China Monetary Policy Report

Q1 2021

(May 11, 2021)

Monetary Policy Analysis Group of

the People's Bank of China

Executive Summary

Since the beginning of 2021, faced with the test of the COVID-19 during the winter and spring as well as uncertainties of external environment, all regions and departments across China have been making progress in coordinating routine pandemic containment measures and economic and social development under the strong leadership of the CPC Central Committee with Comrade Xi Jinping at its core. The Chinese economy is on course for a steady recovery with stronger and better development. New achievements have been made in pursuing high-quality development, as illustrated by the improvement of supplies both in quantity and in quality, the sustained rebound in demand, the continuous enhancement of market vitality, and the effective support for employment and livelihood. In Q1 2021, China's GDP grew by 18.3 percent year on year, contributing to a growth averaging 5.0 percent over the past two years. The CPI was on a par with that in the same period of the last year, and import and export trade maintained sound growth momentum.

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. The sound monetary policy, which was flexible, targeted, reasonable and appropriate, maintained its continuity, stability and sustainability. The PBC managed expectations in a scientific and effective way, kept in place the support necessary for economic recovery, managed financial risks well, and enabled the financial sector to gradually enhance its quality and efficiency in serving the real economy, hence cultivating a favorable monetary and financial environment for achieving high-quality economic development.

First, liquidity was kept adequate at a reasonable level. With the comprehensive use of multiple monetary policy tools, including the Medium-term Lending Facility (MLF) and open market operations, the PBC adjusted liquidity precisely and thus maintained stability of market expectations and smooth movement of money market rates. **Second,** structural monetary policy tools were promoted to play a guiding role. The PBC implemented the policies launched during the special period based on the category of beneficiaries, made proper adjustments at the proper time, prolonged the use of the two monetary policy tools providing direct support for the real economy until the end of 2021, and further enhanced policy support for those areas in need of long-term support, such as sci-tech innovations, micro and small businesses (MSBs), and green development. **Third,** the benefits of the loan prime rate (LPR) reform were unleashed continuously. The PBC urged financial institutions to make full use of the LPR for pricing, and thus guided the overall stabilization and decline of financing costs. All loan products were required to be explicit about their annualized interest rates so as to protect the legitimate rights of financial consumers. Regulations regarding deposit rates were improved to keep the borrowing costs of banks basically stable. **Fourth,** focusing on the domestic situation, attention was also paid to maintaining an external equilibrium. The PBC moved ahead with the market-oriented reform of the exchange rate to maintain the flexibility of the RMB exchange rate and to enable the exchange rate to play a role in adjusting the macro economy and as an auto stabilizer for the balance of payments. **Fifth,** the modern monetary policy framework was improved. The PBC improved the mechanism for money supply management and kept the growth of money supply and aggregate financing to the real economy (AFRE) basically aligned with that of nominal GDP. It also improved the system of central bank policy rates, guided the market rates to move around the policy rates, and improved the mechanism for the formation and transmission of market-based interest rates. **Sixth,** upholding the market-oriented and law-based principles, the PBC managed financial risks well and firmly defended the bottom line that no systemic risk should occur.

Overall, since the beginning of 2021, the sound monetary policy has pursued stability as its priority and it has proved to be forward-looking, proactive, targeted and effective, thereby providing solid support for the real economy. At end-March, broad money (M2) and AFRE grew 9.4 percent and 12.3 percent year on year, respectively. With the credit structure continuously improving, inclusive MSB loans and medium and long-term (MLT) loans to the manufacturing sector grew by 34.3 percent and 40.9 percent year on year, respectively. Loan rates remained at a low level. The weighted average rate on corporate loans registered 4.63 percent in March, down 0.19 percentage points from March 2020. Overall financing costs for MSBs were stable and witnessed a decline. The RMB exchange rate moved in both directions with enhanced flexibility based on market supply and demand and it remained basically stable at an adaptive and equilibrium level. The China Foreign Exchange Trade System (CFETS) RMB Index registered 96.88 at end-March, 2.15 percent higher than that at end-2020.

Currently, the driving force behind China's economic development is growing, and the positive factors are increasing remarkably. However, it should also be noted that externally the environment is still complicated and serious, and internally the economic recovery is unbalanced, and its foundation is not yet solid, hence risks and challenges remain. In response, we should remain confident, overcome difficulties, and consolidate the foundation for recovery and growth, so as to maintain sustained and sound development of the economy and the society. 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 and implement the requirements in the *Report on the Work of the Government* as well as the decisions and arrangements of the CPC Central Committee and the State Council. Adhering to the general principle of seeking progress while ensuring stability, the PBC will take stability as its top priority. Based on the requirements of the new development stage, the PBC will apply the new development philosophy and foster a new development paradigm. Firm in the idea of making cross-cycle policy designs, the PBC will give consideration to both the present and the future, maintain the continuity, stability and sustainability of macro policies, and stabilize expectations. It will implement macro policies in a well-targeted way to consolidate and develop the fruits achieved in pandemic containment and economic and social development, and it will reinforce support for the real economy, key fields, and weak links to bolster high-quality economic development with proper monetary increases.

The sound monetary policy will remain flexible, targeted, reasonable and appropriate. The PBC will place a higher priority on serving the real economy, value the space for normal monetary policy, and properly handle the relationship between economic recovery and risk prevention. By improving the modern monetary policy framework and the mechanism for money supply management, the PBC will ensure proper control of the aggregates so as to keep liquidity adequate at a reasonable level, keep the growth of M2 and AFRE basically in line with that of nominal GDP, and keep the macro leverage ratio basically stable. Tools such as central bank lending, central bank discounts, and the monetary policy tools providing direct support for the real economy will continue to play a guiding role, and systems and mechanisms will be developed for the financial sector to provide effective support for the real economy. While guiding financial institutions to extend more support to sci-tech innovations, MSBs, and green development, the PBC will launch tools in support of carbon emission reductions based on research. It will enhance the market-oriented interest rate formation and transmission mechanism by improving the policy rate system and deposit rate regulations, aiming to continuously unleash the potential of the reform in lowering lending rates and to facilitate a further decline in the actual lending rates. The PBC will ensure that the market plays a decisive role in the formation of the RMB exchange rate to enhance the flexibility of the exchange rate. It will enhance macro-prudential management, guide market expectations, 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 to keep prices basically stable. To safeguard and build 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. Keeping the economic indicators within a reasonable range and promoting a higher level of equilibrium in the economy in the course of recovery, the PBC will contribute to a good start for the 14th Five-Year Plan and celebrate the centenary of the founding of the CPC with great achievements.

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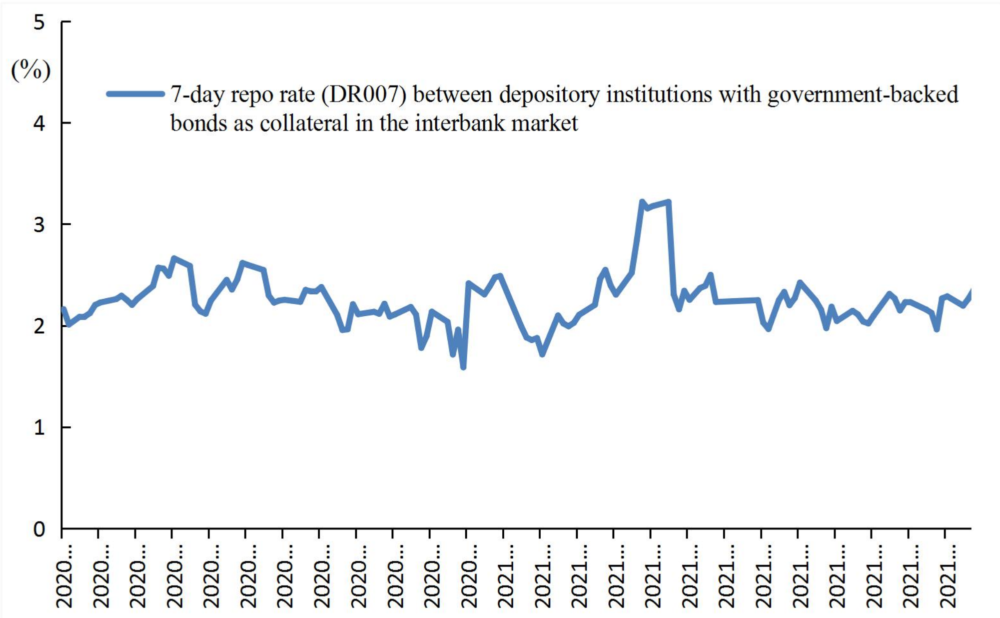
Part 1. Money and Credit Analysis

Since the beginning of 2021, under the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, following the guiding principles of the Fifth Plenary Session of the 19th CPC Central Committee and the Central Economic Work Conference and implementing the requirements of the *Report on the Work of the Government*, the People's Bank of China (PBC) stuck to a sound monetary policy, which is flexible, targeted, reasonable, and appropriate, and it devoted to maintaining its continuity, stability, and sustainability. It placed greater priority on serving the real economy, and it balanced the needs of promoting an economic recovery and preventing risks. At present, liquidity is adequate at a reasonable level, money and credit are maintaining reasonable growth, and financial support for the real economy remains solid.

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

In Q1 2021, the PBC pursued a sound monetary policy that is flexible, targeted, reasonable, and appropriate. By comprehensively using multiple policy tools to inject liquidity, including central bank lending, central bank discounts, the medium-term lending facility (MLF), and open market operations (OMOs), and to iron out short-term disturbances such as cash injections before and after the lunar new year, tax levies, and quarter-end factors in a timely manner, the PBC kept liquidity adequate at a reasonable level, averted any cash crunch ahead of the festival and excess liquidity afterwards, and maintained stable market expectations as well as smooth movement of money market interest rates. In the meanwhile, the PBC strengthened communications with the public in many ways and made monetary policy operations more targeted and effective. Short-term interest rates in the money market were guided to move around the 7-day reverse repo rate within a reasonable range, and policy rates were further exploited as a pivot. At end-March, the excess reserve ratio of financial institutions registered 1.5 percent, down 0.6 percentage points from the corresponding period 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 at low levels

Money and credit saw reasonable growth. With the deepening of the loan prime rate (LPR) reform, significantly enhanced efficiency of monetary policy transmission and continuous rapid growth of credit supply buttressed the economic recovery and the overall momentum for stability and progress. At end-March, outstanding loans issued by financial institutions in domestic and foreign currencies grew 12.3 percent year on year to RMB186.4 trillion, increasing RMB8 trillion from the beginning of the year and RMB673.4 billion more than the increase in the corresponding period of 2020. Outstanding RMB-denominated loans grew 12.6 percent year on year to RMB180.4 trillion, up RMB7.7 trillion from the beginning of 2021 and an increase that was RMB574.1 billion larger than that during the corresponding period of the previous year. Credit supply at an appropriate pace ensured continuous, stable, and sustainable support for the real economy and boosted stamina to serve high-quality development.

The credit structure continued to improve. Medium and long-term loans to enterprises and public entities grew by RMB4.5 trillion from the beginning of the year, a year-on-year acceleration of RMB1.4 trillion. At end-March, medium and long-term loans to the manufacturing sector gained 40.9 percent, accelerating for seventeen consecutive months. In particular, high-tech manufacturing witnessed a year-on-year increase of 45.0 percent. Outstanding inclusive loans to micro and small businesses (MSBs) grew by 34.3 percent year on year to RMB16.7 trillion, 4 percentage points higher than that at end-2020. These loans supported 35.27 million MSBs, an increase of 26.6 percent year on year.

Table 1 The Structure of RMB Loans in Q1 2021

Unit: RMB100 million

	Outstanding amount at end-March	YOY growth (%)	Increase from the beginning of the year	YOY acceleration
RMB loans to:	1804131	12.6%	76719	5741
Households	657467	16.3%	25619	13545
Enterprises and public entities	1137878	11.2%	53530	-6899
Non-banking financial institutions	3039	-62.5%	-2082	-353
Overseas	5747	3.0%	-349	-553

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 Q1 2021

Unit: RMB100 million

	Increase from the beginning of the year	YOY acceleration
Chinese-funded large-sized banks [1]	32060	-3214
Chinese-funded small and medium-sized banks[2]	41255	5019

Small-sized rural financial institutions[3]	11985	2339
Foreign-funded financial institutions	1034	646

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 remained at low levels. In 2021, the PBC continued to release the potential of the LPR reform and give full play to its role in optimizing resource allocations. In a market-oriented approach, financial institutions are encouraged to allocate more financial resources to MSBs, to improve the competitiveness of MSBs in obtaining loans, and to cut profits in favor of the real economy. In March, the one-year LPR and the over-five-year LPR stood at 3.85 percent and 4.65 percent, respectively, both equal to that in December 2020. The weighted average lending rate recorded 5.10 percent in March, remaining at a historic low. In particular, the weighted average interest rate on ordinary loans registered 5.30 percent, down 0.18 percentage points year on year. The weighted average corporate lending rate fell by 0.19 percentage points to 4.63 percent. This indicates that financial support for the real economy continues to yield positive results.

Table 3 Weighted Average Interest Rates on New Loans Issued in March 2021

Unit: %

	March	Change from Last December	YOY change
Weighted average interest rate on new loans	5.10	0.07	0.02
On ordinary loans	5.30	0.00	-0.18
Of which: On corporate loans	4.63	0.02	-0.19
On bill financing	3.52	0.42	0.58
On mortgage loans	5.37	0.03	-0.23

Source: The People's Bank of China.

In March, the share of ordinary loans with rates above, at, or below the LPR registered 69.54 percent, 8.42 percent, and 22.03 percent, respectively.

Table 4 Shares of RMB Lending Rates at Different Levels from January to March 2021

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	23.93	7.51	68.56	15.45	24.38	13.24	8.09	7.39
February	26.24	7.02	66.74	14.26	23.59	12.28	8.25	8.36
March	22.03	8.42	69.54	14.98	24.79	13.56	8.76	7.45

Source: The People's Bank of China.

Interest rates on foreign currency deposits and loans dipped. In March, the weighted average interest rates on demand and large-value USD-denominated deposits with maturities within 3 months registered 0.14 percent and 0.55 percent, respectively, down 0.02 and 0.04 percentage points from December 2020. 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 1.23 percent and 1.09 percent, up 0.01 percentage points and down 0.27 percentage points from December 2020, respectively.

Table 5 Average Interest Rates of Large-value USD-denominated Deposits and Loans from January to March 2021

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	0.14	0.65	0.88	0.92	1.10	1.17	1.25	1.12	1.06	1.04	1.94
February	0.14	0.61	0.72	0.90	1.05	1.04	1.23	1.17	1.05	1.16	2.37
March	0.14	0.55	0.77	0.91	1.09	0.99	1.23	1.09	1.01	0.90	2.14

Source: The People’s Bank of China.

Deposits grew steadily. At end-March, outstanding deposits in domestic and foreign currencies in all financial institutions posted RMB227.2 trillion, up 10.1 percent year on year, 0.1 percentage points lower than that at the end of the previous year. Outstanding RMB deposits registered RMB220.9 trillion, up 9.9 percent year on year, 0.3 percentage points lower than that at the end of the previous year. Outstanding deposits in foreign currencies stood at USD956.8 billion, an increase of USD67.5 billion from the beginning of the year and an acceleration of USD59.9 billion year on year, which was against a backdrop of better economic fundamentals, a widened trade surplus, and a growing willingness on the part of enterprises to hold foreign exchange in China.

Table 6 Structure of RMB Deposits in Q1 2021

Unit: RMB100 million

	Deposits at end-March	YOY growth (%)	Increase from the beginning of the year	YOY acceleration
RMB deposits:	2209233	9.9%	83513	2844
Households	992778	13.1%	66768	2077
Non-financial enterprises	661693	7.9%	2574	-16026
Public entities	302947	1.3%	3491	1457
Fiscal entities	43138	14.4%	-1633	1510

Non-banking financial institutions	195188	15.7%	11747	15461
Overseas	13490	-0.2%	565	-1635

Source: The People's Bank of China.

III. Broad money supply and aggregate financing to the real economy grew moderately

At end-March, outstanding M2 recorded RMB227.6 trillion, up 9.4 percent year on year. Outstanding M1 registered RMB61.6 trillion, up 7.1 percent year on year. Outstanding M0 reached RMB8.7 trillion, up 4.2 percent year on year. The first quarter witnessed a net cash injection into the economy of RMB222.9 billion, a fall of RMB360.4 billion year on year.

According to preliminary statistics, outstanding aggregate financing to the real economy (AFRE) reached RMB294.55 trillion at end-March, up 12.3 percent year on year and a deceleration of 1 percentage point over the end of the previous year. In Q1, the incremental AFRE reached RMB10.24 trillion on a cumulative basis with a decrease of RMB873.0 billion year on year, making it the second largest quarterly increase. Growth of AFRE remained generally stable with the following features. First, RMB loans saw a substantially larger year-on-year increase. Second, both entrusted loans and trust loans experienced net decreases, while undiscounted bankers' acceptances saw a year-on-year increase. Third, the year-on-year increase of corporate bonds narrowed, while that of equity financing expanded. Fourth, affected by local government special bonds, government bond financing recorded a narrow year-on-year increase. Fifth, the increases of both asset-backed securities of depository financial institutions and of written-off loans edged up compared with the same period of the previous year.

Table 7 Aggregate Financing to the Real Economy in Q1 2021

	At end-March 2021		In Q1 2021	
	Stock (RMB1	YOY growth	Flow (RMB100	YOY change

	At end-March 2021		In Q1 2021	
	trillion)	(%)	million)	(RMB100 million)
AFRE	294.55	12.3	102,380	-8,730
Of which：RMB loans	179.51	13.0	79,106	6,589
Foreign-currency loans (RMB equivalents)	2.31	-1.1	1,845	-65
Entrusted loans	11.04	-2.8	-50	920
Trust loans	6.01	-19.2	-3,569	-3,439
Undiscounted bankers' acceptances	3.83	14.1	3,245	2,985
Corporate bonds	28.17	11.7	8,614	-9,178
Government bonds	46.71	18.8	6,584	-9,197
Domestic equity financing by non-financial enterprises	8.50	13.5	2,467	1,212
Other financing	8.25	22.0	1,791	799
Of which：Asset-backed securities of depository financial institutions	1.92	15.7	272	504
Loans written off	5.46	29.4	1,730	184

Notes: ①AFRE (stock) refers to outstanding financing provided by the financial system to the real economy at the end of a period. AFRE (flow) refers to the volume of financing provided by the financial system to the real economy within a certain period of time. ② Since December 2019, the PBC has further improved AFRE statistics by incorporating "treasury bonds" and "local government general bonds" into the AFRE and combining them with the existing "local government special bonds" under the item of "government bonds." The value of this indicator is the face value of bonds under custody. Since 2019, the PBC has further improved the "corporate bonds" statistics contained in AFRE by incorporating "exchange-traded asset-backed corporate securities." 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. ③ Year-on-year statistics in the table are on a comparable basis.

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

Box 1 Improving the Framework for Modern Monetary Policy

The Fifth Plenary Session of the 19th CPC Central Committee proposed "building a modern central banking system," To build a modern central banking system, we need to improve the framework for modern monetary policy, support high-quality economic development, and foster a new development paradigm. A modern monetary policy framework consists of optimized monetary policy objectives, innovative monetary policy instruments, and smooth monetary policy transmission mechanisms. The central bank needs to constantly innovate its monetary policy instrument system, give full play to the role of policy tools, improve the transmission efficiency of monetary policy, and achieve the objectives of monetary policy, all of which are expected to be combined into an organic whole.

1.Sticking to the ultimate objective of currency stabilization and optimizing the anchoring of the intermediary objective

According to the *Law on the People's Bank of China*, the ultimate objective of monetary policy is "to maintain the stability of currency value so as to promote economic growth". The key to price stability lies in maintaining an aggregate monetary supply as appropriate. As China gears into high-quality development, its economic growth turns to be more innovation-driven. Therefore, growth of money supply compatible with development of the real economy will be more in line with nominal economic growth, which calls for supporting high-quality development with moderate growth of money supply. The Central Economic Work Conference in 2020 and the *14th Five-Year Plan for Economic and Social Development and Long-Range Objectives through the Year 2035* proposed that growth of money supply and AFRE should be generally aligned with nominal economic growth, thus clearly defining the "anchor" of the monetary policy framework. The anchoring of the intermediary objective is conducive to formulating appropriate cross-cycle policies and stabilizing monetary aggregates in the long run. Based on the changes in the macro-economic situation, it also contributes to the convergence of growth of M2 and AFRE toward the nominal economic growth underlying potential output growth, which, therefore, provides a more scientific and rational anchor for the implementation of macro policies. Moreover, it also helps to guide the formation of reasonable and stable market expectations. Embedded with a stabilizing mechanism for the macro leverage ratio, the anchoring of the intermediary objective is conducive to achieving a long-term equilibrium between stabilizing growth and preventing risks. In the meanwhile, the PBC will increase the flexibility of the RMB exchange rate, keep the RMB exchange rate basically stable at an adaptive and equilibrium level, and strike a balance between internal and external equilibria.

2.Improving the operational target system of the central bank and smoothing the channels for monetary policy transmission

In recent years, the PBC has deepened the market-based interest rate reform, promoted the formation mechanism for the LPR, and significantly raised the transmission efficiency of monetary policy. As the pricing benchmark of the credit market, the LPR plays an important role in adjusting the demand and supply of credit, thus affecting money supply. Keeping the LPR at a reasonable level helps stabilize the "anchor" of money supply. The LPR is formed with reference to the quotations based on policy rates and in a market-based manner. The PBC guides the market rates represented by the DR007 to move around the policy rates by improving the policy rate system with the OMO rates as the short-term policy rates and the MLF rates as the medium-term policy rates. The market-based interest rate formation and transmission mechanism, which applies throughout the process from the policy rates to the LPR and then to the real lending rates, is further improved to adjust the demand and supply of funds and the allocation of resources and to achieve the objectives of monetary policy.

It is worth noting that there are two types of practices with regard to the operational targets of the central banks' monetary policies globally. One is to take market rates as the operational target and to guide the market rates to move within a range of the operational target through the adjustment of liquidity. The other is to set the interest rates of monetary policy instruments as the central bank's policy rates, or operational targets. Therefore, the operational targets, policy rates, and interest rates of the monetary policy instruments are integrated. In the wake of the 2008 gobal financial crisis, the advantage of the second practice in improving the effectiveness and transmission efficiency of monetary policy was more apparent and gradually became the mainstream. The PBC also adopts the more direct second practice in setting up its operational target system. When observing the orientation of monetary policy, the market and the public only need to observe whether the policy rates have changed and they should avoid paying excessive attention to the volume of open market operations, 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.

3.Innovating monetary policy instruments and improving the mechanism for money supply management

In terms of the aggregates, the PBC improves the long-term mechanism for adjusting the liquidity, capital, and interest rate constraints on banks' money creation. Targeting the banks, which are direct money creators, the PBC employs a mix of monetary policy instruments so as to keep liquidity adequate at a reasonable level. The PBC promotes banks to replenish capital through multiple channels by means of bank-issued perpetual bonds. Moreover, the PBC promotes the LPR reform, removes the implicit floor of interest rates, guides the downward movement of lending rates, relieves the liquidity, capital, and interest rate constraints faced by banks in money creation, and keeps the growth of money supply and AFRE basically in line with nominal economic growth.

In terms of the structure, the PBC sets up a system that enables the financial sector to provide effective support for the real economy. The PBC continues to improve the structural monetary policy instrument system, and links the volume and price of liquidity with the banks' deposit creation from loans through the design of an incentive-compatible mechanism. In accordance with the needs of economic development at different stages, the PBC adjusts its policy priorities dynamically and guides financial resources to flow into key areas and weak links of the national economy, such as scientific and technological innovations, micro and small businesses, as well as green development, so as to promote the sustainability and resilience of the economy.

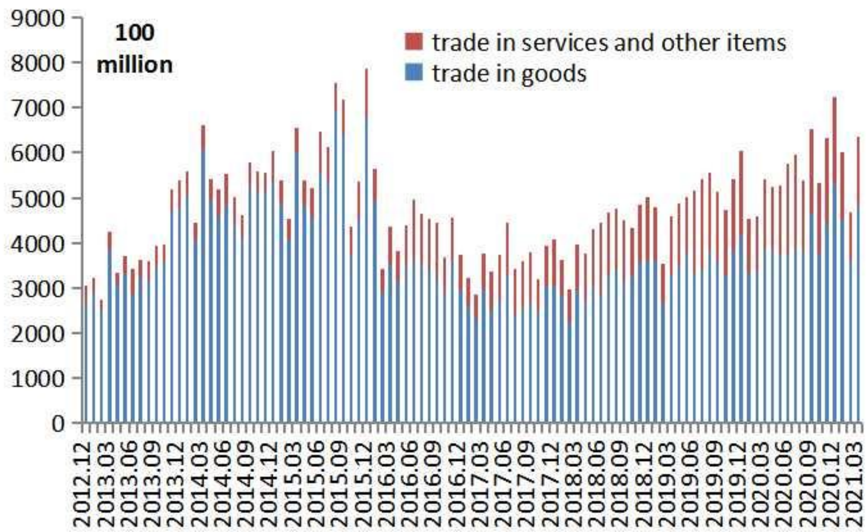
In general, in terms of monetary policy, the PBC sticks to the ultimate target of currency stability, improves the intermediary target of keeping the growth of money supply and AFRE basically aligned with nominal economic growth, and integrates the policy targets with a sound market-based mechanism for interest rate formation and transmission and a better mechanism for money supply management, all of which contribute to the construction of a modern monetary policy framework. Being more open, transparent, and direct, the framework improves the efficiency of communications between the central bank and the public, reduces the costs of communications, effectively guides expectations, enhances the fairness of public access to information, and increases the effectiveness of monetary policy transmission, which is conducive to creating a favorable monetary and financial environment for high-quality economic development.

IV. The RMB exchange rate remained basically stable at an adaptive and equilibrium level, and cross-border RMB transactions continued to grow

Since the beginning of 2021, cross-border capital flows and foreign exchange supply and demand have been basically in equilibrium, with market expectations generally stable. Based on market supply and demand, the RMB exchange rate moved in both directions and remained basically stable at an adaptive and equilibrium level. In Q1, the RMB exchange rate appreciated against the basket of currencies. At end-March, the China Foreign Exchange Trade System (CFETS) RMB exchange rate index and the RMB exchange rate index based on the special drawing rights (SDRs) basket closed at 96.88 and 95.66, respectively, up 2.15 percent and 1.52 percent from end-2020. According to calculations by the Bank for International Settlements (BIS), at end-March 2021, the nominal effective exchange rate (NEER) and the real effective exchange rate (REER) of the RMB appreciated 2.15 percent and 2.10 percent from end-2020, respectively. From 2005 when reform of the exchange-rate formation mechanism commenced to end-March 2021, the NEER and REER of the RMB appreciated by 40.63 percent and 54.55 percent, respectively. In Q1, the RMB exchange rate depreciated slightly against the US dollar. At end-March, the central parity of the RMB against the USD was 6.5713, down 0.71 percent from end-2020, appreciating by 25.95 percent on a cumulative basis from the launch of the reform of the exchange-rate formation mechanism in 2005. In Q1, the annualized volatility rate of the RMB exchange rate against the USD was 3.9 percent.

In Q1 2021, cross-border RMB settlements totaled RMB9 trillion, up 48 percent year on year. In particular, RMB receipts and payments registered RMB4.6 trillion and RMB4.3 trillion, respectively. Cross-border RMB settlements under the current account grew by 17 percent year on year to RMB1.7 trillion, among which RMB settlements of trade in goods registered RMB1.3 trillion, whereas RMB settlements of trade in services and other items registered RMB412.97 billion. Cross-border RMB settlements under the capital account posted RMB7.3 trillion, up 58 percent year on year.

Figure 2 Monthly RMB Payments and Receipts under the Current Account



Source: The People's Bank of China.

Part 2. Monetary Policy Operations

In Q1 2021, the PBC resolutely implemented the decisions and arrangements made by the CPC Central Committee and the State Council and kept the sound monetary policy flexible, targeted, reasonable, and appropriate. The PBC conducted open market operations in a targeted manner, advanced market-based reforms of the interest rate and the exchange rate, further leveraged the targeted guidance role of structural monetary policy instruments and channeled more funds into key areas and weak links, including scientific and technological innovations, micro and small businesses (MSBs), and green development, thus fostering a favorable monetary and financial environment for high-quality economic development.

I. Conducting open market operations effectively

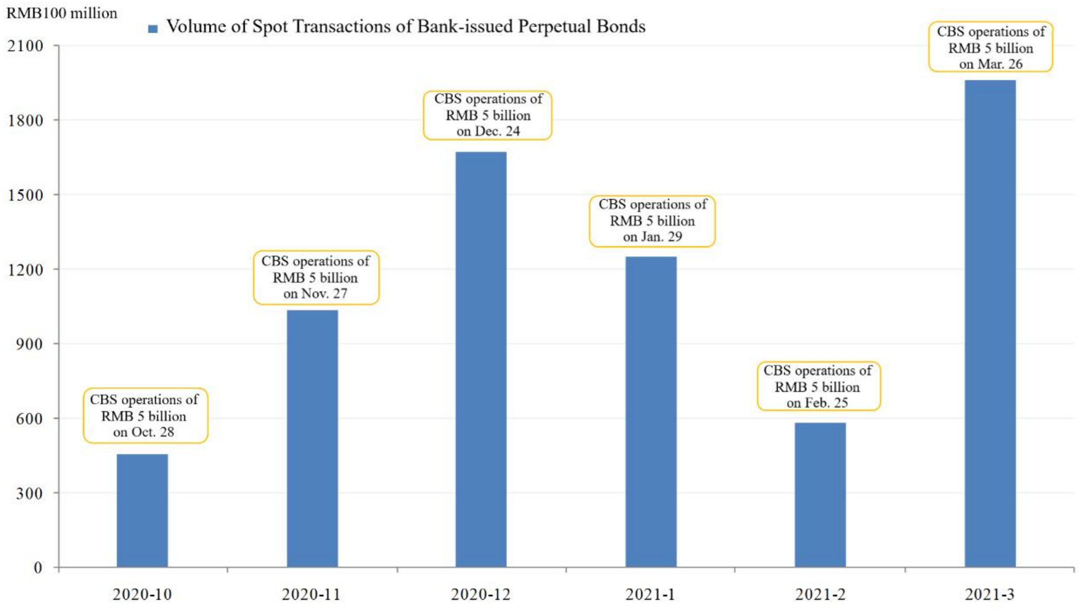
Conducting open market operations in a targeted manner. In Q1 2021, many uncertainties, particularly considerable disruptions brought about by the Spring Festival, affected liquidity supply and demand in the banking system. Amid Covid-19 prevention and control, the PBC fully analyzed the factors affecting supply and demand of funds, such as cash injections during the Spring Festival and fiscal revenue and expenditures, planned in advance, fine-tuned dynamically, conducted operations in a targeted manner, and guided market expectations through various means, such as explaining the central bank's operations around the Spring Festival in the *Announcement on Open Market Operations* and a number of other documents. As a result, market liquidity was kept stable, with a record low level of liquidity supply before the Spring Festival. Meanwhile, short-term reverse repo operations conducted before the Spring Festival all matured within just several trading days after the Festival, and liquidity was maintained at a level that was "neither tight before the Festival nor loose after the Festival." Seven-day reverse repo operations were conducted successively in appropriate amounts after the Spring Festival in the open market to maintain a precise balance of fund supply and demand and to ensure liquidity stability at the end of the quarter.

Guiding market rates to move around the central bank policy rates. Since the beginning of 2021, both the Medium-term Lending Facility (MLF) rate and the reverse repo rate have remained unchanged, demonstrating a sound monetary policy stance. Meanwhile, the PBC improved the continuity of open market operations, steadily sent short-term policy rate signals through daily operations of the 7-day reverse repo, and guided short-term money market rates to move around the open market operation rates within a reasonable range. The open market operation rates have played an increasingly important role as the pivotal short-term market rates. In Q1 2021, the weighted average rate on the 7-day repo between depository institutions in the interbank market (DR007) averaged 2.21 percent, very close to the open market operation rate of 2.2 percent on the 7-day reverse repo.

Continuously conducting central bank bill swap (CBS) operations. In Q1 2021, 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 0.10 percent. At present, the PBC conducts CBS operations regularly on a once-in-a-month basis, and these operations play 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.

Issuing central bank bills in Hong Kong on a regular basis. In Q1 2021, the PBC issued three batches of RMB-denominated central bank bills in Hong Kong, totaling RMB30 billion. Specifically, the 3-month, 6-month, and 1-year bills registered RMB10 billion, RMB5 billion, and RMB15 billion, respectively. 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. In Q1 2021, offshore RMB bond issuances, other than the RMB-denominated central bank bills issued in Hong Kong, registered roughly RMB48 billion, a year-on-year increase of 50 percent. Moreover, the RMB offshore market saw increasingly brisker transactions.

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



Box 2 The Central Bank Conducts Open Market Operations in a Targeted Manner

In recent years, the framework of China's monetary policy operations have continued to improve, open market operations (OMOs) have become more scientific, transparent, flexible, and targeted, and market liquidity has remained appropriate and abundant. The rates of open market operations reflect signals of the central bank's policy rates, play a growingly pivotal role in the market, and effectively guide money market rates to move around the central bank's policy rates. The key to observing open market operations is the price rather than the amount.

In Q1 2021, the PBC conducted open market operations in a targeted manner, effectively offsetting seasonal disruptions such as the Spring Festival and the end of a quarter. Due to Covid-19 prevention and control and other factors during the Spring Festival, liquidity conditions differed significantly from previous years, and uncertainties grew as well. The PBC followed up on the latest developments in Covid-19 prevention and control in real time, strengthened relevant analysis and research, and made rolling forecasts for cash injections, fiscal revenue and expenditures, demand for funds in the market, and other factors. Through measures that aimed at "planning in advance, fine-tuning dynamically, conducting operations in a targeted manner, and guiding expectations," the PBC achieved its operational target, i.e., maintaining stable market rates before and after the Spring Festival. Before the Spring Festival, a total of RMB430 billion was injected into the market for the holiday, the lowest injection amount in recent years. Meanwhile, to enhance the transparency of monetary policies and to stabilize market expectations, the PBC explained in advance in the *Announcement on Open Market Operations* that "cash demand before the Spring Festival is expected to decrease notably and fiscal expenditures are expected to increase by a relatively large amount," enabling the market to better understand the central bank's policy implications. In practice, the money market before and after the Spring Festival remained stable, and the DR007 remained close to the open market operation rate of 2.2 percent on 7-day reverse repos, reflecting a sound monetary policy stance that is neither loose nor tight, and thus the central bank's open market operations became more targeted and forward-looking.

At present, it has become a regular practice for the PBC to conduct MLF operations at a fixed time in the middle of each month and to conduct open market operations successively each day. As a result, the efficiency of monetary policies has improved significantly as the PBC has continuously released policy rate signals and has guided market rates to move around policy rates. Meanwhile, when conducting open market operations, the PBC gave priority to short-term benchmark rates in the money market, such as the DR007, and gave full consideration to cash injections and withdrawals, fiscal revenue and expenditures, market demand, and other factors to flexibly adjust the size and maturity of OMOs. Therefore, when observing the central bank's open market operations, rather than focusing too much on the amount of OMOs, the market should focus more on the policy rates including OMO rates and MLF rates as well as the movement of the benchmark market rates over a certain period of time, and it should refrain from over-interpreting the monetary policy stance. At the beginning of this year, money market rates rose for a short period of time, as short-term liquidity demand grew by a relatively large margin amid loose market expectations. Compared with other developing countries, the volatility of China's money market rates was not high. Moreover, moderate fluctuations of market rates also show that the market mechanism plays its part with normal pricing functions.

With the deepening of the market-based interest rate reform, China has gradually developed a central bank policy rate system, with the MLF rates and the open market operational rates serving as medium-term and short-term policy rates respectively, and the central bank operation rates have gradually played pivotal roles. The movement of market rates around the central bank policy rates shows that the policy rates not only guide markets rates effectively but also fully reflect changes in market supply and demand for funds, demonstrating that the market mechanism has played a decisive role in the formation of interest rates. Meanwhile, in light of the macro economic and financial situations and monetary policy objectives, the central bank sets the policy rates and guides the movement of market rates, which not only meets the needs of a central bank to fulfill its functions in monetary management but also embodies the philosophy that monetary policies serve the real economy with the people as the center.

Going forward, in line with the requirement that the sound monetary policy should be kept flexible and targeted, and at a reasonable and appropriate level, and adhering to the principle that stability should be made a top priority, the PBC will continue to ensure an appropriate aggregate monetary supply, deliver a good cross-cycle liquidity arrangement, conduct open market operations in a targeted manner, maintain an appropriate and abundant level of liquidity in the market, improve the market-based interest rate formation and transmission mechanism, and guide market rates to move around policy rates, thus providing a favorable liquidity environment for the building of a new development paradigm.

II. Timely conducting Standing Lending Facility and Medium-term 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 medium-term policy rate. In Q1, the PBC conducted a total of RMB800 billion of MLF operations, all with a maturity of one year and an interest rate of 2.95 percent. At end-March, the outstanding MLF registered RMB5.35 trillion, RMB200 billion more than that at the beginning of the year.

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 Q1, the PBC conducted a total of RMB47.5 billion SLF operations, and the balance of SLF operations registered RMB6.4 billion at end-March. The SLF played its role as the ceiling of the interest rate corridor, thus promoting smooth performance of the money market. At end-March, the overnight, 7-day, and 1-month SLF rates were 3.05 percent, 3.20 percent, and 3.55 percent, respectively, on par with the rates at the end of the previous quarter.

III. Further improving the macro-prudential policy framework

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. In Q1 2021, in line with the requirements for the key tasks deployed at the Central Economic Work Conference, the PBC further improved the framework of the MPA and attached more importance to the assessment requirements for banks in terms of supporting the key areas and weak links in the real economy. Through adjusting and optimizing the assessment indicators in a dynamic manner, the PBC guided financial institutions to further enhance their support in issuing loans to inclusive MSBs and medium and long-term loan to the manufacturing sector. Meanwhile, non-local deposits absorbed by locally incorporated banks were included in the MPA, thus safeguarding the competitive order in the deposit market and maintaining stable debt costs of banks.

The macro-prudential adjustment coefficients were optimized. First, the *Notice of the PBC and the SAFE on Adjusting the Macro-prudential Adjustment Parameter for Cross-border Financing of Companies* (Yinfa No.5 [2021]) was released, lowering the macro-prudential adjustment parameter for cross-border financing of non-financial companies from 1.25 to 1. Second, the *Notice of the PBC and the SAFE on Adjusting the Macro-prudential Adjustment Coefficient for Domestic Companies Extending Overseas Loans* (Yinfa No.2 [2021]) was issued, raising the macro-prudential adjustment coefficient for overseas loans issued by domestic companies from 0.3 to 0.5.

The management system for the real estate loan concentration was put into place in an orderly manner. Following the establishment of the real estate loan concentration management system at end-2020, the PBC, in collaboration with the CBIRC, directed their provincial-level branches to appropriately set the management requirements for the real estate loan concentration of locally incorporated banks, and urged commercial banks whose concentration level had exceeded the cap to formulate adjustment schemes for the transition period. Currently, the credit structure has been optimized in an orderly manner, and the management system for the real estate loan concentration has entered a phase of conducting and implementing a normal policy.

The regulatory framework for systemically important financial institutions was improved. The PBC, jointly with the CBIRC, drafted the *Additional Regulatory Rules on Systemically Important Banks* (Trial) (Exposure Draft) (hereinafter referred to as the *Rules*), and solicited public opinion starting from April 2. The *Rules,* as a general framework for additional regulation of systemically important banks, specified additional regulatory requirements in terms of an indicator system, recovery and resolution schemes, and prudential regulatory measures.

The regulatory system for financial holding companies (FHCs) was improved. Since the beginning of 2021, the PBC has made proactive efforts to conduct administrative approvals of FHCs. On March 31, it released the *Interim Regulations on Filing-based Management of Directors, Supervisors, and Senior Executives of Financial Holding Companies* (Order No.2 [2021] of the PBC) (hereinafter referred to as the *Regulations*). The *Regulations* clarified that the PBC should perform filing-based management of directors, supervisors, and senior executives of FHCs and specified the eligible conditions for personnel and the relevant filing procedures. In addition, the PBC reinforced appointment management so as to guard against the risks associated with personnel in key positions by regulating behavior, such as holding concurrent posts, performing acting duties, and publicizing personnel information.

IV. 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. The role of central bank lending was further brought into play in providing targeted liquidity and serving as positive incentives so as to underpin and consolidate the effective links between the achievements of poverty eradication and rural revitalization. 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 the four provinces with large Tibetan populations, and the “three autonomous prefectures”, i.e., Linxia in Gansu, Liangshan in Sichuan, and Nujiang in Yunnan, and to lower the financing costs in these areas as well as to consolidate and expand the achievements of poverty eradication. In Q1, central bank lending for special poverty alleviation projects was issued in the amount of RMB8.8 billion, with the balance reaching RMB45.8 billion at end-March. As of end-March, outstanding central bank lending to support rural development registered RMB442.2 billion. Outstanding central bank lending for MSBs and for poverty alleviation posted RMB929.5 billion and RMB209.0 billion, respectively. Outstanding central bank discounts registered RMB574.4 billion. In Q1, the PBC made a net withdrawal of PSLs in the amount of RMB41.0 billion from policy and development banks, with the outstanding PSL registering RMB3.1940 trillion at end-March.

The TMLFs maturing in Q1 were rolled over in the form of MLFs. 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. On January 15, the PBC conducted one-year MLF operations totaling RMB500 billion, with an interest rate of 2.95 percent, including the rolling-over of the TMLFs maturing in Q1. The instrument can be rolled over for up to 3 years. At end-March, the outstanding TMLFs totaled RMB56.1 billion.

With highlighted characteristics of directness and precision, two monetary-policy instruments directly supporting the real economy were continuously promoted with the aim of bolstering the development of MSMEs. In line with the arrangements made at the executive meeting of the State Council, on March 30 the PBC, jointly with CBIRC, Ministry of Finance (MOF), National Development and Reform Commission (NDRC), and Ministry of Industry and Information Technology (MIIT), issued the *Notice on Relevant Issues Concerning Further Extending the Implementation Periods for the Policy of Deferring Principal and Interest Repayments of Inclusive MSB Loans and for the Support Policy for Unsecured Loans* (Yinfa No.81 [2021]), so as to ensure the continuity, stability, and sustainability of the policies. By extending the application period of two monetary-policy instruments directly supporting the real economy to December 31, 2021, the PBC maintained support for the MSBs and leveraged the policies in stabilizing employment. From the beginning of 2020 to end-March 2021, banking institutions nationwide deferred payments totaling RMB9.2 trillion of loan principals and interest repayments and issued cumulative inclusive unsecured MSB loans totaling RMB5.3 trillion.

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

Financial support to keep businesses and employment stable was enhanced. A symposium was held on adjusting the credit structure of major nationwide banks. The PBC strengthened policy guidance, encouraged banks to continuously improve financial services to MSBs, and promoted MSB financing featuring "increased volume, lowered price, improved quality, and expanding coverage." Banks were encouraged to increase the supply of medium and long-term loans to the manufacturing sector so as to promote its high-quality development.

Effective support was provided to consolidate and expand the achievements of poverty eradication. In terms of poverty alleviation, the "Four Withouts" requirement was strictly followed, i.e., lifting areas out of poverty without loading off responsibilities, without abolishing policies, without ceasing support, and without removing supervision. Major financial support policies were kept generally stable, the role of central bank lending in providing targeted liquidity and serving as a positive incentive was continuously brought into play, and financing costs were reduced for agriculture, rural areas, and rural people. Micro-credit loans were effectively provided to people out of poverty. Secured loans for start-ups and student loans were continuously implemented. Efforts were made to provide subsequent financial services following the residents' removal from impoverished areas and to carry out research on strengthening inputs of financial resources into key counties to assist in the project of national rural revitalization.

Resource inputs were further enhanced to support rural revitalization. Measures were taken to provide effective financial services for key areas, such as spring farming, tillage preparation, grain security, seed industry development, and high-standard farmland construction. The PBC supported loan businesses secured by pledges or collateral, including agricultural machinery and tools, greenhouse facilities, the right of contracted rural land management, and it encouraged financial institutions to issue special financial bonds for agriculture, rural areas, and rural people in an attempt to expand the sources of funding with low costs.

VI. Further deepening the market-based interest rate reform

The PBC continued to unleash the potential of reform in reducing loan interest rates, optimized regulation of deposit interest rates and pushed actual loan rates to go further downward. **First**, with continued progress in the loan prime rate (LPR) reform and use of the LPR, the financing costs of enterprises witnessed an obvious decline. **Second**, order in the credit market was regulated. In March 2021, the PBC issued an announcement requiring all banks to explicitly indicate the annualized interest rates of their loan products and specifying the interest calculation rules so as to protect the rights of financial consumers to be informed. **Third**, the PBC strengthened deposit management, regulated the pricing of deposit rates, and banned locally incorporated banks from absorbing non-local deposits. The PBC explicitly required financial institutions to stop new issuances of deposit products with periodic interest payments and urged them to conduct the pricing in a scientific and rational way so as to maintain competitive order in the deposit market. The PBC incorporated non-local deposits absorbed by locally incorporated banks into the MPA and forbade locally incorporated banks from absorbing non-local deposits through various channels, with the outstanding balance settled when coming due. Until now, financial institutions have basically completed rectification of deposit products with periodic interest payments. Most locally incorporated banks have halted the business of absorbing non-local deposits, with the balance brought down in an orderly manner. This will help maintain the stability of the banks' costs in assuming debts and will create a favorable environment for promoting the market-based interest rate reform and the steady decline in the comprehensive financing costs for enterprises.

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

The PBC continued to advance the market-based reform of the RMB exchange rate 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 RMB exchange rate and gave play to the role of the exchange rate in adjusting the macro economy and as an automatic stabilizer for 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 Q1 2021, the highest and lowest CNY central parities were 6.4391 and 6.5713, respectively, against the USD. During the 58 trading days, the RMB appreciated on 27 days and depreciated on 31 days. The biggest intraday appreciation and depreciation were 1.00 percent (648 bps) and 0.83 percent (543 bps), respectively. The RMB exchange rates against other major international currencies floated in two ways. At end-March 2021, the central parities of the RMB against the euro and the Japanese yen had appreciated 4.81 percent and 6.18 percent respectively from end-2020, while the RMB central parity had depreciated 0.71 percent and 1.56 percent against the dollar and the pound during the same period. Since the reform of the RMB exchange rate formation mechanism commenced in 2005, the RMB has appreciated by a cumulative total of 25.95 percent, 30.01 percent, and 22.68 percent, respectively, against the dollar, the euro, and the Japanese yen through end-March 2021. 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 Q1 2021

Unit: RMB100 million

Currency	USD	EUR	JPY	HKD	GBP	AUD	NZD
Trading volume	144845.93	4737.63	856.64	269.81	145.32	219.89	118.15
Currency	SGD	CHF	CAD	MYR	RUB	ZAR	KRW
Trading volume	204.67	138.71	342.18	0.88	52.35	0.48	19.17
Currency	AED	SAR	HUF	PLN	DKK	SEK	NOK
Trading volume	6.13	1.83	0.25	0.14	31.51	17.02	18.30
Currency	TRY	MXN	THB	KHR	KZT	MNT	
Trading volume	0.00	0.43	117.32	0	0	0	

Source: China Foreign Exchange Trade System.

As of end-March, under the bilateral currency swap agreements between the PBC and foreign monetary authorities, the foreign monetary authorities utilized a total of RMB60.862 billion, and the PBC utilized foreign currencies equivalent to USD512 million. These operations played an active role in promoting bilateral trade and investment.

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

Risk resolution and reform and restructuring of small and medium-sized financial institutions have been promoted in an orderly manner. 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 plan of Hengfeng Bank was carried out smoothly, and the risk resolution, reform, and restructuring of Jinzhou Bank was basically completed so as to ensure the sound operation of the financial system during the critical and sensitive period and to firmly defend the bottom line that no systemic risk should occur.

Risk resolution of the Baoshang Bank (BSB) was advanced steadily and orderly. Since the takeover of the BSB, there has been steady progress, breaking the rigid payments in an orderly manner and completing asset and capital verifications on schedule. On November 23, 2020, the Beijing No.1 Intermediate People's Court ruled to accept the bankruptcy petition of the BSB, and it appointed a liquidation group as the administrator of the BSB. On January 12, 2021, the Beijing No.1 Intermediate People's Court held a creditors' meeting for the first time, and the administrator completed a review of the rights of 743 creditors. On February 7, the Beijing No.1 Intermediate People's Court issued its ruling on the BSB's bankruptcy. Equities of the former shareholders were cleared, and large-denomination creditors bore part of the losses, which means risk resolution of the BSB has been basically completed. Going forward, following the delivery of assets and alteration of the body of proceedings and arbitration, the administrator will complete the de-registration of the BSB and its affiliates as soon as possible.

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 constraints 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 on the basis of strengthening risk prevention and control.

IX. Deepening the reform of foreign exchange arrangements

The pilot program of trade facilitation was advanced to expand the coverage and raise the quality. The pilot areas and business scope were expanded steadily and orderly, business procedures were optimized, and market participants were guided to continuously improve their credit rating, administrative capability, and internal control. Until now, the pilot program has been expanded to 22 areas.

Facilitation of individuals' foreign exchange business was promoted. The State Administration of Foreign Exchange issued the *Notice on Further Promoting Facilitation of Individual Foreign Exchange Business under the Current Account* (Huifa〔2021〕13), further optimizing the filling items and methods and enhancing the filling efficiency.

Administration of the foreign exchange market was strengthened. The fostering of the capability of off-site monitoring was enhanced and continuous efforts were made to severely crack down on illegal financial activities, such as underground banks and cross-border gambling. Emphasis was placed on investigating false and deceptive transactions so as to maintain a healthy order in the foreign exchange market. In Q1 2021, a total of 661 cases violating the regulations of the foreign exchange administration were handled, with total fines amounting to RMB216 million.

Part 3. Financial Market Conditions

In Q1 2021, the financial market operated generally smoothly, with firm support for the real economy. The money market remained stable, with interest rates fluctuating within a reasonable range and market transactions growing in a steady manner. The bond market featured declined bond coupon rates, narrowed credit spreads, increased bond issuances, and active cash bond transactions. The stock market index fell after a rise, and both turnover and the amount of funds raised witnessed year-on-year surges.

I. Financial market overview

1. The money market operated in a steady manner

The money market interest rate was stable. In March, the monthly weighted average interest rate of pledged repos posted 2.01 percent, higher than that in end-2020 and getting close to that in end-2019. The monthly weighted average interest rate of government-backed bond repos among depository institutions posted 1.91 percent, 10 basis points lower than the monthly weighted average interest rate of pledged repos. In March, the monthly weighted average interest rate for interbank lending posted 2.01 percent. At end-March, the overnight and 7-day Shibor posted 2.12 percent and 2.25 percent, respectively.

Market transactions experienced steady growth. In Q1 2021, the volume of trading of bond repos on the interbank market reached RMB223.2 trillion, representing an average daily turnover of RMB3.7 trillion and a year-on-year increase of 8.5 percent, down 9.1 percentage points from that in 2020. The volume of cumulative trading of interbank lending registered RMB29.1 trillion, with an average daily turnover of RMB485.1 billion and a year-on-year decrease of 11.6 percent. In Q1 2021, the volume of bond repos traded on the exchange markets increased 20.7 percent year on year to RMB75.8 trillion.

Table 9 Fund Flows Among Financial Institutions in Q1 2021

Unit: RMB100 million

	Repos		Interbank lending	
	Q1 2021	Q1 2020	Q1 2021	Q1 2020
Chinese-funded large banks①	-458,527	-625,803	-71,853	-96,936
Chinese-funded medium-sized banks②	-360,253	-219,725	-25,082	-26,027
Chinese-funded small-sized banks③	3,076	3,900	27,961	24,252

Securities institutions④	268,204	224,001	49,169	69,209
Insurance institutions⑤	19,196	25,677	0	44
Foreign-funded banks	15,918	23,081	-7,502	-1,620
Other financial institutions and vehicles⑥	512,387	568,869	27,307	31,078

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 Q1 2021, 7,489 interbank CDs were issued on the interbank market, raising RMB5.6 trillion. The volume of trading on the secondary market totaled RMB35.1 trillion. At end-March, outstanding interbank CDs reached RMB12.0 trillion. In Q1 2021, the average weighted interest rate of 3-month interbank CDs was 2.83 percent, 11 basis points higher than that of the 3-month Shibor. A total of 20,000 negotiable CDs were issued by financial institutions in Q1 2021, raising RMB3.8 trillion, with an increase of RMB200 billion year on year.

The interest rate swap market witnessed orderly development. In Q1 2021, the RMB interest rate swap market witnessed 75,000 transactions, increasing 23.0 percent year on year, with the volume of the notional principal totaling RMB5.4 trillion, an increase of 24.8 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 RMB3.6 trillion, accounting for 68.0 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 85.7 percent and 13.2 percent, respectively, of the total notional principal of the interest rate swaps. In Q1 2021, interest rate swaps anchored to the LPR witnessed 290 transactions, with

RMB28.85 billion of the notional principal.

Table 10 Transactions of Interest Rate Swaps in Q1 2021

	Transactions	Notional principal (RMB100 million)
Q1 2021	75,460	53,620.9
Q1 2020	61,357	42,955.1

Source: China Foreign Exchange Trade System.

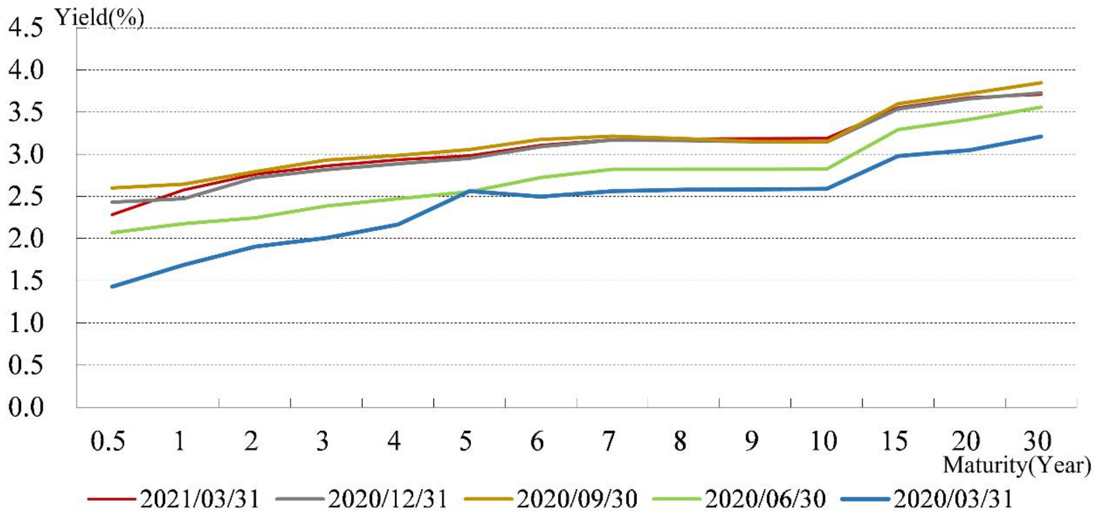
The loan prime rate (LPR) interest rate option business developed steadily. The LPR interest rate option business made its debut on the interbank market in March 2020, and the fixing repo rate (FDR) options was newly added to the interbank market on March 29, 2021. In Q1 2021, a total of 177 interest rate option transactions were concluded, totaling RMB23.64 billion. Specifically, 29 were interest rate swap transactions, amounting to RMB1.52 billion of the notional principal, 148 were interest rate cap/floor transactions, amounting to RMB22.12 billion of the notional principal, 112 were LPR interest rate transactions, totaling RMB 19.79 billion of the notional principal, and 65 were FDR interest rate transactions, amounting to RMB3.85 billion of the notional principal.

2. Coupon rates of bonds declined while bond issuances expanded

On the whole, coupon rates of bonds declined. In March 2021, the yield on 10-year government securities issued by the Ministry of Finance was 3.22 percent, 3 basis points lower than that in December 2020. The coupon rate of 10-year financial bonds issued by the China Development Bank was 3.52 percent, 13 basis points lower than the rate in December 2020. The average rate of 1-year short-term financing bills (bond rating A-1) issued by AAA-rated enterprises was 3.56 percent, 66 basis points lower than the rate in December 2020.

Government securities yields went up slightly. At end-March, yields on 1-year and 10-year government securities increased by 10 basis points and 5 basis points to 2.57 percent and 3.19 percent from end-2020, respectively. Credit spreads narrowed, with credit spreads on 3-year AAA and AA-rated short-to-medium-term bills narrowing by 16 basis points and 29 basis points from end-2020, respectively.

Figure 4 Yield Curves of Government Securities on the Interbank Market



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

Bond issuances saw year-on-year growth. In Q1, the cumulative value of bond issuances increased by 16.7 percent, or RMB2 trillion, year on year to RMB14.1 trillion, most of which were financial bonds, which increased by RMB1.9 trillion. At end-March, outstanding bonds held in custody amounted to RMB120 trillion, an increase of 16.6 percent year on year.

The volume of cash bond transactions on the interbank market decreased, while that on the stock exchanges maintained growth. In Q1, the value of cash bonds trading on the bond market posted RMB51.3 trillion, registering a decrease of 1.5 percent year on year. Specifically, the value of bond trading on the interbank market was RMB46.1 trillion, representing a decrease of 5.5 percent year on year. The value of bond transactions on the stock exchanges totaled RMB5.2 trillion, an increase of 56.5 percent year on year.

Table 11 Bond Issuances in Q1 2021

Unit: RMB100 million

Type of bond	Issuance	YOY change
Government securities	14,358	7,008
Local government bonds	8,951	-7,154
Central bank bills	0	0
Financial bonds①	81,780	18,943
Of which: Financial bonds issued by the China Development Bank and policy financial bonds	16,002	4,183
Interbank certificates of deposit	55,404	14,777
Corporate credit bonds②	35,625	1,273
Of which: Debt-financing instruments of non-financial enterprises	24,751	1,432
Enterprise bonds	1,185	349
Corporate bonds	7,803	598
Bonds issued by international institutions	190	52
Total	140,904	20,121

Notes: ① Including financial bonds issued by the China Development Bank, policy financial bonds, bonds issued by commercial banks (including ordinary bonds, subordinated bonds, and hybrid bonds), bonds issued by securities firms, and interbank certificates of deposit. ②Including 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 increased while maintaining stability, and interest rates in the bill market went up

The bill acceptance business maintained stability. In Q1, commercial drafts issued by enterprises totaled RMB6.1 trillion, rising 1.4 percent year on year. At end-March, outstanding commercial drafts stood at RMB14.1 trillion, increasing by 4.9 percent year on year. Outstanding commercial draft acceptances remained stable, decreasing by RMB2.5 billion from the beginning of this year. Of the outstanding bankers' acceptances, 68.6 percent were issued by micro, small, and medium-sized enterprises (MSMEs).

Bill financing was basically stable. In Q1, total discounts by financial institutions amounted to RMB11.4 trillion, growing 3.8 percent year on year. At end-March, the balance of bill financing was RMB7.9 trillion, down 4.5 percent year on year. The balance accounted for 4.4 percent of total outstanding loans, down 0.8 percentage point year on year.

4. Stock indices first went up and then went down, with turnover and the amount of funds raised increasing year on year

In Q1, stock indices went up before going down, and then, after mid-March, they stabilized. From the beginning of this year to the Spring Festival, due to the continuous consolidation of the momentum for restorative economic growth and the rise of overseas stock markets, the major stock indices in Shanghai and Shenzhen experienced a choppy rise. In February, the highest closing points of the Shanghai Stock Exchange Composite Index and the Shenzhen Stock Exchange Component Index posted 3,732 points and 16,293 points, respectively. After that, the A-share market retreated. At end-March, the Shanghai Stock Exchange Composite Index closed at 3,442 points, decreasing 0.9 percent from end-2020. The Shenzhen Stock Exchange Component Index closed at 13,779 points, decreasing 4.8 percent from end-2020. Turnover on the stock markets expanded. In Q1, the combined turnover on the Shanghai Stock Exchange and the Shenzhen Stock Exchange reached RMB54.9 trillion, and the average daily turnover was RMB947.2 billion, an increase of 9.9 percent year on year. The amount of funds raised on the stock markets surged significantly year on year. In Q1, a cumulative RMB340.4 billion was raised, increasing 142.6 percent year on year and providing solid support for the real economy.

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

In Q1, total premium income in the insurance sector amounted to RMB1.8 trillion, up 7.8 percent year on year, an acceleration of 1.7 percentage points from the same period of the previous year. Claim and benefit payments totaled RMB395.1 billion, representing a year-on-year increase of 30.4 percent. Specifically, total property insurance claims and benefit payments increased 35 percent year on year, and total life insurance claims and benefit payments went up by 27 percent year on year.

Table 12 Asset Allocations in the Insurance Sector at End-March 2021

Unit: RMB100 million, %

	Balance		As a share of total assets	
	End-March 2021	End-March 2020	End-March 2021	End-March 2020
Total assets	242,584	217,193	100.0	100.0
Of which: Bank deposits	27,615	28,621	11.4	13.2
Investments	197,266	165,634	81.3	76.3

Source: China Banking and Insurance Regulatory Commission.

The growth of assets in the insurance sector slowed down. At end-March, total assets in the insurance sector increased 11.7 percent year on year to RMB24.3 trillion, a deceleration of 1.6 percentage points from end-2020. Specifically, bank deposits decreased by 3.5 percent, while investment-linked assets increased by 19.1 percent year on year.

6. Foreign exchange transactions were active

In Q1, cumulative turnover of spot RMB/foreign exchange transactions registered USD2.3 trillion, an increase of 39.8 percent year on year. Cumulative turnover of RMB/foreign exchange swap transactions totaled USD4.5 trillion, an increase of 37.9 percent year on year. Specifically, cumulative overnight RMB/USD swap transactions posted USD2.9 trillion, accounting for 64 percent of the total swap turnover. Turnover of RMB/foreign exchange forward transactions totaled USD25.8 billion, falling 4.2 percent year on year. Turnover of foreign currency pair transactions totaled USD312.9 billion, rising 167.6 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.

7. Gold prices went down

At end-March, international gold prices closed at USD1,691.05 per ounce, representing a loss of 10.58 percent from end-2020. The Au99.99 on the Shanghai Gold Exchange closed at RMB356.79 per gram, decreasing 8.52 percent from end-2020. In Q1, the volume of gold traded on the Shanghai Gold Exchange was 9,333.37 tons, representing a decrease of 48.3 percent year on year. Turnover posted RMB3.51 trillion, a decrease of 45.2 percent year on year.

II. Development of institutional arrangements in the financial markets

1. Institutional arrangements in the bond market

In April 2021, the PBC, the National Development and Reform Commission (NDRC), and the China Securities Regulatory Commission (CSRC) jointly released the *Notice on Issuing the Green Bond Endorsed Projects Catalogue (2021 Edition)*. The notice aimed to further regulate the domestic green bond market and to give full play to the active role of green finance in promoting structural adjustments and transformation, accelerating the construction of an ecological civilization and facilitating sustainable economic development to realize the goals of peak carbon emissions and achieving carbon neutrality.

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

Regulation of capital market conduct was further improved. In January 2021, the CSRC released the *Provisions on Strengthening Regulation of Private Equity Investment Funds*, which raised prohibitive requirements, namely the “ten prohibitions,” for entities, including private equity managers. The provisions reiterated and strengthened regulation of the bottom lines in the operation of private equity funds. In January, the CSRC released *Guideline No.3 for the Operation of Publicly Offered Securities Investment Funds - Index Fund Guidelines*, which regularized the investment and operations of index funds and protected the legitimate rights and interests of investors. In February, the CSRC revised and released the *Provisions on the Registration and Management System of Insiders with Inside Information on Listed Companies*, aiming to regularize the registration and reporting of insiders with inside information on listed companies and to strengthen comprehensive prevention and control of insider trading. In February, the CSRC revised and released the *Measures for the Administration of the Credit Rating*

Business in the Securities Market. The measures replaced administrative licensing with filing management, improved the rules for the securities rating business, and incorporated independence requirements.

The reform of registration-based securities systems was carried forward. In February 2021, the CSRC revised and released the *Measures for the Administration of Issuance and Trading of Corporate Bonds*, with the registration prerequisites, registration procedures, and relevant regulatory requirements clearly specified. In March, the CSRC released the amended *Measures for the Administration of Information Disclosures by Listed Companies*, which improved the basic requirements for information disclosures, upgraded the periodic reporting mechanism, and lowered the costs of information disclosures.

3. Institutional arrangements in the insurance market

Regulation of the solvency of insurance companies was strengthened. In January 2021, the CBIRC revised and released the *Regulations on Solvency Management of Insurance Companies.* The regulations, with a risk-oriented approach, specified regulatory rules of solvency that integrated quantitative capital requirements, qualitative regulatory requirements, and market discipline mechanisms, thus making clear the three-pillar framework of solvency regulation.

The short-term health insurance business was regulated. In January 2021, the CBIRC released the *Notice on Regulating the Short-term Health Insurance Business*, which regulated the short-term health insurance business conducted by insurance companies in such areas as insurance renewals, product sales, information disclosures, and underwriting and claims settlement.

The insurance industry was further opened up. In March 2021, the CBIRC released the *Implementation Rules of the Regulations of the People's Republic of China on Foreign-funded Insurance Companies*, and removed the clauses concerning foreign ownership limits on joint-venture life insurance companies to maintain consistency among the relevant institutional systems. Meanwhile, the detailed rules further elaborated on the entry criteria for foreign insurance group companies and foreign financial institutions to invest in foreign-funded insurance companies. Supplementary improvements were made to clarify the requirements for market access and for changes of shareholders in foreign-funded insurance companies, relevant management systems for domestic insurance group companies, security reviews of foreign investment, etc.

4. Promoting the opening-up of the bond market

The semi-annual review by FTSE Russell was facilitated and conducted successfully. FTSE Russell announced that it would, starting from October 29, 2021, add Chinese government bonds to its World Government Bond Index (WGBI) in a time span of 36 months. So far, all three global major bond index providers have included Chinese bonds in their major indexes.

Part 4. Macroeconomic Overview

I. Global economic and financial developments

The global economy has gradually recovered, and vaccinations have accelerated. Markets tend to hold optimistic expectations about future economic prospects, with rising inflation expectations. Meanwhile, the imbalance in the process of economic recovery became prominent, as evidenced by enlarging divergences among different countries and regions, industries and enterprises, employment groups, as well as financial and real sectors, while the recent COVID-19 resurgence in multiple countries further increased uncertainties about an economic recovery. In the future, attention should be paid continuously to possible adjustments or shifts in the monetary policies of the major advanced economies and their spillover effects.

1. Performance in the economic and financial markets of the major economies

The speed of the vaccination process has accelerated, but the COVID-19 pandemic has reoccurred since late March. By the end of April, more than 1 billion vaccine doses had been administered worldwide. However, progress was uneven among regions amid mutations of the virus and relaxation of pandemic containment measures in some areas; the global pandemic has resurged, with the number of single-day newly confirmed cases returning to over 800,000 at the end of April. Multiple countries in Europe have tightened their pandemic containment measures, among which France, the Czech Republic, Hungary, and other countries have restarted nationwide lock-down policies.

Expectations about global economic growth have improved significantly. In March, the manufacturing PMI posted 64.7, 62.5, 52.7, and 58.9 in the US, the euro area, Japan, and the UK, respectively, all reaching new highs since the outbreak of the pandemic. The International Monetary Fund (IMF) and the Organization for Economic Co-operation and Development (OECD) posted their global economic growth forecasts for 2021 at 6.0 and 5.6 percent in April and March respectively, 0.5 and 1.4 percentage points higher than their previous forecasts.

Recovery of the labor market was relatively slow. The US unemployment rate registered 6.0 percent in March, and the number of jobs was reduced by 7.5 million from the pre-pandemic level. The labor participation rate was 61.5 percent, lower than the pre-pandemic rate of 63.3 percent at the end of 2019. The unemployment rates in the euro area in March and the UK in February was 8.1 and 4.9 percent, respectively, which were still relatively high.

Signs of re-inflation occurred in the major economies. In March, the year-on-year (y-o-y) growth rate of the CPI increased to 2.6 percent in the US. In Q1, the HICP in the euro area ended its negative y-o-y growth that had lasted for 5 consecutive months in the second half of last year, and it posted a y-o-y growth rate of 1.3 percent in March. The y-o-y decrease in the CPI in Japan narrowed significantly from that at the end of last year. Inflation pressures increased in some emerging market economies, as the y-o-y growth rate of the IPCA of Brazil and the CPI of Russia moved higher in March, to 6.1 and 5.8 percent respectively, increasing by 2.8 and 3.3 percentage points compared to the same period of last year.

Table 13 Macroeconomic and Financial Indicators in the Major Advanced Economies

Economy	Indicator	Q1 2020			Q2 2020			Q3 2020			Q4 2020			Q1 2021		
		Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
United States	Real GDP Growth (annualized quarterly rate, %)	-5.0			-31.4			33.4			4.3			6.4		

	Unemployment Rate (%)	3.5	3.5	4.4	14.8	13.3	11.1	10.2	8.4	7.8	6.9	6.7	6.7	6.3	6.2	6.0
	CPI (year-on-year, %)	2.5	2.3	1.5	0.3	0.1	0.6	1.0	1.3	1.4	1.2	1.2	1.4	1.4	1.7	2.6
	DJ Industrial Average (end of the period)	28256	25409	21917	24346	25383	25813	26428	28430	27782	26502	29639	30606	29983	30932	32982
Euro Area	Real GDP Growth (year-on-year, %)	-3.3			-14.6			-4.1			-4.9			-1.8		
	Unemployment Rate (%)	7.5	7.3	7.1	7.3	7.5	8.0	8.5	8.7	8.7	8.5	8.3	8.2	8.2	8.2	8.1
	HICP (year-on-year, %)	1.4	1.2	0.7	0.3	0.1	0.3	0.4	-0.2	-0.3	-0.3	-0.3	-0.3	0.9	0.9	1.3
	EURO STOXX 50 (end of the period)	3641	3329	2787	2928	3050	3234	3274	3273	3294	2958	3493	3572	3481	3636	3919
United Kingdom	Real GDP growth (year-on year, %)	-2.2			-21.4			-8.5			-7.3			…		
	Unemployment Rate (%)	3.9	4.0	4.0	4.0	4.1	4.1	4.3	4.5	4.8	4.9	5.0	5.1	5.0	4.9	...
	CPI (year-on-year, %)	1.8	1.7	1.5	0.8	0.5	0.6	1.0	0.2	0.5	0.7	0.3	0.6	0.7	0.4	0.7
	FTSE 100 (end of the period)	7286	6581	5672	5901	6077	6170	5898	5964	5866	5577	6266	6461	6407	6483	6714
Japan	Real GDP Growth (annualized quarterly rate, %)	-2.2			-29.3			22.8			11.7			…		
	Unemployment Rate (%)	2.4	2.4	2.5	2.6	2.8	2.8	2.9	3.0	3.0	3.1	3.0	3.0	2.9	2.9	2.6
	CPI (year-on-year, %)	0.7	0.4	0.4	0.1	0.1	0.1	0.3	0.2	0.0	-0.4	-0.9	-1.2	-0.6	-0.4	-0.2
	NIKKEI 225 (end of the period)	23205	21143	18917	20194	21878	22288	21710	23140	23185	22977	26434	27444	27663	28966	29179

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

Affected by factors such as expectations of rising economic growth and inflation as well as adjustments of market expectations, volatility in financial markets increased. Commodity prices surged with the futures prices of Brent crude oil, and tin, copper, and aluminum in the London Metal Exchange (LME) increased by 24.3, 24.0, 13.6, and 11.7 percent in Q1, respectively. Treasury yields went up remarkably in the advanced economies, with the 10-year treasury yields increasing from 0.93 and -0.57 percent at the beginning of the year to 1.74 and -0.27 percent at the end of March in the US and Germany, respectively. The stock markets in the major economies have generally increased with greater volatility.

Box 3 Analysis of the Higher US Treasury Yields

This year has seen a rapid rally of US Treasury yields. On January 6, the 10-year Treasury yield rose above 1 percent for the first time since March 2020, and then reached 1.74 percent on March 31, up 120 bps from the record low of 0.51 percent last year and 83 bps from year-end.

The rise in Treasury yields is attributed to both inflation expectations and higher real rates. This year, the real rate as measured by the 10-year US Treasury Inflation-Protected Securities (TIPS) has increased 46 bps to -0.63 percent at end-March, while the spread between the 10-year Treasury yield and the real rate has increased 37 bps, with the latter usually reflecting inflation expectations. Strengthened fiscal support and improved expectations of an economic recovery have both contributed to higher inflation expectations and real rates. With continued vaccination progress, the global economy is generally making a steady recovery. In the *World Economic Outlook* published in April, the IMF raised its global growth forecast for 2021 from 5.5 percent in January to 6 percent, and revised its growth forecast for the US from 5.1 percent to 6.4 percent.

Figure 5 10-Year US Treasury Yield

Source：Bloomberg.

As of now, there will continue to be a high issuance of US Treasuries in 2021. From a supply-demand perspective, holding all else constant, the gap between supply and demand of US Treasuries may be bridged by higher yields. On the supply side, in the *Budget and Economic Outlook: 2021 to 2031,* the Congressional Budget Office projected a deficit of USD2.3 trillion for the 2021 fiscal year, which would be magnified by the USD1.9 trillion fiscal stimulus package; meanwhile, in its first quarter refund announcement, the US Treasury expected the cash balance to drop about USD1.2 trillion to USD0.5 trillion at end-June. In these three respects, institutions have projected that new financing needs may exceed USD2.5 trillion in 2021, and they expect continued high issuance of US Treasuries. On the demand side, if the Federal Reserve continues its monthly purchases of USD80 billion of Treasuries in 2021, it can absorb about USD1 trillion Treasuries, leaving more than USD1.5 trillion to other market investors. Recent years have seen a drop in the proportion of foreign-held Treasuries, from 34.4 percent at the beginning of 2015 to around 25 percent at end-2020. Therefore, there will continue to be a large amount of Treasuries for US domestic investors other than the Fed.

The subsequent movement of Treasury yields depends on the economic performance, the inflation level, and the Federal Reserve's response. In August 2020, the Federal Reserve introduced a new policy framework featuring average inflation targeting. How it is implemented is left for further observation. Fed Chair Jerome Powell expressed in an interview that when the economy is near a full recovery, the Fed will pull back its policy support during emergency times "very gradually" and "with great transparency"; and when the Fed makes further substantial progress toward its goals, it will gradually roll back the amount of asset purchases. In the future, if fiscal support is strengthened and a strong economic recovery leads to an excessively rapid rise in inflation expectations, they may trigger actions by the Fed that will affect the trend in U.S. bond yields.

The impact of higher Treasury yields will be transmitted through several channels: first, through asset prices. They will drive up risk-free rates and trigger global asset price adjustments and bring about repricing risks. Second, through capital flows. They may reverse the direction of cross-border capital flows, causing funds to flow back to the US and to increase the risks of capital outflows in the emerging markets. Emerging economies with weak fundamentals may face repayment and refinancing risks. Third, through exchange rates. Higher Treasury yields may boost the dollar and place downward pressures on the currencies in some emerging economies, thereby intensifying debt risks.

China has become the second largest economy, with resilience and sufficient policy space as well as sound economic performance. Bracing for the impact of COVID-19, China was the only major economy with positive growth in 2020 and one of the few major economies conducting a normal monetary policy, thus presenting unique performance. Meanwhile, as the market-oriented exchange rate reform has further deepened, the RMB exchange rate has become more flexible and has fulfilled its role as an automatic stabilizer for macroeconomic management and for the balance of payments. Since the beginning of 2021, the Chinese financial market has been stable, with the RMB exchange rate floating in both directions and cross-border capital flows generally in equilibrium. Overall, higher U.S. Treasury yields and future policy adjustments by the Fed will have a limited and controllable impact on China. The key to the next step is to focus on fulfilling the PBC's mandates, prioritize stability in monetary policies, remain proactive, and value the normal policy space. Meanwhile, the PBC will pay close attention to changes in global economic and financial conditions, enhance macro-prudential management of cross-border capital flows, strengthen flexibility of the RMB exchange rate, and carry out international macro policy coordination based on domestic conditions.

2. Monetary policies of the major economies

The central banks in the major advanced economies have generally reiterated their stance of maintaining their loose monetary policies to support a more comprehensive economic recovery. In Q1, both the US Fed and the European Central Bank (ECB) kept their policy rates and scale of asset purchases unchanged, and the minutes of the March FOMC meeting of the US Fed illustrate that the Fed will maintain its accommodative stance until the statutory goals of maximum employment and price stability are reached. The Bank of Japan (BOJ) maintained its JPY12 trillion upper limit of exchange traded funds (ETFs) purchases and widened its target range for yield curve control, allowing the 10-year treasury yield to move up and down by 0.25 percent around zero.

Monetary policies in the emerging market economies showed signs of divergence. Although most maintained accommodative stances, some economies took early actions to respond to the pressures of inflation, exchange rate depreciations, and capital outflows, and marginally tightened their monetary policies. In Q1, the central banks of Indonesia and Mexico lowered interest rates by 25 bps, with the policy rates of the central banks of India, South Africa, Malaysia, and the Philippines remaining unchanged, while the central banks of Turkey, Brazil, Ukraine, and Russia increased their policy rates by 200, 75, 50, and 25 bps, respectively.

3. Issues and trends that merit attention

First, the global economic recovery still faces high uncertainties, with increasing divergences and imbalances. For some time in the future, the key determinant of a global economic recovery will still be containment of COVID-19. Currently, vaccination progress and the outcomes of pandemic prevention and control have been rather divergent across countries amid diversified macroeconomics policies and market recovery capacities, thus resulting in significantly uneven economic development. Some areas are experiencing a marked rebound of new cases and a tightening of their lock-down measures, and their economic recovery processes are facing great challenges.

Second, the influence of the ultra-loose macro policies by the major economies and the risks brought about by monetary policy shifts require close attention. At the end of Q1 2021, the balance sheets of the US Fed, the ECB, and the BOJ expanded by 85 percent, 60 percent, and 25 percent, respectively, compared to those at the end of 2019. The expansions mainly resulted from purchases of government bonds, with over half of the newly issued US treasury bonds purchased by the Fed in 2020. The fiscal and monetary policies of the advanced economies are closely integrated, and their scale is huge, pushing global asset prices to rise, to be separated from the real economy, and causing financial risks continue to increase. Whether these risks will be transferred in the future through sovereign debt risks, high inflation, exchange-rate and interest-rate fluctuations, or valuation adjustments in stock and bond markets needs to be closely watched. In Q1, the rise in long-end interest rates in the US triggered higher volatility in global financial markets and brought about greater pressures of capital outflows and an exchange rate depreciation in some emerging market economies with fragile economic fundamentals. The Bank of Canada (BOC) reduced the scale of asset purchases in April. If the major advanced economies release clear signals of monetary policy shifts in the future, the potential spillover effects will further magnify the fluctuations in global cross-border capital flows.

Third, the level of global inflation may continue to trend up. The global economic recovery has driven up the demand for commodities and raw materials; amid the ultra-loose liquidity environment the prices of international commodities, such as iron ore, copper, crude oil, and soybeans, have increased rapidly. Given the low base effect from last year, the y-o-y readings of the global inflation indices may generally trend up for some time in the future, leading to further increases in inflation expectations.

II. Macroeconomic developments in China

In Q1 2021, achievements to coordinate pandemic containment and economic and social development in all regions and departments across the country were consolidated and expanded. China's economy continued to recover steadily, and the development momentum became stronger. The national economy got off to a good start as production continued to resume its growth, all three demands, i.e., consumption, investment, and export, rebounded steadily, consumption played a greater role in economic growth, and employment and consumer prices were stable. According to preliminary statistics, GDP in Q1 2021 grew by 18.3 percent year on year and increased by 10.3 percent compared to the same period of 2019. The average growth rate of GDP in the past two years was 5 percent and the CPI was basically flat compared with the previous year.

1. Consumption gradually improved, investments steadily rebounded, and imports and exports recorded rapid growth.

Residents' income rebounded steadily, and people's willingness to consume improved. In Q1, the country's per capita disposable income increased by 13.7 percent year on year in nominal terms, or 13.7 percent in real terms, and its average growth rate in the past two years was 4.5 percent. The structure of income distribution improved, and the income growth of rural residents outpaced that of urban residents. According to the Urban Depositors' Survey conducted by the PBC in Q1, 22.3 percent of residents were inclined to "consume more," up 0.3 percentage point from the same period of 2020. In Q1, total retail sales of consumer goods grew by 33.9 percent year on year, and the average growth rate during the past two years was 4.2 percent. Consumption by urban residents and online retail sales continued to grow rapidly. Final consumption expenditures contributed to 63.4 percent of economic growth, which contributed to the growth of GDP by 11.6 percentage points and a year-on-year increase of 15.9 percentage points.

Investments rebounded steadily, and investments in the high-tech industry and social areas grew rapidly. In Q1, total fixed-asset investments increased by 25.6 percent year on year, and the average growth rate in the past two years registered 2.9 percent. In terms of sectors, the year-on-year growth of investments in social areas registered 31.7 percent, with an average growth rate of 9.6 percent in the past two years.

Investments in real estate development and infrastructure increased by 25.6 percent and 29.7 percent respectively, and the average growth rate in the past two years registered 7.6 percent and 2.3 percent, respectively. Investments in the manufacturing sector increased by 29.8 percent and the average growth rate was slightly negative in the past two years. The investment structure was further optimized. Investments in the high-tech industry grew by 37.3 percent year on year, 11.7 percentage points higher than the growth of total investments. Specifically, investments in the high-tech manufacturing sector and the high-tech services sector grew by 41.6 percent and 28.6 percent year on year, respectively.

Export momentum was robust, and the trade structure was more optimized. In Q1, imports and exports of goods denominated in RMB grew by 29.2 percent year on year. Specifically, exports grew by 38.7 percent year on year, while imports grew by 19.3 percent year on year, with the trade surplus in goods posting RMB759.3 billion, an increase of RMB663.3 billion year on year. The trade structure continued to improve. The share of imports and exports under general trade reached 61.2 percent, up 1.3 percentage points year on year. Imports and exports by private enterprises accounted for 46.7 percent of total foreign trade, up 4.4 percentage points year on year. Exports of machinery and electronics increased by 43 percent year on year, accounting for 60.4 percent of total exports. Exports of high-tech products increased by 38.9 percent year on year, accounting for 29.9 percent of total exports. China’s trade partners became more diversified. China’s trade with countries along the Belt and Road and with RCEP trade partners grew by 21.4 percent and 22.9 percent, respectively.

The expectations and confidence of foreign direct investment (FDI) were stable with promising signs, and FDI became concentrated in the high-tech industry. In Q1, actually utilized FDI increased by 39.9 percent year on year to RMB302.5 billion, which was 24.8 percent higher than that in the same period of 2019. Actual utilized FDI in the high-tech industry grew by 32.1 percent year on year, among which FDI in the high-tech service industry grew by 43.9 percent year on year.

2. Agricultural production remained stable, industrial production rebounded steadily, and growth of the service industry recovered

In 2020, the value-added of primary, secondary, and tertiary industries grew by 8.1 percent, 24.4 percent, and 15.6 percent year on year, respectively, accounting for 4.6 percent, 37.2 percent, and 58.3 percent of GDP. The average growth rate of primary, secondary, and tertiary industries was 2.3 percent, 6.0 percent, and 4.7 percent respectively in the past two years.

Agricultural production was generally stable and hog production witnessed a significant recovery. Climate conditions in the main agricultural areas of China were generally favorable, as spring ploughing and sowing went smoothly, contributing to slightly better growth of winter wheat than in previous years. In Q1, the value-added of agriculture grew by 3.3 percent year on year, and the average growth rate was 3.4 percent during the past two years. Hogs in stock increased by 29.5 percent year on year and hogs available for slaughter increased by 30.6 percent year on year. The output of pork, beef, lamb, and poultry grew by 21.4 percent year on year, among which the output of pork increased by 31.9 percent year on year.

Industrial production grew steadily, and business profits improved significantly. In Q1, the value-added of Industrial Enterprises above a Designated Size (IEDS) increased by 24.5 percent year on year and the average growth rate in the last two years registered 6.8 percent. The value-added of IEDS in Q1 increased by a seasonally adjusted 2.01 percent quarter on quarter, which was slightly higher than that in Q4 2020. Specifically, the value-added of the high-tech manufacturing sector and the equipment manufacturing sector increased by 31.2 percent and 39.9 percent respectively year on year, with the average growth rate in these two sectors posting 12.3 percent and 9.7 percent in the past two years respectively, significantly higher than the rates in other sectors. In Q1, total profits of the IEDS increased 1.37 times year on year and the average growth rate registered 22.6 percent during the past two years. According to the *Entrepreneur Survey Report* conducted in Q1 by the PBC, the Business Climate Index posted 56.3 percent, up 0.5 percentage points from Q4 2020 and 26 percentage points from the same period of 2020.

Growth in the service industry recovered, and market expectations improved. In Q1, the value-added of the service industry grew by 15.6 percent year on year, accounting for 58.3 percent of GDP, an acceleration of 3.8 percentage points from 2020, and the average growth rate was 4.7 percent during the past two years. In March, the Index of Service Production (ISP) increased by 25.3 percent year on year, and the average growth rate registered 6.8 percent during the past two years. The Business Activities Index for the railway sector, aviation sector, satellite transmission service of the telecommunication/broadcasting/television sector, internet software and information IT services sector, and the financial sector exceeded 60 percent, remaining in an expansion area. The Business Activities Index for accommodations, housing rentals， business services, and residents' services, once affected notably by the pandemic in certain regions at the beginning of 2021, rebounded to a prosperous range and operations in these sectors improved significantly. The Expected Business Activities Index for the service industry reached 62.9 percent, remaining above 60 percent for two consecutive months.

3. Consumer prices were generally stable, and the growth of producer prices expanded

Consumer prices were generally stable. In Q1, both the CPI and the core CPI (food and energy excluded) were basically flat compared with the previous year. Due to the decline in the base figures from the initial high levels in the previous year, the CPI in January and February decreased by 0.3 percent and 0.2 percent year on year, respectively and rose by 0.4 percent year on year in March. As the capacity for hog production gradually recovered, pork prices declined for six consecutive months and dropped by 12.5 percent year on year in Q1, driving down food prices by 0.2 percentage point. Non-food prices decreased by 0.1 percent year on year.

The growth of producer prices expanded. In Q1, the Producer Price Index (PPI) increased by 2.1 percent year on year, an acceleration of 3.5 percentage points compared with Q4 2020. The growth rate of PPI in January, February, and March registered 0.3 percent, 1.7 percent, and 4.4 percent, respectively. Due to the steady recovery of domestic needs, the growth of prices of bulk commodities, such as oil, and the relatively low base figures in the previous year, the growth of PPI expanded year on year. Production materials that are highly connected to price trends in bulk commodities, such as oil, steel, and nonferrous metals, contributed to the acceleration of PPI by 2.13 percentage points. The Purchasing Price Index for Industrial Products (PPIRM) increased by 2.8 percent year on year, accelerating by 4.2 percentage points from Q4 2020. The Corporate Goods Price Index (CGPI), monitored by the PBC, increased by 3.2 percent year on year, accelerating by 4.4 percentage points compared with that in 2020.

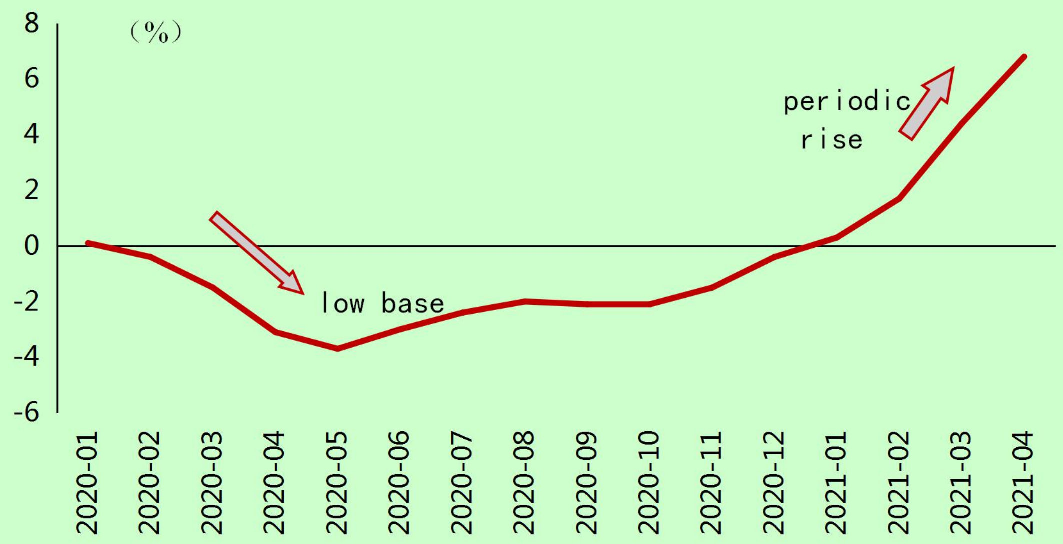
Box 4 How to View the Recent Price Movements Both at Home and Abroad

The global commodity price and inflation indexes of the major economies have recently shown an upward trend. At end-April 2021, the price indexes of WTI crude oil futures, LME copper futures, and CRB spot commodities registered year-on-year growth of 187 percent, 89 percent, and 51 percent, respectively. In March, the CPI in the US and the HICP in the euro area grew by 2.6 percent and 1.3 percent, respectively, year on year, accelerating by 2.5 percentage points and 1.6 percentage points from the low point in 2020. These figures are higher or at par with the pre-pandemic level in December 2019, and the relevant indexes of inflationary expectations have gone upward to varying degrees. In addition, in March the Consumer Price Index in Russia and Brazil grew over 5 percent and 6 percent year on year, respectively.

The major factors pushing up commodity prices and inflation are as follows. First, the governments of the major economies have introduced large-scale stimulus packages, and it is widely expected that overall demand will tend to be exuberant. Second, as there has been an obvious COVID-19 resurgence overseas and the supply side is still facing constraints, the recovery of demand in global economies will outpace that of supply in the post-pandemic era. Third, central banks in the major economies have adopted ultra-loose monetary policies, and global liquidity continues to remain extremely ample. At present, as the above-mentioned three factors cannot be eliminated in the short run, global inflation is likely to continue its moderate upward trend for some time.

As far as China is concerned, the influence of the imported inflation from overseas is mainly reflected in the price rise of industrial products. Combined with the low base in 2020, this is likely to push up the growth of PPI in China in Q2 and Q3 2021. China is the major importer of commodities. In terms of import volume and reliance, the commodities influencing PPI are mainly crude oil, iron ore, and copper. In particular, crude oil is the biggest factor behind PPI movements, as its down-stream industrial chain is fairly long, and it has an impact on the price of chemical products. The temporary rise in the PPI during this year should be viewed historically and objectively. First, the PPI has, to some extent, registered a “high reading” upon a “low base.” In 2020, due to the impact of the pandemic and the considerable drop in commodity prices, PPI growth in China was below -2 percent for seven consecutive months and it hit a low of -3.7 percent in April 2020. Therefore, PPI movements in 2021 will mainly be affected by the “mirroring effect” of the low base (see Figure 6). On average, annual PPI growth from 2020 to 2021 will still remain within a reasonable range. Second, historically the PPI has witnessed relatively large fluctuations, and it is not rare that the PPI temporarily underwent a considerable drop or a surge within a few months. During the past twenty years, the average year-on-year PPI growth posted about 1.2 percent on a monthly basis, with the standard deviation reaching 4.2 percentage points. Large swings in the PPI are common around the globe. Third, the rise in commodity prices reflects a temporary "mismatch" between supply and demand. If the pandemic is effectively contained and capacity for production and supply in the emerging economies returns to normal, the rise in prices for the means of production is likely to slow down. In general, the PPI is likely to stabilize as the base effect subsides and global production and supply recovers.

Figure 6 Year-on-year Growth of the PPI



In terms of its impact on China's consumer price index, during recent years the transmission relationship between PPI and CPI in China has been significantly weakened and the fluctuations in international bulk commodity prices have had a correspondingly low impact on China's trends. In addition, hog supply at home has basically stabilized and pork prices are overall tending to go down. China has witnessed consecutive bumper harvests of grain production for several years and its self-sufficiency ratio of agricultural products is fairly high. Therefore, according to preliminary estimates, CPI growth in 2021 will be moderate and will remain within a reasonable range as the overall impact of external factors will be controllable. In fact, considering that China is one of the largest economies, a rise in global commodity prices is not likely to trigger a notable imported inflation, if it does not overlap with rising domestic demand..

According to the comprehensive analysis, although the global commodity price hike is likely to push up China's PPI at the current stage, the risk of imported inflation is overall controllable. In response to the pandemic, China has maintained a normal monetary policy and has refrained from adopting a deluge of strong stimulus policies in 2020. Given the steady and sound economic development and the basic equilibrium in aggregate supply and demand, there are no grounds for persistent inflation or deflation. Undoubtedly, efforts should be made to closely watch the differentiated impact of the rise of commodity prices on different sectors and businesses. Comprehensive measures should be implemented to ensure supply and to stabilize prices, to timely and effectively manage expectations, and to prevent the price fluctuations from getting out of control.

4. The growth of fiscal revenue and expenditures recovered, and, on the whole, employment was stable

The growth of fiscal revenue recovered. In Q1 2021, revenue in the national general public budget increased by 24.2 percent year on year to RMB5.7115 trillion, accelerating by 38.5 percentage points compared with Q1 2020. Central and local fiscal revenue grew by 27.2 percent and 21.7 percent year on year, respectively. Specifically, tax revenue increased by 24.8 percent year on year, with the domestic value-added tax and the domestic consumption tax growing by 23.9 percent and 18.5 percent year on year, respectively, while non-tax revenue increased by 20.7 percent year on year.

Fiscal expenditures were on the whole stable. In Q1 2021, expenditures in the national general budget saw an increase of 6.2 percent year on year to RMB5.8703 trillion, accounting for 23.5 percent of annual expenditures in the budget. In terms of the structure of expenditures, expenditures on education and science and technology grew by 13.8 percent and 16.3 percent, respectively, expenditures on infrastructure slowed down, while expenditures on agriculture, forestry, and water resource projects dropped by 5.5 percent, and expenditures on transportation dropped by 7.8 percent year on year.

The surveyed urban unemployment rate dropped, and the employment situation was generally stable. In Q1 2021, 2.97 million people were newly employed, up 680,000 year on year. As pandemic containment and collective recruitment in the spring were advanced in an orderly manner, the surveyed urban unemployment rate declined on both on a year-on-year and a month-on-month basis. In March, the surveyed urban unemployment rate was 5.3 percent, down 0.2 percentage points month on month and down 0.6 percentage points year on year. Specifically, the surveyed unemployment rate of populations between the ages of 25 and 29 was 4.8 percent, 0.5 percentage point lower than the surveyed urban unemployment rate.

5. The balance of payments and the external debt

A basic equilibrium was maintained in the balance of payments. In Q1 2021, China's current account surplus registered USD75.1 billion. Specifically, trade in goods recorded a surplus of USD118.7 billion, whereas trade in services recorded a deficit of USD22.3 billion. The capital and financial account deficit was USD75.1 billion. At end-2020, the balance in the all-system foreign debt (denominated in both domestic and foreign currencies) posted USD2.4008 trillion. In particular, the short-term external debt balance was USD1.3164 trillion, accounting for 55 percent of the total external debt balance. At end-March 2021, foreign exchange reserves posted USD3.17 trillion, down 1.5 percent, or USD46.5 billion from end-2020.

6. Analysis by sector

6.1 The real estate sector

In Q1 2021, housing prices remained generally stable in China. Due to the low base figure in the previous year, housing sales and investments in real estate development grew remarkably year on year. In March, among the 70 medium and large-sized cities nationwide, newly built and second-hand residential housing prices increased by 4.4 percent and 3.3 percent year on year respectively, accelerating by 0.7 percentage point and 1.2 percentage points from end-2020. In Q1, total floor area of sold units increased by 63.8 percent year on year, registering average growth of 9.9 percent during the past two years. Housing sales increased by 88.5 percent year on year, registering average growth of 19.1 percent during the past two years. In Q1, investments in real estate development grew by 25.6 percent year on year, registering average growth of 7.6 percent during the past two years. Specifically, investments in residential housing development rose by 28.8 percent year on year, registering average growth of 9.3 percent during the past two years and accounting for 74.8 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 Q1 2021

	Floor area (100 million square meters)	YOY growth (%)	YOY acceleration (percentage points)
Floor area of newly started real estate projects	3.6	28.2	29.4
Floor area of real estate projects under construction	79.8	11.2	7.5
Floor area of completed real estate projects	1.9	22.9	27.8

Source: China National Bureau of Statistics.

Growth of real estate loans on the whole remained stable. At end-March, outstanding real estate loans by major financial institutions (including foreign-funded financial institutions) grew by 10.9 percent year on year to RMB50.0 trillion, a deceleration of 0.6 percentage point from end-2020. Specifically, outstanding individual housing loans grew by 14.5 percent year on year to RMB35.7 trillion, a deceleration of 0.1 percentage point from end-2020. Outstanding housing development loans grew by 5.8 percent year on year to RMB9.5 trillion, a deceleration of 2.4 percentage points from end-2020.

6.2 The electricity sector was is transitioning to achieve the targets of peak carbon emissions and carbon neutrality

In 2020, having overcome the impact of the Covid-19 pandemic and the serious domestic and international situations, the electricity sector managed to provide reliable electricity guarantees for pandemic containment and resumption of work and production. Supply and demand for electricity was on the whole balanced, except for short supplies at peak times in some regions. Since the beginning of 2021, electricity production rebounded rapidly, and demand for electricity was strong, mainly due to cold spells and that people were staying put for the Spring Festival. In Q1 2021, electricity generated by power plants above a designated size grew by 19 percent year on year to 1.9051 trillion kWh, registering average growth of 5.3 percent over the past two years. Total electricity consumption grew by 21.2 percent year on year. Specifically, electricity consumed by the primary, secondary, and tertiary industries grew by 26.4 percent, 24.1 percent, and 28.2 percent year on year respectively, and electricity consumed by residents in urban and rural areas grew by 4.7 percent year on year.

In September 2020, General Secretary Xi Jinping delivered a speech at the general debate of the 75th Session of the United Nations General Assembly, announcing that China will scale up its Intended Nationally Determined Contributions and achieve a carbon emissions peak before 2030 and carbon neutrality before 2060. In recent years, the electricity sector has witnessed remarkable achievements in the transition to low carbon and green development. The structure for electricity generation has been continuously improved, and a relatively complete industrial system of renewable energy technologies has been put into place. To be specific, the hydropower sector boasts independent design and manufacturing capability of the largest million kW-level hydraulic turbine in the world; its technology for low-speed wind power ranks in the forefront of the world; the photovoltaic industry takes the lead in the world with its industrial competitiveness continuously on the rise. At end-2020, the installed capacity of China's renewable energy totaled 930 million kW, accounting for 42.4 percent of Gross Installed Capacity (GIC), up 14.6 percentage points from end-2012. The share of installed capacity of coal-fired power in GIC dropped to 49.1 percent, and clean power accounted for over 70 percent of newly installed capacities in 2020. Grid-connected wind and solar power generation grew rapidly by 15.1 percent and 16.6 percent year on year to 466.5 billion and 261.1 billion kWh respectively in 2020. It should also be noted that most of China's power is thermal power. Although the share of installed capacity of coal-fired power in GIC has been cut to below 50 percent, the share of coal-fired power generation in total power generation is as high as about 65 percent. Therefore, there is still a long way to go to shift the power generating structure. In the meantime, the electricity sector faces technological bottlenecks such as the power generation and conservation of renewable energies as well as the flexibility of grid system, and intermittent and fluctuating wind power and photovoltaic consumption problems are becoming more prominent.

To meet the target of achieving carbon emissions peak before 2030 and carbon neutrality before 2060, while ensuring power safety and supply, it is necessary to construct a new type of electricity system mainly composed of new energies. An institutional mechanism and policy system that are conducive to the joint development and utilization of renewable energy by the whole society should be improved. In terms of power production, China should take action to upgrade energy conservation and emission cuts of coal-fired power so as to achieve peak thermal power generation as soon as possible. Action should be taken to optimize the layout of new energy development, to encourage the local development and utilization of new energy, to gradually realize clean replacement of photovoltaic, wind power, hydropower, etc., and to gradually form a key technology system of new power systems with China's independent intellectual property rights. In terms of power transmission, China should accelerate the smart transformation of grid infrastructure and the construction of smart microgrids; build a long-term mechanism for new energy consumption, strengthen the integration of "source, grid, load, and storage," and enhance the ability to address idle capacities and conservation of clean energies. At the same time, China should accelerate the construction of a unified, open, competitive, and orderly power market system and a national carbon emission trading system, so as to produce effective price signals and to give full play to the decisive role of the market in the distribution of power resources.

Part 5. Monetary Policy Outlook

I. Outlook for the Chinese economy

Since the beginning of 2021, the Chinese economy continued recovering, reinforcing and improving steadily. In Q1, GDP saw year-on-year growth of 18.3 percent, with the growth rate averaging 5.0 percent during the past two years. The economy is off to a good start, and new achievements have been made in high-quality development. The 14th Five-Year Plan period (2021–25) will be the first five years as China embarks on a new journey to build a modern socialist country in all respects. Therefore, China's development is still at an important phase of strategic opportunities, and the fundamentals of steady economic growth in the long run remain unchanged.

The growth momentum of the Chinese economy has been continuously enhanced, and there have been more positive factors in economic performance. In Q1, industrial production steadily picked up, and exports driven by rising external demand maintained fairly fast growth. Investment and consumption sustained the trend of a steady recovery, employment and the people's well-being were secured, and market expectations were generally stable. The quality and efficiency of the financial sector in serving the real economy improved continuously, and the pace of credit supply by financial institutions was appropriate. The macro leverage ratio in Q1 was 276.8 percent, decreasing further by 2.6 percentage points after a drop of 1.6 percentage points in Q4 2020. As a result, the potential momentum to serve high-quality development has been strengthened. Overall financial risks have tended to moderate, and the bottom line that no systemic risk should occur has been firmly defended. The RMB exchange rate has been kept basically stable at an adaptive and equilibrium level, and foreign exchange reserves have remained above USD3 trillion. The economy has strengthened its capacity to address external shocks.

It should also be noted that as the external environment is still complex and serious, the Chinese economic recovery is imbalanced and its foundation is not solid; social and economic development still faces numerous risks and challenges. The COVID-19 pandemic is still raging around the globe with many regions witnessing a resurgence of infections recently. The global economic recovery is imbalanced and unstable, which has become increasingly apparent, and the spillover effect of the overseas accommodative monetary policies continues to be felt. Meanwhile, the rising inflation expectations in the major economies and the increasing yields of their government bonds have caused some emerging economies to face mounting pressures of currency depreciation and capital outflow as well as rising risks in debt repayments and refinancing. Domestically, the foundation for economic recovery is not yet solid as resident consumption is still constrained, investment growth lacks momentum, micro, small and medium-sized enterprises (MSMEs) and self-employed businesses are facing many difficulties, and pressures remain concerning employment. As the contradiction between fiscal revenue and fiscal expenditures is prominent in some regions, there are still potential risks with respect to regional finance. In addition, we must not overlook medium and long-term challenges, such as an insufficient capacity for technological innovations, the extremely urgent task of green transformation and the accelerating aging of the population. Therefore, it is necessary to enhance awareness of both opportunities and risks. The PBC will focus on fulfilling its responsibilities by properly handling the relationship between reforms and macro management, short-term and long-term considerations, as well as internal and external equilibria in a bid to achieve high-quality development.

Consumer prices overall are stable, and there are no grounds for persistent inflation or deflation. In Q1 2021, the COVID-19 resurgence in some regions during the winter and the spring to some extent affected the recovery of consumption in the service industry. Adding the disruption of short-term factors such as the high base and the late arrival of the Spring Festival, CPI growth remained around zero and turned from negative to positive in March, posting 0.4 percent and 0.9 percent in March and in April, respectively. In the near future, the CPI will move stably and stay within a reasonable range. Meanwhile, the steady recovery of domestic demand and the price hikes in commodities such as crude oil have led to rising prices of industrial products and an acceleration of year-on-year PPI growth. Adding the low-base effect, the PPI will witness a rise in 2021. When the base effect subsides and supply gradually recovers, the PPI is likely to stabilize. In the medium and long term, the Chinese economy is expected to witness stable growth. Given that aggregate supply and demand are basically in equilibrium, the monetary policy remains 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, continuing to follow the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, the PBC will implement the guidelines of the Fifth Plenary Session of the 19th CPC Central Committee and the Central Economic Work Conference and will put into practice the requirements set forth in the *Report on the Work of the Government*. In line with the decisions and arrangements of the CPC Central Committee and the State Council, it will adhere to the general principle of pursuing progress while ensuring stability, view things from the perspective of the new development stage, apply the new development philosophy, and foster 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. Meanwhile, it will attach importance to cross-cycle policy design by taking into account both immediate and long-term concerns, maintaining the continuity, stability, and sustainability of macro policies, and keeping up the necessary intensity of support for the economy. Moreover, the PBC will stabilize expectations, implement macro policies in a targeted manner, and consolidate and further the success achieved in pandemic control as well as in economic and social development so as to keep the economic indicators within a reasonable range and achieve a higher level of equilibrium in the course of recovery. With these efforts, the PBC will celebrate the centenary of the CPC with outstanding achievements.

The sound monetary policy will be flexible, targeted, reasonable, and appropriate. It will place even higher priority on serving the real economy, cherish the space for the conduct of a normal monetary policy, and properly handle the relationship between economic recovery and risk prevention. At the same time, the PBC will build a modern central banking system while improving the modern monetary policy framework and the mechanism for money supply management. It will 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. Work will be done to further bring into play the guiding role of central bank lending, central bank discounts as well as the monetary policy tools providing direct support for the real economy, to build the systems and mechanisms needed to provide effective financial support for the real economy, and to intensify support for the real economy, key fields, and weak links. The PBC will enhance the market-oriented interest rate formation and transmission mechanism, improve the central bank policy rate system, optimize regulation over deposit rates, and continue to unleash the potential of reform in lowering loan rates so as to further bring down loan rates in real terms. 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, it will strengthen macro-prudential management, stabilize market expectations, and guide enterprises and financial institutions to always be risk-neutral, thereby keeping the RMB exchange rate basically stable at an adaptive and equilibrium level and consolidating the basis of the RMB's international credit. More efforts will be put into monitoring and analysis as well as expectation management to keep prices basically stable. With the aim of firmly defending 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 set up a long-term mechanism for forestalling and defusing financial risks so as to safeguard and build financial security. Moreover, further steps will be taken to hold all relevant parties accountable and to replenish the capital of small- and medium-sized banks based on their conditions.

First, the PBC will maintain a reasonable growth in money and credit as well as in AFRE. It will improve the mechanism for money supply management, attach importance to cross-cycle policy design, and properly control the general valve of money supply so that the growth rates of money supply and AFRE will be basically in line with nominal economic growth, and the macro leverage ratio will be kept basically stable. Closely watching the developments of economic and financial situations at home and abroad, it will enhance monitoring and analysis of liquidity supply and demand and financial markets. It will also employ a mix of monetary policy tools, such as the Medium-term Lending Facility, open market operations, central bank lending, and central bank discounts, to keep liquidity adequate at a reasonable level and to guide market rates to move around policy rates. Moreover, the PBC will improve the mechanism for sustainable replenishment of bank capital and will step up support for small- and medium-sized banks in their issuances of capital replenishment instruments, such as perpetual bonds, so that banks will be better able to serve the real economy and to forestall and defuse financial risks. Measures will be taken to improve macroeconomic governance, to optimize monetary policy objectives as well as fiscal, employment, industry, investment, consumption, environmental protection, regional and other policy objectives, and to promote a reasonable division of duties and an efficient synergy.

Second, the PBC will promote effective policy implementation to bring into play the guiding role of central bank lending, central bank discounts, and the monetary policy tools providing direct support for the real economy. It will keep central bank lending and central bank discount policies stable, and it will continue to provide inclusive and sustainable funding support for agro-related businesses, micro and small businesses (MSBs), and private enterprises. It will keep up the intensity of financial support for MSBs and further ramp up support for self-employed traders. The structural monetary policy tools providing direct support for the real economy will be used to play an effective role in targeted liquidity provision, and two monetary policy instruments directly supporting the real economy will remain in place for another extended period until the end of this year. Research is being done on the launch of a central bank support instrument for carbon emissions reduction to support eligible financial institutions providing funding at preferential interest rates to projects that will significantly reduce carbon emissions. The PBC will support green and low-carbon development in line with market-oriented principles to help reach the aims of peaking carbon emissions and achieving carbon neutrality.

Third, the PBC will build the systems and mechanisms needed to provide effective financial support for the real economy. It will improve the system for providing financial support for innovation and will develop fund chains for innovation chains and industrial chains. It will improve the regional financial policy system, boost financial support for major national strategies on regional development, balance regional financial support, and promote coordinated development across regions. Financial support policies will remain generally stable to consolidate and further the achievements of poverty eradication. Moreover, work will be done to step up financial support for the modernization of agriculture and rural areas, to vigorously promote unsecured micro loans for farmers, and to intensify financial support for key fields, such as food security, development of the seed industry, and development of high-quality farmland. The PBC will push further ahead with efforts to enhance the ability of commercial banks to provide financial services and will support them to increase credit supply for the agricultural sector, rural areas, farmers, MSBs, and the manufacturing sector. Firmly adhering to the principle that housing is for living in, not for speculation, and that the real estate market shall not be used to provide a short-term stimulus to the economy, the PBC will remain committed to stabilizing land prices, housing prices, and expectations, and it 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 step up financial support 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. It will enhance the market-oriented interest rate formation and transmission mechanism by improving the central bank policy rate system and continuing to deepen the loan prime rate (LPR) reform. In the meantime, it will unleash the potential of reform in lowering loan rates, optimize regulation over deposit rates, further bring down loan rates in real terms, and continue guiding the financial system to make interest concessions to the real economy. 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, enhance the flexibility of the RMB exchange rate, and bring into play the role of the exchange rate in macroeconomic management and as an automatic stabilizer for the balance of payments. It will guide social expectations and keep the RMB exchange rate basically stable at an adaptive and equilibrium level. Work will be done to accelerate development of the foreign exchange market, to guide enterprises and financial institutions to always be risk-neutral, and to provide services of exchange rate risk management for import and export companies with authentic needs. The PBC will steadily advance convertibility of the RMB under the capital account, improve the policy framework and the infrastructure for cross-border use of the RMB, and facilitate use of the RMB in cross-border trade and investment.

Fifth, the PBC will strengthen fundamental institution building in the financial market to serve the real economy and to guard against market risks. Institution building will be strengthened in the bond market to enhance its abilities to serve the real economy. The PBC will see that intermediary institutions fulfil their responsibilities, and it will push for the implementation of the requirements for information disclosures regarding corporate credit bonds and improve the regulations on credit ratings. The mechanism for risk prevention and resolution of bond defaults will be improved in line with market-oriented and law-based principles, while measures will be taken to crack down on debt evasion. Moreover, the PBC will improve the institutional arrangements of relevant policies to steadily open up the bond market. Continued efforts will be made to enhance fundamental institution building in the capital market so as to better protect the interests of investors and promote the stable and healthy development of the capital market.

Sixth, the PBC will push further ahead with the reform of financial institutions and will continue 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 the focus of their services to the primary level and increase efficiency so as to provide better services for MSBs and private enterprises. Through improvements in 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 for checks and balances in governance will be established. Measures will be taken to reform and optimize development finance and policy finance, to stress their respective positioning, and to carry out category-based management of separate accounts so that they will be better able to serve national strategies and planning and to provide financial support for key fields, weak links as well as critical stages in economic and social development.

Seventh, the PBC will improve the systems of financial risk prevention, early warning, resolution, and accountability, and build a long-term mechanism to forestall and defuse financial risks. It will make every effort to defuse existing risks and to contain any possible resurgence of risks. In the meantime, it will further define the respective responsibilities of all concerned parties to see that they truly perform their duties and work together to resolve risks. Efforts will be intensified to write off non-performing assets in the banking system, while the capital of small- and medium-sized banks will be replenished based on their conditions. The PBC will act quickly to shore up the weaknesses in the regulatory framework, accelerate its work to improve the modern financial regulatory system, and strengthen regulatory coordination. It will also improve the mechanism for financial risk accountability and establish a mechanism for fiscal and financial risk resolution led by major local officials so as to hold to account those responsible for major financial risks and effectively prevent moral hazards. While the role of the deposit insurance system will be effectively brought into play, attention will be focused on early rectification. More work needs to be done to improve the mechanism for professional and market-oriented risk resolution under the deposit insurance system. The PBC will work towards financial risk prevention that is more forward-looking, broad-sighted, and preemptive so as to firmly defend the bottom line that no systemic risk should occur.