containment and the resumption of work and production, and became the first economy to post positive growth.

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

In 2020, amid the impact of the pandemic and the complicated economic conditions at home and abroad, there was much more uncertainty about liquidity demand and supply in the banking system. Based on the characteristics of pandemic containment and recovery of the economy and society at different stages, the PBC timely adjusted the intensity and pace, and comprehensively used rich policy tools, to keep the total liquidity in line with market demands, including reserve requirement ratio (RRR) cuts, central bank lending, central bank discounts, the medium-term lending facility (MLF), and open market operations (OMOs). These measures not only helped ensure stable performance of the financial system and satisfy emergency demands for liquidity arising from guaranteeing supplies and resuming work and production during the outbreak of the pandemic but also gradually restored total liquidity to its normal level during the course of the economic and social recovery. In the meanwhile, by announcing monetary policy arrangements in advance and other means, the PBC strengthened expectation management and ironed out short-term disturbances in a timely manner. Money-market interest rates were guided to move around the OMO rates, and policy rates were fully exploited as a pivot. Stable market expectations enabled financial institutions to trim down their preventive demands for liquidity. At end-December, the excess reserve ratio of financial institutions registered 2.2 percent, down 0.3 percentage points from the end of 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

Credit provided stronger support for the real economy at a reasonable pace. Outstanding loans issued by financial institutions in domestic and foreign currencies grew 12.5 percent year on year to RMB178.4 trillion at end-2020, increasing RMB19.8 trillion from the beginning of the year and RMB3.0 trillion more than the increase in the corresponding period of 2019. Outstanding RMB-denominated loans grew 12.8 percent year on year to RMB172.7 trillion, up RMB19.6 trillion from the beginning of the year and an increase that was RMB2.8 trillion larger than that during the corresponding period of the previous year. In response to the pandemic, financial institutions increased their loans in the first half of 2020, especially in the first quarter. After the economy gradually recovered, credit expansion returned to normal, and it changed in small increments during the second half of 2020, basically flat compared with the previous year. Over the past four quarters of 2020, loans increased RMB7.1 trillion, RMB5.0 trillion, RMB4.2 trillion, RMB3.4 trillion respectively, a year-on-year acceleration of RMB1.3 trillion, RMB1.1 trillion, RMB211.1 billion, RMB191.1 billion, stabilizing quarter by quarter.

The credit structure continued to be optimized. Medium and long-term loans to the manufacturing sector and loans to micro and small businesses (MSBs) recorded a rapid growth. At end-2020, loans to enterprises and public entities grew by RMB12.2 trillion from the beginning of the year, a year-on-year acceleration of RMB2.7 trillion. Medium and long-term loans to the manufacturing sector gained 35.2 percent, accelerating for fourteen consecutive months. Outstanding inclusive loans to MSBs grew by 30.3 percent year on year to RMB15.1 trillion, 7.2 percentage points higher than that at end-2019. These loans supported 32.28 million MSBs, an increase of 19.4 percent year on year. In 2020, inclusive loans to MSBs increased by RMB3.5 trillion, a year-on-year acceleration of RMB1.4 trillion.

Table 1 The Structure of RMB Loans in 2020

Unit: RMB100 million

	Outstanding amount at end-2020	YOY growth (%)	Increase from the beginning of the year	YOY acceleration
RMB loans to:	1727452	12.8%	196340	28196
Households	631847	14.2%	78657	4354
Enterprises and public entities	1084388	12.6%	121673	27192
Non-banking financial institutions	5121	-47.9%	-4706	-3773
Overseas	6096	13.6%	717	424

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 2020

Unit: RMB100 million

	Increase from the beginning of the year	YOY acceleration
Chinese-funded large-sized banks [1]	87430	19710

Chinese-funded small and medium-sized banks[2]	106968	6497
Small-sized rural financial institutions[3]	25210	4343
Foreign-funded financial institutions	638	-392

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 hit a record low. In 2020, with the deepening of the loan prime rate (LPR) reform, the implicit floor of loan rates was completely removed and the efficiency of the transmission of monetary policy was further enhanced. The low lending rates created favorable conditions for financial institutions to waive profits of RMB1.5 trillion in favor of the real economy. In December 2020, 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. The weighted average lending rate recorded 5.03 percent, down 0.41 percentage points year on year, falling to a record low. In particular, the weighted average interest rate on ordinary loans registered 5.30 percent, down 0.44 percentage points year on year. The weighted average corporate lending rate fell by 0.51 percentage points from December 2019 to 4.61 percent, a drop clearly exceeding that of the LPR, breaking the record for the second successive month. This shows the role that the LPR plays in indicating direction and guidance.

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

Unit: %

	December	Change from September	YOY change
Weighted average interest rate on new loans	5.03	-0.09	-0.41
On ordinary loans	5.30	-0.01	-0.44

Of which: On corporate loans	4.61	-0.02	-0.51
On bill financing	3.10	-0.13	-0.16
On mortgage loans	5.34	-0.02	-0.28

Source: The People's Bank of China.

In December 2020, the share of ordinary loans with rates above, at, or below the LPR registered 66.04 percent, 7.02 percent, and 26.93 percent, respectively. In general, the upward and downward float of the loan rates around the LPR moved downward as a whole compared with that in December 2019.

Table 4 Shares of RMB Lending Rates at Different Levels from January to December 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
October	23.63	7.08	69.28	13.76	22.63	13.40	9.67	9.82
November	25.89	5.99	68.12	13.33	23.41	13.47	9.02	8.88
December	26.93	7.02	66.04	13.56	22.62	13.17	8.83	7.86

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 December 2020, the weighted average interest rates on demand and large-value USD-denominated deposits with maturities within 3 months registered 0.16 percent and 0.59 percent, respectively, down 0.14 percentage points and 1.34 percentage points year on year. The weighted average interest rates on USD-denominated loans with maturities within 3 months and with maturities between 3 months (including 3 months) and 6 months registered 1.22 percent and 1.36 percent, down 1.79 percentage points and 1.65 percentage points year on year, respectively.

Table 5 Average Interest Rates of Large-value USD-denominated Deposits and Loans from January to December 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
October	0.19	0.65	0.94	1.08	1.11	1.27	1.37	1.26	1.22	1.31	1.87
November	0.20	0.61	0.89	0.96	1.13	1.08	1.35	1.21	1.35	1.33	2.21
December	0.16	0.59	0.79	0.86	1.09	1.19	1.22	1.36	1.25	1.30	2.10

Source: The People’s Bank of China.

Deposits grew rapidly. At end-2020, outstanding deposits in domestic and foreign currencies in all financial institutions posted RMB218.4 trillion, up 10.2 percent year on year, 1.6 percentage points higher than those at the end of the previous year. Outstanding RMB deposits registered RMB212.6 trillion, up 10.2 percent year on year, 1.5 percentage points higher than those at the end of the previous year. Outstanding deposits in foreign currencies stood at USD889.3 billion, an increase of USD131.5 billion from the beginning of the year and an acceleration of USD101.3 billion year on year.

Table 6 The Structure of RMB Deposits in 2020

Unit: RMB100 million

	Deposits at end-2020	YOY growth (%)	Increase from the beginning of the year	YOY acceleration
RMB deposits:	2125721	10.2%	196457	42840
Households	925986	13.9%	112954	15912
Non-financial enterprises	660180	10.9%	65740	32799
Public entities	298738	0.6%	1569	-9818
Fiscal entities	44771	9.6%	3931	3630
Non-banking financial institutions	183108	6.8%	10645	-891
Overseas	12938	14.5%	1618	1209

Source: The People's Bank of China.

Box 1 Strengthening Deposit Management and Safeguarding Competitive Order in the Deposit Market

Safeguarding competitive order in the deposit market is conducive to maintaining a reasonable and stable cost for financial institutions to assume debt, cutting down on social financing costs, and creating favorable conditions for the orderly promotion of the market-based interest rate reform. The PBC attaches great importance to strengthening deposit management. In accordance with the *Regulations on the Administration of Savings*, the *Administrative Measures for RMB Corporate Deposits,* and other relevant provisions, the PBC issued the *Notice of the PBC on Strengthening* *the Administration of Deposit Interest Rates* (Yinfa No.59 [2020]), requiring financial institutions to strictly implement the provisions on setting deposit interest rates as well as calculating and settling interest. Moreover, the PBC guides the Self-discipline Mechanism for Market Interest Rate Pricing (referred to as the Interest Rate Self-discipline Mechanism) to implement self-discipline management of deposit interest rates so as to maintain orderly competition in the deposit market.

First, urging the rectification of non-compliant deposit innovations. Prior to 2019, in order to absorb deposits, some financial institutions issued so-called “innovative” products, such as demand deposit products with interest calculated upon withdrawal with reference to the interest rate of time deposits with corresponding maturity, time deposit products withdrawn in advance with interest calculated with reference to the interest rate of time deposits with corresponding maturity, and time deposit products with periodic interest payments. These products, whose actual interest rates are obviously higher than the deposit rates with the same maturities, violate the regulations that time deposits withdrawn in advance are deemed to be current deposits when calculating the interest, and the principal and interest of lump-sum time deposits are due to be repaid in lump sums at maturity. In order to maintain orderly competition in the deposit market, since 2019 the PBC has guided the Interest Rate Self-discipline Mechanism to reinforce self-discipline management of the deposit market, and it has urged financial institutions to operate in accordance with the laws and regulations and to rectify non-compliant deposit innovations in an orderly manner. In terms of demand deposit products with interest calculated with reference to the interest rate of time deposits with corresponding maturity, the outstanding balance before the rectification (as of May 16, 2019) stood at RMB6.7 trillion. Financial institutions were required to make rectifications gradually from May 17, 2019 and halted new businesses from December 1, 2019, with the balance maturing naturally. As of end-2020, the outstanding balance of the products registered RMB1.2 trillion, a remarkable drop of RMB5.5 trillion, or over 81 percent, as compared with that before the rectification. As for time deposit products withdrawn in advance with interest calculated with reference to the interest rate of time deposits with corresponding maturity, the outstanding balance posted RMB15.4 trillion before the rectification (as of December 16, 2019). Financial institutions were required to stop new businesses immediately from December 17, 2019, and to bring the balance to zero by the end of 2020. In order to implement the rectification requirements, some banks announced in December 2020 that the interest calculation rules of these time deposit products withdrawn in advance would be adjusted from January 1, 2021 and they made it clear that interest on time deposit products withdrawn in advance would be calculated with reference to the interest rate of demand deposits. As of end-2020, the balance of these time deposit products had been reduced to zero, a total drop of RMB15.4 trillion.

Second, bringing the guaranteed yield of structural deposits under self-discipline management. The yield of structural deposits generally consists of a guaranteed yield and the yield linked to derivatives, the former of which is the same as the interest rate of common deposits. However, in order to attract customers, some financial institutions set a relatively high guaranteed yield for structural deposits, which, to some extent, disturbed competitive order in the deposit market. With the aim of promoting the regulated and orderly development of structural deposits, in December 2019, the PBC guided the Interest Rate Self-discipline Mechanism to incorporate the guaranteed yield of structural deposits into the self-discipline management, and urged banks to set the interest rates at a reasonable level. Moreover, the China Banking and Insurance Regulatory Commission (CBIRC) also took measures to foster the orderly development of the structural deposit business by banks. In December 2020, the guaranteed yield of structural deposits stood at 1.25 percent, 1.18 percentage points lower as compared with that in December 2019. In the meanwhile, the overall expected yield and redemption yield of structural deposits witnessed a rapid decline of 0.5 percentage points and 0.54 percentage points from December 2019 to reach 3.09 percent and 3.03 percent in December 2020, respectively. At end-2020, the outstanding balance of structural deposits amounted to RMB6.3 trillion, RMB4.4 trillion less than the peak of RMB10.7 trillion in April 2020.

Third, strengthening the management of non-local deposits. Non-local deposits refer to deposits absorbed by locally incorporated banks through accounts opened in regions or cities where they have not set up physical outlets, including deposits taken via third-party Internet platforms or through their own online banking and mobile banking platforms or other channels. In the past two years, some locally incorporated banks witnessed rapid expansion by absorbing non-local deposits, which deviated from their positioning of serving local communities. As non-local deposits lack stability, the accumulated liquidity risks are prone to rapid spreading, jeopardizing the competitive order in the market and the stability of the financial system. In order to guide locally incorporated banks to better serve the local communities and to maintain competitive order in the market, the PBC will, starting from Q1 2021, incorporate non-local deposits absorbed by locally incorporated banks into the macro-prudential assessment (MPA), and forbid locally incorporated banks from absorbing non-local deposits through various channels, with the outstanding balance settled when coming due. The provision does not apply to banks operating wholly online without physical outlets. As their business is free of geographical constraints, they are essentially nationwide banks. Therefore, they are regulated by the Interest Rate Self-discipline Mechanism with reference to state-owned banks.

As the cornerstone of the interest-rate system, the deposit benchmark interest rate will remain in place for a long time. Going forward, the PBC will continue to bring the role of the Interest Rate Self-discipline Mechanism into play, strengthen the management of non-compliant deposit innovations, structural deposits, and non-local deposits, prevent irrational competition, safeguard orderly competition in the deposit market, and maintain a stable cost for banks in assuming debts so as to create a favorable environment for promoting the market-based interest rate reform and fostering the steady decline of the comprehensive funding costs of enterprises.

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

At end-2020, outstanding M2 recorded RMB218.7 trillion, up 10.1 percent year on year, an acceleration of 1.4 percentage points from the end of 2019. Outstanding M1 registered RMB62.6 trillion, a year-on-year growth of 8.6 percent and 4.2 percentage points higher than that at the end of the previous year. Outstanding M0 reached RMB8.4 trillion, up 9.2 percent year on year and an increase of 3.8 percentage points from the end of 2019. The year 2020 witnessed a net cash injection into the economy of RMB712.5 billion, a rise of RMB314.4 billion year on year.

According to preliminary statistics, outstanding aggregate financing to the real economy (AFRE) reached RMB284.83 trillion at end-2020, up 13.3 percent year on year and an acceleration of 2.6 percentage points over the end of the previous year. In 2020, the incremental AFRE reached RMB34.86 trillion on a cumulative basis, an increase of RMB9.19 trillion year on year. The following features characterized the growth of the AFRE. First, RMB loans saw a substantially larger year-on-year increase. Second, the drop in entrusted loans narrowed and the growth in undiscounted bankers' acceptances expanded. Third, both corporate bonds and equity financing increased considerably compared with the previous year. Fourth, government bond financing recorded a significantly larger year-on-year increase. Fifth, the increase in asset-backed securities of depository financial institutions narrowed from the previous year, while the growth of written-off loans accelerated.

Table 7 Aggregate Financing to the Real Economy in 2020

	At end-December 2020		In 2020	
	Stock (RMB1 trillion)	YOY growth (%)	Flow (RMB100 million)	YOY change (RMB100 million)
AFRE	284.83	13.3	348,633	91,898
Of which：RMB loans	171.60	13.2	200,310	31,475
Foreign-currency loans (RMB equivalents)	2.10	-0.6	1,450	2,725

	At end-December 2020		In 2020	
Entrusted loans	11.06	-3.4	-3,954	5,442
Trust loans	6.34	-14.8	-11,020	-7,553
Undiscounted bankers' acceptances	3.51	5.3	1,746	6,503
Corporate bonds	27.62	17.2	44,466	11,082
Government bonds	46.06	22.1	83,370	36,166
Domestic equity financing by non-financial enterprises	8.25	12.1	8,923	5,444
Other financing	8.07	21.1	14,081	-67
Of which：Asset-backed securities of depository financial institutions	1.89	12.5	2,109	-1,925
Loans written off	5.28	30.0	12,180	1,629

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 the AFRE statistics by incorporating "treasury bonds" and "local government general bonds" into the AFRE and combining them with the existing "local government special bonds" under the item of "government bonds." The value of this indicator is the face value of 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.

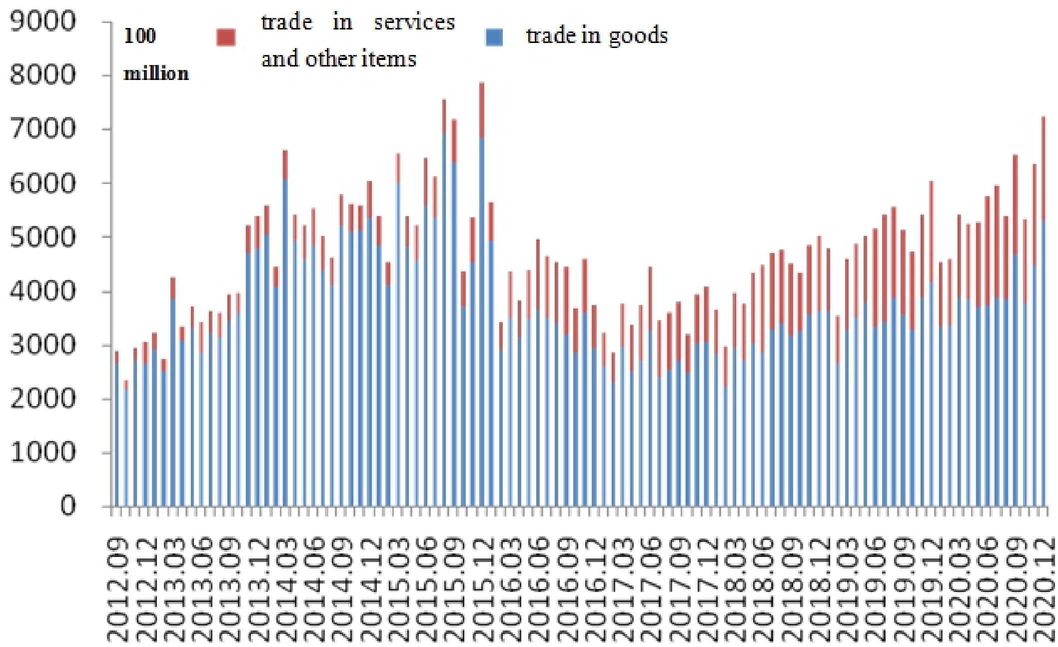
Sources: The People's Bank of China, China Banking and Insurance Regulatory Commission, China Securities Regulatory Commission, China Central Depository & Clearing Co., Ltd., National Association of Financial Market Institutional Investors, etc.

IV. The RMB exchange rate fluctuated, and cross-border RMB transactions continued to grow

In 2020, cross-border capital flows and foreign exchange supply and demand have been basically in equilibrium, with market expectations being 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 five months, both China and other economies were hindered by the COVID-19 pandemic and the international foreign exchange market experienced greater fluctuations. Consequently, the RMB exchange rate depreciated against the USD and appreciated slightly against the basket of currencies. After June, China took the lead in containing the pandemic, and economic fundamentals continued to improve. As a result, the RMB exchange rate appreciated against both the USD and the basket of currencies. The year 2020 witnessed increased RMB exchange rate elasticity that served an effective role in regulating the macro-economy and as an automatic stabilizer for the balance of payments. At end-2020, 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 94.84 and 94.23, respectively, up 3.78 percent and 2.64 percent from end-2019. According to calculations by the Bank for International Settlements (BIS), at end-2020, the nominal effective exchange rate (NEER) and the real effective exchange rate (REER) of the RMB appreciated 4.05 percent and 3.33 percent from end-2019, respectively. From 2005 when reform of the exchange rate formation mechanism commenced to end-2020, the NEER and REER of the RMB appreciated by 37.67 percent and 51.32 percent, respectively. At end-2020, the central parity of the RMB against the USD was 6.5249, up 6.92 percent from end-2019, appreciating by 26.84 percent on a cumulative basis from the launch of the reform of the exchange rate formation mechanism in 2005. In 2020, the annualized volatility rate of the RMB exchange rate against the USD was 4.5 percent.

In 2020, cross-border RMB settlements totaled RMB28.4 trillion, up 44 percent year on year. In particular, RMB receipts and payments registered RMB14.1 trillion and RMB14.3 trillion, respectively. Cross-border RMB settlements under the current account grew by 13 percent year on year to RMB6.8 trillion, among which RMB settlements of trade in goods registered RMB4.8 trillion whereas RMB settlements of trade in services and other items registered RMB2 trillion. Cross-border RMB settlements under the capital account posted RMB21.6 trillion, up 59 percent year on year.

Figure 2 Monthly RMB Payments and Receipts under the Current Account



Source: The People's Bank of China.

Part 2. Monetary Policy Operations

In 2020, in the face of COVID-19, a pandemic unseen in a century, the PBC has upheld 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, adhered to the fundamental method of scientific decision-making and innovative response, and adopted a sound monetary policy in a flexible, appropriate, and targeted manner. The PBC coordinated pandemic containment with economic and social development, and went all out to ensure stability on six fronts, namely, employment, the financial sector, foreign trade, foreign investment, domestic investment, and expectations, and to 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 securing a decisive victory in building a moderately prosperous society in all respects.

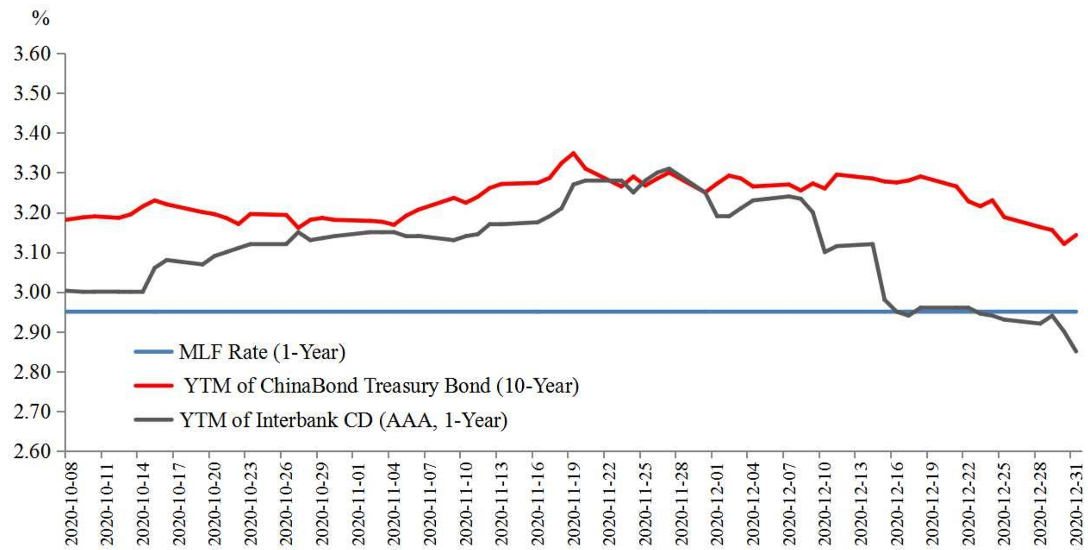
I. Conducting open market operations in a flexible manner

Maintaining adequate liquidity at a reasonable level in the banking system. In 2020, the PBC closely monitored the liquidity supply and demand in the banking system and conducted open market operations in a more preemptive, precise, and timely manner. Besides long-term liquidity injections made through the use of instruments such as the cut in the required reserve ratio (RRR), central bank lending, central bank discounts, and the Medium-term Lending Facility (MLF), the PBC flexibly conducted open market operations, which were centered on the 7-day reverse repos, so as to maintain adequate liquidity at a reasonable level and to always strike a balance between liquidity supply and demand. In the meanwhile, the PBC strengthened market communications, improved the transparency of monetary policy, and effectively stabilized market expectations through various means, such as posting in advance the operation plan in the *Announcement of Open Market Operations*. In Q4, amid multiple seasonal and market factors affecting liquidity supply and demand, the PBC appropriately managed the intensity and pace of open market operations and responded to short-term truculence in a targeted manner. In late December, the PBC injected cross-year funds through 14-day reverse repo operations to meet market demand and maintain the stability of market liquidity at year-end.

Guiding market rates to move around the central bank policy rates. In 2020, in response to the impact of COVID-19, the PBC preemptively guided the downward movement of policy rates, with both the MLF rate and the reverse repo rate falling by 30 bps, and cut the funding costs for private enterprises and micro and small-sized businesses (MSBs) through the transmission of the loan prime rate (LPR). In the second half of the year, both the MLF rate and the reverse repo rate remained unchanged, demonstrating a sound monetary policy stance. In the meanwhile, the PBC improved the continuity of open market operations, steadily sent short-term policy rate signals through daily operations, and guided short-term money market rates to move around the 7-day reverse repo operation rate on the open market within a reasonable range. The MLF rate, as the medium-term policy rate, has obvious guiding effects on medium and long-term market rates. In December, both interest rates on interbank CDs and yields on government bonds declined and converged toward the MLF rate.

To judge the trend of short-term interest rates, we need to determine whether policy rates have changed in the first place, especially whether the 7-day reverse repo rate of the central bank's open market operations has changed, and to avoid paying excessive attention to the number of open market operations. The number of open market operations is flexibly adjusted in accordance with temporary factors, such as public finance and cash as well as market demand. Its change does not fully reflect the trend in market rates, nor does the change represent a change in the central bank policy rate. Second, when observing market rates, we need to focus on the weighted average of DR007, which is the main indicator of market rates, and the average of DR007 over a period of time, rather than the transaction rate of an individual institution or the interest rate at a certain point of time, which may be disturbed by short-term factors.

Figure 3 Convergence of Interest Rates on Interbank CDs and Yields on Government Bonds Toward the MLF Rate

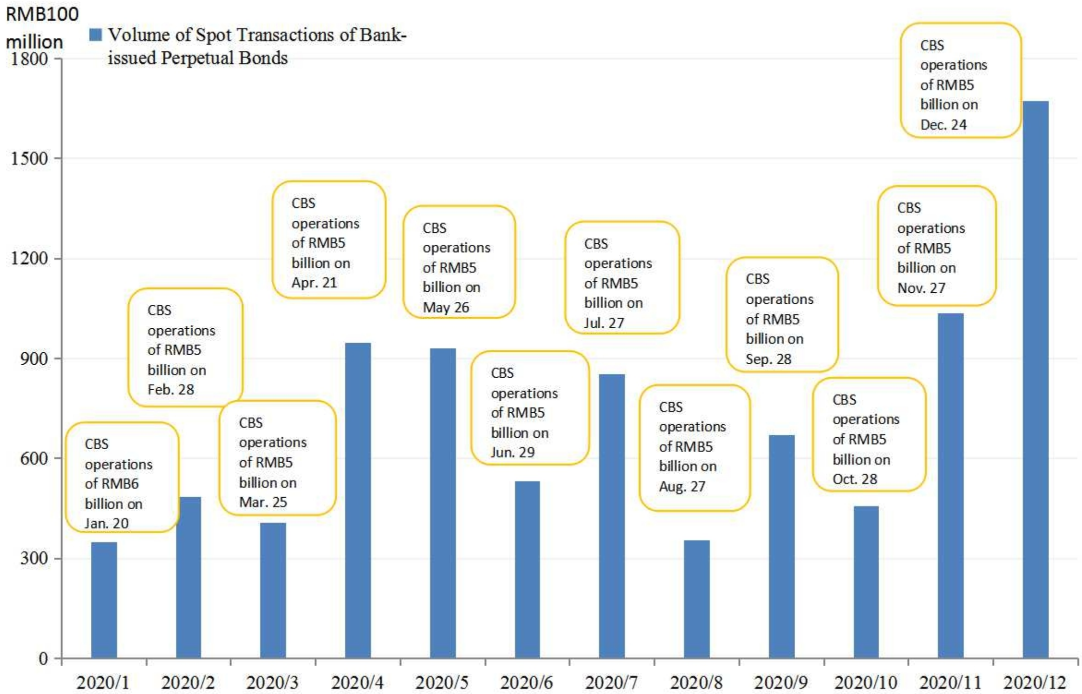


Continuously conducting central bank bill swap (CBS) operations. In Q4 2020, the PBC conducted CBS operations three times, with the total amount registering RMB15 billion. The maturity of each operation was three months, at a fixed rate of 0.1 percent. In 2020, the PBC conducted CBS operations once in each month, totaling RMB61 billion. The CBS operations played a positive role in improving liquidity in 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, and hence strengthened the capability of the financial sector to serve development of the real economy.

Issuing central bank bills in Hong Kong on a regular basis. In Q4 2020, the PBC issued three batches of RMB-denominated central bank bills in Hong Kong, totaling

RMB35 billion. Specifically, the 1-year, 3-month, and 6-month bills registered RMB15 billion, RMB10 billion, and RMB10 billion, respectively. In 2020, the PBC issued in Hong Kong twelve batches of RMB-denominated central bank bills, totaling RMB155 billion. The regular issuance of RMB-denominated central bank bills in Hong Kong not only enriched RMB investment products and RMB liquidity management tools in the Hong Kong market but also drove both domestic and overseas market entities to issue RMB-denominated bonds and to conduct RMB business in the offshore market, thus promoting the sustainable and sound development of the offshore RMB market. On January 27, 2021, Bank of China (Hong Kong) Limited launched a market-making mechanism for the RMB-denominated central bank bills repo business, fostering liquidity in the secondary market of RMB-denominated central bank bills in Hong Kong. According to statistics, in 2020, offshore RMB bond issuances, other than the RMB-denominated central bank bills issued in Hong Kong, exceeded RMB130 billion, a year-on-year increase of 30 percent. Moreover, with the how and where to issue RMB bonds offshore increasingly diversified, the RMB offshore market saw more brisk transactions.

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



II. Timely conducting Medium-term Lending Facility and Standing Lending Facility operations

Well-timed MLF operations were conducted. An appropriate supply of medium- and long-term liquidity was ensured, giving full play to the signaling and guiding functions of the mid-term policy rate. In 2020, the PBC conducted a total of RMB5.15 trillion of MLF operations, all with a maturity of one year. In particular, the amount of MLF operations posted RMB0.6 trillion, RMB0.4 trillion, RMB1.7 trillion, and RMB2.45 trillion in Q1, Q2, Q3 and Q4 respectively. At the end of the year, the outstanding MLF registered RMB5.15 trillion, RMB1.46 trillion more than that at the beginning of the year. The MLF operations were conducted by bidding, with the rate of February 17, 2020 posted 3.15 percent, down 10 basis points, and the rate of April 15, 2020 posted 2.95 percent, a further drop of 20 basis points.

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. In 2020, the PBC conducted a total of RMB186.2 billion SLF operations, of which RMB102.7 billion, RMB48.7 billion, RMB6 billion, and RMB28.8 billion SLF operations were conducted in Q1, Q2, Q3 and Q4 respectively. At the end of the year, the balance of SLF operations registered RMB19.8 billion. The SLF played a role as the ceiling of the interest rate corridor, thus promoting the smooth operation of the money market. The rates for SLF operations were reduced by 30 basis points in Q2. After the cut, the overnight, 7-day, and 1-month SLF rates were 3.05 percent, 3.20 percent, and 3.55 percent respectively.

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

To coordinate regular pandemic containment and economic and social development, the intensity, pace and focus of monetary policy adjustments were properly managed based on the different features at each stage. Policy measures were implemented in a more targeted and direct manner, with the aim of ensuring stability on six fronts and maintaining security in six areas. The efforts to provide financial support to stabilize businesses and secure employment have achieved the expected results.

Macro policies were enhanced in a timely manner to offset the impact of the

pandemic. In 2020, RMB1.7 trillion of short-term liquidity was provided to the financial market when it reopened after the Spring Festival holiday, which effectively stabilized market expectations. The three rounds of RRR cuts in 2020 released RMB1.75 trillion of long-term funds. By means of 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 and local government bonds.

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. In 2020, the PBC rolled out RMB300 billion of special central bank lending, RMB500 billion quota of central bank lending and central bank discounts, and RMB1 trillion quota of central bank lending and central bank discounts in three rounds, with a total amount of RMB1.8 trillion, in support of pandemic containment, the resumption of work and production, as well as the development of the real economy, including micro, small and medium-sized enterprises (MSMEs). By end-June 2020, the RMB300 billion quota of special central bank lending was used up, supporting relevant banks to issue a cumulative RMB283.4 billion of preferential loans to a total of 7,597 nationwide and local key enterprises, with a weighted average interest rate of 2.49 percent. The actual financing costs for enterprises dropped to 1.25 percent after a 50-percent fiscal subsidy on the loan interest. The special central bank lending policy vigorously eased the shortage of medical supplies at the beginning of the outbreak and fostered the normal supply of daily necessities in key areas during the pandemic. The RMB500 billion quota of central bank lending and central bank discounts was used up, supporting locally incorporated banks to issue a cumulative RMB498.3 billion of preferential loans to around 590,000 enterprises, with a weighted average interest rate of 4.22 percent, which effectively addressed the pressing problems of debt repayment, turnover of capital, and expansion of financing in face of the resumption of work and production. In December 2020, the RMB1 trillion quota of inclusive central bank lending and central bank discounts was allocated, supporting locally incorporated banks to support around 1,580,000 enterprises, with a weighted average interest rate of 4.67 percent. These policies boosted a sense of gain in the real sector, accelerated the resumption of work and production, and improved the job market.

With highlighted characteristics of directness and precision, two monetary-policy instruments directly supporting the real economy were proactively promoted, with the aim of bolstering the development of MSMEs. By end 2020, the principal and interest repayments on loans of RMB7.3 trillion had been deferred by banking financial institutions across the country. The instrument in support of deferred repayments on inclusive MSB loans operated on a monthly basis, providing a cumulative RMB8.7 billion of incentive funds to locally incorporated banks and supporting deferral of the principal on a total of RMB873.7 billion inclusive MSB loans from June to December. The weighted average time extension registered 12.8 months, easing the temporary pressures on MSBs to repay the loan principal and interest. In 2020, a total of RMB3.9 trillion of inclusive unsecured loans for MSBs were provided by banking financial institutions, RMB1.6 trillion more than that in 2019. The support scheme for inclusive unsecured loans for MSBs operated on a quarterly basis, providing a cumulative RMB170 billion of preferential funding to locally incorporated banks and supporting a total of RMB480.8 billion in unsecured loans for MSBs from March to December, effectively alleviating the financing strains on MSBs.

In line with the arrangements decided by the executive meeting of the State Council on extending the policies of deferred repayments on inclusive MSB loans and the support scheme of inclusive unsecured loans for MSBs, on December 31, 2020, the PBC, jointly with the China Banking and Insurance Regulatory Commission (CBIRC), Ministry of Finance (MOF), the National Development and Reform Commission (NDRC), and Ministry of Industry and Information Technology (MIIT), issued the *Notice on Extending the Policies of Deferred Repayments of Principal and Interest on Inclusive Loans for Micro and Small Businesses and the Support Scheme of Inclusive Unsecured Loans for Micro and Small Businesses* (Yinfa No.324 [2020]), extending the two policies until March 31, 2021. First, the policy of deferred repayments of principal and interest on inclusive loans to MSBs was extended. Repayment of all the inclusive MSB loans eligible for this policy could be deferred based on market principles, and banks and enterprises could discuss the relevant terms. For inclusive MSB loans with a deferred repayment period of no less than 6 months that are issued by locally incorporated financial institutions, the PBC provides incentive funding of 1 percent of the loan principal. Second, the support scheme of inclusive unsecured MSB loans was extended. For inclusive unsecured MSB loans that are newly issued by eligible locally incorporated financial institutions, the PBC provides favorable funding for 40 percent of the loan principal.

IV. Lowering the Required Reserve Ratio for financial institutions

In 2020, the PBC launched three rounds of RRR cuts for financial institutions and lowered the interest rate on excess reserves in an attempt to support the economic recovery. In January 2020, the PBC reduced the RRR for financial institutions (excluding finance companies, financial leasing companies, and auto finance companies) by 0.5 percentage points releasing over RMB800 billion of long-term funds. In March, the PBC implemented a targeted RRR cut for inclusive finance. For banks that met the criteria for loan issuances for inclusive finance in 2019, the PBC granted a preferential RRR cut of 0.5 or 1.5 percentage points. Moreover, joint-stock commercial banks that received a 0.5-percentage-point RRR cut according to this assessment would enjoy an additional RRR cut of 1 percentage point. These two measures released about RMB550 billion of long-term funds in total, and guided financial institutions to expand loan issuances for inclusive finance. In April, the PBC announced a RRR cut of 1 percentage point for rural commercial banks, rural cooperative banks, rural credit cooperatives, village banks, and city commercial banks operating solely within their provincial-level administrative regions. The measure was implemented in two phases, under which cuts were carried out on April 15 and May 15 respectively. About RMB400 billion of long-term funds were freed up by the cuts. Meanwhile, the interest rate on excess reserves deposited in the central bank by financial institutions was lowered from 0.72 percent to 0.35 percent. All the above-mentioned measures contributed to broadening long-term and stable funding sources for financial institutions, improving their efficiency in the use of funds, and boosting their credit support for MSMEs as well as for industries and firms that were seriously hit by the pandemic.

V. Further improving the macro-prudential policy framework

The mechanism of a countercyclical capital buffer was established. In September 2020, the PBC and CBIRC jointly issued the *Notice on Establishing the 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. The mechanism will contribute to the sound business operation of banking institutions and safeguard the stability of China's financial system.

A regulatory framework for financial holding companies (FHCs) was preliminarily set up. In September 2020, the PBC released the *Trial Measures on the Regulation of Financial Holding Companies* (Order No. 4 [2020] of the People's Bank of China), which entered into effect from November 2020. The Measures specify law-based market access for FHCs that are invested in and controlled by non-financial companies. The capital, behavior, and risk of FHCs shall be regulated in an all-round, continuous, and look-through manner, so as to effectively isolate the FHCs' real economic activities from their financial activities and to prevent cross-organization, cross-industry, or cross-market risk contagion.

The regulatory framework for systemically important financial institutions was improved. On December 3, 2020, the PBC and the CBIRC jointly released the *Measures for Assessment of Systemically Important Banks (SIBs)* (Yinfa No. 289 [2020]). The Measures specify the indicators, procedures, and work division in the assessment of SIBs in China, and they establish the basis for SIB identification.

A management system for real estate loan concentration for banking institutions was established. In December 2020, the PBC, jointly with CBIRC, issued the *Notice on Establishing a Management System for Real Estate Loan Concentration for Banking Institutions* (Yinfa No.322 [2020]), which set up a management system for real estate loan concentration and specified the ceiling proportions of real estate loans and personal housing loans in the total loans of banking institutions. The system will contribute to strengthening the resilience and soundness of the financial system, promoting steady and healthy development of the real estate market, enhancing the banking institutions' internal constraints, improving the credit structure, and fostering balanced development of the financial sector, the real estate sector, and the real economy.

The role of the macro-prudential assessment (MPA) was effectively brought into play to optimize the credit structure and to promote the supply-side structural reform of the financial sector. Since the beginning of 2020, in line with the requirements for key tasks set at the Central Economic Work Conference, the PBC further improved the MPA, optimized the credit structure, and reduced financing costs. First, the weight of financing to MSBs and private enterprises as well as the manufacturing sector was increased in bank assessments, and "use of central bank lending" was introduced as a temporary assessment indicator. These measures guided financial institutions to enhance their support for the key areas and weak links in the national economy and secured incremental financing flows to the manufacturing sector and MSMEs. Second, the PBC improved the assessment of the use of the LPR, released the potential of LPR reform in reducing loan interest rates, encouraged banks to accelerate the shift in the pricing benchmark for outstanding floating-rate loans, and pushed ahead with a marked decline in the overall financing costs for enterprises.

The macro-prudential adjustment parameter for cross-border financing was adjusted. On March 11, 2020, the PBC and the State Administration of Foreign Exchange (SAFE) released the *Notice on Adjusting the Macro-prudential Adjustment Parameter for Cross-border Financing* (Yinfa No. 64 [2020]), increasing the parameter from 1 to 1.25. In order to improve the macro-prudential management of overall cross-border financing and to guide financial institutions to adjust their asset and liability structure of foreign exchange in a market-based manner, the PBC and the SAFE decided to lower the macro-prudential adjustment parameter for financial institutions' cross-border financing to 1 from 1.25 on December 11, 2020. In addition, the PBC and the SAFE released the *Notice on Adjusting the Macro-prudential Adjustment Parameter for Cross-border Financing* (Yinfa No. 5 [2021]), lowering the macro-prudential adjustment parameter for cross-border financing of enterprises to 1 from 1.25 on January 7, 2021.

The foreign exchange risk reserve ratio was adjusted when appropriate. Since the beginning of 2020, the RMB exchange rate experienced two-way floating based on market supply and demand amid strengthened flexibility, stable market expectations, orderly cross-border capital flows, stable performance in 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.

VI. Actively leveraging the role of structural monetary policy instruments

The PBC actively used central bank lending to support rural development, central bank lending for MSBs, central bank discounts, pledged supplementary lending (PSL), and other 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 for special poverty alleviation projects to increase credit supply to the "three autonomous regions", i.e., Tibet, the 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 the four quarters of 2020, central bank lending for special poverty alleviation projects was issued in the amounts of RMB6.3 billion, RMB8.0 billion, RMB7.2 billion, and RMB7.9 billion, respectively, with the balance recording RMB37.0 billion at end-2020. At end-2020, outstanding central bank lending to support rural development registered RMB457.2 billion. Outstanding central bank lending for MSBs and for poverty alleviation posted RMB975.6 billion and RMB215.3 billion, respectively. Outstanding central bank discounts registered RMB578.4 billion. In 2020, the PBC made a net withdrawal of PSLs in the amount of RMB302.3 billion from policy and development banks, with the net withdrawal in Q4 totaling RMB199.3 billion and the outstanding PSL registering RMB3.2350 trillion at end-2020.

Targeted Medium-term Lending Facility (TMLF) operations were conducted. The TMLFs provided a stable and long-term funding source for financial institutions to expand their credit supply to MSBs and private firms with preferential interest rates. In the first quarter of 2020, the PBC conducted one-year TMLF operations totaling RMB240.5 billion, with a rate of 3.15 percent. In the second quarter, the PBC conducted one-year TMLF operations totaling RMB56.1 billion, with a rate of 2.95 percent. The TMLFs maturing in Q3 were rolled over in the form of MLFs. In the fourth quarter, the PBC did not conduct any TMLF operations. At end-2020, the outstanding TMLFs totaled RMB296.6 billion.

Box 2 Boosting Green Finance to Reach a Carbon Emissions Peak and Achieve Carbon Neutrality

In 2020, General Secretary Xi Jinping announced at the General Debate of the 75th Session of the United Nations General Assembly that China would strive to reach a carbon emissions peak by 2030 and to achieve carbon neutrality by 2060. It was required at the Fifth Plenary Session of the 19th CPC Central Committee and the Central Economic Work Conference that efforts should be made to accelerate green and low-carbon development and to make good progress in reaching a carbon emissions peak and carbon neutrality. Centering around the objectives of peak carbon emissions and carbon neutrality, the PBC will deliver a sound overarching design and plan for green finance, give play to the three functions of finance to support green development, and gradually improve the five pillars of the green finance system.

I. Bringing into play the three major functions of finance to support green development

Green finance refers to economic activities aimed at supporting improvements in the environment, mitigating climate change, and high-efficiency utilization of resources. It means providing financial services for the funding and investment, project operation, and risk management of programs concerning environmental protection, energy conservation, clean energy, green transport, and green building. Centering around the goals of a carbon emissions peak and carbon neutrality, work should be done to further focus on carbon emissions reductions, to give full play to the role of resource allocations, and to manage well the risks related to climate change in the process of developing green finance. In addition, efforts should be made to promote carbon price discovery under the constraints of carbon neutrality and to guide the financial system to allocate more resources to green and low-carbon areas.

First, full play should be given to resource allocations. Currently, fossil fuels account for a large share of the total energy consumption in China. With the aim of achieving a carbon emissions peak and carbon neutrality, the proportion of fossil fuel against total energy consumption needs to gradually decline. Therefore, great efforts must be made to promote the development of renewable resources, such as wind and solar power, and to conserve energy and reduce carbon emissions in the areas of electricity, industry, architecture, and transportation. Meanwhile, development of technologies such as carbon capture and storage should be further supported. In order to promote the development of green finance to focus on green and low-carbon areas, a variety of policy measures, such as monetary policies, credit policies, regulatory policies, compulsory disclosures, green evaluations, self-regulation, and product innovations should be adopted so as to guide and allocate more financial resources to green innovation projects in terms of clean energy, green transformation, and carbon capture and storage.

Second, there should be proper management of risks related to climate change. In the future, constraints on carbon emissions will be strengthened notably, incurring risks to the transformation of the high-carbon industries. The frequent occurrence of natural disasters caused by climate change will also have an impact on various fields. Various means such as pressure tests on climate risks and environmental and climate risk analyses should be adopted to enhance the financial system’s capability to manage the risks related to transformation and climate change.

Third, carbon price discovery will be promoted under the constraint of carbon neutrality. Centering around the objective of carbon neutrality, it is necessary to set carbon emissions quotas with strong binding force. Construction of a national carbon emissions trading market will be promoted, along with related financial product and trading mechanism designs so as to promote market discovery of a reasonable carbon price under the carbon emissions constraints.

II. Gradually improving the five major pillars of a green finance system

To give play to the three major functions of finance in support of green development, the five major pillars of a green finance system should be gradually improved.

First, continue building a standard system for green finance. China is already taking the lead in terms of setting the standards for green finance, but these standards have yet to be gradually unified domestically as well as to be compatible with international practices. We can start with trials of national standards and industrial standards for green finance so as to promote regulated development of green finance and to accumulate valuable experience for promoting nationwide green finance standards that is feasible for banks and beneficial to enterprises.

Second, improve supervision of financial institutions and the requirements for information disclosure. Gradually establish a system of climate and environmental information disclosures for financial institutions and guide more investment toward environment friendly enterprises, such as those that are green and low-carbon.

Third, establish a policy incentive and constraint mechanism. Performance evaluations of green finance should be periodically conducted for financial institutions. The feasibility of setting differentiated risk weights for green and brown assets should be studied. The PBC will comprehensively adopt a variety of monetary policy tools to guide financial institutions to step up credit support to the green and low-carbon sectors.

Fourth, continuously improve green financial products and the relevant market system. As of end-Q3 2020, outstanding green loans denominated in RMB and foreign currencies in China posted over RMB11 trillion, ranking first in the world. Full play will be given to the market mechanism. By means of innovating products and tools, enhancing pricing rationality, and strengthening environmental risk management, the PBC will continue to encourage products including green credit, green bonds, and green funds, build a carbon trading market, and develop carbon futures.

Fifth, strengthen international cooperation on green finance. Continue to deepen international cooperation in green finance under multilateral frameworks, such as the G20, the Central Banks, and the Supervisors Network for Greening the Financial System (NGFS), and the "Belt and Road", as well as under bilateral frameworks between China and Europe, China and the United Kingdom, China and France, etc.

Going forward, the PBC will follow the arrangements of the CPC Central Committee and the State Council, focus on the three major functions and five pillars of green financial development, and improve the policy framework and the incentive and constraint mechanisms for green finance. It will utilize structural monetary policy instruments and guide financial institutions to support green and low-carbon development in accordance with market-oriented principles so as to achieve the objectives of peak carbon and carbon neutrality.

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

Oriented by high-quality development, the PBC guided financial institutions to continuously step up support to key areas and weak links in the national economy, enhanced financial support for market entities impacted by COVID-19, and focused on keeping businesses and employment stable. It also provided powerful support to achieve the goal of winning the battle against poverty and to complete the building of a moderately prosperous society in all respects.

Emphasis was placed on providing financial support to keep businesses and employment stable. Financial services were continuously improved, promoting MSB financing featuring "increased volume, lowered price and expanding coverage". The PBC enhanced support for medium and long-term loans to the manufacturing sector to promote its high-quality development. The PBC implemented the policy of deferred repayments for inclusive loans to MSBs, and provided support for unsecured inclusive loans to MSBs, and work was done to ensure the continuation and reasonable adjustment of policy so as to invigorate market entities and stabilize market expectations. By focusing on key groups and key businesses, the PBC conducted a variety of innovative activities connecting government agencies, banks, and businesses to enable more effective and better-matched financing.

No efforts were spared in providing targeted financial support for completing the task of poverty alleviation. The PBC focused on the deeply impoverished regions and the counties listed for supervision of poverty relief. Financial support was enhanced for industrial development used as a means of poverty alleviation and for relocation of impoverished residents. The quality of basic financial services in the poverty-stricken areas was improved, with all the impoverished counties lifted out of poverty. In addition, the PBC promoted the improvement of corresponding regulatory mechanisms for financing poverty alleviation, concentrated on preventing and resolving relevant risks, and cooperated with the census on poverty elimination, thereby facilitating high-quality and sustainable poverty alleviation.

More resources were allocated to support the rural revitalization strategy. The PBC arranged special quotas of central bank lending to support rural development and supported bank issuance of more loans to expand pig farming. Financial services were improved for spring plough and farming preparations, and for agricultural investment. Work was done to optimize financial services for reform of the rural property rights system, to develop the collective economy, and to promote the collateralization of operational rights of contracted farmland.

VIII. Further deepening the market-based interest rate reform

Since the beginning of 2020, the PBC has smoothed the transmission of monetary policy by means of reforms. With continued progress in the LPR reform, the financing costs of enterprises have witnessed an obvious decline. First, taking a forward-looking view, the PBC guided the open market operation (OMO) rates and the MLF rates to move downward by 30 basis points, driving down the one-year LPR by 30 basis points. Accordingly, the overall market rates and loan rates went downward, supporting the reasonable growth of loan demand. In December, the weighted average rate on corporate loans posted 4.61 percent, down by 0.51 percentage points from the previous December and hitting a record low for two consecutive months. Second, use of the LPR was further promoted. Starting from January 1, 2020, newly-issued loans no longer took the benchmark loan rates as their pricing reference. During the period from March to August 2020, the shift in the pricing benchmark for outstanding floating-rate loans was completed in line with market-oriented and law-based principles. As of end-August, 92.4 percent of outstanding loans had completed the shift in the pricing benchmark. Banks were urged to incorporate the LPR into the funds transfer pricing (FTP) of loans, fundamentally removing the implicit floor of loan rates. Accordingly, more financial resources were guided to be allocated to MSBs and private enterprises, and the actual loan rates declined. Third, the market-oriented reform of credit-card overdraft interest rates was promoted. The credit-card overdraft interest rates were determined by negotiations between credit-card issuers and cardholders from January 1, 2020, with the caps and floors removed. Administrative controls on credit-card overdraft interest rates were lifted and market-oriented pricing was completely achieved, which was conducive to promoting market competition and urging card issuers to improve services. Fourth, the self-regulatory mechanism for interest rates was strengthened, promoting explicit indications of annualized loan rates. Special membership was set up and micro-credit companies were included into the scope of interest rate self-regulation so as to improve the self-regulatory mechanism for market-rate pricing. Fifth, the benchmark deposit interest rates continued to play their role as the “ballast” for the overall interest rate system in China. Efforts were made to strengthen the self-regulation of deposit interest rates, to reduce irregular innovative deposit products, and to maintain competitive order in the deposit market. The LPR reform promoted optimization of the financial structure, smoothed the internal pricing mechanism of banks, and effectively promoted the market-based reform of deposit rates, as indicated by the overall decline of deposit rates.

IX. Improving the market-based RMB exchange rate formation mechanism

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

In 2020, the highest and lowest CNY central parities were 6.5236 and 7.1316, respectively, against the USD. During the 243 trading days, the RMB appreciated on 140 days and depreciated on 103 days. The biggest intraday appreciation and depreciation were 1.00 percent (670 bps) and 0.76 percent (530 bps), respectively. The RMB exchange rates against other major international currencies floated in two ways. At end-2020, the central parities of the RMB against the dollar, the pound. and the Japanese yen had appreciated 6.92 percent, 2.92 percent, and 1.34 percent, respectively, from end-2019, while the RMB central parity had depreciated 2.61 percent against the euro during the same period of time. Since the reform of the RMB exchange rate formation mechanism commenced in 2005, the RMB had appreciated by a cumulative total of 26.84 percent, 24.79 percent, and 15.53 percent, respectively, against the dollar, the euro, and the Japanese yen through end-December, 2020. Direct RMB trading was buoyant in the interbank foreign exchange market with stable liquidity, which helped lower the exchange costs of micro economic entities and to facilitate bilateral trade and investment.

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

Unit: RMB100 million

Currency	USD	EUR	JPY	HKD	GBP	AUD	NZD
Trading volume	553205.22	14194.95	2733.76	1456.62	586.77	588.75	214.39
Currency	SGD	CHF	CAD	MYR	RUB	ZAR	KRW
Trading volume	840.00	134.80	337.00	5.04	143.69	1.75	61.52
Currency	AED	SAR	HUF	PLN	DKK	SEK	NOK
Trading volume	8.92	21.68	15.83	15.97	54.66	28.11	11.25
Currency	TRY	MXN	THB	KHR	KZT	MNT	
Trading volume	9.50	9.11	358.88	0.06	0.02	0	

Source: China Foreign Exchange Trade System.

As of end-December, under the bilateral currency swap agreements between the PBC and foreign monetary authorities, the foreign monetary authorities utilized a total of RMB50.032 billion, and the PBC utilized foreign currencies equivalent to USD516 million. These operations played an active role in promoting bilateral trade and investment.

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

Resolution of high-risk small and medium-sized financial institutions was carried out smoothly. The PBC strove to ease the impact of the pandemic and achieved crucial progress and important initial results in the resolution of high-risk small and medium-sized financial institutions. The reform and restructuring plans of key financial institutions, including Hengfeng Bank and Jinzhou Bank, were carried out smoothly to ensure the sound operation of the financial system during the critical and sensitive period and to firmly safeguard the bottom line that no systemic risks should occur.

Risk resolution of Baoshang Bank (BSB) was advanced steadily and orderly. The reform and restructuring of BSB has been progressing smoothly, and Mengshang Bank and Huishang Bank, which have entered into the purchase and assumption process with BSB, are abundant in capital and operating smoothly. As BSB has become seriously insolvent and has failed to repay debts that came due, the takeover group filed a bankruptcy petition with the CBIRC in the name of the troubled bank and the regulator has approved the bank's application to enter into bankruptcy procedures. On November 23, 2020, the Beijing No.1 Intermediate People's Court ruled to accept the bankruptcy and liquidation petition of BSB, and it appointed the BSB liquidation group as the administrator. Up to now, the work on BSB bankruptcy and liquidation has been progressing steadily and orderly.

Reform of development and policy financial institutions was continuously deepened. The PBC advanced the reform plans for development and policy financial institutions across the board to redefine their responsibilities and the scope of their business, improve corporate governance, strengthen the constraint and incentive mechanism, and prevent financial risks. The PBC guided development and policy financial institutions to fulfill their responsibilities, focus on their main business, and give full play to their role in supporting economic restructuring and high-quality development, thus better serving the national development strategies.

XI. Deepening the reform of foreign exchange arrangements

Two-way opening-up of the financial market was pushed forward. First, the pilot quota of Qualified Domestic Limited Partner (QDLP) and Qualified Domestic Investment Enterprise (QDIE) was increased to USD10 billion in Shanghai, Beijing, and Shenzhen. Second, Hainan Free Trade Port and the city of Chongqing were added to the QDLP pilot program, with a quota of USD5 billion in each area.

Facilitation of receipts and payments for trade was boosted. First, the pilot program for facilitating foreign exchange receipts and payments for trade was expanded to cover more areas in a steady and orderly manner. Second, outbound foreign exchange payments under trade in services became more convenient. On November 1, 2020, online verification services for tax registration of foreign exchange payments under trade in services were launched for trial operation nationwide. Third, to facilitate individuals' foreign exchange business under the initiative of "going global". The pilot program was expanded for online processing of foreign exchange sales and purchases for overseas studies which are not part of the annual quota for foreign exchange purchases by individuals. Fourth, to improve the environment for foreign exchange business after "bringing in". The pilot programs for facilitating small-value consumption by foreign individuals and for facilitating foreign exchange purchases and payments for the income of foreign top-level talents in China were promoted.

Administration of the foreign exchange market was strengthened. With regular pandemic containment measures remaining in place, efforts were made to coordinate pandemic containment with financial risk prevention and mitigation. Monitoring and analysis of potential risks incurred in 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 to maintain security in six areas. In 2020, a total of 2,440 cases violating the laws and regulations of the foreign exchange administration were handled, with total fines amounting to RMB940 million.

Part 3. Financial Market Conditions

In 2020, the financial market operated smoothly. Market interest rates were basically stable. The volume of bond issuances and cash bond transactions expanded. The stock market index picked up and 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

Liquidity in the banking system was adequate at a reasonable level, and money market interest rates were stable. In December 2020, the monthly weighted average interest rate for interbank lending and pledged repos posted 1.3 percent and 1.36 percent, respectively, down 79 basis points and 74 basis points, respectively, from December 2019. The monthly weighted average interest rate of government-backed bond repos among depository institutions posted 1.14 percent, 22 basis points lower than the monthly weighted average interest rate of pledged repos. At end-2020, the overnight and 7-day Shibor posted 1.09 percent and 2.38 percent, respectively, down 60 and 36 basis points from end-2019, respectively.

The market saw active repo transactions and interbank lending. In 2020, the volume of trading of bond repos on the interbank market reached RMB959.8 trillion, representing an average daily turnover of RMB3.9 trillion and a year-on-year increase of 17.6 percent. The volume of cumulative trading of interbank lending registered RMB147.1 trillion, with an average daily turnover of RMB590.9 billion and a year-on-year decrease of 2.6 percent. In terms of the maturity structure, overnight repos and overnight lending accounted for 84.7 percent and 90.2 percent, respectively, of the total turnover in bond repos and interbank lending, decreasing 0.5 percentage points and 1.2 percentage points year on year. The volume of bond repos traded on the exchange markets increased 20.3 percent year on year to RMB287.3 trillion.

Table 9 Fund Flows Among Financial Institutions in 2020

Unit: RMB100 million

	Repos		Interbank lending	
	2020	2019	2020	2019
Chinese-funded large banks①	-2,711,676	-1,918,715	-405,206	-280,598
Chinese-funded medium-sized banks②	-950,665	-744,800	-58,995	-148,506
Chinese-funded small-sized banks③	-49,334	132,798	127,947	111,408
Securities institutions④	1,100,130	861,901	261,702	258,387

Insurance institutions⑤	122,001	84,960	819	175
Foreign-funded banks	74,489	89,211	-27,072	-21,598
Other financial institutions and vehicles⑥	2,415,055	1,494,646	100,806	80,733

Notes： ①Chinese-funded large banks include the Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, China Construction Bank, China Development Bank, Bank of Communications, and Postal Savings Bank of China. ②Chinese-funded medium-sized banks refer to policy banks, China Merchants Bank, and the eight other joint-equity commercial banks, Bank of Beijing, Bank of Shanghai, and Bank of Jiangsu. ③Chinese-funded small-sized banks refer to Hengfeng Bank, China Zheshang Bank, China Bohai Bank, other city commercial banks, rural commercial banks, rural cooperative banks, private banks, and village and township banks. ④Securities institutions include securities firms, fund management companies, and futures companies. ⑤Insurance institutions include insurance firms and corporate annuities. ⑥Other financial institutions and vehicles include urban credit cooperatives, rural credit cooperatives, finance companies, trust and investment companies, financial leasing companies, asset management companies, social security funds, mutual funds, wealth management products, trust plans, and other investment vehicles. Some of these financial institutions and vehicles do not participate in the interbank lending market. ⑦A negative sign indicates net lending and a positive sign indicates net borrowing.

Source: China Foreign Exchange Trade System.

Interbank Certificates of Deposit (CD) and negotiable CD businesses operated steadily. In 2020, around 29,000 interbank CDs were issued on the interbank market, raising RMB19.0 trillion. The volume of trading on the secondary market totaled RMB167.3 trillion. At end-2020, outstanding interbank CDs reached RMB11.2 trillion. Around 52,000 negotiable CDs was issued by financial institutions in 2020, raising RMB9.7 trillion, a decrease of RMB2.3 trillion year on year. In 2020, the average weighted interest rate of 3-month interbank CDs was 2.60 percent, 20 basis points higher than that of the 3-month Shibor.

Interest rate swap transactions witnessed steady growth. In 2020, the RMB interest rate swap market witnessed 274,000 transactions, increasing 15.3 percent year on year, with the volume of the notional principal totaling RMB19.6 trillion, an increase of 7.8 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 RMB12. 5 trillion, accounting for 63.8 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 82.7 percent and 14.9 percent, respectively, of the total notional principal of the interest rate swaps. In 2020, interest rate swaps anchored to the LPR witnessed 1,718 transactions, with RMB266.5 billion of the notional principal.

Table 10 Transactions of Interest Rate Swaps in 2020

	Transactions	Notional principal (RMB100 million)
2020	274,029	195,564.6
2019	237,654	181,394.2

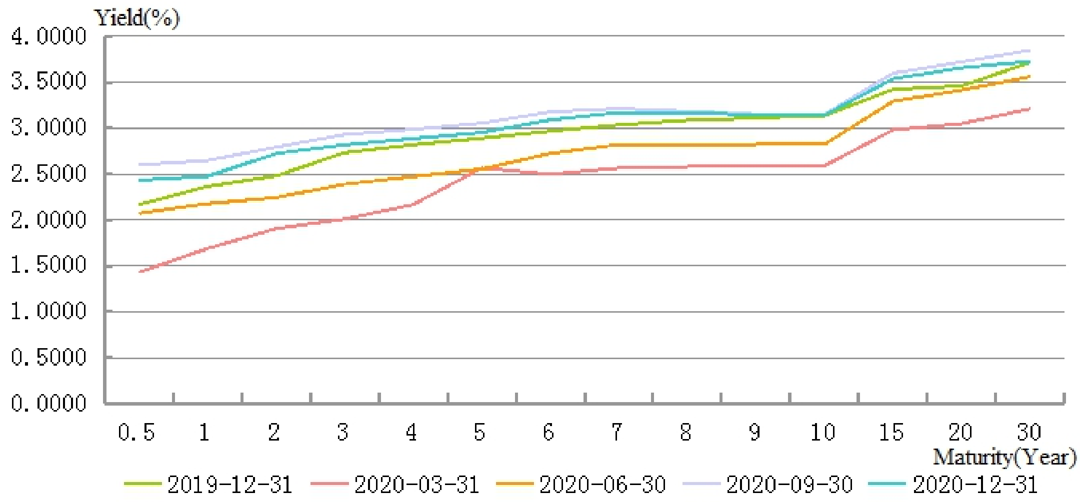
Source: China Foreign Exchange Trade System.

The loan prime rate (LPR) interest rate option business developed steadily. After the LPR interest rate option business made its debut on the interbank market on March 23, 2020, 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. At end-2020, a total of 484 interest rate option transactions were concluded, adding up to RMB90.75 billion. Specifically, 126 LPR interest rate swap transactions were concluded, amounting to RMB14.35 billion of the notional principal, and 358 were LPR interest rate cap/floor transactions, amounting to RMB76.4 billion of the notional principal.

2. Bond financing costs decreased on the whole, and transactions and issuances of cash bonds expanded

Bond market yields went down first and then picked up, with credit spreads widening. Government securities yields decreased continuously from January to April 2020, and have rebounded since then. At end-2020, the yields on 1-year and 10-year government securities increased by 11 basis points and 1 basis point, respectively, from end-2019. Credit spreads on 3-year AAA and AA-rated short-to-medium-term bills expanded by 3 basis points and 52 basis points year on year, respectively.

Figure 5 Yield Curves of Government Securities on the Interbank Market



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

The costs of financing through the issuance of bonds decreased. In 2020, the average coupon rate of 10-year government securities issued by the Ministry of Finance was 2.93 percent, 24 basis points lower than the rate in 2019. The average coupon rate of 10-year financial bonds issued by China Development Bank was 3.31 percent, 26 basis points lower than the rate in 2019. The average rate of 1-year short-term financing bills (bond rating A-1) issued by AAA-rated non-financial enterprises was 2.82 percent, 58 basis points lower than the rate in 2019.

The volume of cash bond transactions on the interbank market maintained growth and that on the stock exchanges witnessed a significant increase. In 2020, the value of cash bonds trading on the bond market posted RMB253 trillion, registering an increase of 16.5 percent year on year. Specifically, the value of bond trading on the interbank market was RMB232.8 trillion, representing an increase of 11.5 percent year on year. The value of bond transactions on the stock exchanges totaled RMB20.2 trillion, an increase of 141.6 percent year on year. The value of bond lending transactions stood at RMB7.5 trillion, an increase of 61.6 percent year on year.

Bond issuances saw year-on-year growth. In 2020, the value of bond issuances increased by 26 percent, or RMB11.7 trillion, year on year to RMB56.9 trillion, with government bonds, financial bonds, and corporate debenture bonds increasing by RMB5 trillion, RMB3.2 trillion, and RMB3.5 trillion, respectively. At end-2020, outstanding bonds held in custody amounted to RMB116.7 trillion, an increase of 17.9 percent year on year.

Table 11 Bond Issuances in 2020

Unit: RMB100 million

Type of bond	Issuance	YOY change
Government securities	70,855	29,292
Local government bonds	64,438	20,814
Central bank bills	0	0
Financial bonds①	291,539	32,179
Of which: Financial bonds issued by China Development Bank and policy financial bonds	51,638	15,451
Interbank certificates of deposit	189,720	10,007
Corporate debenture bonds②	142,012	34,954
Of which: Debt-financing instruments of non-financial enterprises	91,461	23,385
Enterprise bonds	5,542	286
Corporate bonds	31,322	7,728
Bonds issued by international institutions	554	85
Total	569,397	117,324

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 grew continuously

The bill acceptance business grew continuously. In 2020, commercial drafts issued by enterprises totaled RMB22.1 trillion, rising 8.4 percent year on year. At end-2020, outstanding commercial drafts stood at RMB14.1 trillion, increasing 10.7 percent year on year. In 2020, outstanding commercial draft acceptances rose by RMB1.4 trillion, and 70.3 percent of the outstanding bankers' acceptances were issued by micro, small, and medium-sized enterprises (MSMEs).

Bill financing expanded continuously. In 2020, total discounts by financial institutions amounted to RMB40.4 trillion, growing 17.7 percent year on year. At end-2020, the balance of bill financing was RMB8.4 trillion, up 9.7 percent year on year. The balance accounted for 4.8 percent of the total outstanding loans, 0.1 percentage points lower year on year.

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

Stock indices soared. At end-2020, the Shanghai Stock Exchange Composite Index closed at 3,473 points, increasing 13.9 percent from end-2019. The Shenzhen Stock Exchange Component Index closed at 14,471 points, increasing 38.7 percent from end-2019. Turnover on the stock markets expanded significantly. In 2020, the combined turnover of the Shanghai Stock Exchange and the Shenzhen Stock Exchange reached RMB206.8 trillion, and the average daily turnover was RMB851.1 billion, an increase of 63 percent year on year. The amount of funds raised on the stock markets surged year on year. In 2020, a cumulative RMB1.2 trillion was raised, increasing 68.6 percent year on year.

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

In 2020, total premium income in the insurance sector amounted to RMB4.5 trillion, up 6.1 percent year on year, a deceleration of 6.1 percentage points from 2019. Claim and benefit payments totaled RMB1.4 trillion, representing a year-on-year increase of 7.9 percent. Specifically, total property insurance claim and benefit payments increased 7 percent year on year, and total life insurance claim and benefit payments went up by 8.8 percent year on year.

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

Unit: RMB100 million, %

	Balance	As a share of total assets

	End-2020	End-2019	End-2020	End-2019
Total assets	232,984	205,645	100.0	100.0
Of which: Bank deposits	25,973	25,227	11.1	12.3
Investments	190,828	160,043	81.9	77.8

Source: China Banking and Insurance Regulatory Commission.

The growth of assets in the insurance sector accelerated. At end-2020, total assets in the insurance sector increased 13.3 percent year on year to RMB23.3 trillion, an acceleration of 1.1 percentage points from end-2019. Specifically, bank deposits and investment-linked assets increased by 3 percent and 19.2 percent, respectively, year on year.

6. Foreign exchange transactions rose slightly year on year

In 2020, the cumulative turnover of spot RMB/foreign exchange transactions registered USD8.4 trillion, an increase of 5.6 percent year on year. The cumulative turnover of RMB/foreign exchange swap transactions totaled USD16.3 trillion, a decrease of 0.2 percent year on year. Specifically, cumulative overnight RMB/USD swap transactions posted USD9.5 trillion, accounting for 57.9 percent of the total swap turnover. Turnover of RMB/foreign exchange forward transactions totaled USD104.4 billion, rising 37.4 percent year on year. Turnover in foreign currency pair transactions totaled USD810.9 billion, rising 70.5 percent year on year. In particular, the EUR/USD pair registered the largest trading volume, accounting for 57.2 percent of the total market share.

Participants on the foreign exchange market expanded continuously. At end-2020, there were 735 members on the foreign exchange spot market, 266 members on the foreign exchange forward market, 259 members on the foreign exchange swap market, 213 members on the currency swap market, and 163 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 experienced a choppy rise. At end-2020, Loco London closed at USD1,897.5 per ounce, representing a gain of 25.07 percent from end-2019. The Au99.99 on the Shanghai Gold Exchange closed at RMB390.0 per gram, increasing 14.44 percent from end-2019. In 2020, the volume of gold traded on the Shanghai Gold Exchange was 58,700 tons, representing a decrease of 14.44 percent year on year. The turnover posted RMB22.55 trillion, increasing 4.91 percent year on year.

II. Development of institutional arrangements in the financial markets

1. Institutional arrangements in the bond and bill market

The legal system of the bond market was improved. In February 2020, the China Securities Regulatory Commission (CSRC), Ministry of Finance (MOF), People's Bank of China (PBC), and China Banking and Insurance Regulatory Commission (CBIRC) jointly released an announcement allowing qualified pilot commercial banks and insurers with proper investment management capacity to participate in the trading of treasury bond futures at the China Financial Futures Exchange in line with the principles of law compliance, manageable risks, and sustainable business development. In June 2020, the PBC, together with the relevant departments, released the *Notice of the PBC, NDRC, and CSRC on Issues Concerning Disposal of Defaults on Corporate Debenture Bonds* (Yinfa No.144 [2020]), which improved the risk prevention and disposal mechanism of defaults on corporate debenture bonds. In the meantime, the PBC promoted release of the *Minutes of the Symposium on Courts' Hearings of Bond-Related Dispute Cases* by the Supreme People's Court so as to consolidate legal safeguards. In July 2020, the PBC and relevant departments 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. In December 2020, the PBC released Announcement No.21 [2020] of the PBC, for the purpose of strengthening interim and ex-post management of market makers for spot bond trading in the interbank market following the cancellation of administrative approvals. In December 2020, the PBC, together with the relevant departments, released the *Administrative Measures for Information Disclosures of Corporate Debenture Bonds* (Announcement No.22 [2020] of the PBC, NDRC and CSRC), which unified the standards for information disclosures of corporate debenture bonds. In December 2020, the Standing Committee of the 13th National People's Congress deliberated and approved *Amendment (XI) to the Criminal Law*, which greatly increased penalties for crimes such as fraudulent issuances, fabricated information disclosures, false certificates provided by intermediaries, and so on, in an attempt to provide a solid legal safeguard for the high-quality development of the bond market.

In June 2020, the PBC released the *Administrative Measures on Standardized Bills* (Announcement No.6 [2020] of the PBC). Standardized bills connect the bill market with the bond market and enable the professional pricing and investing capacity of the bond market to be fully leveraged in a way that improves the standardization of bill transactions and enhances the financing function of bills. In December, the PBC released Announcement No.19 [2020] of the PBC, which specifies, in terms of commercial acceptance drafts, the requirements for information indicated on the drafts and the disclosure of credit information of acceptors so as to improve market-based constraint mechanisms and safeguard the legitimate rights and interests of holders.

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

Significant progress was secured in the capital market reform. On a national scale, the CSRC removed foreign ownership limits in futures companies from January 1, 2020 and those in securities companies and fund management companies from April 1, 2020. In July 2020, the first group of enterprises went public on the newly established National Equities Exchange and Quotations Select (NEEQ Select), achieving critical headway in building a multi-layer capital market. In August 2020, the reform of ChiNext market was officially launched with the pilot registration-based system in place, which was an important achievement in the reform of the registration-based IPO system.

The legal system in the capital market was further improved. The new *Securities Law* was implemented as of March 1, 2020, which provided a solid legal guarantee for preventing and controlling market risks, safeguarding the legitimate rights and interests of investors, and forging a well-regulated, transparent, open, vigorous, and resilient capital market. In July 2020, the Supreme People's Court released the *Provisions on Several Issues Concerning Representative Actions Arising from Securities Disputes*, marking the official launch of China's class action system in securities disputes.

Capital market building was stepped up. In October 2020, the State Council released the *Opinions on Further Improving the Quality of Listed Companies*, for the purposes of improving the quality of listed companies in six respects, including advanced corporate governance and strengthened corporate growth. In November 2020, the Central Committee for Deepening Overall Reform deliberated and approved the *Implementation Plan for Improving the Delisting Mechanism of Listed Companies*, aiming to improve the delisting mechanism and enhance the delisting intensity for listed companies through six means, including improving delisting standards and streamlining delisting procedures.

3. Institutional arrangements in the insurance market

The development of commercial insurance in the social service sector was bolstered. In January 2020, the CBIRC, together with 12 other ministries and commissions, issued the *Opinions on Promoting the Development of Commercial Insurance in the Field of Social Services*, which introduced 11 policies and measures in five respects to help commercial insurance play a better role in the social service sector.

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) for Promoting High-Quality Development of the Property Insurance Industry* and put forward elaborate planning, including such aspects as the transformation and development of the industry, the capability to serve the national economy, society, and people's livelihood, the level of opening-up and international influence as well as regulatory policies, systems, and mechanisms.

The development of personal insurance was promoted, featuring wider coverage, improved quality, and steady growth. In December 2020, measures were rolled out at the executive meeting of the State Council to promote personal insurance development featuring wider coverage, improved quality, and steady growth. The measures include accelerating the development of commercial health insurance, incorporating commercial pension insurance into old-age pension services as the third pillar and speeding up its construction, and enhancing the long-term investment capacity of insurance funds.

4. Enhancing coordinated supervision of the financial infrastructure

In March 2020, after being deliberated and passed at the tenth meeting of the Central Committee for Deepening Overall Reform, the *Work Plan on Coordinating Supervision over the Financial Infrastructures* (Yinfa No.54 [2020]) was co-issued by the PBC, NDRC, MOF, CBIRC, CSRC, and State Administration of Foreign

Exchange (SAFE). The work plan aimed to further improve the coordinated supervision and construction planning of the financial infrastructure in China and to enhance the capability of serving the real economy and forestalling financial risks. In July 2020, the PBC and CSRC jointly issued Announcement No. 7 [2020] of the PBC and CSRC and approved interconnectivity cooperation between relevant infrastructure institutions in the interbank bond market and the exchange-traded 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 high-level opening-up of the financial market

In March 2020, under the guidance of the PBC, relevant financial infrastructures improved their transaction settlement arrangements and launched services such as rolling settlement and flexible settlement intervals, which met the diversified needs of overseas institutional investors and further facilitated their operations. 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 China government bonds to its World Government Bond Index (WGBI) in October 2021. So far, all of the three global major bond index providers have included 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 further opening-up of China's financial sector.

Part 4. Macroeconomic Overview

I. Global economic and financial developments

In 2020, impacted by the COVID-19 pandemic, the global economy has experienced the most severe recession since World War II. The advanced economies have implemented ultra-loose monetary policies and large-scale fiscal stimulus plans, and the economies recovered in the second half of the year. Meanwhile, the pandemic has caused the rise of fiscal sustainability risks and financial risks that deeply influenced the global economic structure, international trade and investment, and may lead to a long-lasting scarring effect.

1. Economic and financial market performance in the major economies

The global economy has experienced a slow recovery. In 2020, the major advanced economies went through a GDP drop in Q2, a GDP rise in Q3, and a recovery divergence in Q4. In Japan, the year-on-year GDP growth rate in Q3 was -5.7 percent, with the drop declining by 4.6 percent from Q2. The US posted a 2.5 percent year-on-year GDP decrease in Q4, with the drop declining by 6.6 and 0.4 percentage points from Q2 and Q3 respectively, while the annual year-on-year GDP decrease was 3.5 percent. The euro area posted a 5.1 percent year-on-year GDP decrease in Q4, with the drop declining by 9.6 percentage points from Q2 but expanding slightly by 0.8 percentage points from Q3, while the annual year-on-year GDP decrease was 6.8 percent. The global pandemic has worsened since December 2020, with nearly 20 million new confirmed COVID-19 global cases in a single month and over 100 million cumulative confirmed COVID-19 global cases. Numerous countries enhanced their pandemic control measures, and the economic recovery slowed down. The US Consumer Confidence Index dropped from its peak of 49.8 in November to 44.6 in December, while the services PMI in the euro area and the U.K. dropped below 50 since September and November, respectively. The International Monetary Fund (IMF), World Bank, and Organization for Economic Co-operation and Development (OECD) posted a decrease in their latest global growth forecasts for 2020 by 3.5, 4.3, and 4.2 percent, while bouncing back by 5.5, 4.0, and 4.2 percent for 2021, respectively, with the global economy basically not recovering to its pre-pandemic level until Q4 of 2021.

The labor market has deteriorated. The US unemployment rate reached its peak of 14.8 percent in April 2020 and has gradually decreased ever since, while the drop continued to decline, with the December unemployment rate remaining unchanged at 6.7 percent from November. From April to November 2020, the euro area unemployment rate increased from 7.2 percent to 8.3 percent, while the U.K. unemployment rate increased from 4.0 percent to 5.0 percent. The deterioration of labor market conditions not only reflected the increase in the unemployment rate but also the decline in working hours. The International Labor Organization estimated that global working hours in Q3 2020 decreased by 12.1 percent from Q4 2019, which equals a loss of 345 million full-time jobs.

Inflation generally went down, with a divergence across the economies. The major advanced economies have continued with a low level of inflation. In December 2020, the year-on-year growth rate of the CPI posted 1.4 and 0.6 percent for the US and

U.K., respectively, while the year-on-year growth rate of the HICP in the euro area and the CPI for Japan posted -0.3 and -1.2 percent. Some of the emerging market economies experienced a deflation. Thailand and Malaysia continued to have a negative CPI growth rate since March 2020, with a year-on-year growth rate of -0.3 and -1.4 percent, respectively. Meanwhile, India, Brazil, and other economies have to some extent faced some structural inflationary pressures, with a 4.6 percent year-on-year growth rate of the CPI for India and a 4.5 year-on-year growth rate of the IPCA for Brazil in December.

International trade and investment declined significantly. The WTO forecast that the volume of world merchandise trade would record a 9.2 percent year-on-year decline in 2020, followed by a potential 7.2 percent rebound in 2021, while the trade volume might still be significantly lower than the level in 2019. The United Nations Conference on Trade and Development (UNCTAD) stated that global foreign direct investment experienced a 42 percent year-on-year decrease, and growth would continue to be weak in 2021.

Table 13 Macroeconomic and Financial Indicators in the Major Advanced Economies

Economy	Indicator	Q4 2019			Q1 2020			Q2 2020			Q3 2020			Q4 2020		
		Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.
United States	Real GDP Growth (annualized quarterly rate, %)	2.4			-5.0			-31.4			33.4			4.0		
	Unemployment Rate (%)	3.6	3.6	3.6	3.5	3.5	4.4	14.8	13.3	11.1	10.2	8.4	7.8	6.9	6.7	6.7
	CPI (year-on-year, %)	1.8	2.1	2.3	2.5	2.3	1.5	0.3	0.1	0.6	1.0	1.3	1.4	1.2	1.2	1.4
	DJ Industrial Average (end of the period)	27046	28051	28538	28256	25409	21917	24346	25383	25813	26428	28430	27782	26502	29639	30606
Euro Area	Real GDP Growth (year-on-year, %)	1.0			-3.2			-14.7			-4.3			-5.1		
	Unemployment Rate (%)	7.4	7.4	7.4	7.3	7.2	7.4	7.3	7.6	7.9	8.6	8.6	8.6	8.4	8.3	8.3
	HICP (year-on-year, %)	0.7	1.0	1.3	1.4	1.2	0.7	0.3	0.1	0.3	0.4	-0.2	-0.3	-0.3	-0.3	-0.3
	EURO STOXX 50 (end of the period)	3604	3704	3745	3641	3329	2787	2928	3050	3234	3274	3273	3294	2958	3493	3572

United Kingdom	Real GDP growth (year-on year, %)	1.2			-2.4			-20.8			-8.6			…		
	Unemployment Rate (%)	3.8	3.8	3.8	3.9	4.0	4.0	4.0	4.1	4.1	4.3	4.5	4.8	4.9	5.0	...
	CPI (year-on-year, %)	1.5	1.5	1.3	1.8	1.7	1.5	0.8	0.5	0.6	1.0	0.2	0.5	0.7	0.3	0.6
	FTSE 100 (end of the period)	7248	7347	7542	7286	6581	5672	5901	6077	6170	5898	5964	5866	5577	6266	6461
Japan	Real GDP Growth (annualized quarterly rate, %)	-7.2			-2.1			-29.2			22.9			…		
	Unemployment Rate (%)	2.4	2.2	2.2	2.4	2.4	2.5	2.6	2.9	2.8	2.9	3.0	3.0	3.1	2.9	2.9
	CPI (year-on-year, %)	0.2	0.5	0.8	0.7	0.4	0.4	0.1	0.1	0.1	0.3	0.2	0.0	-0.4	-0.9	-1.2
	NIKKEI 225 (end of the period)	22927	23294	23657	23205	21143	18917	20194	21878	22288	21710	23140	23185	22977	26434	27444

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

There were heightened potential risks in the financial markets. In March 2020, financial markets in the major advanced economies fell into a panic, reflected by a sell-off in risky assets and some traditional safe haven assets, and circuit-breakers in the stock markets of multiple countries amid a liquidity contraction of the US dollar, as well as currency depreciations and large capital outflows in the emerging economies. Since April, as the major economies adopted large-scale stimulus plans, market sentiment tended to calm down, and the financial markets were significantly restored. The liquidity of the US dollar converted from a shortage to abundance, with the USD index declining from 102 in March to 90 at the end of December. At the end of 2020, the one-year London interbank market USD-Libor was 0.34 percent, 166 bps lower than that at the end of last year, while the one-year euro-area interbank market Euribor was -0.50 percent, 25 bps lower than that at the end of last year. Against the background of a weak recovery of the real economy, global stock markets rebounded strongly, with a new high for the three major US stock market indexes in December 2020, which was detached from economic fundamentals with heightened potential risks.

2. Monetary policies of the major economies

Implementing ultra-loose monetary policies. First, policy rates were swiftly lowered. In March 2020, over 40 central banks across the globe lowered their interest rates more than 50 times in total, while the US Fed, the Bank of England (BOE), and the Bank of Canada (BOC) set their policy rates close to zero. Second, the scale of monetary policy operations was expanded. The US Fed, the BOC, and the Bank of Japan (BOJ) increased the scale and duration of their repurchase agreements. The European Central Bank (ECB) increased the volume and decreased the price of its targeted longer-term refinancing operations (TLTRO III). Third, asset purchase plans were resumed or enhanced. The US Fed and the BOJ committed unlimited treasury purchases, while the ECB expanded its asset purchase program (APP) and set up a new pandemic emergency purchase program (PEPP). The central banks in Australia, Canada, India, South Korea, and other countries also launched bond purchase plans.

Providing targeted support through liquidity facilities. The US Fed resumed and upgraded the rescue facilities it had used during the 2008 Global Financial Crisis to relieve the pressure on financial markets. It also established the paycheck protection program liquidity facility (PPPLF) and multiple structural facilities to engage in rescuing enterprises, individuals, and other market entities. The ECB introduced long-term COVID-19 pandemic emergency refinancing operations.

Assessing and adjusting monetary policy frameworks. In 2020, the central banks of some advanced economies in succession conducted assessments of their monetary policy frameworks. In August, after completing its latest assessment, the US Fed declared it would revise its monetary policy framework aiming to achieve an inflation rate that averages 2 percent. It stated that its monetary policy response to real employment would depend on the shortfalls, instead of the deviations, from the maximum employment level, and it emphasized that employment judgments would be based on multiple dimensions. The ECB and the BOC are expected to complete their assessments of their monetary policy frameworks in 2021.

Box 3 The Spillover Effect of Monetary Policies in the Major Economies

Central banks in the major economies, including the US, the euro area, and Japan, have rolled out large-scale monetary stimulus measures since March, 2020 to respond to the shock of the COVID-19 pandemic that has affected economic development and financial markets. The balance sheets of the US Fed, the European Central Bank, and the Bank of Japan expanded by 77 percent, 50 percent, and 23 percent respectively through 2020, and global liquidity remained extremely ample.

The spillover effect of overseas accommodative monetary policies warrants our attention. In general, when major central banks adopt accommodative policies, the liquidity within these countries will leak across borders. In previous crises, as the turbulence in the international financial market easily triggered panic in the market, and funds flew back to the major developed economies amid heightened risk aversion, the impact of such leakage on policy effect was, to some extent, moderated. However, global liquidity that flew back to the major developed countries dwindled during this round of the COVID-19 response. For instance, foreign holdings of US treasuries grew by 3.3 percent in 2008 when the global financial crisis broke out, while such holdings decreased by 3.8 percent during the first 11 months of 2020. Comparatively, the current situation in China is sound, as it is the first country to contain the pandemic, to resume work and production, and to achieve positive economic growth. Overseas fund inflows to China's bond market exceeded RMB1 trillion in 2020, among which long-term funds from overseas central banks accounted for over 60 percent, with government bonds and policy financial bonds as the main types of purchases. Of course, in the long run, as the pandemic gradually comes under control and the economic recovery becomes clear, the accommodative monetary policies in the major economies may end, and the direction of capital flows may change as well. For a super-large economy like China's, this is normal, but we should also guard against the risks.

As the second largest economy in the world, China made an average of 30 percent of an actual contribution to global economic growth over the past decade; it is no longer a passive receiver of the spillover effect of macro-policies from the advanced economies and it has its own macro policies manifesting such an effect. Moreover, China has been pursuing conventional monetary policies since 2020, and it is one of the few major economies to do so. Conventional monetary policies have the following three features: First, the interest rate remains within the normal range, not falling to zero or into negative territory; Second, the central bank's balance sheet is basically stable, and the banks' market-based function of money creation is brought into play normally and effectively; Third, the macro-leverage ratio and the growth pace of money and credit are far below the level during the global financial crisis responses in 2009. On balance, China fairly manages a long-tern equilibrium of stabilizing growth and preventing risks by pursuing a conventional monetary policy. In 2020, with the economy growing at 2.3 percent, China is the only major economy that has achieved positive growth, which is conducive to boosting a global economic recovery and to promote the normalization of monetary policies in other major economies.

It was noted at the Fifth Plenary Session of the 19th CPC Central Committee that we will establish a modern central banking system and will strengthen coordination of international macroeconomic policies. Improvements in the mechanism for the coordination, cooperation, and governance of international finance not only reflect strengthened coordination of international macroeconomic policies but they also constitute an important part of the development of a modern central banking system. In the next stage, in accordance with the guiding principles of the Fifth Plenary Session of the 19th CPC Central Committee and the Central Economic Work Conference and from the perspective of improving the mechanism for the coordination, cooperation, and governance of international finance, we will strengthen the coordination of international monetary policies, advance the reform of the international monetary system and financial supervision, actively participate in the construction of a global financial safety net, improve the RMB exchange rate formation mechanism, and promote two-way opening up in the financial sector.

3. Issues and trends that merit attention

First, the COVID-19 pandemic will remain the largest source of uncertainty for the global economy in 2021. Recently, the number of new global cases has remained high, and virus mutations have appeared in multiple locations, while the effectiveness and side-effects of the vaccines, and people's willingness to get vaccinated, remain uncertain. These factors may continuously influence the economic recovery process. In addition, a long-lasting pandemic might lead to adjustments in industrial chains, supply chains, and the landscape of international trade and investment, which could deeply influence global labor productivity, the inflation rate, and other factors.

Second, the sustainability of macroeconomic policies in the advanced economies faces challenges. The IMF estimated that in 2020 the fiscal deficit to GDP ratio in the advanced economies and the emerging market economies reached 13.3 and 10.3 percent, respectively, while the ratio of overall global public debt to GDP approached nearly 100 percent, which illustrates the challenge to maintain the strength of the fiscal stimulus. The major advanced economies have adopted accommodative monetary policies for a long time, with decreasing marginal policy utility, which in turn will worsen the problem of asset price bubbles, wealth inequalities, and debt burdens.

Third, the risks in financial markets continue to accumulate. The overlap of pressures in the real economy and vulnerabilities in financial markets has led to an increase in the non-performing loans ratio for the banks in the advanced economies. Due to a lack of prudential supervision, the leveraging behavior of non-banking financial institutions may become an important source of potential risks. As the valuations in capital markets become detached from the economic fundamentals, the risks of market volatility rise.

Fourth, there are risks from trade protectionism and geopolitics. In recent years, de-globalization has emerged with rising protectionism and unilateralism, while the pandemic and the economic recession it has caused have further strengthened introspective tendencies in some countries. Amid an increasingly complex international environment, instabilities and uncertainties have increases notably.

II. Macroeconomic developments in China

In 2020, facing the complex and serious situations at home and abroad, especially the shocks from the COVID-19 pandemic, departments in all regions adhered to the general guideline of making progress while maintaining stability in their work, and they made major strategic achievements to coordinate pandemic containment and economic and social development. With the steady recovery of the national economy, continuous development of industrial production, steady pickup of consumption and investment, robust momentum of exports, and stable employment on the whole, China is expected to be the only major economy in the world with positive economic growth. According to preliminary statistics, GDP in 2020 grew by 2.3 percent year on year to RMB101.6 trillion. By quarters, GDP in Q1 dropped by 6.8 percent year on year, while that in Q2, Q3, and Q4 grew by 3.2 percent, 4.9 percent, and 6.5 percent year on year respectively.

1. Consumption continuously improved, investments steadily rebounded, and foreign trade registered positive growth

Residents' income continuously rebounded, and consumption recovered steadily. In 2020, per capita disposable income registered RMB32189, up 4.7 percent year on year in nominal terms. It increased by 2.1 percent in real terms, slightly lower than economic growth. Residents' income from wages and salaries recovered steadily, and the income growth of rural residents outpaced that of urban residents. In 2020, total retail sales of consumer goods dropped by 3.9 percent year on year to RMB39.2 trillion, among which those in Q4 grew by 4.6 percent year on year and registered an acceleration of 3.7 percentage points from Q3. Sales of upgraded consumer goods and online retail sales continued their rapid growth.

Fixed-asset investments rebounded steadily, and investments in the high-tech industry grew rapidly. In 2020, total fixed-asset investments increased by 2.9 percent year on year to RMB51.9 trillion. In terms of sectors, the year-on-year growth of investments in infrastructure, the manufacturing sector, and real estate development registered 0.9 percent, -2.2 percent, and 7.0 percent, respectively. Investments in the high-tech industry grew by 10.6 percent, 7.7 percentage points higher than the growth of total investments. Specifically, investments in the high-tech manufacturing sector and the high-tech service sector grew by 11.5 percent and 9.1 percent year on year, respectively. Investments in social areas increased by 11.9 percent, among which investments in health care and education grew by 29.9 percent and 12.3 percent, respectively.

The momentum of exports was robust, and the trade structure continued to improve. In 2020, imports and exports of goods grew by 1.9 percent year on year to RMB32.2 trillion. Specifically, exports grew by 4.0 percent year on year, with growth in November and December accelerating to 14.9 percent and 10.9 percent respectively, while imports decreased by 0.7 percent year on year. As a result, the trade surplus in goods posted RMB3.7 trillion. The trade structure improved continuously. In 2020, the share of imports and exports under general trade reached 59.9 percent, up 0.9 percentage points from 2019. Imports and exports of private enterprises grew by 11.1 percent year on year, accounting for 46.6 percent of total foreign trade, up 3.9 percentage points from 2019. Exports of machinery and electronics increased by 6 percent year on year, accounting for 59.4 percent of total exports, up 1.1 percentage points from 2019. In 2020, China's top five trade partners were ASEAN, the EU, the US, Japan, and the ROK, and their trade with China grew by 7 percent, 5.3 percent, 8.8 percent, 1.2 percent, and 0.7 percent year on year respectively. China's trade with countries along the Belt and Road grew by 1 percent to reach RMB9.37 trillion.

Utilized foreign direct investment (FDI) hit a record high, with a further improved structure. In 2020, actually utilized FDI increased by 6.2 percent year on year to RMB999.98 billion. Specifically, actually utilized FDI in the service industry grew by 13.9 percent to RMB776.77 billion, accounting for 77.7 percent of total FDI. FDI in the high-tech industry grew by 11.4 percent, among which that of the high-tech service industry grew by 28.5 percent.

In 2020, outward investment cooperation remained stable. Outward direct investments (ODI) grew by 3.3 percent to USD132.94 billion, among which non-financial ODI edged down by 0.4 percent year on year to USD110.15 billion. In 2020, investment cooperation with countries along the Belt and Road made steady progress. Non-financial ODI in 58 countries along the Belt and Road grew by 18.3 percent year on year to USD17.79 billion, accounting for 16.2 percent of total ODI over the same period, up 2.6 percentage points from 2019. In particular, ODI in the leasing/commercial services industry and the wholesale/retail industry witnessed year-on-year growth of 17.5 percent and 27.8 percent, respectively.

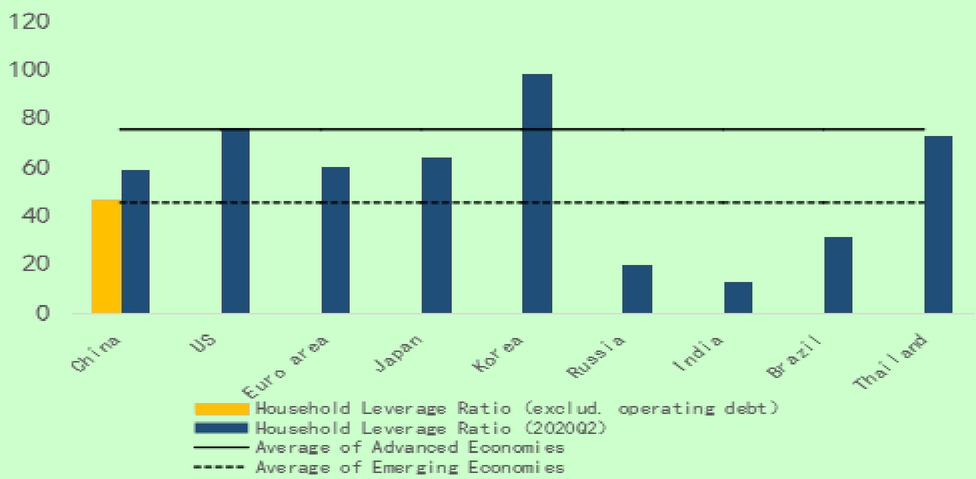
Box 4 Rational Evaluation of Risks Concerning Household Debt

The rising household leverage in China has recently attracted wide attention. The increase is mainly due to growing home loans, consumer loans, and credit card overdrafts, but part of it also represents the operating loans of self-employed businesses, which thereby require objective differentiation and a rational evaluation. At the same time, we need to be highly vigilant of debt sustainability and the potential risks caused by surging household leverage, and refrain from over-relying on consumer finance to boost consumption.

The main difference between consumer debt and operating debt lies in a capability to generate revenue for repayment. Although household debt, which is largely consumption-oriented, may be an expedient way of financing, it tends to erode households' future consumption capacity and therefore may become unsustainable, as consumption activities cannot generate revenue that covers debt obligations and repayment relies primarily on payroll earnings. By contrast, corporate debt is mostly business-related and it finances the purchase of labor, equipment, and raw materials for production and sales, which not only generates revenue for debt repayments but also bolsters consumption through job creation. According to some research, multi-national evidence shows that household debt hangover is worse than that of corporate debt. It should be noted, however, that if household debt finances business activities, then it resembles corporate debt, which makes it the key difference between China's household leverage and that in other major economies. Therefore, when observing and comparing China's household leverage, we should exclude the part that finances business activities.

Around 20 percent of the household debt in China is business-related, the exclusion of which would put household leverage within a reasonable range compared with other economies. The operating debt in China's household sector mainly consists of operating loans issued to self-employed businesses. It also includes consumer loans and credit card financing used by these businesses for operational purposes. According to BIS, as of end-H1 2020, the leverage ratio of the household sector in China was 59.1 percent, close to that in the eurozone and Japan. However, after removing the operating debt from the total household debt, the ratio drops to roughly 46 percent, which is still within a reasonable range in a global context (see figure below).

Figure 6 Household Leverage in a Global Context



Source: PBC, BIS.

The risks of China's household debt are generally manageable, although there is limited macro policy space. Against the background of "houses are for living in, not for speculation" and enhanced regulation of consumer finance, the growth of household debt has decelerated from 20 percent in previous years to the current 15 percent, and household leverage has also shown a deceleration. Given the large contribution of operating debt to household leverage, the traditionally high savings rate, the high down payment requirement, and the diversified household debt, the risks related to China's household debt are still manageable. However, we should be vigilant of the rising leverage of the household sector since 2011. From end-2011 to H1 2020, the leverage increased more than 31 percentage points, leaving very little space for further expansion of household debt and therefore deserves close attention.

We need to be highly vigilant of debt sustainability and potential risks due to surging household leverage. First, in terms of consumer finance, some consumer-debtors are irrational in that their prospective income does not match their repayment expenditures and they borrow and spend beyond their future repayment capability, thereby posing potential financial risks. In addition, should businesses expand their production in response to these credit-driven consumption demands, the problem of overcapacity will arise when household debt builds up and the consumer-debtors can no longer repay their debt. This is inconsistent with the need for high-quality development. Meanwhile, some financial institutions have overlooked the risks underlying consumer finance during the rapid expansion of consumer loans. This has led to a significant deterioration of client quality as well as to the prominent problems concerning multiple platforms lending to the same client and over-extending credit to related parties of a client. Since the beginning of 2020, there have been signs of higher non-performing ratios for credit card financing and consumer loans in certain banks.

In general, facilitating the building of a new development paradigm entails emphasis on management of the demand side and adherence to a strategic focus of boosting domestic demand so as to stimulate consumption. However, it is inappropriate to expand consumption through an over-reliance on consumer finance. Financial innovations should proceed under prudential regulation, and more efforts should be put into promoting employment and improving social security, the income structure, and the consumption environment. Work should be done to combine the dual tasks of boosting domestic demand and deepening the supply-side structural reform, thereby enhancing the fundamental role of consumption in promoting high-quality economic development.

2. Agricultural production improved, industrial production continued to grow, and the service industry recovered gradually

In 2020, the primary, secondary, and tertiary industries grew by 3.0 percent, 2.6 percent, and 2.1 percent year on year, respectively, accounting for 7.7 percent, 37.8 percent, and 54.5 percent of GDP. The share of tertiary industry in total industry surpassed that of secondary industry by 16.7 percentage points, up 1.0 percentage point from 2019.

China witnessed another bumper harvest of grain production and a rapid recovery of hog production. In 2020, the value-added of agriculture grew by 3.0 percent year on year, decelerating by 0.1 percentage points from 2019. Grain output recorded a new high and the annual output has been over 650 million tons for six years in a row. Hogs in stock continued a fast recovery and the decline in hogs available for slaughter narrowed significantly. At end-2020, hogs in stock increased by 31.0 percent year on year and saw quarter-on-quarter growth for five consecutive quarters. In 2020, hogs available for slaughter declined by 3.2 percent year on year. Specifically, the year-on-year growth of hogs available for slaughter turned positive in Q3 and growth in Q4 accelerated to 22.9 percent.

Industrial production recovered gradually quarter on quarter, with the economic efficiency of enterprises continuously improved. In 2020, the value-added of Industrial Enterprises above a Designated Size (IEDS) increased by 2.8 percent year on year, specifically, that in Q4 increased by 7.1 percent. In 2020, the high-tech manufacturing sector and the equipment manufacturing sector saw rapid growth, namely, 7.1 percent and 6.6 percent respectively year on year. This was 4.3 percentage points and 3.8 percentage points higher than that of the IEDS, which played an important role in supporting economic development. In 2020, total profits of the IEDS increased by 4.1 percent year on year and maintained double-digit growth for seven consecutive months, particularly with year-on-year growth in December accelerating to 20.11 percent. According to the *Entrepreneur Survey Report* conducted in Q4 by the PBC, the Business Climate Index posted 55.8 percent, up 6.4 percentage points from Q3 and 0.2 percentage points from the same period of 2019. The Profitability Index registered 59.8 percent, up 2.5 percentage points from the same period of 2019.

The service industry recovered steadily and the modern service industry showed sound growth momentum. In 2020, the Index of Service Production (ISP) was on par with that in 2019. Specifically, the ISP in Q4 increased by 7.7 percent year on year, accelerating by 3.4 percentage points from Q3. In 2020, the value-added of the service industry grew by 2.1 percent year on year, accounting for 54.5 percent of GDP, accelerating by 0.2 percentage points from 2019. In particular, the value-added of the service industry in Q4 grew by 6.7 percent year on year, which was on par with that in Q4 2019. The vitality of the modern service industry was continuously released. The value-added of the information communications/software/IT services sector, the financial sector, and the real estate sector increased by 16.9 percent, 7.0 percent, and 2.9 percent respectively year on year, which contributed to the acceleration in the total service industry by 2.7 percentage points. In December 2020, the Expected Business Activities Index for the service industry reached 60.1 percent, remaining in the expansion area for six consecutive months and demonstrating the strong confidence of enterprises in the development of the market. It should also be noted that due to the pandemic, although some service sectors such as the catering sector resumed, their growth was still relatively slower than that of other sectors. In 2020, revenue of the catering sector decreased by 16.6 percent year on year, decelerating by 7.3 percentage points from Q1–Q3 of 2020.

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

The growth of consumer prices decelerated. Due to factors such as the pandemic, the gradual recovery of the capacity for hog production, and the high base figure in H2 2019, the CPI had been on a rising trend for some time before falling thereafter, registering a year-on-year growth of 2.5 percent in 2020. Specifically, the growth of food prices grew by 10.6 percent year on year, accelerating by 1.4 percentage points from 2019. The growth of non-food prices grew by 0.4 percent year on year, decelerating by 1.0 percentage point from 2019. The core CPI (food and energy excluded) rose moderately by 0.8 percent year on year, decelerating by 0.8 percentage points from 2019.

The decline in producer prices decelerated. In 2020, the Producer Price Index (PPI) mainly moved in the negative territory. However, as industrial production steadily recovered, market demand continuously picked up, and the industrial product prices gradually rose, the PPI in 2020 saw a U-shaped trend and then dropped by 1.8 percent year on year, an acceleration of 1.5 percentage points compared with 2019. The Purchasing Price Index for Industrial Products (PPIRM) dropped by 2.3 percent year on year, accelerating by 1.6 percentage points from 2019. In 2020, the Corporate Goods Price Index (CGPI), monitored by the PBC, decreased by 1.2 percent year on year, decelerating by 0.2 percentage points compared with Q1–Q3 of 2020.

4. The decline in fiscal revenue decelerated, and employment generally improved

The decline in fiscal revenue decelerated. In 2020, revenue in the national general public budget posted RMB18.3 trillion and decreased by 3.9 percent year on year, decelerating by 6.9 percentage points compared with H1 2020. Specifically, tax revenue amounted to RMB15.4 trillion, down 2.3 percent year on year. Non-tax revenue reached RMB2.9 trillion, down 11.7 percent year on year. The domestic value-added tax, domestic consumption tax, and business income tax dropped by 8.9 percent, 4.3 percent, and 2.4 percent year on year, respectively, while the personal income tax increased by 11.4 percent year on year.

Fiscal expenditures rebounded gradually. In 2020, expenditures in the national general budget saw an increase of 2.8 percent year on year to RMB24.6 trillion, accelerating by 8.6 percentage points compared with H1 2020. In terms of the expenditure structure, expenditures related to health care and social security/employment grew quickly, registering year-on-year growth of 15.2 percent and 10.9 percent, respectively.

In 2020, budgetary revenue from nationwide government-managed funds totaled RMB9.3 trillion, up 10.6 percent year on year. Specifically, revenue from land sales rose by 15.9 percent year on year. Budgetary expenditures from nationwide government-managed funds increased by 28.8 percent year on year to RMB11.8 trillion.

Employment was generally stable. At the beginning of 2020, the outbreak of the pandemic resulted in restrictions on economic activities and shutdowns of enterprises, with the job market severely affected. As the pandemic containment achieved positive results, enterprises resumed production and the job market gradually recovered, with employment continuously improving. In 2020, 11.86 million people were newly employed, which was noticeably higher than the expectation of above 9 million, and it fulfilled 131.8 percent of the annual target. In 2020, the surveyed unemployment rate in urban areas was 5.6 percent, lower than the set target of 6 percent. Employment pressures from rural migrants were eased and the employment of graduates was generally stable. The number of rural migrants in 2020 decreased by 1.8 percent year on year to 285.6 million, down 5.17 million from 2019. The average annual revenue of rural migrants increased by 2.8 percent year on year to RMB4,072. In December, the unemployment rate of employees aged between 20 and 24 with college diplomas or above was on par with that in the same period of 2019.

5. The balance of payments and external debt

A basic equilibrium was maintained in the balance of payments. China’s current account surplus stood at USD168.7 billion in Q1–Q3 2020. To be specific, the surplus in trade in goods was USD340.2 billion, whereas the deficit in trade in services was USD116.8 billion. The capital and financial account deficit stood at USD73.8 billion. At end-December, foreign exchange reserves increased by 3.5 percent year on year to USD3.2165 trillion, up USD108.6 billion from end-2019. By end-September 2020, the balance of full-caliber foreign debt (denominated in both domestic and foreign currencies) posted USD2.2944 trillion. In particular, the short-term external debt balance was USD1.2956 trillion, accounting for 56 percent of the total external debt balance.

6. Analysis by sector

6.1 The real estate sector

In 2020, housing prices remained generally stable in China. Due to the pandemic, housing sales and investments in real estate development witnessed a decrease at the beginning of 2020 but have recovered continuously since March. At end-2020, among the 70 medium and large-sized cities nationwide, newly built housing prices and second-hand residential housing prices increased by 3.7 percent and 2.1 percent year on year respectively, decelerating 3.1 percentage points and 1.5 percentage points from end-2019. In 2020, the total floor area of sold units increased by 2.6 percent year on year, and housing sales increased by 8.7 percent year on year. In 2020, investments in real estate development grew by 7 percent year on year, decelerating by 2.9 percentage points from 2019. Specifically, investments in residential housing development rose by 7.6 percent year on year, registering a deceleration of 6.3 percentage points from 2019 and accounting for 73.8 percent of total investments in real estate development.

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

	Floor area (100 million square meters)	YOY growth (%)	Acceleration of YOY growth from 2019 (percentage points)
Floor area of newly started real estate projects	22.4	-1.2	-9.7
Floor area of real estate projects under construction	92.7	3.7	-5.0
Floor area of completed real estate projects	9.1	-4.9	-7.5

Source: National Bureau of Statistics of China.

The growth of real estate loans decelerated. At end-2020, outstanding real estate loans by major financial institutions (including foreign-funded financial institutions) grew by 11.6 percent year on year to RMB49.6 trillion, a deceleration of 3.2 percentage points from end-2019. Outstanding real estate loans accounted for 28.7 percent of the total lending balance. Specifically, outstanding individual housing loans grew by 14.5 percent year on year to RMB34.5 trillion, a deceleration of 2.2 percentage points from end-2019. Outstanding housing development loans grew by 8.2 percent year on year to RMB9.1 trillion, a deceleration of 6.4 percentage points from end-2019.

6.2 The high-tech manufacturing sector

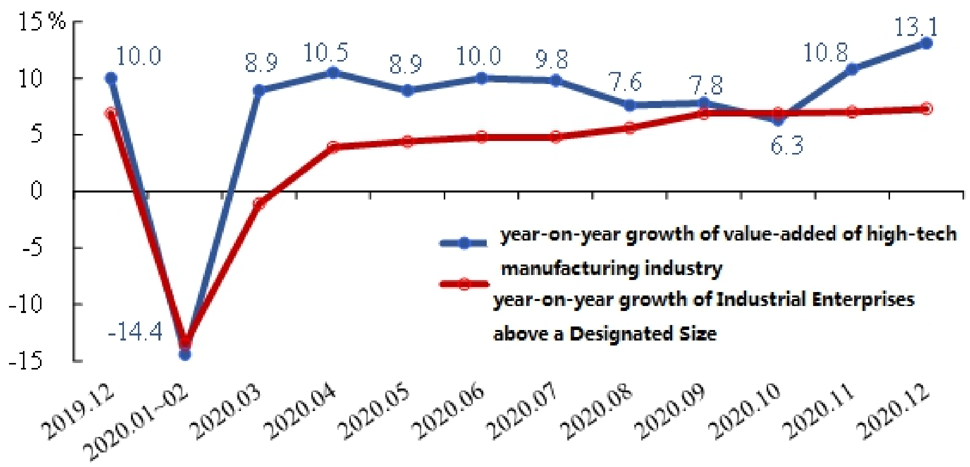
The high-tech manufacturing sector mainly refers to the manufacturing industry with intensive Research and Development (R&D) investments. As a high added-value subset of the manufacturing industry, it represents the trend of high-quality development, covering the manufacturing of pharmaceuticals, aerospace and equipment, electronics and communication equipment, computers and office equipment, medical equipment and instruments, and electronic chemicals. In recent years, under the active guidance of the national innovation-driven strategy, China's high-tech manufacturing sector has witnessed improvements in quality and effect, accelerated progress, and continuous expansion of scale.

In 2020, the pandemic dealt a blow to the high-tech manufacturing industry. However, as major strategic achievements were made in the coordination of pandemic containment with economic and social development, recovery of the high-tech manufacturing sector accelerated, which served as an important prop for economic growth. First, the scale of the sector expanded continuously. Year-on-year growth of the value-added of the high-tech manufacturing sector turned positive in March 2020 and stood at 7.1 percent in 2020, 4.3 percentage points higher than that of Industrial Enterprises above a Designated Size (IEDS). Specifically, the value-added of medical equipment and instruments, of electronics and communication equipment, and of computers and office equipment grew by 12.1 percent, 8.8 percent, and 6.5 percent year on year, respectively, allowing this sector to play a greater role in driving the economy. Second, the economic benefits of the sector recovered steadily. In 2020, the profits of the high-tech manufacturing sector grew by 16.4 percent year on year, an acceleration of 3.5 percentage points from the first three quarters of 2020. Third, investment growth of the sector rebounded stably. In 2020, investments in the high-tech manufacturing sector grew by 11.5 percent, among which those in the pharmaceuticals manufacturing and computers and office equipment manufacturing sectors grew by 28.4 percent and 22.4 percent, respectively.

Despite great achievements in the high-tech manufacturing sector, there are still various challenges. First, as the investments in fundamental R&D and key and core technologies are relatively insufficient, China's industrial structure is at the low and middle ends of the global value chain, and its capability for independent innovation is in urgent need of improvement. Second, the share of the value-added of the high-tech manufacturing sector in GDP remains fairly low, which lags far behind that in the developed economies. Therefore, the role of the sector in driving the economy needs to be enhanced. Third, due to the pandemic, the global supply chain has become regional and localized. In addition, as global economic and trade frictions escalate, China's high-tech companies are faced with suppression and sanctions from some countries, which pose a serious challenge to the upgrading of the high-tech manufacturing sector.

Going forward, China will accelerate development of the high-tech manufacturing sector as required for high-quality development. On the one hand, China will adhere to the structural reform of the supply side, expand investments in the high-tech manufacturing sector, promote the high-tech manufacturing sector to move up the value chain, and guide and create new demand through innovation and high-quality supply. It is necessary to invest more in R&D, make more breakthroughs in key technologies, continue to focus on enhancing quality and effect, and strengthen the guidance of innovation. China will provide professional and medium-to-long-term funding support for sci-tech enterprises through innovating financial service models. On the other hand, China will attach importance to the combination of developing advanced manufacturing clusters and promoting the opening-up. It will continue to attract foreign investment into advanced manufacturing clusters, promote integration of the manufacturing industry into the international industrial chain, and guide and adapt to the great changes brought about by the restructuring of the global industrial chain.

Figure 7 Year-on-Year Growth of the Value-added of the High-tech Manufacturing Industry



Source: National Bureau of Statistics of China.

Part 5. Monetary Policy Outlook

I. Outlook for the Chinese economy

The year 2020 is a very unusual and extraordinary year. Facing severe and complicated international situations and the arduous tasks regarding domestic reform and stability, and especially the serious impact of COVID-19, the entire nation made concerted efforts under the strong leadership of the CPC Central Committee with Comrade Xi Jinping at its core, and was among the first countries to contain the pandemic, to resume work and production, and to return to a positive economic growth. China achieved significant strategic results in coordinating pandemic containment and economic and social development. The 13th Five-year Plan wrapped up smoothly, and China is on course to finish building a moderately prosperous society in all respects. The Chinese economy is steadily recovering. The economic growth recorded 6.5 percent year on year for Q4 2020 and 2.3 percent for the whole year, and the GDP in 2020 exceeded RMB100 trillion. China is the only major economy to record a positive economic growth and one of the few major economies that maintain a normal monetary policy. Looking beyond the near term, the fundamentals of steady economic growth in the long run and high-quality development remain unchanged.

The Chinese economy is returning to normal with stronger endogenous growth drivers, and the economic fundamentals have improved in general. The recent period has seen significantly rising industrial production and sustained export momentum. Investments in the manufacturing sector are recovering and consumption is in an overall recovery as well. Employment and people's well-being are secured, market expectations are generally stable, and there are more positive factors in economic development. The financial sector has significantly improved the quality and efficiency of its support for the real economy and has continuously enhanced its support for micro, small and medium-sized enterprises (MSMEs) and private businesses, providing the real sector with significantly more perceivable benefits. Having achieved major progress in the critical battle against financial risks, the financial system is 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 remain above USD3 trillion. The economy has become more resistant to external shocks.

Given that global economic and financial conditions are still complicated and severe, and there are many uncertainties regarding the pandemic and the external environment, the grounds for domestic economic recovery are not yet solid. Since the beginning of Q4 2020, multiple regions around the world have discovered coronavirus variants. COVID-19 cases resurged in major developed economies while the vaccination progress was slower than expected. The rising debt of the public and real sectors poses greater potential risks to financial markets, with the global liquidity being extremely excessive. There is still considerable pressure from imported infections and risks associated with the global economy and financial markets. This winter brought concentrated COVID-19 outbreaks to many places in China, which may cause uncertainties for a further recovery of consumption. The macro leverage ratio temporarily rose because of pandemic responses, and the credit risk of nonperforming loans may appear later, so there are still potential risks concerning regional finance in China. In addition, we must not overlook medium and long-term challenges, such as the accelerating aging of the population, insufficient technological innovation capacity, and increasing constraints on resources and the environment. Therefore, it is necessary to enhance awareness of opportunities and risks. 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 equilibria, so as to contribute to high-quality development.

Consumer price growth is generally within a reasonable range, and there are no grounds for persistent inflation or deflation. The CPI in 2020 dropped continuously on a seasonal basis. The CPI growth recorded 2.5 percent in 2020, which is basically within a reasonable range. In Q4 2020, the CPI growth dropped to near zero and occasionally into the negative territory, which was mainly the result of the rebounding of pandemic cases, the fluctuations in pork prices, and the high-base effect. Although the CPI will be further subject to holiday disruptions at the beginning of 2021, these factors are all momentary, and the CPI will likely rise again to a stable level as the base effect and supply disruptions subside. Meanwhile, due to stronger endogenous growth drivers and the continuous recovery of industrial production, the prices of the means of production have grown more rapidly since the beginning of Q4 2020. The PPI's negative year-on-year growth narrowed further and is likely to turn positive in the short term. Despite this, short-term price movements deserve close attention given the uncertainties concerning the future path of the pandemic and the impact of containment measures on supply and demand. In the medium and long term, the Chinese economy is expected to witness a stable growth. Given that the aggregate supply and demand are basically in equilibrium, monetary policies remain sound, and monetary conditions are reasonable and appropriate, there are 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 will fully implement the guidelines of the Fifth Plenary Session of the 19th CPC Central Committee and the Central Economic Work Conference. It will firmly implement the decisions and arrangements of the CPC Central Committee and the State Council by adhering to the general principle of pursuing progress while ensuring stability and by following the requirements of the new development stage, applying the new development philosophy, and fostering a new development paradigm. Giving top priority to ensuring stability, the PBC will focus on what is important, defend the bottom line, and live up to its responsibilities in an effort to consolidate and further the success achieved in pandemic control as well as in economic and social development, while maintaining policy continuity, stability, and sustainability. Work will also be done to improve macroeconomic governance, to build a modern central banking system, to conduct a cross-cyclical policy design, to achieve a balance of economic aggregates, and to promote structural optimization as well as both internal and external equilibria. Moreover, the PBC will continue to do its part well in ensuring stability on six fronts, namely, employment, the financial sector, foreign trade, foreign investment, domestic investment and expectations, and in maintaining security in six areas, namely, employment, people's basic livelihood, operations of market entities, food and energy security, stable industrial and supply chains and the normal functioning of primary-level governments, thereby contributing to a good start for the establishment of a new development paradigm and bringing on a new look.

The sound monetary policy will be flexible, targeted, reasonable, and appropriate, giving top priority to ensuring stability and refraining from taking sharp turns. At the same time, the PBC will manage the timing, intensity, and effectiveness of policy, properly handle the relationship between economic recovery and risk prevention, and keep sustainable room for the conduct of a normal monetary policy. To pursue the objective of “maintaining the stability of the currency value and thereby promoting economic growth”, the PBC will improve the mechanism of money supply management, using a mix of monetary policy tools to keep liquidity adequate at a reasonable level so that the growth rates of money supply and aggregate financing to the real economy (AFRE) will be basically in line with nominal economic growth and the macro leverage ratio will be kept basically stable. In the process, flexible adjustments will be made to the intensity, pace, and focus of policy to accommodate changes in the circumstances. The role of structural monetary policy tools in targeted liquidity provision will be effectively brought into play, while steps will be taken to build the systems and mechanisms needed to provide effective financial support for the economy. The PBC will enhance the market-oriented interest rate formation and transmission mechanism by improving the central bank policy rate system and deepening the loan prime rate (LPR) reform. It will also consolidate the achievements made in lowering real lending rates and will stabilize and reduce overall financing costs for enterprises. While giving play to the decisive role of market supply and demand in the formation of exchange rates and enhancing the flexibility of the RMB exchange rate, the PBC will strengthen macro-prudential management to stabilize market expectations and will guide enterprises and financial institutions to be risk-neutral so that the RMB exchange rate will be kept basically stable at an adaptive and equilibrium level. More efforts will be put into monitoring and analysis as well as expectation management in order to keep prices basically stable. To firmly defend the bottom line that no systemic risk should occur, the PBC will improve the systems of financial risk prevention, early warning, resolution, and accountability and will resolve prudently the risks associated with individual institutions and the risks arising in key fields, while further steps will be taken to hold all relevant parties accountable and to broaden channels for the replenishment of bank capital. Moreover, 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 circulations reinforcing each other.

First, the PBC will pursue a sound monetary policy that is flexible, targeted, reasonable, and appropriate. It will 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 meet the reasonable demand of financial institutions for short-, medium- and long-term liquidity. Through targeted and effective operations, it will keep liquidity adequate at a reasonable level without adopting indiscriminate stimulus measures. The PBC will improve the long-term mechanism of liquidity, capital and interest rate constraints used for central bank adjustments of bank money creation so as to properly control the general valve of money supply and to keep economic growth close to its potential output growth. Work will be done to guide market rates to move around OMO rates and MLF rates. Moreover, the PBC will improve the mechanism for sustainable replenishment of bank capital to support bank issuances of perpetual bonds, such as convertible perpetual bonds, and to step up support for capital replenishment by small and medium-sized banks via issuance of 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, the PBC will make effective use of central bank lending, central bank discounts, and the monetary policy tools providing direct support for the real economy to bring into play their roles in targeted liquidity provision. On the one hand, the countermeasures introduced in extraordinary times will be adjusted prudently and follow-up arrangements will be made, while the two monetary policy tools providing direct support for the real economy, i.e., the policy of deferring principal and interest repayments for micro and small businesses (MSBs) and the support scheme for unsecured inclusive MSB loans, will remain in place. On the other hand, the PBC 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. It will continue to use inclusive central bank lending and central bank discount policies to increase financial support for sci-tech innovations, MSBs, and green development. In an effort to implement the important decisions on peaking carbon emissions and achieving carbon neutrality, the PBC will attach importance to policy designs and planning and will establish policy incentives and constraints to channel financial resources to the fields of green development.

Third, the PBC will build the systems and mechanisms needed to provide effective financial support for the real economy. Measures will be taken to improve the system for providing financial support for innovation 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 to promote the industrialization and large-scale application of new technologies. 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. Financial support will be provided to ensure that the work done to consolidate and further the achievements of poverty eradication be linked up effectively with rural revitalization efforts, while financial support policies for regions lifted out of poverty will be kept generally stable. Credit supply will be increased to support key agricultural fields, such as development of the seed industry and food security. Measures will also be taken to broaden the range of collaterals according to laws and regulations and to innovate rural financial products and services. The PBC will push further ahead with the project aimed at enhancing commercial banks' capacity to provide financial services for MSMEs, taking steps to improve external incentives and constraints as well as banks' internal policy arrangements, and to foster, through the application of science and technology, a long-term mechanism whereby banks will have the confidence, willingness, ability, and professionalism to make loans. Additionally, financial institutions will be guided to step up credit support for the manufacturing sector and other key fields. 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, and expectations and will maintain the continuity, consistency, and stability of real estate finance policies. It will also implement rules for prudential management of real estate finance and improve financial support policies for the rental of housing.

Fourth, the PBC will deepen the market-oriented interest rate and exchange rate reforms to smooth the channels of monetary policy transmission. To enhance the market-oriented interest rate formation and transmission mechanism, it will improve the central bank policy rate system in which OMO rates are taken as short-term policy rates and MLF rates as medium-term policy rates, and it will advance the reform of money market benchmark rates so that market rates are guided to move around policy rates. Continued efforts will be made to deepen the LPR reform, to consolidate the achievements made in lowering real lending rates, and in the process to gradually give rise to market-oriented deposit rates. The self-regulatory mechanism for market rate pricing will play its part in regulating the conduct of deposit rate pricing while deposit management will be tightened, with locally incorporated banks prohibited from providing cross-regional deposit services. And the requirement will be reinforced that lending entities of all types give explicit indications of annualized loan rates so as to safeguard a level playing field in the market and to 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, to guide enterprises and financial institutions to be risk-neutral, and to keep the RMB exchange rate basically stable at an adaptive and equilibrium level. 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 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. It will support bond financing by private enterprises and enhance the ability of the financial sector to serve the real economy. It will implement the *Administrative Measures for Information Disclosures Regarding Corporate Debenture Bonds* to promote a unification of standards. 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 infrastructure and accelerate steps to advance the interconnectivity between bond market infrastructure so as to ensure that financial markets are generally safe and stable while performing efficiently. Efforts will be made to steadily move ahead with the two-way opening-up of the bond market and to introduce more medium and long-term investors.

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, more work will be done to deepen the reform of large commercial banks and to establish a modern financial enterprise system with Chinese characteristics. Large banks will be guided to shift their focus of services to the primary level and increase efficiency so as to provide better services for MSBs and private enterprises. Through improvements of monetary, regulatory and tax rules, small and medium-sized banks and rural credit cooperatives will be encouraged to focus on their main duties and businesses and to reassume their roles in serving local needs and their original purposes, while an effective mechanism of checks and balances in governance will be established. Measures will be taken to reform and optimize development finance and policy finance and to carry out classified accounting so that they will be better able to support national strategies.

Seventh, the PBC will improve the systems of financial risk prevention, early warning, resolution, and accountability. It will safeguard financial security, improve the systems of financial risk prevention, early warning, resolution, and accountability, take quick action to shore up the weaknesses of regulatory institutions, and firmly defend the bottom line that no systemic risk should occur. Work will be done to ensure that the development of financial innovations be brought under prudential regulation and to stabilize and improve the quality and competitiveness of inclusive financial services. Stress tests fully covering the banking system will be conducted. To enhance 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. Efforts will be intensified to set aside loss provisions for non-performing loans and carry out write-offs while deposit insurance institution building and the organizational structure will be improved. Endeavors to defuse risks will be advanced prudently, with particular attention paid to wrapping up ongoing risk resolutions. The PBC will further define the respective responsibilities of all concerned parties to see that they truly perform their duties and join efforts to resolve risks. A possible resurgence of risks must be contained. Under no circumstances will local risks be allowed to evolve into systemic risks, nor will regional risks be allowed to evolve into national risks.