

China Monetary Policy Report

Q2 2021

(August 9, 2021)

**Monetary Policy Analysis Group of
the People's Bank of China**

Executive Summary

Since the beginning of 2021, under the strong leadership of the CPC Central Committee with Comrade Xi Jinping at its core, the achievements made in pandemic containment and in social and economic development have been continuously consolidated and expanded, and macro policies have been effectively implemented. With the economy recovering and improving steadily, and with supply remaining stable and demand rising, high-quality development has witnessed steady progress. China's GDP grew by 12.7 percent year on year in H1 2021, averaging 5.3 percent over the past two years. In particular, growth registered 7.9 percent in Q2, averaging 5.5 percent over the past two years and an acceleration of 0.5 percentage points over Q1. In H1, the CPI rose 0.5 percent year on year. Employment was stable 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. Pursuing stability as its top priority, the PBC implemented a sound monetary policy, which was flexible, targeted, reasonable, and appropriate. With proper cross-cycle designs, the PBC maintained the continuity, stability, and sustainability of its policies. Meanwhile, the PBC managed market expectations scientifically, remained committed to serving the real economy, and managed financial risks effectively. These efforts have cultivated a favorable monetary and financial environment for achieving high-quality economic development.

First, liquidity was kept adequate at a reasonable level. Using multiple monetary policy tools, including lowering the required reserve ratios (RRR), conducting Medium-term Lending Facility (MLF) operations and open market operations, the PBC flexibly and precisely adjusted liquidity, and thus maintained stability of market expectations, ensured smooth movement of money market rates, and improved the funding structure of financial institutions. **Second**, structural monetary policy tools were assigned a guiding role. The PBC prolonged the use of the two monetary policy tools providing direct support for the real economy, boosted coordinated regional development with multiple measures, including increasing central bank lending for those provinces with low credit growth, and enhanced policy support for those areas in need of long-term support, such as sci-tech innovations, micro and small businesses (MSBs), green development, and the manufacturing sector. **Third**, the potential of the loan prime rate

(LPR) reform in lowering lending rates was continuously unleashed. The PBC continued to promote use of the LPR, improved regulations over deposit rates, adjusted the methods for setting deposit rate ceilings under the self-disciplinary mechanism, and thus guided overall financing costs to remain stable with a slight decline. **Fourth**, focusing on the domestic situation, attention was paid to maintaining a balance between internal and external equilibria. The PBC deepened the market-oriented reform of the exchange rate to enhance the RMB exchange rate flexibility, and it strengthened expectation management to give play to the exchange rate in adjusting the macro economy and as an auto stabilizer for the balance of payments. **Fifth**, upholding the market-oriented principles and the rule of law, the PBC coordinated development and security, managed financial risks well, and firmly defended the bottom line that no systemic risk should occur.

Overall, since the COVID-19 outbreak, China has adhered to implementing a normal monetary policy, whose intensity in H1 2021 basically returned to normal as before the pandemic, maintaining a leading position among global macro policies. At end-June, broad money (M2) and aggregate financing to the real economy (AFRE) recorded year-on-year growth of 8.6 percent and 11 percent, respectively. With the credit structure continuously improving, inclusive MSB loans and medium and long-term (MLT) loans to the manufacturing sector grew by 31 percent and 41.6 percent year on year, respectively. In June, the weighted average rate on loans registered a record low of 4.93 percent, and that on corporate loans registered 4.58 percent, down 0.06 percentage points from June 2020. Overall financing costs for MSBs were stable and witnessed a slight decline. The RMB exchange rate moved in both directions and remained basically stable at an adaptive and equilibrium level. The China Foreign Exchange Trade System (CFETS) RMB Index registered 98.00 at end-June, 3.3 percent higher than that at end-2020.

Currently, the Chinese economy continues to recover with stronger growth drivers. However, it should also be noted that globally the pandemic is still evolving, externally the environment is more serious and complicated, and internally the economic recovery is not yet solid or balanced. In response, we should remain confident, face the challenges, and focus on domestic issues so as to achieve high-quality development. During 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 apply the new development philosophy fully, faithfully, and comprehensively. It will deepen the supply-side structural reform, speed up the building of a new development paradigm, and contribute to high-quality development. In coordinating macro policies for 2021 and 2022, the PBC will maintain the stability of the monetary policy while making it more forward-looking and effective. While providing strong support for the real economy, the PBC will stand firm in not adopting indiscriminate stimulus and maintain a proper monetary increase for high-quality economic development. It will help small and medium-sized enterprises (SMEs) and those sectors facing difficulties to achieve a sustained recovery, and it will keep the economic indicators within a reasonable range.

The sound monetary policy will remain flexible, targeted, reasonable, and appropriate. Taking stability as its top priority, the PBC will maintain a normal monetary policy, properly design cross-cycle policies, and enhance the autonomy of macro policies. It will manage the intensity and pace of its policies based on the domestic economic situation and price movements, and it will properly handle the relationship between economic development and risk prevention so as to keep the economy generally stable and to strengthen the resilience of economic development. In developing a modern central bank system and in improving the framework for a modern monetary policy 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 the AFRE basically in line with that of nominal GDP, and keep the macro leverage ratio basically stable. The PBC will closely follow and study price movements to stabilize social expectations and to keep prices generally stable. Tools such as central bank lending and discounts, and monetary policy tools providing direct support for the real economy will play a guiding role, and central bank lending policies will be effectively implemented in those provinces with slow credit growth. While taking steps to launch and use the tools in support of carbon emissions reduction, the PBC will guide financial institutions to extend more support to sci-tech innovations, MSBs, green development, and the manufacturing sector. It will enhance the market-oriented interest rate formation and transmission mechanism by continuing to unleash the potential of the LPR reform, improving the central bank policy rate system and deposit rate regulations, and facilitating a further decline in actual lending rates. It will deepen the market-oriented exchange rate reform, enhance the RMB exchange rate flexibility, stabilize market expectations, intensify macro-prudential management, and guide enterprises and financial institutions to remain “risk neutral,” thereby keeping the RMB exchange rate basically stable at an adaptive and equilibrium level. By reinforcing the institutional system for financial risk prevention, early warning, resolution, and

accountability, the PBC will firmly defend the bottom line that no systemic risk should occur. The PBC will consolidate the momentum for stable growth of the economy and enable the economy to reach a higher level of equilibrium in the course of recovery, thereby contributing to a good start for the 14th Five-Year Plan as well as to steady economic development in the long run.

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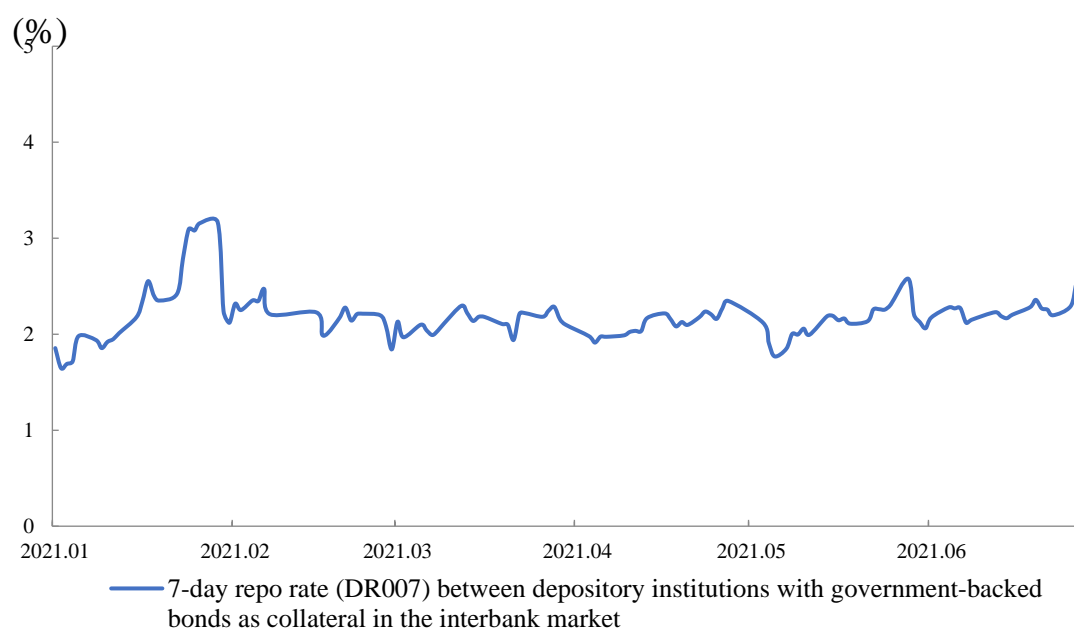
Part 1. Money and Credit Analysis

Starting from 2021, under the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, following the guidelines of the Fifth Plenary Session of the 19th CPC Central Committee and the Central Economic Work Conference, and implementing the requirements set forth in the *Report on the Work of the Government*, the People's Bank of China (PBC) pursued a sound monetary policy which is flexible, targeted, reasonable, and appropriate. Money, credit, and aggregate financing to the real economy gained reasonable growth. Overall financing costs remained stable, albeit with a slight decline. Financial support for the real economy, key areas, and weak links was further strengthened. All this buttressed stable performance of the economy with good momentum.

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

In Q2 2021, the PBC pursued a sound monetary policy that is flexible, targeted, reasonable, and appropriate. It made scientific judgments about macroeconomic conditions and implemented the concept of a cross-cycle design. By comprehensively using multiple policy tools, such as the Medium-term Lending Facility (MLF) and open market operations (OMOs), to inject liquidity, and conducting these operations in a more forward-looking, flexible, and effective manner, the PBC maintained adequate liquidity in the banking system at a reasonable level. In the meantime, the PBC strengthened direct communications with market entities in many ways to stabilize market expectations, and it steadily released policy rate signals. Market interest rates were guided to move around the OMO rates, further strengthening the stability of interest rates. On July 15, the PBC reduced the required reserve ratio (RRR) by 0.5 percentage points, optimizing the capital structure of financial institutions through liquidity management. The PBC proactively took into consideration factors, such as the peak tax period, the maturity of the MLF, and the accelerated issuance of local government bonds, and placed an emphasis on balancing demand and supply of market funds. Thus, the short, medium, and long-term liquidity supply was kept adequate at a reasonable level, basically in line with market demand. At end-June, the excess reserve ratio of financial institutions registered 1.2 percent, down 0.4 percentage points from the corresponding period of 2020.

Figure 1 Movement of Money-Market Interest Rates



Source: www.chinamoney.com.cn.

II. Lending by financial institutions grew reasonably, with the lending rates at historically low levels

Credits provide solid support for the real economy. During the COVID-19 pandemic, there was an increase in enterprises' demand for additional financing, which was fully satisfied by financial institutions. This pushed up the base of financial data in H1 2020. Despite a high base, financial data still witnessed fairly large year-on-year growth in H1 2021, with the normal financing demands of enterprises satisfied and support for the real economy steady. At end-June, outstanding loans issued by financial institutions in domestic and foreign currencies grew 11.9 percent year on year to RMB191.6 trillion, increasing RMB13.2 trillion from the beginning of 2021 and RMB500.2 billion more than the increase during the corresponding period of 2020, respectively. Outstanding RMB-denominated loans grew 12.3 percent year on year to RMB185.5 trillion, up RMB12.8 trillion from the beginning of 2021 and an increase that was RMB667.7 billion larger than that during the corresponding period of 2020.

With the credit structure continuously being improved, key areas and weak links, such

as the manufacturing sector and micro and small businesses (MSBs), received targeted support. At end-June, medium and long-term loans to enterprises and public entities grew by RMB6.6 trillion from the beginning of the year, a year-on-year acceleration of RMB1.8 trillion. Medium and long-term loans to the manufacturing sector increased by 41.6 percent, marking the fourth consecutive month of growth over 40 percent. In particular, the high-tech manufacturing sector witnessed a year-on-year increase of 46.3 percent. Outstanding inclusive loans to MSBs grew by 31 percent year on year to RMB17.7 trillion, 18.7 percentage points higher than that of total loans during the same period. These loans supported 38.3 million MSBs, rising 29.2 percent year on year.

Table 1 The Structure of RMB Loans in H1 2021

Unit: RMB100 million

	Outstanding amount at end-June	YOY growth (%)	Increase from the beginning of the year	YOY acceleration
RMB loans to:	1854977	12.3%	127564	6677
Households	677623	15.1%	45776	10215
Enterprises and public entities	1168032	11.2%	83684	-4021
Non-banking financial institutions	3290	-53.4%	-1832	944
Overseas	6032	4.4%	-64	-461

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 H1 2021

Unit: RMB100 million

	Increase from the beginning of the year	YOY acceleration
Chinese-funded large-sized banks ¹	56486	989

Chinese-funded small and medium-sized banks ²	68392	3631
Small-sized rural financial institutions ³	18933	1404
Foreign-funded financial institutions	1335	928

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

Source: The People's Bank of China.

The weighted average interest rates on loans hit a record low. In 2021, the PBC continued to release the potential of the loan prime rate (LPR) reform, guided actual lending rates to go down amidst stability, and encouraged the financial sector to cut profits in favor of the real economy. In the meantime, the PBC optimized regulation over deposit rates and adjusted the self-disciplinary ceiling for deposit rates, leading to a decline in the borrowing costs of banks. In June, the one-year LPR and the over-five-year LPR stood at 3.85 percent and 4.65 percent, respectively, on par with those in December 2020. The weighted average lending rate recorded 4.93 percent in June, sinking to a new low. In particular, the weighted average interest rate on ordinary loans registered 5.20 percent, down 0.06 percentage point year on year, hitting a record low. The weighted average corporate lending rate fell by 0.06 percentage point year on year to 4.58 percent, reaching historically low levels. 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 June 2021

Unit: %

	June	Change from last December	YOY change
Weighted average interest rate on new loans	4.93	-0.10	-0.13
On ordinary loans	5.20	-0.10	-0.06
Of which: On corporate loans	4.58	-0.03	-0.06

On bill financing	2.94	-0.16	0.09
On mortgage loans	5.42	0.08	0.00

Source: The People's Bank of China.

In June, the share of ordinary loans with rates above, at, or below the LPR registered 67.67 percent, 8.07 percent, and 24.25 percent, respectively.

Table 4 Shares of RMB Lending Rates at Different Levels from January to June 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
April	21.08	7.46	71.46	14.45	23.88	14.78	9.69	8.68
May	22.89	7.38	69.73	14.27	23.60	14.00	9.04	8.82
June	24.25	8.07	67.67	15.46	23.79	13.36	8.10	6.97

Source: The People's Bank of China.

Interest rates on foreign-currency deposits and loans declined slightly. In June, the weighted average interest rates on demand and large-value USD-denominated deposits with maturities within 3 months registered 0.10 percent and 0.43 percent, down 0.06 and 0.16 percentage point from December 2020, respectively. 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 1.15 percent and 0.99 percent, down 0.07 percentage points and 0.37 percentage points from December 2020, respectively.

Table 5 Average Interest Rates of Large-value USD-denominated Deposits and

Loans from January to June 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
April	0.12	0.51	0.77	0.81	0.99	1.07	1.32	1.15	1.16	1.03	1.93
May	0.11	0.46	0.69	0.73	0.92	0.84	1.31	1.11	0.86	0.90	2.20
June	0.10	0.43	0.62	0.77	0.91	0.90	1.15	0.99	0.90	0.78	2.22

Source: The People's Bank of China.

Deposits grew steadily. At end-June, outstanding deposits in domestic and foreign currencies in all financial institutions increased 9.5 percent year on year to RMB233.2 trillion, up RMB14.8 trillion from the beginning of 2021 and an acceleration of RMB50.1 billion. Outstanding RMB deposits grew 9.2 percent year on year to RMB226.7 trillion, an increase of RMB14 trillion from the beginning of the year and a deceleration of RMB506.4 billion. Outstanding deposits in foreign currencies stood at USD1 trillion, an increase of USD129.7 billion from the beginning of 2021 and an acceleration of USD109.1 billion. This was against the backdrop of China leading the global economic recovery and a widened trade surplus.

Table 6 Structure of RMB Deposits in H1 2021

Unit: RMB100 million

	Deposits at end-June	YOY growth (%)	Increase from the beginning of the year	YOY acceleration
RMB deposits:	2266173	9.2%	140453	-5064

Households	1000474	11.6%	74464	-8821
Non-financial enterprises	681665	5.3%	22547	-30226
Public entities	310215	0.6%	10759	-318
Fiscal entities	54170	19.8%	9399	5014
Non-banking financial institutions	205302	24.4%	21861	29308
Overseas	14347	12.4%	1423	-20

Source: The People's Bank of China.

III. Broad money supply and aggregate financing to the real economy displayed appropriate growth

Outstanding M2 recorded RMB231.8 trillion at end-June, increasing 8.6 percent year on year, and thus maintaining strong support for the real economy. Outstanding M1 and M0 registered RMB63.7 trillion and RMB8.4 trillion, respectively, increasing 5.5 percent and 6.2 percent year on year. H1 2021 witnessed a net cash injection of RMB3.2 billion, which is RMB223.8 billion less than that in the same period of the previous year.

According to preliminary statistics, outstanding aggregate financing to the real economy (AFRE) at end-June reached over RMB300 trillion, recording RMB301.56 trillion specifically. Year-on-year growth registered 11 percent, decelerating 2.3 percentage points compared to the growth recorded at end-2020. The AFRE increment in H1 2021 totaled RMB17.74 trillion, dropping RMB3.13 trillion year on year. It shows the following characteristics: first, RMB-denominated loans recorded a larger year-on-year increase. Second, trust loans and undiscounted bankers' acceptances recorded a significantly larger year-on-year drop. Third, corporate bonds showed a year-on-year drop in growth, while domestic equity financing of non-financial companies exhibited a year-on-year increase. Fourth, government bonds recorded a significantly smaller year-on-year increase. Fifth, asset-backed securities of depository institutions showed a larger year-on-year increase.

Table 7 Aggregate Financing to the Real Economy in H1 2021

	End-June 2021		H1 2021	
	Stock (RMB1 trillion)	YOY growth (%)	Flow (RMB100 million)	YOY change (RMB100 million)
AFRE	301.56	11.0	177357	-31327
Of which: RMB loans	184.54	12.6	129422	6135
Foreign-currency loans (RMB equivalent)	2.32	-7.0	2281	-1201
Entrusted loans	10.93	-2.6	-1145	1161
Trust loans	5.64	-22.9	-7239	-5944
Undiscounted bankers' acceptances	3.5	-5.8	-53	-3916
Corporate bonds	28.58	6.7	14884	-18710
Government bonds	48.5	16.8	24532	-13418
Domestic equity financing by non- financial enterprises	8.74	15.0	4955	2494
Other financing	8.57	22.0	5006	1334
Of which: Asset-backed securities of depository institutions	1.96	20.4	670	1208
Loans written off	5.72	26.8	4334	-129

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. ②Since December 2019, the PBC has further improved AFRE statistics by incorporating “central government 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 September 2019, the PBC has further improved the “corporate bonds”

statistics contained in the 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 institutions” and “loans written off” into the AFRE statistics under the item of “other financing” since July 2018. ③Year-on-year statistics in the table are on a comparable basis.

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

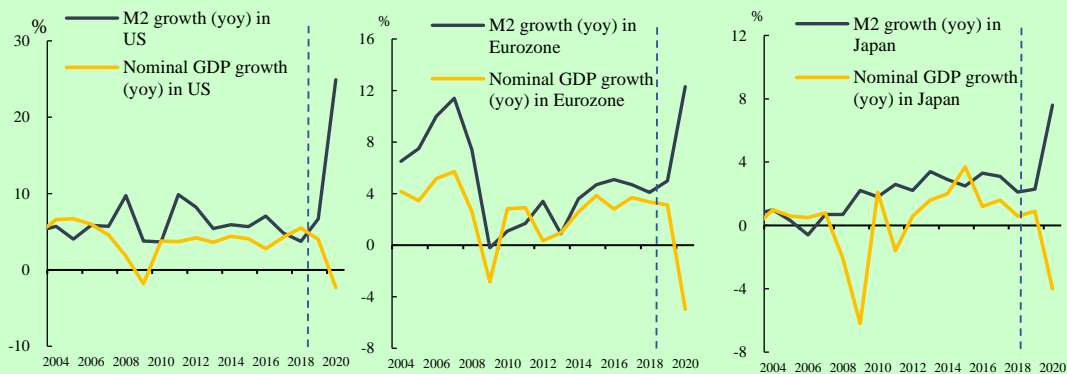
Box 1 A Proper Understanding of Money and Inflation

There are views that the relationship between money and inflation is no longer functional because in the wake of the global financial crisis in 2008, the prolonged over-issuance of money in the major advanced economies did not lead to high inflation. Consequently, central bank purchasing of assets as a way to expand money supply has become the elixir that can spur the economy without causing high inflation. In this respect, it is necessary to take a proper view of the difference between the quantitative easing (QE) policies unveiled following the 2008 global financial crisis and those policies adopted in response to the 2020 pandemic, and correctly understand the relationship between money and inflation.

First, the QE policy that focuses on increasing base money, under which real money growth is limited. For nearly a decade following the 2008 global financial crisis, various factors had contributed to low inflation in the major advanced economies, such as globalization and technological development on the supply side, the aging population, debt overdrafts, and wealth polarization on the demand side. From a monetary perspective, although central banks in the US, Europe, and Japan adopted QE policies and significantly expanded their balance sheets from end-Q3 2008 to end-2017 to increase base money, average annual growth of money supply (broad money) in these regions were only 6.5 percent, 2.8 percent, and 2.7 percent, respectively, which roughly matched their average nominal GDP growth of 3.1 percent, 1.8 percent, and 0.4 percent during the same period. This is the fundamental reason that the advanced economies did not experience a significant inflation.

Figure 2 Broad Money Growth and Nominal GDP Growth in the US,

Europe, and Japan



It should be noted that in a modern banking and credit money system, the direct money creators are banks rather than the central bank, and QE policies, including central bank purchases of government bonds, do not necessarily drive money growth. Base money is different from money in that it mainly serves the purpose of reserve requirements in the banking system and payment clearing needs. Therefore, it is money that is used in circulation by economic entities, and it is created by banks through asset expansions, such as bank loans. Thus, in the long term, it is money and not base money that is closely related to inflation. After the 2008 crisis, central bank purchases of government bonds in the US and other advanced economies led to higher excess reserves in the banking system. But as central bank purchases mainly included existing government bonds in the market, there were no significant monetized deficits. In addition, the banking system was not enthusiastic about creating money through bank loans, which kept the corresponding excess reserves within the banking system and thus did not cause significant growth of money. From end-August 2008 before the crisis to end-2017, the balance sheets of the central banks in the US, Europe, and Japan expanded 375 percent, 209 percent, and 375 percent, respectively, while money supply during the same period only increased 80 percent, 30 percent, and 27 percent, far lower than the expansion rates of the central bank balance sheets.

Second, QE policies adopted to increase money in coordination with fiscal policies, which significantly fueled the global inflation in 2021. After the outbreak of the pandemic in 2020, to address its impact and support an economic recovery, the major advanced economies adopted a policy combination of an excessively loose monetary policy and a massive fiscal stimulus, thereby driving money growth through government-led efforts. From the perspective of the underlying mechanism: the central bank buys government bonds and increases excess reserves, which are turned into fiscal

deposits through new issues of government bonds; fiscal deposits are then turned into deposits of economic entities through fiscal spending of households and businesses. The combinations of these interwoven operations cause money to grow. In 2020, the US Fed purchased about 52 percent of newly issued Treasury bonds, and the money supply generated from this support to fiscal spending constituted 61 percent of M2 growth in the US. As of end-2020, money supply in the US, Europe, and Japan recorded year-on-year growth of 24.9 percent, 12.3 percent, and 7.6 percent, while nominal GDP growth registered -2.3 percent, -5 percent, and -4 percent, respectively. Money growth was highly inconsistent with nominal GDP growth. In terms of consumer price movements, inflation was most serious in the US, and the gap between monetary expansion and nominal GDP growth was also the widest. The US CPI in June reached a 13-year high of 5.4 percent, up 4 percentage points from end-2020. Meanwhile, the CPI in Europe and Japan were up 2.2 and 1.4 percentage points, respectively, from end-2020. It should also be noted that government-led growth of broad money has undesirable consequences, such as disrupting financial discipline, damaging the ability of the banking system to create money in a market-oriented manner, and a lack of vitality in the economy.

In general, the relationship between money and inflation is unchanged, and a massive over-issuance of money will inevitably intensify inflation. Therefore, the key to keeping inflation stable is to maintain sound management of money. Current inflation pressures in China are generally contained, which can be attributed to the fact that since last May the growth of money supply in China has been returning to its normal level at a faster pace than that in other large economies. As of end-June 2021, M2 growth in China registered 8.6 percent, basically equivalent to its pre-pandemic level and corresponding to nominal economic growth, thus keeping prices stable from a macro standpoint. Next, it is necessary that monetary policy continue to prioritize stability. A sound monetary policy should be flexible, targeted, reasonable, and appropriate. The PBC will keep the growth of money supply and the AFRE generally in line with nominal economic growth, and it will stick to its role as a fund provider that is separate from the fiscal authorities so as to fundamentally ensure the overall stability of consumer prices.

IV. The RMB exchange rate remained basically stable at an adaptive and equilibrium level

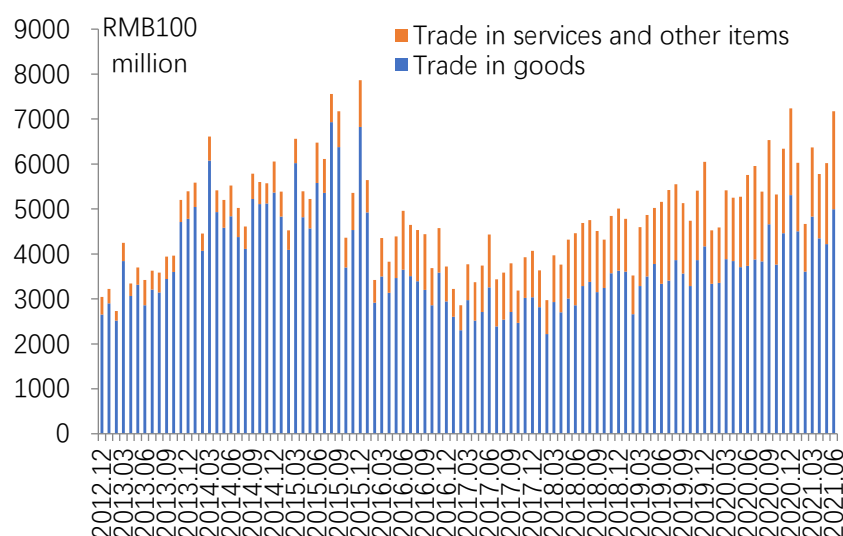
Since the beginning of 2021, cross-border capital flows and foreign-exchange supply

and demand have been basically in equilibrium. Market expectations have been generally stable. Based on market supply and demand, the RMB exchange rate moved in both directions and remained basically stable at an adaptive and equilibrium level. In H1, the RMB appreciated to some extent against a basket of currencies. At end-June, the China Foreign Exchange Trade System (CFETS) RMB exchange rate index and the RMB exchange rate index based on the special drawing rights (SDRs) basket closed at 98.00 and 96.77, respectively, up 3.3 percent and 2.7 percent from end-2020. According to calculations by the Bank for International Settlements (BIS), as of end-June 2021, the nominal effective exchange rate (NEER) and the real effective exchange rate (REER) of the RMB have appreciated 2.9 percent and 0.3 percent since end-2020, and 41.7 percent and 51.9 percent since the reform of the exchange rate formation mechanism that began in 2005. The RMB appreciated against the US dollar in H1. At end-June, the central parity of the RMB against the US dollar was 6.4601, appreciating 1.0 percent from end-2020 and 28.1 percent on a cumulative basis since the reform of the exchange rate formation mechanism that began in 2005. In H1, the annualized volatility rate of the RMB against the US dollar was 3.5 percent.

Cross-border RMB settlements in H1 totaled RMB17.6 trillion, increasing 39 percent year on year. In particular, RMB receipts and payments registered RMB8.9 trillion and RMB8.6 trillion, respectively. Cross-border RMB settlements under the current account grew by 17 percent year on year to RMB3.6 trillion, among which RMB settlements of trade in goods registered RMB2.7 trillion, whereas RMB settlements of trade in services and other items registered RMB952.69 billion. Cross-border RMB settlements under the capital account posted RMB14 trillion, increasing 46 percent year on year.

Figure 3 Monthly RMB Payments and Receipts under the Current

Account



Source: The People's Bank of China.

Part 2. Monetary Policy Operations

In Q2 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 and targeted, and at a reasonable and appropriate level. The PBC conducted open market operations (OMOs) in a targeted manner, advanced the market-based reforms of interest rates and exchange rates, further leveraged the targeted guidance role of structural monetary policy instruments, and intensified policy support to areas that call for long-term support, such as scientific and technological innovations, micro and small businesses (MSBs), green development, and manufacturing, thus fostering a favorable monetary and financial environment for high-quality economic development.

I. Conducting open market operations

Conducting open market operations in a flexible manner. The PBC fully analyzed market developments in terms of the supply and demand of funds, and conducted successive open market operations daily to enhance operational flexibility, preciseness, and effectiveness, to avoid both liquidity strains and excessive idle funds arising from oversupply and to maintain liquidity within the banking system at a proper and adequate level that was neither too tight nor loose, with the provision of medium and long-term

liquidity via monetary policy instruments such as the Medium-term Lending Facility (MLF) as the basis. The central bank's cross-cyclical arrangements reduced liquidity fluctuations, stabilized market expectations, lowered the demand for precautionary funds, and enhanced the efficiency of its liquidity operations. In late June, the PBC properly scaled up its open market reverse repurchase operations (repos) to satisfy the market's short-term funding needs at the end of the six-month period and to maintain money-market stability at the end of the first half-year.

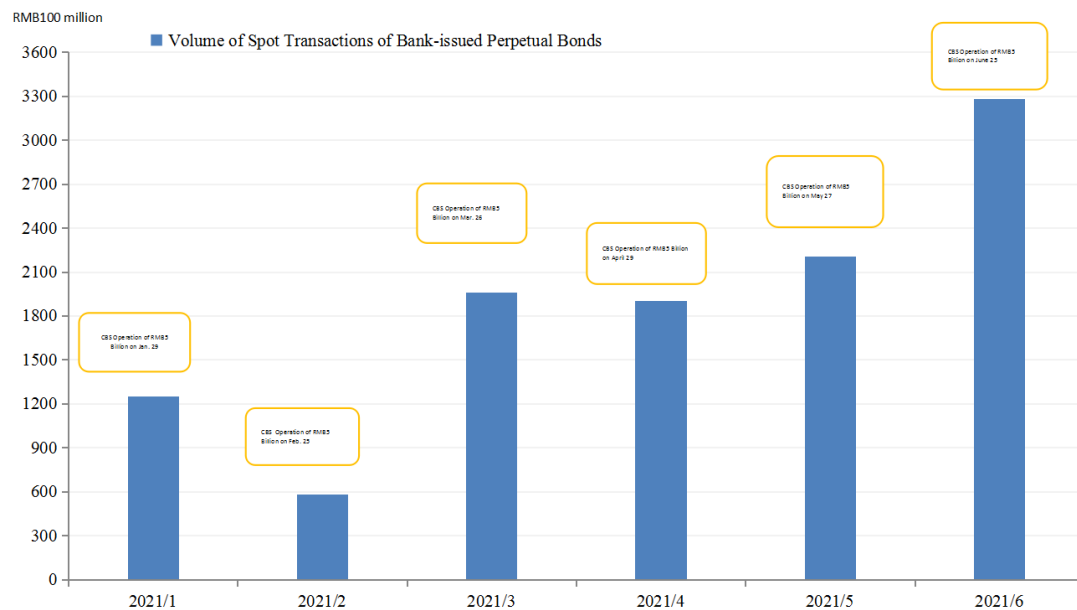
Guiding market rates to move around central bank policy rates. In Q2 2021, both the rates paid on the MLF and the reverse repos remained unchanged. Meanwhile, the PBC sent short-term policy rate signals through daily operations of 7-day reverse repos, and guided money-market rates to move around the OMO rates. As a result, the fluctuation of interest rates declined further, market expectations became more stable, and OMO rates played a strengthened role as the pivotal short-term rates. In Q2 2021, the weighted average rate on 7-day repos between depository institutions in the interbank market (DR007) averaged 2.16 percent, close to the central bank's 7-day reverse repo rate. The money-market rates at end-Q2 remained stable, and the deviations from the OMO rates sharply narrowed compared to those in previous years.

Continuously conducting central bank bill swap (CBS) operations. In Q2 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. Since the beginning of 2021, the PBC has conducted CBS operations regularly on a monthly basis, and these operations have played a positive role in boosting liquidity in the secondary market of bank-issued perpetual bonds and in supporting the issuance of perpetual bonds to replenish capital by banks, especially by small and medium-sized banks.

Issuing central bank bills in Hong Kong on a regular basis. In Q2 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. In H1 2021, the issuance of six batches of RMB-denominated central bank bills totaled RMB60 billion, which enriched the RMB investment products and the RMB liquidity management tools in the Hong Kong market, propelled both domestic and overseas market entities to issue RMB-denominated bonds and to conduct RMB business in the offshore market, and helped promote the sustainable and sound development of the offshore RMB market.

In H1 2021, offshore RMB bond issuances, excluding RMB-denominated central bank bills issued in Hong Kong, registered roughly RMB100 billion, a year-on-year increase of 80 percent. Moreover, the RMB offshore market saw increasingly brisker transactions.

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



Box 2 The Management of Monetary Policy Expectations Attained Notable Achievements

Developing a mechanism for the management of monetary policy expectations is an important step to improve a modern monetary policy framework. The increasingly rule-based and transparent monetary policy operations as well as the establishment of an institutionalized monetary policy communications mechanism facilitate effective management and guidance of public expectations, and they boost the consistency between market entities and policy goals, thereby stabilizing the macro economy. *The 14th Five-year Plan for Economic and Social Development and the Long-range Objectives through the Year 2035* sets out to improve the formulation and implementation mechanism for macro policies and to attach importance to the management and guidance of expectations. In recent years, when formulating and implementing monetary policies, the PBC has continued to improve expectation management and it has developed a scientific and effective mechanism for the management and guidance of monetary policy expectations, thus enhancing the central

bank's transparency and accountability.

Enhancing a modern monetary policy framework and elevating monetary policy transparency. Under a modern monetary policy framework, the PBC clarified its intermediary target that the growth of money supply and of aggregate financing to the real economy (AFRE) roughly matched nominal economic growth, clarifying how monetary policy objectives should be anchored. The PBC improved the policy rates system with open market operation (OMO) rates and the MLF rates serving as short and medium-term policy rates respectively and it targeted these two rates in operations, enabling institutions and the public to observe the monetary policy orientation. The PBC deepened the loan prime rate (LPR) reform and improved the formation and transmission mechanism of market-based rates from policy rates to the LPR and to lending rates, which significantly enhanced policy transmission efficiency and greatly improved the central bank's efficiency in information transmission.

Improving the regular monetary policy communication mechanism and fostering stable market expectations. The PBC gradually fixed the frequency of expectations management as it conducted successive daily open market operations and MLF operations at a fixed time in the middle of each month with the release of operation arrangements in advance to stabilize market expectations; the PBC illustrated its monetary policy stance and released monetary policy signals in each of the 12 months, as in each quarter it held a press briefing on financial statistics in the first month, released the *China Monetary Policy Report* in the second month, and held a quarterly meeting of the Monetary Policy Committee and released an announcement in the third month; the PBC held working conferences early and mid-year and issued press releases; the PBC released the *Annual Report of the PBC* and the *Report of China's Regional Financial Development* annually to objectively reflect the effects of its monetary policies.

Diversifying the methods used in monetary policy communications and effectively enhancing the efficiency of communications with the public. The PBC responded to market concerns through a wide range of methods, including attending regular State Council policy briefings and press conferences of the State Council Information Office, releasing answers to press questions regarding certain policies and the transcripts of press conferences (briefings), participating in interviews with domestic and foreign media, and publishing signed articles; the PBC reported its judgments about the economic and financial situation and about future targeted

approaches to the Financial and Economic Affairs Committee of the National People's Congress (NPC) and the Chinese People's Political Consultative Conference (CPPCC), and held consultative meetings with financial experts and industry associations to introduce the work concerning monetary policies, to exchange ideas, and to establish a two-way interaction mechanism; the PBC effectively leveraged the combined strength of its new media matrix, including its WeChat account and Weibo and its Chinese and English websites, to create a diversified three-dimensional system for expectations management and guidance.

The effective management of monetary policy expectations primarily lies in the PBC "practicing what it preaches." The mutual verification and coordination between the PBC's policy operations and external communications reinforces the accountability of monetary policies. In terms of liquidity expectations from the market, the PBC guided financial institutions to focus on the level of interest rates instead of focusing too much on the amount of liquidity, and the central bank conducts OMOs each day to send short-term policy rate signals. Since the beginning of 2021, the liquidity and money-market rates have remained stable, with no large fluctuations at the end of each month and at the end of each quarter, and the deviation of the DR007 in relation to the OMO rates on the 7-day reverse repos remained low compared with the same period in recent years, thus providing a stable environment for liquidity management by financial institutions and for stabilizing market expectations. Stable market expectations further reduced precautionary liquidity demands and enhanced liquidity stability.

On balance, the management of monetary policy expectations scored notable achievements as the monetary policy framework was more open and straightforward, monetary policy operations became more rule-based and transparent, monetary policy communications were more regular and institutionalized, the efficiency of communications between the PBC and the public improved significantly, and the efficiency of monetary policy transmissions was enhanced. In the next stage, the PBC will continue to uphold the people-centered philosophy of governance, focus on enhancing the transparency of the monetary policy framework, maintain the efficiency and fairness of expectations management, further improve equity in access to information by the public, and bolster the effectiveness of monetary policy transmission and the accountability of the central bank.

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

Well-timed MLF operations were conducted. To ensure an appropriate supply of medium and long-term liquidity and to give play to the signaling and guiding functions of the medium-term policy rates, the PBC conducted a total of RMB1.25 trillion of MLF operations in H1, all with a maturity of one year and an interest rate of 2.95 percent. The MLF operations conducted in Q2 totaled RMB450 billion. At end-June, the outstanding MLF registered RMB5.40 trillion, RMB250 billion more than that at the beginning of 2021.

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 H1, the PBC conducted a total of RMB59.1 billion in SLF operations, of which operations in Q2 registered RMB11.6 billion and the balance of such operations at end-June posted RMB8.6 billion. The SLF rate played its role as the ceiling of the interest rate corridor, and it safeguarded the smooth operation of the money market. At end-June, the overnight, 7-day, and 1-month SLF rates stood at 3.05 percent, 3.20 percent, and 3.55 percent, respectively, on par with the rates at the end of the previous quarter. In May 2021, the PBC issued the *Notice on Issues Concerning Improvements in SLF Management* (YinFa No.135 [2021]) to strengthen SLF management. The efficiency of SLF operations improved through a systemic transformation that enabled small and medium financial institutions to borrow SLF in the form delivery versus payment (DVP).

III. Adjusting the required reserve ratio for financial institutions

The foreign exchange required reserve ratio was raised for financial institutions and foreign exchange liquidity management of financial institutions was enhanced. The PBC decided to raise the foreign exchange required reserve ratio by two percentage points, from 5 percent to 7 percent, effective on June 15, 2021, soaking up foreign exchange liquidity in the amount of over USD 20 billion.

The required reserve ratio for financial institutions was lowered by 0.5 percentage points in an attempt to support the real economy and ensure that costs of overall

financing drop steadily. The PBC decided to reduce the required reserve ratio by 0.5 percentage point, effective on July 15 (not applicable to financial institutions that had already carried a required reserve ratio of 5 percent), releasing about RMB 1 trillion of long-term funds. After this round of RRR cuts, the weighted average required reserve ratio for financial institutions stood at 8.9 percent. This RRR reduction is a conventional operation following normalization of monetary policies, aimed at improving the funding structure of financial institutions and enhancing their capability to allocate funds. First, by keeping adequate liquidity at a reasonable level, the PBC created a favorable monetary and financial environment for high-quality development and supply-side structural reform. Second, by optimizing the financing structure of financial institutions, the PBC effectively expanded the sources of long-term stable funding for financial institutions to support the real economy and guided these institutions to actively use the funds released from the RRR reduction to boost support for MSBs. Third, the RRR reduction lowered the funding costs of financial institutions by approximately RMB13 billion per year, which further reduced overall social financing costs through the transmission of financial institutions.

IV. Further improving the macro-prudential management 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 H1 2021, in line with the requirements for the key tasks set at the Central Economic Work Conference, the PBC further improved the MPA and attached more importance to the assessment requirements to support key areas and weak links. It dynamically adjusted the relevant assessment indicators in an attempt to guide financial institutions to step up support to provide medium and long-term financing to inclusive MSBs and the manufacturing sector.

The regulatory framework for systemically important financial institutions was improved. In order to implement the requirements established by the *Guiding Opinions on Improving Supervision of Systemically Important Financial Institutions*, the PBC issued supporting regulations in line with the *Measures for Assessments of Systemically Important Banks* (SIBs). The PBC, jointly with the CBIRC, drafted the *Additional Regulatory Rules for Systemically Important Banks* (Trial) (Exposure Draft) (hereinafter referred to as the *Rules*), and solicited public opinion starting from April 2. The *Rules* specify additional regulatory requirements on SIBs in terms of an indicator system, recovery and resolution schemes, and prudential regulatory measures, and they

urge the SIBs to reduce systemic risks and to enhance their resilience and bail-in capabilities.

V. 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, and other tools to guide financial institutions to step up support for areas such as MSBs, private firms, agriculture, rural areas, and rural people as well as for poverty alleviation. The role of central bank lending was further brought into play to provide targeted liquidity and to serve as positive incentives. Central bank lending to support rural development and central bank lending for MSBs was used to guide locally incorporated financial institutions to expand the supply of credit for rural revitalization. Central bank lending for poverty alleviation was rolled over according to the current regulations so as to underpin and consolidate the achievements of poverty eradication. Coordinated development of the regional economy and finance was promoted with a newly added quota of RMB200 billion of central bank lending to ten provinces with slow credit growth. Locally incorporated financial institutions were guided to step up policy support for areas such as agro-related businesses, MSBs, and private enterprises in these ten provinces. As of end-June, outstanding central bank lending to support rural development stood at RMB465.3 billion. Outstanding central bank lending for MSBs and for poverty alleviation posted RMB888.2 billion and RMB201.4 billion, respectively. Outstanding central bank discounts registered RMB592.2 billion. In H1, the PBC made net withdrawals of PSLs in the amount of RMB142.4 billion from development and policy banks, with net withdrawals in Q2 totaling RMB101.4 billion and the outstanding PSLs registering RMB3.0926 trillion at end-June.

Targeted Medium-term Lending Facility (TMLF) operations maturing in Q2 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 April 15, the PBC conducted one-year MLF operations totaling RMB150 billion, with a rate of 2.95 percent, including the rollover of TMLFs maturing in April. At end-June, the TMLFs maturing in Q2 were rolled over in the form of MLFs, with the outstanding TMLFs posting zero.

Highlighting the characteristics of directness and precision, two monetary policy instruments that directly support the real economy were continuously promoted, with the aim of bolstering the development of MSMEs. From the introduction of the policy in June 2020 to end-June 2021, operations of instruments supporting deferred repayments of inclusive MSB loans were conducted on a monthly basis and provided a total of RMB14.5 billion in incentive funds to local corporate banks to support extensions of repayments of the principal of inclusive small and micro enterprise loans. A total of RMB1.4478 trillion was used to alleviate the pressures on small and micro enterprises to repay the principal and interest in stages. The support plan for inclusive unsecured MSB loans operated on a quarterly basis. Cumulative preferential funding of RMB221.5 billion was used to provide support for the issuance RMB620.4 billion of unsecured loans to MSBs, thereby effectively alleviating their difficulties to access financing. From the beginning of 2020 to June 2021, banking institutions nationwide deferred RMB11.8 trillion of principal and interest repayments totaling RMB11.8 trillion and issued cumulative inclusive unsecured MSB loans totaling RMB6.9 trillion.

In line with the arrangements of the CPC Central Committee and the State Council, the PBC promoted the launch of instruments in support of carbon emissions reductions. According to the requirements set forth in the *Report on the Work of the Government* and the decisions of the executive meeting of the State Council, the PBC launched a structural monetary policy instrument supporting carbon emissions reductions. Through the provision of low-cost funds for eligible financial institutions, the PBC supported financial institutions by providing funding at preferential interest rates to key projects that will significantly reduce carbon emissions. As a structural monetary policy instrument providing direct support for the real economy, the PBC supported developments in areas of clean energy, energy savings and environmental protection, and carbon emissions reduction technology in a precise and direct manner, and it leveraged more social funding to promote carbon emissions reduction. In line with market-oriented, law-based, and international principles, the design of the instrument fully exhibits openness and transparency. With such a “feasible, calculable, and verifiable” design, the instrument is precise and direct. Being feasible means that efforts are made to clearly support key areas that will significantly reduce carbon emissions, including clean energy, energy savings and environmental protection, and carbon emissions reduction technology. Being calculable means that financial institutions can calculate the amount of carbon emissions reductions driven by loans, and they can disclose the information on carbon emissions reductions, subject to social supervision. Being verifiable means that third-party professional institutions can be introduced to verify the authenticity of the information disclosed by financial institutions so as guarantee their policy effects.

Box 3 The Role of Monetary Policy in Supporting Regional Coordinated Development

At the 19th National Congress of the Communist Party of China (CPC), it was proposed that the principal challenge facing Chinese society has shifted to the gap between unbalanced and inadequate development and the people's ever-growing needs for a better life. According to the requirements of the Fifth Plenary Session of the 19th CPC Central Committee, coordinated development between urban and rural areas and among regions should be enhanced notably during the 14th Five-Year Plan. Meanwhile, the new development concept also places an emphasis on coordinated development. At present, the economic downturn and financial issues are interconnected in some regions, with a poor cycle between the economy and finance and fairly slow growth of credit. In order to promote coordinated regional development, targeted measures that suit local conditions need to be adopted to increase credit supply to regions with slow credit growth, thereby helping foster a virtuous circle between the economy and finance.

The PBC attaches great importance to promoting coordinated regional development. Multiple measures have been adopted and coordinated efforts have been made to guide all kinds of financial institutions to enhance credit support to regions with slow credit growth, under the precondition that risks are kept well under control. First, policy banks are guided to remedy their weaknesses in regional development. The three policy banks, namely, China Development Bank, Agricultural Development Bank of China, and Export-Import Bank of China, are required to guarantee that the proportion of new loans in certain regions to their new loans in 2021 be no less than that in 2020, and they should strive to raise that proportion. **Second,** full play should be given to the national commercial banks, especially the large state-owned banks, to spearhead their role in credit supply. In line with market-oriented and law-based principles, and under the precondition of sound risk control, banks are guided to optimize their internal assessments and incentive measures and to increase the credit supply in the relevant regions according to local conditions so as to support coordinated regional development. The Agricultural Bank of China is required to effectively use the preferential required reserve ratio policy granted for its Finance Division of Agriculture, Rural Areas, and Rural People and to beef up support for regions with slow credit growth. The proportion of new loans provided by the Finance Division of Agriculture, Rural Areas, and Rural People to the relevant regions to all new loans in 2021 should be higher than that in 2020. **Third,** local financial institutions should be fully motivated as the central bank increased the quota of central bank lending

by RMB200 billion to the relevant regions. In addition, under the precondition of guaranteeing the safety of central bank funds, the requirements have been properly eased for eligible borrowers. Local financial institutions are guided to step up credit support for weak links, such as agro-related businesses, MSBs, and private enterprises, under the precondition of sound risk control.

A series of targeted measures have produced positive results. **First**, support policies of central bank lending have been promoted in an orderly manner, achieving notable results in leveraging the loans of locally incorporated financial institutions in certain regions. As of end-June 2021, the PBC issued central bank lending in the amount of RMB160 billion, accomplishing 80 percent of the total quota. In H1 2021, new loans by locally incorporated financial institutions witnessed a notable increase in certain regions. **Second**, policy banks and national commercial banks have actively implemented policies and have stepped up support for regions with fairly slow credit growth. The supply of credit has been enhanced to relevant regions through increasing the allocation of credit resources, optimizing the pricing of internal fund transfers and capital employment, and implementing differentiated internal assessments and incentive measures.

In H1 2021, the proportion of new loans in certain regions to all new loans issued by the three policy banks and the six large state-owned commercial banks witnessed a year-on-year increase. It is the same case with the Finance Division of Agriculture, Rural Areas, and Rural People of the Agricultural Bank of China. Overall, the credit situation has obviously improved in regions with slow credit growth. In certain regions, both the amount of new RMB loans and the proportion to new loans across the country saw a year-on-year rise in H1 2021.

Going forward, the PBC will continue to effectively implement all measures and constantly track and monitor the use of RMB200 billion of central bank lending. Further support will be given to such provinces by the rapid issuance of central bank lending, a high ratio of utilization, and active introduction of corresponding measures by the local governments in an attempt to give full play to the leveraging role of central bank lending. Various kinds of financial institutions will be guided to continuously enhance credit support for regions with slow credit growth. Efforts will be made to accelerate improvements in the financial environment, to smooth the virtuous circle between the economy and finance, and to guide the shift toward positive expectations, so as to create a favorable environment for achieving high-quality development in certain regions.

VI. Bringing into play the role of credit policy to guide structural reform

Financial support to keep businesses and employment stable was enhanced. The *Notice on Promoting the Project of Enhancing the Capacity to Provide Financial Services for Micro, Small, and Medium-Sized Enterprises* (Yinfa No. 176 [2021]) was issued, which established detailed requirements for improving the capacity to provide financial services for MSMEs and strengthened the building of a long-term mechanism for “lending with confidence, willingness, ability, and professionalism.” A dedicated project with the theme of “Lending to Support Small Businesses for Serving the General Public’s Livelihood” was launched in a bid to boost financial support for self-employed businesses and to further improve financial services. At end-June 2021, outstanding inclusive loans to MSBs grew by 31 percent year on year to RMB17.7 trillion. These loans supported 38.30 million MSBs, an increase of 29.2 percent year on year.

Effective support was provided to consolidate and expand the achievements of poverty eradication and to comprehensively promote rural revitalization. The PBC, jointly with five other departments, released the *Opinions on Financial Support for Consolidating Achievements in the Critical Battle against Poverty and Comprehensively Promoting Rural Revitalization* (Yinfa No. 171 [2021]), which adjusted and optimized financial support policies. It clarified priorities and key measures in terms of effectively linking up the consolidation and expansion of poverty eradication achievements with rural revitalization, optimized the comprehensive system of financial organizations in rural areas, integrated and improved financial products for rural development, and expanded direct financing channels for agro-related areas. The PBC rolled out appraisal and assessment measures on financial institutions’ services for rural revitalization in an attempt to enhance incentive and constraint effects as well as to guide financial institutions to continuously enhance their financial resource inputs in support of rural revitalization. At end-June 2021, outstanding agro-related loans increased 10.1 percent year on year to RMB41.66 trillion.

Financial support for key areas such as new types of agribusinesses was enhanced remarkably. The PBC took the lead in issuing the *Opinions on Extending Financial Support for the Development of New Types of Agribusinesses* (Yinfa No.133 [2021]). It guided financial institutions to continuously boost the availability, coverage, and

facility of financial services for new types of agribusinesses, promoted the integrated development of primary, secondary, and tertiary industries in rural areas, and enhanced the quality, economic performance, and competitiveness of agriculture.

Financial support for key areas such as sci-tech innovations and the manufacturing sector was strengthened. The PBC made efforts to enhance and improve financial support for sci-tech innovations, to meet the effective financing demands of core enterprises aimed at seeking key technology breakthroughs, and to boost the availability of financing for tech-SMEs. Financial institutions were guided to increase the supply of medium and long-term loans to the manufacturing sector so as to promote its high-quality development. At end-June 2021, outstanding medium and long-term loans to the manufacturing sector soared by 41.6 percent year on year, the growth of which stood above 40 percent for four consecutive months. In particular, growth of the high-tech manufacturing sector witnessed a year-on-year increase of 46.3 percent.

Financial support for green development was intensified. A symposium was held on adjusting the credit structure of major nationwide banks. Financial institutions were guided to increase their support for green and low-carbon industries. With the aim of achieving the strategic goals of a carbon emissions peak and carbon neutrality, the PBC introduced carbon neutrality-related special financial bonds and carbon neutrality-related debt financing instruments on the interbank market so as to support projects with significant effects on carbon emissions reductions. Based on market-oriented principles, commercial banks were guided to provide reasonable and necessary support for the transformation and upgrading of coal and other traditional energy industries.

VII. Further deepening the market-based interest rate reform

Since the beginning of 2021, the PBC further deepened the market-based interest-rate reform, continuously unleashed the potential of the reform in reducing loan interest rates, and optimized regulation of deposit interest rates, pushing actual loan rates further downward. **First**, with continued progress in the loan prime rate (LPR) reform and application of the LPR, the financing costs of enterprises witnessed a further decline. **Second**, regulation of deposit rates was improved. After modification, the self-disciplined ceiling of deposit rates will be determined by adding basis points to the benchmark interest rates; this was formally put into practice on June 21. **Third**, order

in the credit market was regulated. Lenders of all sorts were promoted to explicitly indicate the annualized interest rates of their loan products so as to effectively protect the rights of financial consumers to be informed. **Fourth**, the PBC promoted a shift in the pricing benchmark for USD floating-rate loans by financial institutions and it guided the market self-discipline mechanism for interest rates to study and issue the recommended agreement format for domestic USD floating-rate loans. Starting from June 1, financial institutions can sign contracts for USD floating-rate loans with reference to the format or they can make adaptive adjustments to the recommended format based on actual conditions.

Box 4 Actual Loan Interest Rates were Generally Stable with a Decline

Since the beginning of 2021, the sound monetary policy has maintained stability as its top priority, reflecting its feature of being forward-looking, targeted, and effective. With the benefits of the loan prime rate (LPR) reform continuously unleashed, the PBC improved regulations over deposit rates, promoted explicit indications of annualized loan rates, safeguarded the sound competitive order in the market, and guided actual loan rates to remain generally stable with a decline, compared with the historical lowest level of 2020.

The PBC promoted financial institutions to improve application of the LPR pricing mechanism and continuously released the potential of the LPR reform. Banks were guided to incorporate the LPR into their internal funds transfer pricing (FTP) so as to strengthen the benchmark role of the LPR in their internal and external pricing. Up until now, all nationwide financial institutions have established relevant rules and systems of FTP and have continuously improved their loan FTP mechanisms pegged to the LPR, through which movement of the LPR may be promptly transferred to loan rates. Locally incorporated financial institutions continuously improved establishment of the FTP mechanism, with 63 percent of these institutions setting up internal FTP management systems, 14 percentage points more than before the LPR reform.

Regulations over deposit rates were improved, with bank liability costs basically stable. On June 21, 2021, the self-disciplinary mechanism for setting interest rates optimized determination of the self-disciplinary ceiling for deposit interest rates, which had shifted from multiplying the benchmark deposit rates by a designated multiplier to adding basis points to the benchmark interest rates. This modification has not only safeguarded financial institutions' right of independent pricing but it has also

contributed to orderly market competition. Deposits are guided to return to an appropriate maturity structure, and the liability costs of banks have stabilized. Currently, all financial institutions have put in place the relevant requirements of the self-disciplinary mechanism for setting interest rates, and the new self-disciplinary ceiling of interest rates has been implemented in a stable and orderly manner. In terms of quoted interest rates, they remain basically unchanged for nationwide banks, while some have been adjusted downwards for medium and long-term deposits by some local financial institutions that still meet the requirements for the new self-disciplinary ceiling of interest rates. In practice, within the self-disciplinary ceiling, banks may independently negotiate with the depositors so as to determine their respective deposit interest rates.

Explicit indications of annualized loan rates were promoted to safeguard the vital interests of financial consumers. On March 31, 2021, the PBC issued *Announcement No. 3 [2021]*, requiring all institutions conducting lending businesses to explicitly indicate their annualized loan rates, and it specified the calculation methodology. Meanwhile, the PBC directed the National Internet Finance Association of China to study the incorporation of annualized loan rates into national standards as mandatory disclosure requirements. By end-June, 2021, banking institutions had all explicitly indicated their annualized loan rates, and over 6,000 lending institutions as well as major internet financial platforms had basically completed this task. In general, explicit indications of annualized loan rates help borrowers understand actual borrowing costs and they effectively safeguard the right of financial consumers to be informed.

Actual loan interest rates were generally stable with a decline. Currently, the Chinese economy has improved steadily with sound momentum, and its growth rate has basically returned to its potential level. Financial support for the real economy is strong and solid, and the growth rates of money supply and the AFRE are basically in line with nominal economic growth. This demonstrates that from a macro perspective, interest rates remain at a reasonable level in China, which provides a favorable interest-rate environment for steady economic operations and high-quality development. In H1 2021, the weighted average rate on loans registered 5.07 percent, down 0.07 percentage points year on year and 0.08 percentage point compared with that of 2020, respectively. In particular, interest rates on corporate loans witnessed a greater drop. In H1 2021, the weighted average rate on corporate loans fell by 0.16 percentage points year on year to 4.63 percent, down 0.09 percentage points compared with that in 2020. The financing costs of the real economy remained generally stable, albeit with a decline. In an international comparison, although they were slightly higher than those in the major

advanced economies, the interest rates in China remain relatively low among the developing countries and the emerging economies. In addition, from the perspective of the actual interest rates for corporate lending, they are generally on par with the major commercial banks of China and the US. In Q1 2021, the average corporate lending rate of the four major commercial banks in the US (Citibank, Bank of America, Wells Fargo, and JP Morgan) registered 4.03 percent, which was 4.04 percent of the four major commercial banks in China (the Industrial and Commercial Bank of China, the Agricultural Bank of China, Bank of China, and China Construction Bank).

Going forward, the PBC will perfect the market-oriented interest-rate formation and transmission mechanism and improve the policy rate system of the central bank. It will continue to unleash the potential of the LPR reform, smooth the transmission channels for loan interest rates, optimize the allocation structure of financial resources, and consolidate previous achievements in the reduction of loan interest rates. Meanwhile, the PBC will optimize regulations over deposit interest rates, keep the banks' liability costs basically stable, and urge banks to transfer the policy benefits to the real economy so as to further bring down the actual loan rates and to secure general stability with a decline in the overall financing costs for MSBs.

VIII. 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 enhanced the RMB exchange rate flexibility 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 H1 2021, the highest and lowest RMB central parities were 6.3572 and 6.5713, respectively, against the USD. During the 118 trading days, the RMB appreciated on 62 days and depreciated on 56 days. The biggest intraday appreciation and depreciation were 1.0 percent (648 bps) and 0.8 percent (543 bps), respectively. The RMB exchange rates against the other major international currencies floated in two ways. At end-June, the central parities of the RMB against the dollar, the euro, and the Japanese yen appreciated 1.0 percent, 4.4 percent, and 8.2 percent, respectively, from end-2020, while the RMB central parity against the pound had depreciated 0.6 percent during the same period. Since the reform of the RMB exchange

rate formation mechanism commenced in 2005, the RMB had appreciated by a cumulative total of 28.1 percent, 30.3 percent, and 25 percent, respectively, against the dollar, the euro, and the Japanese yen by the end of June 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 facilitated bilateral trade and investment.

Table 8 Trading Volume of the RMB Against Other Currencies in the Interbank Foreign Exchange Spot Market in H1 2021

Unit: RMB100 million

Currency	USD	EUR	JPY	HKD	GBP	AUD	NZD
Trading volume	306672.34	8540.30	1746.23	558.29	414.46	535.03	257.57
Currency	SGD	CHF	CAD	MYR	RUB	ZAR	KRW
Trading volume	395.77	320.38	574.26	1.69	61.92	0.81	36.06
Currency	AED	SAR	HUF	PLN	DKK	SEK	NOK
Trading volume	7.86	9.47	0.38	0.59	62.06	31.35	24.98
Currency	TRY	MXN	THB	KHR	KZT	MNT	
Trading volume	0.22	0.79	238.18	0.01	0.00	0.00	

Source: China Foreign Exchange Trade System.

As of end-June, under the bilateral currency swap agreements between the PBC and foreign monetary authorities, the foreign monetary authorities utilized a total of RMB60.461 billion, and the PBC utilized foreign currencies equivalent to USD475 million. These operations played an active role in promoting bilateral trade and investment.

Box 5 A Norm of Two-way Fluctuations of the RMB Exchange Rate

In recent years, with the continuous progress in the reform of the RMB exchange rate formation mechanism, the market has played a decisive role in the formation of the exchange rate. The RMB exchange rate fluctuates in two ways, both upward and downward, and the exchange rate flexibility is increasing, creating conditions for independent implementation of a normal monetary policy.

The current managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies is suitable for China's conditions and should be maintained for a long time, which is the basis for the two-way fluctuations in the RMB exchange rate. A mix of measures adopted by the PBC work as an integral whole so that the two-way fluctuations of the RMB exchange rate have become a norm, and the RMB exchange rate is kept basically stable at an adaptive and equilibrium level. First, the market plays a decisive role in the formation of the exchange rate. The PBC has withdrawn from regular intervention in the foreign exchange market. The exchange rate, determined by market supply and demand, plays the role of a price signal, which improves the efficiency of resource allocations. **Second**, the reform of the RMB exchange rate formation mechanism has been deepened. In October 2020, the counter cyclical factor faded out of the quotation model of the RMB central parity against the USD. After the adjustment, the central parity formation mechanism has become more transparent, benchmarking, and effective, which also reflects that the market has been given full play in the self-discipline mechanism of the foreign exchange market. **Third**, the macro-prudential management framework for cross-border financing has been improved. Since 2020, in line with macroeconomic conditions and the balance of payments, the PBC has adjusted the macro-prudential parameter for cross-border financing of financial institutions and enterprises and has expanded coverage of the macro-prudential management framework for cross-border financing. Apart from raising management efficiency, the PBC has also implemented differentiated policies according to the size of the financial institutions, ensured the reasonable and orderly succession of policies, and guided financial institutions to adjust the structure of their assets and liabilities in a market-oriented manner. **Fourth**, expectation management has been emphasized. In the case of large swings in the RMB exchange rate and market expectations, the PBC responded actively to market concerns and communicated policy intentions with the market through various channels so as to curb the overshooting of the foreign exchange market and to safeguard the market's sound operation. **Fifth**, liquidity in the foreign exchange market has been adjusted effectively. On May 31, 2021, the PBC announced to raise the reserve ratio for foreign exchange deposits of financial institutions by 2 percentage

points, from 5 percent to 7 percent. The adjustment was aimed at pumping out part of the market liquidity and offsetting the impact of the external environment on the domestic market. **Sixth**, enterprises and financial institutions have been guided to establish the concept of “risk neutrality.” The PBC has guided financial institutions to provide foreign exchange risk management services to enterprises in line with the principle that foreign exchange management is based on real needs and should stick to risk neutrality. Financial institutions have also been guided to maintain sound operations in a bid to foster the stable and healthy development of the foreign exchange market.

Beginning from 2020, the two-way fluctuations in the RMB exchange rate have also reflected the differences in economic cycle and monetary policies at home and abroad. In the midst of globalization, the economy and finance of various economies are interacting with one another. The pandemic containment and economic recovery have been advancing at different paces, and different monetary policies have been adopted worldwide. The two-way fluctuation of the RMB exchange rate reflects that the domestic and external economic cycles and monetary policies do not match one another. In 2020, faced with the global economic impact of COVID-19, China stepped up its macro-policy response and the PBC kept its sound monetary policy flexible, appropriate, and targeted, all of which buttressed China’s leading role in pandemic containment, resumption of work and production, and attainment of positive economic growth. China’s monetary policy started to turn around to normal in May 2020, when the pandemic was increasingly rampant elsewhere and ultra-loose monetary policies were being adopted by the major economies. As a result, the RMB appreciated against the USD and a basket of currencies. In 2020, the RMB central parity appreciated against the USD by 6.9 percent, less than that of the euro, and the CEFTS index rose by 3.8 percent. Since the beginning of 2021, the COVID-19 vaccination has been making progress in the developed economies, and reflation trade has been on the rise in the market. The international financial market has been concerned that the US Fed may reduce its quantitative easing and raise interest rates in advance. In June, the USD appreciated against the major currencies, while China insisted on implementing its normal monetary policies, with its economy operating near its potential growth rate. The RMB depreciated by 1.4 percent against the USD in the same month, while the CFETS index remained stable.

On the whole, the two-way fluctuation of the RMB exchange rate results from the changes in domestic and external economic conditions, the balance of payments, and the foreign exchange markets both at home and abroad. It reasonably reflects changes

in supply and demand in the foreign exchange market. It plays a role in adjusting the macro economy and as an automatic stabilizer for the balance of payments, promotes both internal and external equilibria, and helps expand the space for implementation of an independent monetary policy. In the future, it will continue to be a norm for the RMB exchange rate to fluctuate in two ways, and the RMB may either appreciate or depreciate, which cannot be accurately predicted by any single person. Going forward, the PBC will maintain the managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. It will appropriately employ multiple monetary policy tools, enhance macro-prudential management of cross-border financing, reasonably guide expectations through various means, and help enterprises and financial institutions establish the concept of “risk neutrality” so as to keep the RMB exchange rate basically stable at an adaptive and equilibrium level.

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

Risk resolution and reform and restructuring of small and medium-sized financial institutions have been promoted in an orderly manner. Since the takeover of the Baoshang Bank (BSB), there has been steady progress in various relevant tasks, breaking the rigid payments in an orderly manner, and completing liquidation and asset verification on schedule. On January 12, 2021, Beijing No.1 Intermediate People’s Court held a creditors’ meeting for the first time, and the administrator completed a review of the claims of 743 creditors. On February 7, Beijing No.1 Intermediate People’s Court issued its ruling on the BSB’s bankruptcy. Equities of former shareholders were cleared, and large creditors bore partial losses. Risk resolution of the BSB was basically completed, and the follow-up work was advanced in a steady and orderly manner. Moreover, 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 and to firmly defend the bottom line so that no systemic risk should occur.

The reform of development and policy financial institutions was continuously deepened. The PBC advanced comprehensive reform plans for development and policy financial institutions to redefine their responsibilities and business scope, implement classified accounting, improve corporate governance, strengthen restraint mechanisms, 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.

X. Deepening reform of foreign exchange arrangements

Continue to strengthen positive incentives for trade facilitation pilot programs. **Persist in high standards** when verifying the pilot conditions. Coverage of the program was expanded in a steady and orderly manner and the pilot program was further optimized. As of end-June 2021, the pilot program had been expanded to incorporate 22 areas, 99 banks, and 909 enterprises.

New ideas for international trade management were explored. Based on the pilot work in Hainan and other places regarding new international trade patterns, the PBC has supported Jiangsu, Zhejiang, and other regions with actual needs to develop new offshore international trade and it has guided banks to improve their capability to verify compliance so as to facilitate real and legitimate business activities.

Two-way individual foreign exchange business was facilitated. The State Administration of Foreign Exchange (SAFE) issued the *Notice on Further Promoting Facilitation of Individual Foreign Exchange Business under the Current Account* (Huifa [2021] 13), aiming to improve the banks' capability to handle complex individual current-account businesses. The SAFE also issued the *Individual Foreign Exchange Business Manual (First Edition)* so as to popularize knowledge about individual foreign exchange policies. Moreover, the SAFE guided its Guangdong and Shenzhen branches to launch pilot programs to facilitate cross-border insurance exchange under the current account and to promote the interconnectivity of insurance markets in Guangdong, Hong Kong, and Macau.

Stable and sound operation of the foreign exchange market was maintained. The PBC enhanced the timeliness and accuracy of off-site inspections and placed emphasis on punishing illegal financial activities, such as underground banks and cross-border gambling. Special investigations of key entities were conducted so as to effectively deter foreign exchange market violations and to maintain an orderly foreign exchange market. In H1 2021, a total of 1290 foreign exchange violations were investigated and penalized, with total fines amounting to RMB375 million.

Part 3. Financial Market Conditions

In H1 2021, the financial market generally operated smoothly and steadily. Money market interest rates remained stable with active market transactions. The bond market featured generally declining bond coupon rates, increased bond issuances, and decreased cash bond transactions. The stock market index rose, and both turnover and the amount of funds raised witnessed year-on-year increases.

I. Financial market overview

1. Money market interest rates remained stable, and the growth of market transactions slowed down

Money market interest rates were generally stable. In June, the monthly weighted average interest rate of pledged repos posted 2.17 percent, 16 basis points higher than that in March. The monthly weighted average interest rate of government-backed bond repos among depository institutions posted 2.04 percent, 13 basis points lower than the monthly weighted average interest rate of pledged repos. In June, the monthly weighted average interest rate for interbank lending posted 2.13 percent. At end-March, the overnight and 7-day Shibor posted 2.18 percent and 2.41 percent, respectively.

Market transactions remain active. In H1 2021, the volume of bond repos trading on the interbank market reached RMB471.4 trillion, representing an average daily turnover of RMB3.9 trillion and almost on par with that in the previous year. The volume of cumulative trading of interbank lending registered RMB58.1 trillion, with an average daily turnover of RMB476.1 billion and a year-on-year decrease of 26.6 percent. In terms of the maturity structure, overnight repos accounted for 83.6 percent of the total turnover in bond repos, decreasing 1.2 percentage points year on year, and overnight lending made up 89.2 percent of interbank lending, down 1.4 percentage points year on year. The volume of bond repos traded on the exchange markets increased 21.6 percent year on year to RMB156.2 trillion.

Table 9 Fund Flows Among Financial Institutions in H1 2021

Unit: RMB100 million

	Repos		Interbank lending	
	H1 2021	H1 2020	H1 2021	H1 2020
Chinese-funded large banks ^①	-935,415	-1,452,030	-145,893	-230,389
Chinese-funded medium-sized banks ^②	-777,320	-427,545	-49,245	-42,523
Chinese-funded small-sized banks ^③	62,461	23,779	51,987	60,861
Securities institutions ^④	601,295	511,590	105,388	155,881
Insurance institutions ^⑤	48,897	57,105	131	267
Foreign-funded banks	35,594	39,158	-12,808	-12,065
Other financial institutions and vehicles ^⑥	964,488	1,247,944	50,439	67,968

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 witnessed orderly development. In H1 2021, 15,000 interbank CDs were issued on the interbank market, raising RMB10.9 trillion. The volume of trading on the secondary market totaled RMB70.8 trillion. At end-June, outstanding interbank CDs reached RMB12.4 trillion. In H1 2021, the average weighted interest rate of 3-month interbank CDs was 2.70 percent, 8 basis points higher than that of the 3-month Shibor. A total of 33,000 negotiable CDs were issued by financial institutions in H1 2021, raising RMB6.2 trillion, with an increase of RMB200 billion year on year.

The turnover of interest rate swaps was stable. In H1 2021, the RMB interest rate swap market witnessed 142,000 transactions, decreasing 1.9 percent year on year, with the volume of the notional principal totaling RMB11.1 trillion, an increase of 12.7 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 RMB8.0 trillion, accounting for 72.0 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 85.4 percent and 13.7 percent, respectively, of the total notional principal of the interest rate swaps. In H1 2021, interest rate swaps anchored to the LPR witnessed 419 transactions, with RMB43.29 billion of the notional principal.

Table 10 Transactions of Interest Rate Swaps in H1 2021

	Transactions	Notional principal (RMB100 million)
H1 2021	141,605	111,163.5
H1 2020	144,363	98,646.2

Source: China Foreign Exchange Trade System.

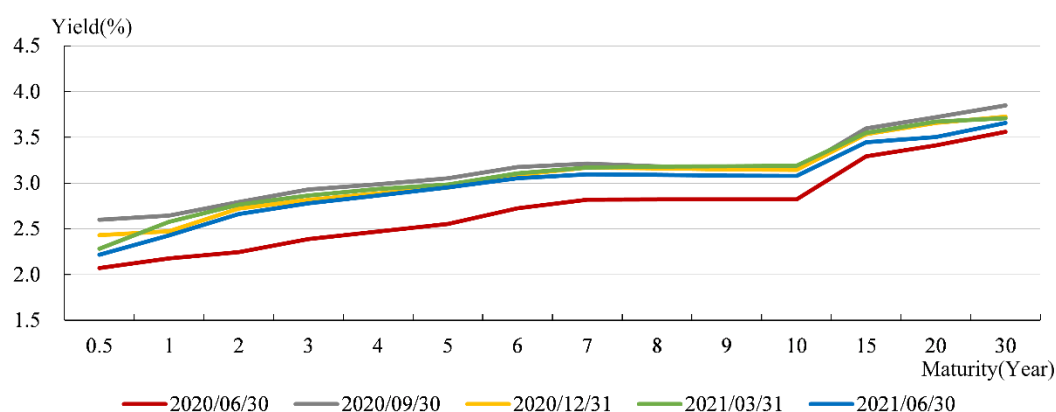
The loan prime rate (LPR) interest rate option business developed steadily. The LPR interest rate option business made its debut on the interbank market in March 2020, and fixing repo rate (FDR) options were newly added to the interbank market on March 29, 2021. In H1 2021, a total of 266 interest rate option transactions were concluded, totaling RMB46.66 billion. Specifically, 29 were interest rate swap transactions, amounting to RMB1.52 billion of the notional principal, 237 were interest rate cap/floor transactions, amounting to RMB45.14 billion of the notional principal, 199 were LPR interest rate transactions, totaling RMB42.61 billion of the notional principal, and 67 were FDR interest rate transactions, amounting to RMB4.05 billion of the notional principal.

2. Coupon rates of bonds declined while bond issuances expanded

On the whole, coupon rates of bonds declined. In June 2021, the yield on 10-year

government securities issued by the Ministry of Finance was 3.10 percent, 12 basis points lower than that in March. The coupon rate of 10-year financial bonds issued by the China Development Bank (CDB) was 3.47 percent, 5 basis points lower than the rate in March. The average rate of 1-year short-term financing bills (bond rating A-1) issued by AAA-rated enterprises was 3.94 percent, 38 basis points higher than the rate in March.

Figure 5 Yield Curves of Government Securities on the Interbank Market



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

On the whole, government securities yields went down in H1. At end-June, yields on 1-year and 10-year government securities decreased by 4 basis points and 7 basis points to 2.43 percent and 3.08 percent from end-2020, respectively; the spread between 1-year and 10-year government securities was 65 basis points, down 2 basis points from end-2020. Credit spreads narrowed at end-June, with yield spreads on 3-year AAA and AA-rated short-to-medium-term bills and CDB bonds narrowing by 16 basis points and 40 basis points to 40 basis points and 101 basis points from end-2020, respectively.

Bond issuances saw year-on-year growth. In H1, the cumulative value of bond issuances increased by 13 percent, or RMB3.4 trillion, year on year to RMB29.4 trillion, most of which were interbank certificates of deposit, which increased by RMB3.1 trillion. At end-June, outstanding bonds held in custody amounted to RMB123.6 trillion, an increase of 15 percent year on year.

The volume of spot bond transactions on the interbank market decreased, while the exchange volume of spot trading continued to grow. In H1, the value of cash bonds

trading on the bond market posted RMB108.2 trillion, registering a decrease of 15.1 percent year on year. Specifically, the value of cash bonds trading on the interbank market was RMB96.7 trillion, representing a decrease of 19 percent year on year. The value of cash bond transactions on the stock exchanges totaled RMB11.5 trillion, an increase of 44 percent year on year.

Table 11 Bond Issuances in H1 2021

Unit: RMB100 million

Type of bond	Issuance	YOY change
Government securities	28,086	2,748
Local government bonds	33,411	-1,453
Central bank bills	0	0
Financial bonds ^①	162,071	34,273
Of which: Financial bonds issued by the China Development Bank and policy financial bonds	30,708	2,893
Interbank certificates of deposit	109,283	31,008
Corporate credit bonds ^②	70,349	-1,727
Of which: Debt-financing instruments of non-financial enterprises	46,883	-2,249
Enterprise bonds	2,667	351
Corporate bonds	15,347	364
Bonds issued by international institutions	465	70
Total	294,382	33,911

Notes: ①Including 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 saw steady growth, and interest rates in the bill market were basically stable

The bill acceptance business recorded stable growth. In H1, commercial drafts issued by enterprises totaled RMB12.3 trillion, rising 5.3 percent year on year. At end-June, outstanding commercial drafts stood at RMB14.3 trillion, increasing by 1.0 percent year on year. At end-June, outstanding commercial draft acceptances witnessed stable growth, increasing by RMB250.4 billion from the beginning of this year and RMB252.9 billion from end-March, respectively. Of the outstanding bankers' acceptances, 67.9 percent were issued by micro, small, and medium-sized enterprises (MSMEs).

Bill financing witnessed steady growth, with generally stable interest rates. In H1, total discounts by financial institutions amounted to RMB23.8 trillion, growing 7.6 percent year on year. At end-June, the balance of bill financing was RMB8.6 trillion, down 0.1 percent year on year. The balance accounted for 4.6 percent of total outstanding loans, down 0.6 percentage points year on year. In H1, the interest rates of bill financing first increased and then decreased, but they remained generally stable.

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

Driven by the economic recovery, stock indices experienced a choppy rise. At end-June, the Shanghai Stock Exchange Composite Index closed at 3,591 points, increasing by 3.4 percent from end-2020. The Shenzhen Stock Exchange Component Index closed at 15,162 points, increasing by 4.8 percent from end-2020. Turnover on the stock markets expanded. In H1, the combined turnover on the Shanghai Stock Exchange and the Shenzhen Stock Exchange reached RMB107.6 trillion, and the average daily turnover was RMB912.0 billion, representing an increase of 20 percent year on year. The amount of funds raised on the stock markets surged significantly year on year. In H1, a cumulative RMB657.8 billion was raised, increasing by 97 percent year on year.

5. Growth of assets in the insurance sector and premium income slowed down

In H1 2021, total premium income in the insurance sector amounted to RMB2.9 trillion, up 5.2 percent year on year, a deceleration of 0.9 percentage points from the previous year. Claim and benefit payments totaled RMB765.1 billion, representing a year-on-year increase of 21.3 percent. Specifically, total property insurance claims and benefit payments increased by 15.8 percent year on year, and total life insurance claims and benefit payments went up by 26.2 percent year on year.

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

Unit: RMB100 million, %

	Balance		As a share of total assets	
	End-June 2021	End-June 2020	End-June 2021	End-June 2020
Total assets	247,776	219,792	100.0	100.0
Of which: Bank deposits	27,349	28,152	11.0	12.8
Investments	203,800	173,099	82.3	78.8

Source: China Banking and Insurance Regulatory Commission.

The growth of assets in the insurance sector slowed down. At end-June 2021, total assets in the insurance sector increased 12.7 percent year on year to RMB24.8 trillion, a deceleration of 0.6 percentage point from end-2020. Specifically, bank deposits decreased by 2.9 percent, while investment-linked assets increased by 17.7 percent year on year.

6. Turnovers of spot and swap foreign exchange transactions witnessed rapid growth

In H1 2021, the cumulative turnover of spot RMB/foreign exchange transactions registered USD5 trillion, an increase of 44.4 percent year on year. The cumulative turnover of swap RMB/foreign exchange transactions totaled USD9.3 trillion, an increase of 26.7 percent year on year. Specifically, cumulative overnight RMB/USD swap transactions posted USD6.2 trillion, accounting for 66.5 percent of the total swap turnover. The turnover of RMB/foreign exchange forward transactions totaled USD52.3 billion, rising 1.9 percent year on year. The turnover of foreign currency pair transactions totaled USD608.9 billion, increasing by 97.4 percent year on year. In particular, the EUR/USD pair registered the largest trading volume, accounting for 60.5 percent of total market share.

7. Gold prices first went up but then dropped

In H1 2021, international gold prices closed at USD1,763 per ounce, representing a loss of 5.9 percent from end-2020. The Au99.99 on the Shanghai Gold Exchange closed at RMB365.82 per gram, decreasing by 6.2 percent from end-2020. In H1 2021, the volume of gold traded on the Shanghai Gold Exchange was 18,400 tons, representing a decrease of 45.5 percent year on year. Turnover posted RMB6.96 trillion, a decrease of 44.0 percent year on year.

II. Development of institutional arrangements in the financial markets

1. Institutional arrangements in the bond market

To better serve market entities and actively respond to market needs, the PBC released *Announcement No. 4 [2021] of the People's Bank of China (Revision of the Announcement on Bond Trading and Circulation in the Interbank Bond Market)*. The announcement further improved institutional arrangements and efficiency for bond trading and circulation, thus enhancing the capability of the bond market to serve the real economy. To be specific, first, it is clearly specified that infrastructure agencies shall build direct connections among their systems to achieve an electronic transmission of information. Second, issuers or lead underwriters are no longer required to provide the National Interbank Funding Center (NIBFC) with a list of the initial bondholders and their holdings. Third, the function of infrastructure agencies as intermediary service providers has been strengthened.

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

The institutional design of the capital market was improved. In April 2021, the CSRC released the *Decision on Revising the "Guidelines for the Evaluation of Sci-Tech Innovation Attributes (for Trial Implementation)"*, which focused on supporting the core goals of hard technology and emphasizing substance over form, implementing classified processing and negative list management and further enriching the evaluation indicators of science and technology attributes, and strengthening comprehensive research and judgment. The Guidelines urged intermediaries to shoulder due responsibilities and reinforce the supervision and inspection of implementation of the rules so as to improve the quality of companies listed on the Science and Technology Innovation Board at their source. In May, the CSRC released the *Guiding Opinions on Improving the Rules for Delisting on the National Equities Exchange and Quotations*. The Guiding Opinions improved the basic institutional framework for both voluntary and forced delistings, clarified the post-delisting regulatory arrangements, and

emphasized the responsibility of the exchange, thus promoting a more standardized market exit mechanism.

Protection of legitimate rights and interests of investors was strengthened. In May 2021, the CSRC released the *Elements of Asset Management Product Introduction—Part 2: Asset Management Plan and Related Products Offered by the Securities and Futures Operators*, which introduced the basic elements for asset management plans and relevant securities and futures products, including their definitions, classifications, operating modes, and risks, thus making it more convenient for investors to understand the risk and return characteristics of the products. In June, the CSRC released two codes concerning the content and format of information disclosures of listed companies for the purposes of regulating the compiling of periodic reports and information disclosures of listed companies as well as for safeguarding the investors' rights to be informed.

Construction of an information-based capital market was promoted. In June 2021, the CSRC released the *Settlement Participant Code for the Securities and Futures Industry* and four other industry standards for the financial sector in order to encourage the standardization of data and the exchange of information within the sector.

3. Institutional arrangements in the insurance market

An exclusive commercial pension insurance pilot was launched. In May 2021, the CBIRC released the *Notice on Exclusive Commercial Pension Insurance Pilots* and it decided to launch an exclusive commercial pension insurance pilot in Zhejiang Province (including Ningbo City) and Chongqing Municipality for one year starting on June 1, 2021. The PICC Life Insurance Company Limited and five other life insurance companies were to carry out the pilot work. The Notice specified the methods of payment, design of the accumulation period and annuitization period, the insurance liabilities, rules for insurance cancellation, information disclosures, and product management. It also made clear the regulatory support policies with respect to equity asset allocations and the minimum capital requirement.

Corporate governance of insurance companies was improved. In June 2021, the CBIRC released the *Code of Corporate Governance of Banking and Insurance Institutions*. The Code, for the first time at the level of regulatory institutions, put forward general requirements for the integration of the leadership of the CPC and corporate governance, and they made clear that CPC organizations in private institutions shall be actively

availed of as political centers. The Code improved the regulatory rules for the corporate governance of banking and insurance institutions, clarified the responsibilities of corporate governance bodies, and further standardized operation of the corporate governance mechanism.

Regulatory requirements for the recovery and resolution plans of insurance institutions were improved. In June 2021, the CBIRC released the *Interim Measures on Implementing the Recovery and Resolution Plans of Banking and Insurance Institutions*. The *Interim Measures* specified key elements and the implementation process for the recovery and resolution plans as well as regulatory management covering resolvability assessment by regulatory authorities, the improvement of resolvability, and so forth. The *Interim Measures* stressed that the recovery and resolution plans shall insist on using the institution's own assets, shareholder assistance, or other market-based channels to raise funds to carry out a self-rescue, aiming at making institutions assume primary responsibility and shareholders assume corresponding responsibility, and avoiding moral hazards.

Part 4. Macroeconomic Overview

I. Global economic and financial developments

In Q2, the global economy on the whole continued to recover, but economic performance diverged remarkably across regions. The labor market recovered slightly, and inflation expectations rose remarkably amid the new uncertainties brought about by the resurgence of the pandemic in many countries. In the future, evolution of the pandemic will remain the fault line for a global economic recovery. In addition, persistent high inflation, a possible acceleration of shifts in the monetary policy stances of the major advanced economies, increased cross-border capital flows, and sharper volatility of exchange rates and financial markets in the global economies, especially in the emerging economies, also merit our attention.

1. Economic performance and financial markets of the major economies

The global economy on the whole maintained a momentum for recovery, but divergences across regions were exacerbated. Among the advanced economies, the US economic recovery showed a sound momentum as its annualized quarterly rate of GDP

in Q2 reached 6.5 percent and its Manufacturing and Services PMI in June registered high levels of 60.6 and 60.1, respectively. In the euro area, the annualized quarterly rate of GDP in Q2 reached 8.3 percent, and the Manufacturing PMI in June hit a record high of 63.4. In Japan, the annualized quarterly rate of GDP in Q1 contracted to -3.9 percent, and the Manufacturing PMI edged down to 52.4 in June. Among the emerging economies, Brazil and India, both of which were severely affected by the pandemic, witnessed year-on-year quarterly GDP growth of 0.96 percent and 1.64 percent, respectively, in Q1. In India, the Manufacturing and Services PMI in June dipped to 48.1 and 41.2, respectively.

The resurgence of the pandemic posed a new challenge to prospects for an economic recovery. Since March, the pandemic has rebounded in many countries, with the number of single-day newly confirmed cases surpassing the 900,000 mark in April and still standing at around 400,000 at end-June. Virus mutations and some countries' reopening of their economies despite the ongoing pandemic were the major reasons for the resurgence of the pandemic. The delta variant, which is more contagious than the previous variants, has been found in at least 98 countries and regions and has become the prevalent strain in many countries. As a result, pressure for global pandemic containment is mounting.

Recovery of the labor market was slow. The US unemployment rate registered 5.9 percent in June, edging up from 5.8 percent in May, which indicated that there was still a long way to go for the job market to return to pre-pandemic levels. The labor participation rate remained at the low level of 61.6 percent, while job vacancies in June were over 2 million more than the average level in 2019, demonstrating a lack of motivation for the unemployed to resume work and the existence of prominent structural problems, such as the coexistence of difficulties in finding both employees and employers. Unemployment rates in the euro area in June and the UK in May also stood at high levels of 7.7 percent and 4.8 percent, respectively. According to the projections of the International Labour Organization, global unemployment will stand at no less than 220 million in 2021 and the labor market will not return to pre-pandemic levels until 2023.

Elevated inflation was common across the globe. In the US, the year-on-year (y-o-y) growth rate of the CPI increased to 5.4 percent in June, and that of the core CPI posted 4.5 percent, hitting a record high since 1992. In the euro area, the Harmonized Index of Consumer Prices (HICP) grew by 1.9 percent year on year in June, standing at around

the policy target of 2 percent for two consecutive months. In Japan, deflation pressures eased slightly, and the CPI in June grew by 0.2 percent year on year, turning positive for the first time in nine months. Compared with the CPI, the PPI rose more notably. In June, the PPI in the US and Japan grew by 7.3 percent and 5.0 percent year on year, respectively, while that in the euro area grew more notably by 10.2 percent. Inflation pressures also mounted in some emerging economies, with the IPCA of Brazil and the CPI of Russia growing by 8.4 percent and 6.5 percent year on year, respectively, in June.

Table 13 Macroeconomic and Financial Indicators in the Major Advanced Economies

Economy	Indicator	Q2 2020			Q3 2020			Q4 2020			Q1 2021			Q2 2021		
		Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.
United States	Real GDP Growth (annualized quarterly rate, %)	-31.2			33.8			4.5			6.3			6.5		
	Unemployment Rate (%)	14.8	13.3	11.1	10.2	8.4	7.8	6.9	6.7	6.7	6.3	6.2	6.0	6.1	5.8	5.9
	CPI (year-on-year, %)	0.3	0.1	0.6	1.0	1.3	1.4	1.2	1.2	1.4	1.4	1.7	2.6	4.2	5.0	5.4
	DJ Industrial Average (end of the period)	24346	25383	25813	26428	28430	27782	26502	29639	30606	29983	30932	32982	33875	34529	34503
Euro Area	Real GDP Growth (year-on-year, %)	-14.4			-4.0			-4.6			-1.3			13.7		
	Unemployment Rate (%)	7.3	7.5	8.0	8.4	8.6	8.5	8.3	8.1	8.1	8.2	8.2	8.1	8.1	8.0	7.7
	HICP (year-on-year, %)	0.3	0.1	0.3	0.4	-0.2	-0.3	-0.3	-0.3	-0.3	0.9	0.9	1.3	1.6	2.0	1.9
	EURO STOXX 50 (end of the period)	2928	3050	3234	3274	3273	3294	2958	3493	3572	3481	3636	3919	3975	4039	4064
United Kingdom	Real GDP Growth (year-on year, %)	-21.4			-8.5			-7.3			-6.1			...		
	Unemployment Rate (%)	4.0	4.1	4.1	4.3	4.5	4.8	5.0	5.1	5.2	5.1	5.0	4.9	4.8	4.8	...
	CPI (year-on-year, %)	0.8	0.5	0.6	1.0	0.2	0.5	0.7	0.3	0.6	0.7	0.4	0.7	1.5	2.1	2.5
	FTSE 100 (end of the period)	5901	6077	6170	5898	5964	5866	5577	6266	6461	6407	6483	6714	6970	7023	7037
Japan	Real GDP Growth (annualized quarterly rate, %)	-28.6			22.9			11.7			-3.9			...		

Unemployment Rate (%)	2.6	2.8	2.8	2.9	3.0	3.0	3.1	3.0	3.0	2.9	2.9	2.6	2.8	3.0	2.9
CPI (year-on-year, %)	0.1	0.1	0.1	0.3	0.2	0.0	-0.4	-0.9	-1.2	-0.6	-0.4	-0.2	-0.4	-0.1	0.2
NIKKEI 225 (end of the period)	20194	21878	22288	21710	23140	23185	22977	26434	27444	27663	28966	29179	28813	28860	28792

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

In terms of the global economic recovery, there was a mismatch between supply and demand, the prospects for recovery were precarious, market expectations diverged, and financial markets became more volatile. Commodity prices continued to surge in Q2, and they became more volatile in July. In Q2, the futures price of Brent crude oil increased by 16.6 percent, and the futures prices of aluminum and copper in the London Metal Exchange (LME) increased by 13.3 percent and 7.2 percent, respectively. International oil prices fluctuated, rebounding after a remarkable drop in mid-July. Treasury yields underwent adjustments in the advanced economies. Ten-year Treasury yields in the US dropped from 1.74 percent at end-March to 1.45 percent at end-June, while those in Germany went up to a high of -0.09 percent in May from -0.27 percent at end-March and then dropped to -0.23 percent at end-June. On the whole, the stock markets in the major economies rose, but the volatility increased.

2. Monetary policies of the major economies

Central banks in the major advanced economies maintain accommodative monetary policy stances. In Q2, the US Fed kept policy rates and the scale of asset purchases unchanged, but the Federal Open Market Committee (FOMC) in June discussed the issue of tapering asset purchases. According to the dot-matrix plot, seven out of eighteen FOMC members projected that policy rates would increase in 2022. The FOMC in June also made technical adjustments to increase both the interest rate paid on excess reserve balances and the overnight reverse repo rate by five basis points. The European Central Bank kept policy rates unchanged and reiterated that it would accelerate asset purchases, revise the monetary policy framework, and make an adjustment to adopt a symmetric 2 percent inflation target over the medium term. The Bank of Japan maintained its current monetary policy and will release plans that encourage financial institutions to respond to climate changes.

Some emerging market economies began to increase policy rates in response to the pressures of inflation, capital outflows, and a currency depreciation. Since the beginning of 2021, the central banks of Russia and Brazil increased policy rates four

times and three times, respectively, those in Kyrgyzstan, Tajikistan, Georgia, and other countries increased policy rates twice, and those in Mexico, Turkey, Chile, and other countries increased policy rates once. Against this backdrop, monetary policies diverged among some emerging economies and advanced economies, which may have an impact on an economic resurgence and may exacerbate imbalances in the global economic recovery.

3. Issues that merit attention

First, the global economic recovery may be stalled by recurrent shocks from the pandemic. Since March, the spread of Covid-19 variants at a faster pace in many countries has led to a resurgence of the pandemic, which has been a drag on economic recovery and has dampened market confidence to some extent. In the meantime, with most developing countries facing vaccine shortages, there is a disparity in vaccination progress across the globe, which may exacerbate the dual divergence of pandemic containment and economic recovery.

Second, there is still a mismatch between supply and demand, and it remains to be seen whether inflation will continue to rise. During the pandemic, ultra-loose monetary policies adopted by the major advanced economies led to ample market liquidity and substantial currency growth. In parallel, the pickup in demand outpaced that of supply in the economic recovery, leading to chip shortages, and freight rates continued to hit record highs. These have exerted upward pressures on commodity and durable prices. As a result, short-term increases in global inflation have become a reality. However, there are still big differences of opinion about whether inflation will continue over the longer term, which requires close attention.

Third, the shifts in the monetary policies of the major advanced economies may have spillovers and cause a spread of risks. In addition to increasing inflation pressures, huge fiscal and monetary policy stimuli since the outbreak of the pandemic have also spawned bubbles in asset prices, caused a deviation in financial markets from the real economy, and increased vulnerability. An acceleration of monetary policy shifts in the major advanced economies in the future may result in adjustments in the valuation of financial markets, add to pressures on capital outflows and currency depreciation in most emerging economies, and increase the risks of debt repayments and refinancing.

II. Macroeconomic developments in China

In H1 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 sustained a steady recovery, production demand continued to recover, and employment and consumer prices were generally stable. The national economy witnessed steady and sound development. According to preliminary statistics, GDP in H1 stood at RMB53.2167 trillion, growing by 12.7 percent year on year on a comparable basis and the average growth rate of GDP during the past two years was 5.3 percent. GDP in Q2 grew by 7.9 percent year on year, and the average growth rate of GDP during the past two years was 5.5 percent, an acceleration of 0.5 percentage points from Q1.

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

Residents' income grew steadily and people's willingness to consume improved. In H1, the country's per capita disposable income increased by 12.6 percent year on year in nominal terms, or 12.0 percent in real terms, with the average growth rate during the past two years at 5.2 percent. The increase in residents' income kept pace with economic growth. The income growth of rural residents outpaced that of urban residents, and the structure of income distribution continuously improved. According to the Urban Depositors' Survey conducted by the PBC in Q2, 25.1 percent of residents were inclined to "consume more," up 2.8 percentage points from Q1. In H1, total retail sales of consumer goods grew by 23.0 percent year on year, and the average growth rate during the past two years was 4.4 percent, an acceleration of 0.2 percentage points from Q1.

Investments rebounded steadily and the structure continued to improve. In H1, total fixed-asset investments throughout China (excluding those by rural households) increased by 12.6 percent year on year, and the average growth rate during the past two years registered 4.4 percent, accelerating 1.5 percentage points from Q1. In terms of sectors, year-on-year growth of investments in the manufacturing sector was 19.2 percent, 6.6 percentage points higher than that of total investments, and the average growth rate was 2.0 percent during the past two years. Investments in infrastructure increased by 7.8 percent, and the average growth rate during the past two years registered 2.4 percent. Investments in real estate development increased by 15.0 percent, and the average growth rate during the past two years registered 8.2 percent. Investments in the high-tech industry saw sound growth and grew by 23.5 percent year

on year in H1, and the average growth rate during the past two years registered 14.6 percent, an acceleration of 4.7 percentage points from Q1. Private investment recovered steadily, growing by 15.4 percent year on year in H1, and the average growth rate during the past two years was 3.8 percent, an acceleration of 2.1 percentage points from Q1.

Imports and exports continued to grow rapidly. In H1, imports and exports of goods grew by 27.1 percent year on year. Specifically, exports grew by 28.1 percent year on year, while imports grew by 25.9 percent year on year, with the trade surplus in goods posting RMB1.6336 trillion. The trade structure continued to improve. In H1, the share of exports of machinery and electronics increased by 0.6 percentage points year on year. The share of imports and exports under general trade increased by 1.7 percentage points year on year. The share of imports and exports by private enterprises increased by 2.8 percentage points year on year.

The expectations and confidence of foreign direct investments (FDI) were stable with promising signs. In H1, actually utilized FDI increased by 28.7 percent year on year to RMB607.84 billion, which was 27.1 percent higher than that in the same period of 2019. Actually utilized FDI in the service industry totaled RMB482.77 billion, up 33.4 percent year on year. Actually utilized FDI in the high-tech industry grew by 39.4 percent year on year, among which FDI in the high-tech services industry grew by 42.7 percent year on year and FDI in the high-tech manufacturing industry grew by 29.2 percent year on year.

2. Agricultural production saw another bumper harvest, industrial production grew steadily, and the service industry recovered continuously

In H1 2021, the value-added of the primary, secondary, and tertiary industries grew by 7.8 percent, 14.8 percent, and 11.8 percent year on year, respectively. The average growth rate of the primary, secondary, and tertiary industries was 4.3 percent, 6.1 percent, and 4.9 percent, respectively, during the past two years.

Agricultural production grew steadily, and China saw another bumper grain harvest this summer. In H1, the value-added of agriculture grew by 3.6 percent year on year, an acceleration of 0.3 percentage point from Q1, and the average growth rate was 3.7 percent during the past two years. In H1, the output of summer grains increased by 2.1 percent year on year. The output of pork, beef, lamb, and poultry grew by 23.0 percent year on year. Hogs in stock increased by 29.2 percent year on year at end-June.

Specifically, fertile sows in stock increased by 25.7 percent year on year.

Industrial production increased steadily, and the industrial structure was continuously optimized. In H1, the value-added of Industrial Enterprises Above a Designated Size (IEDS) increased by 15.9 percent year on year and the average growth rate during the last two years registered 7.0 percent, an acceleration of 0.2 percentage point from Q1. Specifically, the value-added of the mining sector increased by 6.2 percent year on year, and the average growth rate during the last two years registered 2.5 percent. The manufacturing sector increased by 17.1 percent year on year, and the average growth rate during the last two years registered 7.5 percent. The electricity, heat, gas and water production and supply sectors increased by 13.4 percent year on year, and the average growth rate during the last two years registered 6.0 percent. The industrial structure was continuously optimized. The value-added of the high-tech manufacturing sector increased by 22.6 percent year on year, with the average growth rate posting 13.2 percent during the past two years. In terms of products, the average growth rates of new energy cars, industrial robots, and integrated circuits all exceeded 30 percent, respectively.

Growth in the services industry continued to recover, and market expectations improved. In Q2, the value-added of the tertiary industry grew by 8.3 percent year on year, and the average growth rate was 5.1 percent during the past two years. In June, the Index of Service Production (ISP) increased by 10.9 percent year on year, and the average growth rate registered 6.5 percent during the past two years. From January to May, the revenue of Service Enterprises Above a Designated Size (SEDS) increased by 31.9 percent year on year and the average growth rate during the last two years registered 11.1 percent, which was 0.2 percentage point higher than that from January to April. The Business Activities Index for the service industry reached 52.3 percent, remaining above a critical point for sixteen consecutive months.

3. Consumer prices increased moderately, and producer prices rose greatly

Consumer prices increased moderately. In H1, the CPI increased by 0.5 percent year on year, an acceleration of 0.5 percentage points from Q1. The CPI in April, May, and June increased by 0.9 percent, 1.3 percent, and 1.1 percent year on year respectively, and the core CPI (food and energy excluded) increased by 0.4 percent year on year. As hog production gradually recovered and the supply of pork continued to increase, the decline in pork prices expanded, dropping by 19.3 percent year on year in H1. As Covid-19 prevention and control improved and the suppressed service demand

continuously recovered, the growth of non-food prices rebounded, increasing by 0.7 percent year on year in H1.

Producer prices rose greatly. In H1, the Producer Price Index (PPI) increased by 6.8 percent year on year, an acceleration of 4 percentage points from Q1. The growth rate of PPI in April, May, and June registered 6.8 percent, 9.0 percent, and 8.8 percent, respectively. The Purchasing Price Index for Industrial Products (PPIRM) increased by 7.1 percent year on year, accelerating by 4.3 percentage points from Q1. The Corporate Goods Price Index (CGPI) monitored by the PBC increased by 5.7 percent year on year, accelerating by 2.5 percentage points from Q1.

4. Fiscal revenue experienced rapid growth

In H1 2021, revenue in the national general public budget increased by 21.8 percent year on year to RMB11.7 trillion, accounting for 59.3 percent of annual revenue in the budget. Specifically, central and local fiscal revenue grew by 23.2 percent and 20.6 percent year on year, respectively.

In H1 2021, expenditures in the national general budget saw an increase of 4.5 percent year on year to RMB12.2 trillion, accounting for 48.6 percent of annual expenditures in the budget. Specifically, central fiscal expenditures experienced a marginal drop of 6.9 percent year on year, while local fiscal expenditures edged up by 6.4 percent year on year.

5. The employment situation remained generally stable

In H1 2021, 6.98 million people were newly employed, accounting for 63.5 percent of the annual employment goal. In June, the surveyed urban unemployment rate was 5.0 percent, on par with that in May and down 0.7 percentage point year on year. The surveyed urban unemployment rate in 31 major cities was 5.2 percent, on par with that in May. The average weekly working hours of employees in enterprises were 47.6 hours, increasing by 0.3 hours month on month.

6. The balance of payments and the external debt

A basic equilibrium was maintained in the balance of payments. According to preliminary statistics, in H1 2021 China's current account surplus registered USD122.2

billion. Specifically, trade in goods recorded a surplus of USD230.6 billion, whereas trade in services recorded a deficit of USD43.8 billion. The capital and financial account deficit was USD122.3 billion. Specifically, direct investments recorded a surplus of USD123.7 billion. At end-June 2021, foreign exchange reserves posted USD3.2140 trillion, up 1.4 percent, or USD44.0 billion from end-March. At end-March, the balance in the all-system foreign debt (denominated in both domestic and foreign currencies) posted USD2.5266 trillion. In particular, the short-term external debt balance was USD1.3987 trillion, accounting for 55 percent of the total external debt balance.

7. Analysis by sector

7.1 The real estate sector

In H1 2021, housing prices in China remained generally stable. In June, among 70 medium and large-sized cities nationwide, newly built residential housing prices increased by 4.3 percent year on year, decelerating by 0.1 percentage points from March, and second-hand residential housing prices increased by 3.5 percent year on year, accelerating by 0.2 percentage points from March. Due to the low base figure in the previous year, housing sales and investments in real estate development experienced relatively rapid year-on-year growth. In H1, total floor area of sold units increased by 27.7 percent year on year, registering average growth of 8.1 percent during the past two years. Housing sales increased by 38.9 percent year on year, registering average growth of 14.7 percent during the past two years. In H1, investments in real estate development grew by 15 percent year on year, registering average growth of 8.2 percent during the past two years. Specifically, investments in residential housing development rose by 17 percent year on year, registering average growth of 9.6 percent during the past two years and accounting for 75.2 percent of total investments in real estate development.

Table 14 Floor Area of Real Estate Projects that were Newly Started, Under Construction, and Completed in H1 2021

	Floor area (100 million square meters)	YOY growth (%)	YOY acceleration (percentage points)
Floor area of newly started real estate projects	10.1	3.8	-24.4

Floor area of real estate projects under construction	87.3	10.2	-1.0
Floor area of completed real estate projects	3.6	25.7	2.8

Source: China National Bureau of Statistics.

On the whole, growth of real estate loans remained stable. At end-June, outstanding real estate loans by major financial institutions (including foreign-funded financial institutions) grew by 9.5 percent year on year to RMB50.8 trillion, a deceleration of 1.4 percentage points from end-March. Specifically, outstanding individual housing loans grew by 13 percent year on year to RMB36.6 trillion, a deceleration of 1.5 percentage points from end-March. Outstanding housing development loans grew by 3.4 percent year on year to RMB9.4 trillion, a deceleration of 2.4 percentage points from end-March.

7.2 Transformation and development of the coal industry toward achieving a carbon emissions peak before 2030 and carbon neutrality before 2060

The supply-side reform in the coal industry made remarkable progress, which established a solid foundation for adjustment of the energy structure and the transition to low carbon development toward achieving a carbon emissions peak before 2030 and carbon neutrality before 2060. During the 13th Five-Year Plan period from 2016 to 2020, the coal industry enjoyed a shift from extensive growth focusing on quantity and speed to intensive development focusing on quality and benefits, basically forming a supply pattern with an advanced production capacity as the mainstay. Arrangements for coal exploitation continued to improve, with enhanced capability to secure a stable supply. In 2020, the output of raw coal in Shanxi, Shaanxi, and Inner Mongolia added up to 2.79 billion tons, accounting for 71.5 percent of total output in China, and the 14 major coal bases produced 96.6 percent of the coal in China. Structural adjustments in the coal industry made new progress with a remarkably higher degree of industrial concentration. At end-2020, a total of 5,500 collieries ceased to operate and the shutdown of outdated coal production capacity exceeded one billion tons per year. The number of collieries operating nationwide shrank to less than 4,700, with the top eight producers producing 47.6 percent of total raw coal in China. Clean and efficient use of coal has accelerated. Remarkable results were achieved in the comprehensive management of scattered coal as well as in the reduction and replacement of coal use with alternative energy sources. At end-2020, the installed capacity that had undergone low-emission and energy-savings transformation in coal-fired power plants across

China reached 950 million kilowatts, accounting for 76 percent of the total installed capacity of coal-fired power plants nationwide. The scattered coal consumption was reduced by more than 200 million tons in the "Thirteenth Five-Year Plan" period.

For the coal industry, opportunities and challenges will coexist in the 14th Five-Year Plan period from 2021 to 2025. Toward achieving its carbon emissions peak before 2030 and carbon neutrality before 2060, stricter measures will be taken to control the aggregate and intensity of coal consumption, and the proportion of coal in primary energy consumption will continue to fall. However, some deep-rooted problems in the coal industry that have been accumulating for a long time are yet to be solved, including unbalanced productivity development in the industry, some enterprises still running at a loss, and salient structural problems in coal production and coal products. Hence, there is much pressure for a low-carbon transformation of the coal industry.

All in all, the function of coal-fired power as the last resort needs to be consolidated. In the future, the coal industry should adapt to the new stage of development, building up a new development paradigm for its production chain and supply chain as follows. First, it needs to continuously improve arrangements in coal exploitation, make clear the function of grand bases through reasonable classification, and enhance capability to safeguard the power supply. Second, it should phase out excess production capacity, shut down outdated production facilities, and build up advanced production facilities in a way that improves coordination in the coal production chain. Third, it should promote clean production and the clean and efficient use of coal and accelerate the shift toward smart production, information-based management, a specialized division of labor, and clean use of coal.

Part 5. Monetary Policy Outlook

I. Outlook for the Chinese economy

Since the beginning of 2021, China has coordinated pandemic containment and economic and social development, and the economy has continued recovering and improving steadily. In Q2, GDP saw a year-on-year growth of 7.9 percent, with the growth rate averaging 5.5 percent during the past two years, which was 0.5 percentage points higher than that in Q1. In the medium and long term, China's

development will still be at an important phase of strategic opportunities, and the fundamentals of steady economic growth in the long run and high-quality development will remain unchanged.

China's economy has continued to recover, and the momentum for growth has been further enhanced. In Q2, the quality and efficiency of industrial production improved, exports maintained fairly fast growth, investment and consumption sustained steady recovery, the employment situation was generally stable, and market expectations remained stable. All of these have established a good foundation for economic performance in the second half of the year. The sound monetary policy has maintained continuity, stability, and sustainability, and significant achievements have been made in managing market expectations in a scientific way, serving the real economy, preventing and controlling financial risks, and keeping the macro leverage ratio basically stable. The RMB exchange rate is expected to be stable, and it has been moving in both directions with enhanced flexibility, playing the role of a macroeconomic stabilizer.

It should also be noted that the global pandemic continues to evolve, the external environment is becoming more severe and complex, and the domestic economic recovery remains unstable and imbalanced. The orderly vaccination has generally boosted the global economic outlook, with the IMF and the World Bank in Q2 both raising their global economic growth forecasts for 2021. However, with the recent rampage of coronavirus variants in many countries and the resurgence of COVID-19 cases in several economies, there is still uncertainty about the future evolution of the pandemic. The spillover effect of the ultra-loose monetary policy in the major developed economies has become increasingly apparent, leading to significantly higher inflation. If the pace of their monetary policy shifts accelerates, it may cause global cross-border capital flows and exchange rate volatility to increase and financial market valuations to adjust significantly. Domestically, the foundation for an economic recovery is not yet solid as export growth may slow down due to the high base effect, investment growth in some areas is relatively weak, contact-based consumption such as catering and tourism have not been fully restored, and the sustainability of the momentum for economic growth faces certain challenges. Enterprises' operating costs are pushed up as commodity prices rise sharply, bringing great difficulties especially to some micro, small, and medium-sized enterprises (MSMEs). Close attention should be paid to the pressure of a rebound of non-performing assets and shadow banking while the medium and long-term challenges, such as the decline in potential economic growth rate, the accelerating aging of the population and green transformation should not be

overlooked. Therefore, it is necessary to be confident and face up to the difficulties. 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.

The CPI is rising moderately and the PPI is rising temporarily. Overall, inflation pressures are controllable, and there are no grounds for persistent inflation or deflation. In Q2 2021, under the combined effects of the resumption of travel by residents, rising gas and diesel prices, and falling pork prices, the CPI was at a low level of about 1 percent, and was expected to move smoothly within a reasonable range in the second half of the year. At the same time, due to rising commodity prices and the low base effect, PPI growth has accelerated, which should be viewed historically and objectively. On the one hand, as it is a high reading upon the low base of last year, the change in the PPI can be viewed from an overall perspective based on the figures from last year, this year, and next year; on the other hand, historically the PPI has witnessed relatively large fluctuations, and it is not rare that it temporarily underwent a considerable drop or a surge within a few months. Overall, the rise of China's PPI is most probably temporary, and the PPI may remain relatively high in the short term. In the future when the base effect subsides and global supplies gradually recover, the PPI is likely to fall. In the medium and long term, the decline in labor productivity growth and the aging population will curb inflation, while the explicit pricing of carbon emissions will push up prices to some extent, hence being conducive to price stability. As China's economy is improving steadily and a normal monetary policy has been maintained since the outbreak of the pandemic last year, domestic aggregate supply and demand are basically stable, which is conducive to keeping prices stable. Therefore, 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, apply the new development philosophy fully,

faithfully, and comprehensively, deepen the supply-side structural reform, accelerate the building of a new development paradigm, and promote high-quality development. The PBC will work to align this year and next year's macro policies in a coordinated way, maintain the stability of monetary policy, enhance its foresightedness and effectiveness, and firmly refrain from adopting indiscriminate stimulus measures. By doing so, it will continue to focus on providing support for the real economy to help sustain the recovery of small and medium-sized enterprises and industries in difficulties and to keep the major economic indicators within a reasonable range. With these efforts, we will get off to a good start for the 14th Five-Year Plan period and the economy will see sound and sustained growth for the long term.

The sound monetary policy will be flexible, targeted, reasonable, and appropriate, giving top priority to stability. The PBC will remain committed to conducting a normal monetary policy and attach importance to cross-cycle policy design. The autonomy of macro policies will be enhanced, with policy intensity and pace aligned with the domestic economic situation and price movements. The PBC will properly handle the relationship between economic recovery and risk prevention to keep the economy generally stable and to strengthen the resilience of economic development. It 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) are basically in line with nominal economic growth, and the macro leverage ratio will be kept basically stable. Closely following and studying price movements, the PBC will stabilize social expectations and keep prices generally stable. In an effort to bring into play the guiding role of structural monetary policy tools, it will work effectively to implement the decision to extend the expiration dates of the two monetary policy tools providing direct support for the real economy, and it will issue central bank lendings to provinces with slow credit growth. Moreover, the PBC will take steps to put into operation the support instruments for carbon emissions reduction, ramp up support for inclusive finance, and guide financial institutions to intensify support for sectors such as sci-tech innovation, micro and small businesses (MSBs), green development, and manufacturing. It will enhance the market-oriented interest rate formation and transmission mechanism by further unleashing the potential of the loan prime rate (LPR) reform, improving the central bank policy rate system, optimizing regulation over deposit rates, and bringing down actual loan rates. It will deepen the market-oriented exchange rate reform, enhance the RMB exchange rate flexibility, stabilize market expectations, strengthen macro-prudential management of cross-border financing, 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. 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, set up a long-term mechanism for forestalling and defusing financial risks, and replenish the capital of small and medium-sized banks based on their conditions.

First, the PBC will maintain reasonable growth in money and credit as well as in the AFRE. It will improve the mechanism for money supply management by enhancing the long-term mechanisms of liquidity, capital, and interest rate constraints with which the central bank adjusts money creation of commercial banks. The general valve of money supply will be properly controlled so that the growth rates of money supply and the AFRE will be basically in line with nominal economic growth and the macro leverage ratio will be kept basically stable. A mix of monetary policy tools, such as the Medium-term Lending Facility, open market operations, central bank lending, and central bank discounts, will be used to keep liquidity adequate at a reasonable level and to guide market rates to move around policy rates. Moreover, the PBC will reinforce monitoring and analysis of uncertainties, such as fiscal revenue and expenditures, government bond issuances, and monetary policy adjustments by the major economies, to further improve the foresightedness, flexibility, and effectiveness of operations. At the same time, it will manage policy intensity and pace in line with the development of the economic and financial situations to provide strong support for the real economy. It will improve the mechanism for sustainable capital replenishment and prioritize support for small and medium-sized banks in capital replenishment so that banks will be better able to serve the real economy and to forestall and defuse financial risks.

Second, the PBC will move ahead with policy implementation to bring into play the guiding role of structural monetary policy tools and will promote green low-carbon development with the instrument supporting carbon emissions reduction. It will keep central bank lending and discount policies stable while effectively implementing the decision on extending the expiration dates of the two monetary policy tools providing direct support for the real economy. It will continue to provide inclusive and sustained funding support for agro-related businesses, MSBs, and private enterprises, and it will keep up the intensity of financial support for MSBs so that they can play a bigger role in stabilizing businesses and safeguarding employment. Additionally, it will issue central bank lendings to provinces with slow credit growth in order to support coordinated development across regions. To help reach the aims of peaking carbon emissions and achieving carbon neutrality, the PBC will take steps to put into operation the instruments supporting carbon emissions reduction, which will

provide low-cost funds for eligible financial institutions to support lending at preferential interest rates to those areas that will significantly reduce carbon emissions. It will guide financial institutions to support green and low-carbon development in line with market-oriented principles, promote concepts such as green low-carbon life and a circular economy to the public, and encourage social investment and financing in green low-carbon fields.

Third, the PBC will build the systems and mechanisms needed to provide effective financial support for the real economy. It will make coordinated efforts to promote the integrated development of inclusive finance, green finance, sci-tech innovation finance, and supply chain finance, and it will improve the system for providing financial support for sci-tech innovation to foster a virtuous cycle among the financial sector, the sci-tech sector, and industries. It will push for an adjustment and optimization of the regional credit structure, step up financing support via the multi-tiered capital market, and improve the regional financial environment. It will ensure that efforts to consolidate the achievements in poverty eradication join up effectively with rural revitalization efforts, for which it will continue to provide financial services and support. Emphasis will also be placed on providing financial services for new types of agribusinesses and stepping up financial support for key fields, such as food security and development of the seed industry, to promote the modernization of agriculture and rural areas. Financial institutions will be urged to optimize their internal resource allocations and policy arrangements and to enhance the use of sci-tech approaches so that they will be better able to provide financial services for MSMEs and a long-term mechanism will be formed whereby banks will have the confidence, willingness, ability, and professionalism to provide loans. Moreover, the PBC will improve the system for the management of carbon neutrality financial bonds to promote their well-regulated development, and it will impose strict control over credit supply to energy-intensive and high-emissions projects in order to push for their green transformation and upgrading. 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 increase 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 continuing

to unleash the potential of the LPR reform and improving the central bank policy rate system to smooth the channels of interest rate transmission and further bring down actual loan rates. It will optimize regulation over deposit rates, maintain fair competition in the deposit market, and keep bank liability costs basically stable. In the meantime, it will urge banks to transmit policy benefits to the real economy and will increase competition in the MSB loan market so that MSBs can more easily receive financing and their comprehensive financing costs will stabilize and fall. 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 RMB exchange rate flexibility, 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 stabilize market expectations and keep the RMB exchange rate basically stable at an adaptive and equilibrium level. The PBC will work on the development of the foreign exchange market. Guiding enterprises and financial institutions to be risk-neutral, it will offer guidance to financial institutions on the provision of services of exchange rate risk management for enterprises with authentic needs based on the risk-neutral concept, thereby maintaining the stable and sound development of the foreign exchange market. The PBC will continue to advance RMB internationalization stably and prudently by launching the pilot program of high-quality opening-up of cross-border trade and investment, further facilitating use of the RMB in cross-border trade and investment, and steadily advancing convertibility of the RMB under the capital account.

Fifth, the PBC will strengthen fundamental system building in the financial market to serve the real economy and to guard against market risks. Placing equal emphasis on preventing risks and promoting development, it will continue to advance high-quality development of the bond market. In an effort to strengthen the legal system building in the bond market, the PBC will see that intermediary institutions fulfil their responsibilities, and it will push for implementation of the requirements for information disclosures regarding corporate credit bonds and improve the regulations on credit ratings. In line with market-oriented and law-based principles, the PBC will continue to put into practice the newly formed mechanisms for bond default resolution and will crack down on debt evasion. Continued efforts will be made to enhance fundamental system building in the capital market so as to better protect the interests of investors and promote the stable and sound development of the capital market.

Sixth, the PBC will push ahead further with the reform of financial institutions and it will continue to improve corporate governance and optimize financial

supply. Focusing on strengthening corporate governance, it will deepen the reform of large commercial banks and 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, while small and medium-sized banks will be encouraged to focus on their main duties and businesses. With these efforts, the financial market is expected to become more vigorous and resilient, and a modern financial system that is highly adaptable, competitive, and inclusive will be developed. The reform of development financial institutions and policy financial institutions will continue, with their institutional framework improved according to the laws and regulations. Bank-specific measures will be taken to start reform from incremental businesses and advance the reform of existing businesses progressively and step by step. These measures are aimed at carrying out category-based management of businesses and separate accounting, gradually improving transparency, strengthening capital constraints as well as risk management, enhancing incentives, and holding the institutions truly accountable. In this way, the important role of development financial institutions and policy financial institutions will be better brought into play in serving the real economy and supporting national strategies.

Seventh, the PBC will improve the systems of financial risk prevention, early warning, resolution, and accountability, and it will build a long-term mechanism to forestall and defuse financial risks. It will pay special attention to monitoring and screening potential risks in key fields, act quickly to shore up weaknesses in the regulatory framework, accelerate its work to improve the modern financial regulatory system, and strengthen regulatory coordination. While effectively giving play to the deposit insurance system, it will focus on early rectification and will further improve the mechanism for professional and market-oriented risk resolution under the deposit insurance system. The PBC will make every effort to defuse existing risks and to contain any possible resurgence of risks. It will intensify efforts to write off non-performing assets in the banking system, while capital replenishments for small and medium-sized banks will be conducted based on their conditions. Moreover, the PBC will push for implementation of the mechanism for fiscal and financial risk resolution led by major local officials to stress the responsibilities of local governments for local risk resolution, and it will urge actions to bring down the number of high-risk institutions in the provinces of concern. It will also push for implementation of mechanisms, such as financial risk information sharing and accountability for major financial risks, to effectively prevent moral hazards. 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.