China Monetary Policy Report

Q1 2023

(May 15, 2023)

Monetary Policy Analysis Group of

the People's Bank of China

Executive Summary

Since the beginning of 2023, in the face of the severe and complicated international environment as well as the arduous task of advancing reform and development while ensuring stability at home, China pursued the principle of seeking progress while taking stability as a top priority in macro policymaking, and it took proactive and coordinated measures under the strong leadership of the CPC Central Committee with Comrade Xi Jinping at its core. The economy got off to a good start, with the GDP and the CPI recording year-on-year growth of 4.5 percent and 1.3 percent, respectively, in Q1. Following the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, the People's Bank of China (PBOC) resolutely implemented the decisions and arrangements of the CPC Central Committee and the State Council, and it implemented a sound monetary policy in a targeted and effective manner, aiming for overall and lasting improvements in economic performance.

First, money and credit witnessed reasonable growth. The PBOC announced a required reserve ratio (RRR) cut of 0.25 percentage points on March 17, and it injected liquidity through multiple channels, including central bank lending, the medium-term lending facility (MLF) operations, and open market operations (OMOs), to keep liquidity adequate at a reasonable level. It guided financial institutions to pay greater attention to the pace and intensity of credit extensions so as to enhance the stability and the sustainability of aggregate credit growth. **Second,** overall financing costs were reduced. With the loan prime rate (LPR) reform continuously unleashing its potential and the mechanism for market-oriented adjustments of deposit rates playing an important role, the PBOC guided members of the interest rate self-regulatory mechanism to adjust deposit rates rationally in line with market rates, thus helping to stabilize and bring down the actual lending rates. The mechanism for dynamic adjustments to first-home mortgage rates was still in effect. **Third,** the structural monetary policy toolkit continued to play its role. The PBOC made full use of the inclusive micro and small business (MSB) lending facilities, intensified central bank lending in support of rural development and MSBs, and prolonged implementation of the carbon emission reduction facility (CERF) and central bank lending for clean and efficient coal use. It continued to make effective use of special central bank lending for sci-tech innovation, inclusive elderly care services, and equipment upgrading, and it also launched special central bank lending for troubled property developers and a scheme for providing lending support for rental housing. **Fourth,** the RMB exchange rate remained basically stable. The PBOC deepened the market-oriented reform of the exchange rate and upheld the decisive role of the market in the RMB exchange rate formation. Strengthening expectation management, the PBOC enhanced the flexibility of the RMB exchange rate and gave play to the role of the exchange rate as an automatic stabilizer for the macro economy and the balance of payments. **Fifth,** risk prevention and resolution were enhanced. While upholding market principles and the rule of law for risk resolution, the PBOC accelerated the steps to put in place arrangements to safeguard financial stability so as to firmly defend the bottom line whereby no systemic risks will occur.

Overall, monetary policy this year has remained sound. It has achieved good results and provided strong support for economic recovery and development. Money and credit witnessed reasonable growth. RMB loans saw a cumulative rise of RMB10.6 trillion in Q1, RMB2.27 trillion more than their growth during the same period of the last year. At end-March, RMB loans, broad money (M2), and outstanding aggregate financing to the real economy (AFRE) recorded year-on-year growth of 11.8 percent, 12.7 percent, and 10.0 percent, respectively. The credit structure continued to improve. At end-March, inclusive MSB loans and medium and long-term (MLT) loans to the manufacturing sector grew by 26.0 percent and 41.2 percent year on year, respectively. The financing costs for businesses and the costs of consumer credit for individuals were stable, with a slight decline. In March, the weighted average rate on new corporate loans and on personal housing loans registered 3.95 percent and 4.14 percent, respectively, down 0.41 percentage points and 1.35 percentage points year on year. The RMB exchange rate moved in both directions and remained basically stable at an adaptive and equilibrium level. At end-March, the central parity of the RMB against the US dollar registered 6.8717, an appreciation of 1.4 percent from end-2022.

Currently, China's socio-economic functioning has returned to normal. With the pressures of shrinking demand, supply shocks, and weakening expectations having been alleviated, the economy has outperformed expectations, and market demand is gradually recovering. In addition, China enjoys advantages for development in the long run, considering its huge market, full-fledged industrial system, and rich human resources. However, it should also be noted that domestically the intrinsic driving force of the economy is not yet strong and demand is insufficient, and globally economic growth is slowing down, inflation remains elevated, and the policy tightening by the major central banks is being felt. In response, we should maintain firm confidence in economic work and, at the same time, we should be more mindful of potential problems and uphold bottom-line thinking. In the next stage, guided by Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, the PBOC will thoroughly implement the guidelines of the 20th CPC National Congress, the Central Economic Work Conference, and the annual sessions of the National People's Congress and the National Committee of the Chinese People's Political Consultative Conference. Following the decisions and arrangements of the CPC Central Committee and the State Council, it will uphold the general principle of pursuing progress while ensuring stability, apply the new development philosophy fully, faithfully, and comprehensively, and play its part in accelerating the building of a new development paradigm and in advancing Chinese modernization. The PBOC will integrate implementation of the strategy to expand domestic demand with efforts to deepen the supply-side structural reform, and it will motivate business entities while ensuring policy effects. It will develop a modern central banking system and fully explore the efficacy of monetary and credit policies with a focus on stabilizing growth, employment, and prices. The PBOC will seize the good momentum to effectively upgrade and appropriately expand economic output.

The PBOC will pursue a sound monetary policy in a targeted and effective manner, properly managing both the aggregate and the pace. While ensuring proper intertemporal adjustments, it will keep liquidity adequate at a reasonable level, and it will ensure that the growth rates of M2 and the AFRE continue to be basically in line with nominal economic growth. It will back efforts to expand domestic demand to provide strong and solid support for the real economy, and, at the same time, it will balance short-term and long-term goals, economic growth and price stability, as well as internal and external equilibria, to improve sustainable support for the real economy. The PBOC will pay attention to marginal changes in prices, guide and stabilize social expectations, and contribute to developing an institutional mechanism for ample supply and stable prices of food and energy so as to maintain basic price stability. It will continue to deepen the market-oriented interest rate reform, optimize the central bank policy rate system, unleash the potential of the LPR reform, and give play to the important role of the mechanism for market-oriented deposit rate adjustments so as to keep interest rates at a reasonable level. The structural monetary policy tools will be targeted, appropriate, and flexible, and the central bank lending and discounts will remain stable. Meanwhile, the temporary instruments still in effect will be properly used to provide strong support for key areas and weak links, such as inclusive finance, sci-tech innovation, and green development. The PBOC will continue to tap into the policy-backed and development-oriented instruments and enhance the guiding role of government investment and policy motivation in a bid to stimulate private investment. Pursuing a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies and upholding the decisive role of the market in exchange rate formation, the PBOC will enhance the flexibility of the RMB exchange rate and improve expectation management so as to keep the RMB exchange rate basically stable at an adaptive and equilibrium level. It will coordinate financial support for the real economy and risk prevention, strengthen the system for maintaining financial stability, and prevent inward transmission of overseas risks, thereby firmly defending the bottom line whereby no systemic financial risks will occur.

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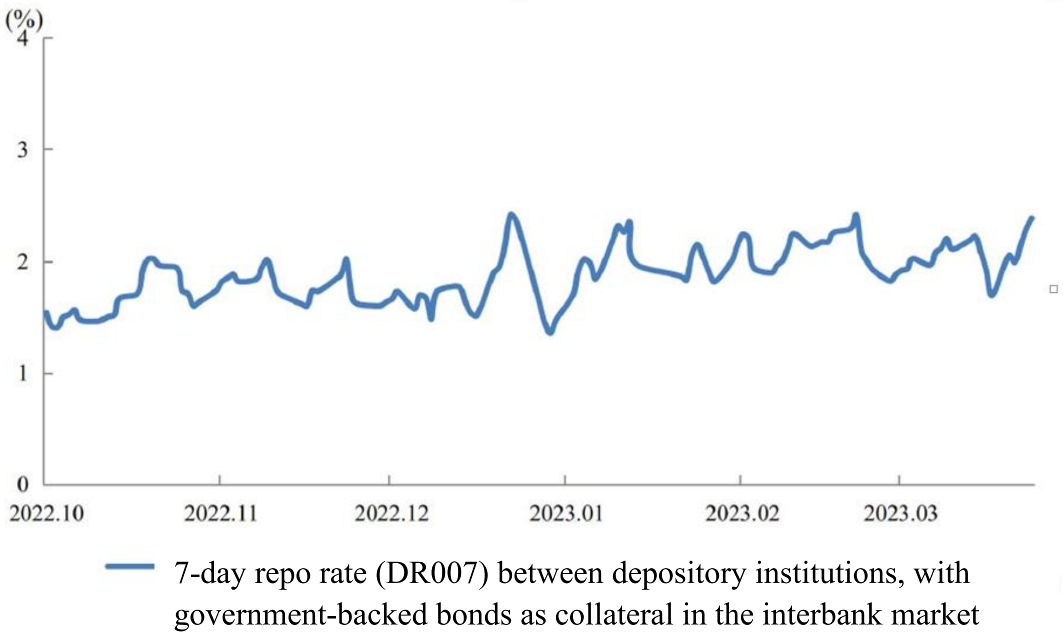
Part 1 Money and Credit Analysis

Since the beginning of 2023, the People's Bank of China (PBOC) has followed the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era and has fully implemented the guidelines of the 20th National Congress of the Communist Party of China (CPC), the Central Economic Work Conference, and the requirements set forth in the *Report on the Work of the Government*. Taking stability as its top priority and pursuing progress while ensuring stability, it has implemented a sound monetary policy in a targeted and effective manner to ensure stability of growth, employment, and prices. As a result, money, credit, and aggregate financing to the real economy (AFRE) witnessed reasonable growth, overall financing costs declined steadily, and the credit structure improved continuously, thereby promoting a good start for economic development

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

In Q1, 2023, the PBOC employed a mix of instruments, such as the required reserve ratio (RRR) cut, the medium-term lending facility (MLF), central bank lending, and open market operations (OMOs), to inject liquidity into the economy in a targeted and effective manner and keep liquidity adequate at a reasonable level in the banking system. Specifically, the PBOC cut the RRR by 0.25 percentage points in March, releasing over RMB500 billion in long-term liquidity. It also managed the intensity and pace of OMOs in a flexible manner so as to iron out short-term fluctuations, such as cash injections during the Spring Festival, fiscal levies, and liquidity swings at quarter-ends, and maintained the stability of money market interest rates, creating a favorable liquidity environment for promoting financial support for high-quality development of the real economy. At end-March, the excess reserve ratio for financial institutions registered 1.7 percent, up 0.1 percentage points year on year.

Figure 1 Movement of Money Market Interest Rates



Source: www.chinamoney.com.cn.

II. Lending by financial institutions grew rapidly and lending rates remained at historic lows

Credit aggregates grew rapidly. Driven by a range of factors such as economic stabilization and recovery, the sustained effectiveness of stabilization policies at an early stage, local governments' efforts to vigorously promote economic development, and low lending rates, loans maintained rapid growth in Q1. At end-March, outstanding loans issued by financial institutions in domestic and foreign currencies grew 11.1 percent year on year to RMB230.7 trillion, increasing RMB10.7 trillion from the beginning of 2023, or a year-on-year (YOY) acceleration of RMB2.1 trillion. Outstanding RMB loans grew 11.8 percent year on year to RMB225.4 trillion, up RMB10.6 trillion from the beginning of 2023, or a YOY acceleration of RMB2.3 trillion.

The credit structure has been improving. At end-March, medium and long-term loans to enterprises and public entities grew by RMB6.7 trillion from the beginning of 2023, accounting for 74.3 percent of total corporate loans. The YOY growth rate of medium and long-term loans to the manufacturing sector registered 41.2 percent, 29.4 percentage points higher than the growth of total loans. The YOY growth rate of medium and long-term loans to the infrastructure sector was 15.2 percent, 3.4 percentage points higher than the growth of total loans. Outstanding inclusive loans to MSBs grew 26.0 percent year on year, 14.2 percentage points higher than the growth of total loans. A total of 57.65 million MSBs were supported, a rise of 14.4 percent year on year.

Table 1 The Structure of RMB Loans in Q1 2023

Unit: RMB100 million

	Outstanding amount at end-March	YOY growth (%)	Increase from the beginning of the year	YOY acceleration
RMB loans to:	2254455	11.8%	106013	22658
Households	774755	6.0%	17095	4496
Enterprises and public entities	1465077	14.9%	89919	19122
Non-banking financial institutions	5029	19.9%	-791	-710
Overseas	9594	33.3%	-211	-251

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 from Financial Institutions in Q1 2023

Unit: RMB100 million

	Increase from the beginning of the year	YOY acceleration
Chinese-funded large-sized banks [1]	55612	12211
Chinese-funded small and medium-sized banks[2]	50453	10217
Small-sized rural financial institutions[3]	14381	2477
Foreign-funded financial institutions	194	-211

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 rate of loans remained at a historic low. The PBOC continuously deepened the market-oriented reform of interest rates, tapping into the loan prime rate (LPR) reform and bringing into play the key role of the market-based adjustment mechanism for deposit interest rates so as to promote a steady decline in actual lending rates. In March, the one-year LPR and the over-five-year LPR stood at 3.65 percent and 4.30 percent, respectively, the same as those in December 2022. In March, the weighted average interest rate on new loans recorded 4.34 percent, down 0.31 percentage points year on year. In particular, the weighted average interest rate on ordinary loans registered 4.53 percent, down 0.45 percentage points year on year, the weighted average interest rate on corporate loans was 3.95 percent, down 0.41 percentage points year on year, and the weighted average interest rate on mortgage loans fell by 1.35 percentage points year on year to 4.14 percent, providing effective support for the stable and sound development of the real estate market. In March, the share of ordinary loans with rates above, at, and below the LPR registered 56.16 percent, 6.88 percent, and 36.96 percent, respectively.

Table 3 Weighted Average Interest Rates on New Loans Issued in March 2023

Unit: %

	March	Change from the previous December	YOY Change
Weighted average interest rate on new loans	4.34	0.20	-0.31
on ordinary loans	4.53	-0.04	-0.45
of which: on corporate loans	3.95	-0.02	-0.41
on bill financing	2.67	1.07	0.27
on mortgage loans	4.14	-0.12	-1.35

Source: The People's Bank of China.

Table 4 Shares of RMB Lending Rates at Different Levels, from January to March 2023

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	37.38	6.28	56.34	16.65	19.06	10.22	5.70	4.72
February	37.60	6.02	56.38	16.32	16.84	10.28	6.54	6.40
March	36.96	6.88	56.16	17.10	17.57	10.57	6.18	4.74

Source: The People's Bank of China.

Interest rates on foreign-currency deposits and loans edged up. In March, the weighted average interest rates on demand large-value USD-denominated deposits and on large-value USD-denominated deposits with maturities within three months registered 1.64 percent and 4.23 percent, respectively, up 0.44 and 0.57 percentage points, respectively, from December 2022. The weighted average interest rates on USD-denominated loans with maturities within three months and USD-dominated loans with maturities between three months (including three months) and six months registered 5.25 percent and 5.33 percent, up 0.22 and 0.34 percentage points from December 2022, respectively.

Table 5 Average Interest Rates on Large-value USD-denominated Deposits and Loans, from January to March 2023

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	1.25	3.99	4.62	5.34	5.46	4.96	4.91	5.12	5.10	5.53	5.99
February	1.42	4.18	5.10	5.51	5.50	5.44	5.08	5.23	5.39	5.46	5.58
March	1.64	4.23	5.02	5.53	5.67	5.54	5.25	5.33	5.11	5.34	5.86

Source: The People's Bank of China.

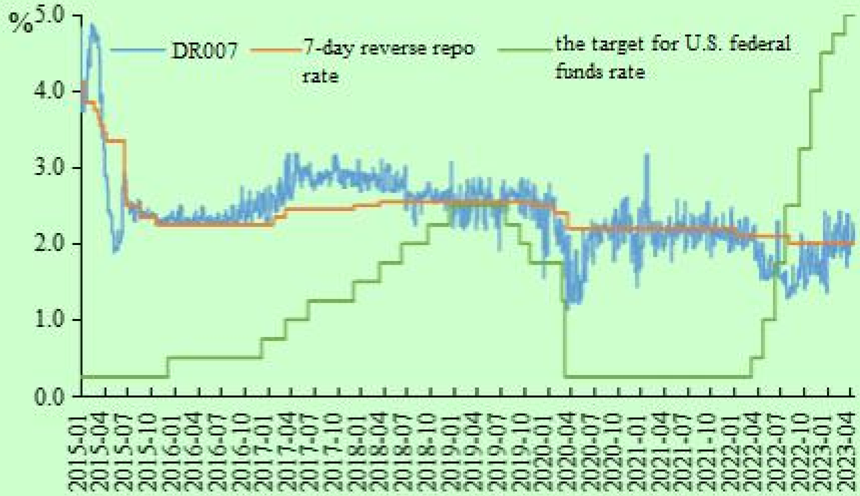
Box 1 Interest Rates Should be Maintained at Proper Levels

Interest rates represent the price of money, and they play a key role in guiding the equilibrium of the macro economy and the effective allocation of resources. As the signal reflecting fund scarcity, interest rates also represent major production factor prices, such as labor wages and land rent. They directly affect people's savings and consumption, corporate investment and financing decisions, imports and exports and the balance of payments, thus having an extensive influence on overall economic activities.

The macro interest rates should be generally in step with the natural interest rates. Persistent higher interest rates will lead to elevated financing costs, a supply gap, and shrinking demand, which will be a drag on economic development. Prolonged excessively low interest rates will lead to overcapacity, inflation, asset price bubbles, and funds circulating within the financial sector without entering the real economy. Too high and too low interest rates are both difficult to sustain as they undermine financial and economic stability. This has been testified by both historical and practical experiences. Therefore, when guiding and adjusting interest rates, the central banks should follow the economic laws and meet the requirements for macro adjustments and inter-temporal designs.

According to statistics from the past two plus decades, real interest rates in China have been kept at a level slightly below potential economic growth, or at a Golden Rule level, and they have generally been in step with potential economic growth rates, thus contributing to a macro equilibrium and price stability. In recent years, the global economy has faced multiple unexpected shocks, heightening uncertainties in the economic environment and the policy effects. Against this backdrop, the PBOC could adopt an Attenuation Principle to adjust interest rates. To be specific, it could follow the doctrine of the mean, being prudent in decision-making, leaving room for maneuver, and, to some extent, depending on "sound intuition." When adjusting policy rates, the PBOC should take current economic and financial situations into consideration and ensure that policy rates converge to averages across historical periods and world regions to reduce fluctuations. For instance, in 2018, amid successive interest rate hikes by the major central banks, the open market operation

(OMO) rates of the PBOC remained unchanged after an uptick of only five basis points early in the year. In 2020, in response to COVID-19, some central banks slashed interest rates to almost zero, while, after edging down 20 basis points, the OMO rates of the PBOC remained stable, and market rates also remained at a proper level. In 2022, in contrast to the aggressive interest rate hikes by the major central banks, the PBOC focused on domestic issues and maintained a policy stance of macro adjustments, guiding the OMO rates to move down by 20 basis points and market rates to remain stable with a slight decline.



Figure：Policy Rates of the PBOC and the US Federal Reserve

In the meantime, the PBOC has continued to deepen the market-based reform of interest rates and to improve the formation and transmission regime of market-based interest rates. It has been improving the central bank policy rate system and establishing a complete market-based interest rate system. The PBOC has been advancing the loan prime rate (LPR) reform to ensure that lending rates reflect changes in market supply and demand. It has also established a market-based adjustment mechanism for deposit rates, urging financial institutions to take an initiative in properly adjusting deposit rates in accordance with market rates. As the market-based reform of interest rates has advanced, the market has begun to play a decisive role in the formation of interest rates, and the transmission efficiency of monetary policy has been enhanced remarkably. In recent years, driven by the decreasing market rates, actual lending rates have declined notably, providing effective support for development of the real economy. In March 2023, the weighted average interest rate for newly issued loans registered 4.34 percent, and the weighted average interest rate for corporate loans was 3.95 percent, both at historically low levels.

Going forward, the PBOC will continue to implement its sound monetary policy, keep macro interest rates at a proper level, continue to deepen the market-based reform of interest rates, and improve the monetary policy transmission mechanism featuring "market rates+central bank guidance → LPR → lending rates" so as to create favorable conditions for effectively upgrading and appropriately expanding economic output.

Deposits grew significantly. At end-March, outstanding deposits in domestic and foreign currencies at all financial institutions increased 12.2 percent year on year to RMB280.2 trillion, up RMB15.7 trillion from the beginning of 2023 and an acceleration of RMB4.6 trillion year on year. Outstanding RMB deposits grew 12.7 percent year on year to RMB273.9 trillion, an increase of RMB15.4 trillion from the beginning of 2023 and an acceleration of RMB4.5 trillion year on year. Outstanding deposits in foreign currencies stood at USD911.5 billion, up USD57.6 billion from the beginning of 2023 and an acceleration of USD8.2 billion year on year.

Table 6 The Structure of RMB Deposits in Q1, 2023

Unit: RMB100 million

	Outstanding deposits at end-March	YOY growth (%)	Increase from the beginning of the year	YOY acceleration
RMB deposits:	2739076	12.7%	153869	45278
Households	1302280	18.1%	99040	20853
Non-financial enterprises	777323	9.5%	31802	17871
Public entities	341880	6.9%	11455	3114
Fiscal entities	52987	-1.9%	2974	-452
Non-banking financial institutions	246845	7.3%	7987	2243
Overseas	17761	24.2%	611	1649

Source: The People's Bank of China.

III. Money supply and the AFRE grew at a stable pace

The monetary aggregate grew at a faster pace. At end-March, outstanding broad money M2 registered RMB281.5 trillion, up 12.7 percent year on year and 0.9 percentage points higher than that at the end of the previous year; narrow money M1 and currency in circulation M0 registered RMB67.8 trillion and RMB10.6 trillion, respectively, up 5.1 percent and 11.0 percent year on year, respectively. The first quarter of 2023 witnessed a net cash injection of RMB96.1 billion, RMB335.6 billion less than that in the first quarter of 2022.

According to preliminary statistics, the outstanding AFRE reached RMB359.0 trillion at end-March and its year-on-year growth registered 10.0 percent, up 0.4 percentage points compared with that at end-2022. In the first quarter, the AFRE increment totaled RMB14.5 trillion, RMB2.5 trillion more than that in the first quarter of 2022. The AFRE was characterized by the following structural features: first, RMB loans witnessed rapid growth. In the first quarter, the increment in RMB loans issued by financial institutions to the real economy grew by RMB2.4 trillion year on year to RMB10.7 trillion, accounting for 73.6 percent of the AFRE increment during the same period. Second, in the first quarter of 2023, new government bonds financing increased year on year by RMB247 billion more than that in the first quarter of 2022; the increment in direct corporate financing decreased significantly year on year, with the increment in corporate bonds and domestic equity financing by non-financial enterprises decreasing by RMB471.8 billion and RMB83.3 billion year on year, respectively. Third, there has been a recovery in off-balance-sheet financing. In the first quarter of 2023, the increases in entrusted loans and undiscounted bankers' acceptances were RMB22.1 billion and RMB389.2 billion, respectively, more than the increases during the first quarter of 2022, while the decrease in trust loans was RMB164.9 trillion less than that in the first quarter of 2022. Fourth, asset-backed securities of depository institutions decreased by a larger margin year on year, while loans written off increased at a slower pace year on year.

Table 7 Aggregate Financing to the Real Economy in Q1 2023

	End-March 2023		First quarter of 2023	
	Stock (RMB trillion)	YOY growth (%)	Flow (RMB100 million)	YOY change (RMB100 million)
AFRE	359.02	10	145295	24716
Of which: RMB loans	223.96	11.7	106984	23615
Foreign-currency loans (RMB equivalent)	1.88	-19.3	606	-1144
Entrusted loans	11.32	3.5	681	221
Trust loans	3.74	-10.4	-41	1649
Undiscounted bankers' acceptances	3.13	1.6	4683	3892
Corporate bonds	31.42	1.2	8480	-4718
Government bonds	62.02	13.5	18292	2470
Domestic equity financing by non-financial enterprises	10.85	11.2	2149	-833
Other financing	10.49	7.8	768	-895
Of which: Asset-backed securities of depository institutions	1.91	-10.6	-762	-392
Loans written off	7.7	15.7	1915	-210

Notes: ①AFRE (stock) refers to outstanding funds provided by the financial system to the real economy at the end of a period. AFRE (flow) refers to the volume of funds provided by the financial system to the real economy within a certain period of time. ②Since January 2023, the PBOC has included three types of non-deposit financial institutions in the banking industry, namely consumer finance companies, wealth management companies, and financial asset investment companies in the scope of financial statistics. Therefore, adjustments will be made to the data on "RMB loans issued by the real economy" and "loans written off" in the scale of social financing. 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 2 Perspectives on M2 and Deposit Growth

Since the beginning of 2023, China's M2 and RMB deposit growth has maintained a momentum of relatively rapid growth. At end-April, the year-on-year growth of M2 and deposits both stood at 12.4 percent, 1.9 percentage points and 2 percentage points higher, respectively, than that in the corresponding period of the previous year. Various factors contribute to the growth of M2 and deposits, and its relationship with the real economy should be viewed in an unbiased manner.

In theory, economic development and the monetization process are the main drivers behind medium and long-term growth in money and deposits. First, the growth is fueled by economic growth. According to the theories of demand for money, the size and growth rate of the economy are the major variables affecting demand, and expanded corporate investment, increased consumer consumption, and larger economic size each brings an increase in monetary demand. Over the past ten years (2013-2022), nominal GDP growth averaged 8.8 percent a year, and M2 growth averaged 10.6 percent a year. The growth rate of M2 was generally in step with, but 1-2 percentage points higher than that of nominal GDP, and it properly met the monetary demand for development of the real economy. **Second**, growth is driven by monetization demand during a transition period. In the past, monetary growth in China was also affected by monetization during the financial deepening. In addition to GDP growth, substantial changes in asset prices also absorbed monetary growth, thereby keeping inflation at a basically stable level. **Moreover**, on a horizontal comparison basis, a country's economic characteristics also affect its growth in money and deposits. China's financing structure, with indirect financing constituting the lion's share and residents' inclinations to savings both make demand for money and deposits larger than that in other economies. In terms of statistical specifications, there are some requirements for the value and maturity of deposits to be counted as M2 metrics in the US and the European countries, while no such requirements exist in China. Therefore, there is a wider range of M2 metrics.

In practice, as the requirements for proper inter-temporal adjustments became more specified, the faster pace in recent growth of M2 and deposits to a considerable extent reflected how macro-policies were properly intensified and how the behavior of market entities changed. In terms of macro-policies,

countercyclical policy adjustments were intensified and a package of policies were implemented to stabilize growth. As monetary policies were fully leveraged and supporting funds were in place in advance, financial data ran ahead of economic data. **In terms of commercial banks**, the transmission effects of previous policies fueled relatively faster growth in M2. The accelerated issuances of loans by banks have forcefully satisfied the financing needs of the real economy. RMB loans increased by RMB11.3 trillion from January to April, an acceleration of RMB2.3 trillion over the same period of the previous year. Bond purchases by banks also rose markedly, which effectively enabled fiscal policies to produce effects early on. Bond investments by financial institutions increased by RMB2.9 trillion from January to April, a year-on-year growth of RMB625.3 billion, 76 percent of which were government bonds. **In terms of enterprises and residents**, on the one hand, as China's market-oriented interest rate system and interest rate transmission mechanism continue to be improved, the rigid redemption of wealth management products have been broken and net asset value has been achieved, thereby narrowing the spread between wealth management products and deposits. Therefore, wealth management funds flew back to the banks' balance sheet as deposits, which pushed the growth rate of M2. As of end-Q1, outstanding assets under the category of asset management products registered RMB94.7 trillion, RMB1.6 trillion lower than that at the beginning of this year. On the other hand, the post-pandemic recovery of the real economy is still lagging in terms of production, circulation, and transmission as well as in terms of consumer demand, and obstacles and frictions in economic circulation remain, resulting in a lower velocity of money, a larger amount of currency holdings by market entities, and higher precautionary savings.

In the medium and long run, steady economic growth and price stability are the standards and key factors to assess whether monetary growth is appropriate. On balance, increases in money supply and aggregate financing are generally in step with nominal economic growth, delivering an optimized combination of relatively high growth and low inflation. During the past ten years, real GDP growth averaged 6.2 percent a year, and the CPI grew at an annual average rate of about 2 percent. The gap between M2 growth and inflation and economic growth was mainly due to the time-lag in the policy effects and the recovery of demand. With the further diminishing of the negative effects of the pandemic, the continuous improvement of market expectations, and the accelerated recovery of the economy, households' willingness to consume and invest will pick up and precautionary savings that accumulated previously are expected to be gradually released, thus contributing to the steady growth of M2 and deposits. The year-on-year acceleration of household deposits between March and April has narrowed markedly compared to that between January and February, and the growth rate of M2 at end-April fell by 0.5 percentage points from its high in February.

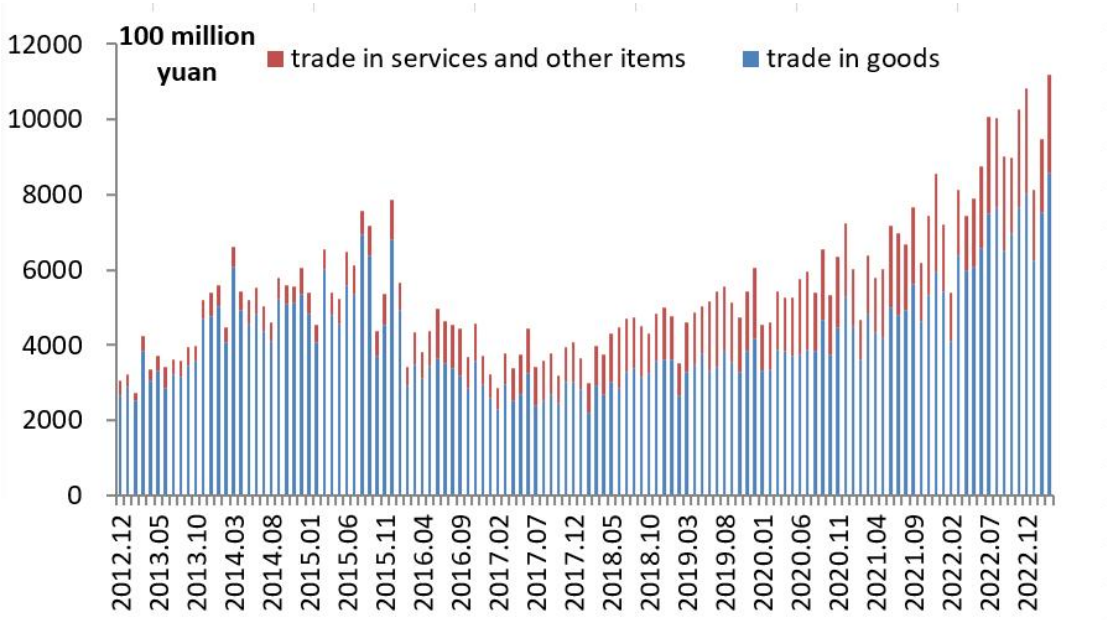
During the next stage, the PBOC will, following the guidelines of the CPC Central Committee and the State Council, implement a sound monetary policy in a targeted and effective manner, conduct proper inter-temporal adjustments, balance short-term and long-term perspectives, economic growth and price stability, as well as an internal and external equilibrium to maintain the continuity, stability, and sustainability of monetary policy. It will both focus on supporting the expansion of domestic demand to provide strong support to the real economy and pursue appropriate monetary aggregates and a steady pace, thus keeping increases in money supply and aggregate financing generally in step with nominal economic growth, consolidating and expanding the recovery momentum for a brighter outlook, and better serving the Chinese path to modernization.

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

Since the beginning of 2023, cross-border capital flows and foreign exchange supply and demand have been basically in equilibrium, and, on the whole, market expectations have been stable. The major developed economies have continued to adjust their monetary policies, and international financial markets have experienced fluctuations due to risk events. The RMB exchange rate has moved in both directions with greater flexibility, and the market has played a decisive role in the formation of the RMB exchange rate. In the first quarter, based on market supply and demand, the RMB exchange rate appreciated against a basket of currencies. At end-March, the China Foreign Exchange Trade System (CFETS) and the RMB Exchange Rate Index based on the special drawing rights (SDRs) basket closed at 99.80 and 96.40, respectively, up 1.2 percent and 0.3 percent, respectively, from end-2022. According to calculations by the Bank for International Settlements (BIS), from end-2022 to end-March 2023 the nominal effective exchange rate (NEER) and the real effective exchange rate (REER) of the RMB appreciated 1 percent and depreciated 0.6 percent, respectively. From 2005, when the reform of the RMB exchange-rate formation regime began, to end-March 2023, the NEER and REER of the RMB appreciated 45.6 percent and 44.6 percent, respectively. At end-March, the central parity of the RMB against the US dollar was 6.8717, appreciating 1.4 percent from end-2022 and appreciating 20.4 percent on a cumulative basis since the beginning of the reform of the exchange-rate formation regime in 2005. In the first quarter, the annualized volatility rate of the RMB against the US dollar was 6.4 percent.

In the first quarter, cross-border RMB settlements increased 15 percent year on year to RMB11.4 trillion. Specifically, RMB receipts and payments posted RMB5.6 trillion and RMB5.7 trillion, respectively. Cross-border RMB settlements under the current account grew by 39 percent year on year to RMB2.9 trillion. In particular, RMB settlements under trade in goods registered RMB2.2 trillion, while RMB settlements under trade in services and under other items registered RMB650.1 billion. Cross-border RMB settlements under the capital account registered RMB8.5 trillion, an increase of 9 percent year on year.

Figure 2 Monthly RMB Settlements under the Current Account



Source: The People's Bank of China.

Part 2 Monetary Policy Operations

In Q1 2023, the PBOC resolutely implemented the decisions and arrangements made by the CPC Central Committee and the State Council. Following the principle of seeking stability while making progress, the PBOC pursued a sound monetary policy in a targeted and effective manner. It worked to keep liquidity adequate at a reasonable level, to manage the intensity and pace, to guide the steady growth of credit aggregates, to promote a steady decline in the costs of corporate financing and consumer credit, and to guide financial institutions to scale up financial support for weak links and key areas in the national economy, such as MSEs, sci-tech innovation, and green development, thus contributing to a good start in economic performance.

I. Conducting open market operations in a flexible manner

Conducting reverse repos in a flexible and targeted manner. In Q1, the PBOC closely followed the macroeconomic and financial situations and strengthened the assessment and market monitoring of liquidity supply and demand in the banking system. We managed the intensity and pace of open market operations in a flexible manner in view of the demands of primary dealers and we properly combined them with medium and long-term liquidity injection tools so as to keep liquidity in the banking system adequate at a reasonable level. We timely conducted 14-day reverse repos before the Spring Festival, and we injected a total of RMB2.3 trillion into the market via 7-day and 14-day reverse repos during the festival, which covered the liquidity gap arising from the conjunction of cash injections, tax payments, and reserve deposits. In late March, following the RRR cut of 0.25 percentage points to pump long-term funds, the PBOC increased reverse repos in response to the short-term liquidity gap emerging in markets at quarter-end, which effectively met cross-quarter demands for funds and ensured the smooth operation of money markets. In Q1, the rates of the open market 7-day reverse repos remained unchanged at 2 percent. The weighted average rate of 7-day reverse repos for depository institutions in the interbank market (DR007) was 2.03 percent. Interest rates were more stable during peak tax periods, the end of each quarter, and during other specific time points.

In addition, the PBOC continued to conduct central bank bill swap (CBS) operations on a monthly basis, which are conducive to improving liquidity in the secondary market of bank-issued perpetual bonds. In the meanwhile, the regular issuance of central bank bills in Hong Kong played a positive role in promoting the sound development of the offshore RMB money market and the bond market.

II. Conducting medium-term lending facility and standing lending facility operations

Conducting MLF operations to fully meet market demand. The PBOC ensured an appropriate supply of medium and long-term liquidity, giving play to the signaling and guiding roles of the medium-term policy rates. In Q1, it conducted a total of RMB1.759 trillion of MLF operations, all with a maturity of one year and an interest rate of 2.75 percent, on par with that at the end of the previous year. At end-March, outstanding MLFs registered RMB5.109 trillion, an increase of RMB559 billion from the beginning of 2023.

Conducting standing lending facility (SLF) operations. Locally incorporated financial institutions were provided with a sufficient amount of short-term liquidity support as needed so as to stabilize market expectations, strengthen the stability of liquidity in the banking system, and prevent liquidity risks. In Q1, the PBOC conducted a total of RMB7.67 billion in SLF operations. At end-March, outstanding SLF operations registered RMB5.06 billion. The SLF rate continued to serve as the ceiling of the interest-rate corridor, thereby helping to maintain smooth operation of the money market. At end-March, the overnight, 7-day, and 1-month SLF rates stood at 2.85 percent, 3.00 percent, and 3.35 percent, respectively, flat with those at the end of 2022.

III. Lowering the required reserve ratio (RRR) for financial institutions

Lowering the RRR to inject long-term liquidity. On March 27, 2023, the PBOC reduced the RRR for financial institutions (excluding those that had already implemented an RRR of 5 percent) by 0.25 percentage points. It freed up over RMB500 billion in long-term funds and saved about RMB6 billion in capital costs. After the cut, the weighted average RRR for financial institutions was 7.6 percent.

IV. Further improving the macro-prudential system and the management framework

Giving full play to the role of the macro prudential assessment (MPA) in optimizing the credit structure and promoting the supply-side structural reform of the financial sector. In Q1, the PBOC further optimized the MPA framework and guided financial institutions to maintain appropriate credit aggregates at a steady pace and to step up support for inclusive MSB loans, especially unsecured inclusive MSB loans, for medium and long-term financing to the manufacturing sector.

Refining the regulatory framework for systemically important financial institutions. Pursuant to the *Additional Supervisory Regulations on Systemically Important Banks (Trial)*, the 19 banks, first designated as systemically important banks (SIBs) in 2021, submitted their recovery plan and resolution plan proposal on time and met their additional capital and leverage ratio requirements on January 1, 2023. The PBOC, together with other regulators, examined the recovery plan and resolution plan proposal submitted by the SIBs and provided feedback.

Making significant progress in the **continuous regulation and institutional construction of financial holding companies (FHCs).** First, establishing the regulatory framework. In September 2020, the State Council authorized the PBOC to implement market access management of FHCs. Accordingly, the latter promulgated *the Trial Measures on Regulation of Financial Holding Companies*, which specify that non-financial enterprises that have de facto control of at least two types of financial institutions shall set up FHCs and be subject to the regulation. Second, improving supporting rules for regulation. The PBOC released the *Interim Regulations on Filing-based Management of Financial Holding Companies' Appointment of Directors, Supervisors, and Senior Executives* in March 2021, and the *Administrative Measures for Related-party Transactions of Financial Holding Companies* in February 2023, and worked to formulate the detailed rules on consolidated management and capital management. Third, implementing market access management in an orderly manner. After clearly identifying non-financial enterprises that control various types of financial institutions, the PBOC promoted qualified enterprises to establish FHCs in accordance with the law. As of March 2023, the PBOC had approved the establishment of China CITIC Financial Holdings, Beijing Financial Holdings Group, and China Merchants Financial Holdings. Fourth, making concrete and meticulous efforts for continuous regulation. The PBOC carried out all-round, prudent, and penetrating regulation over FHCs on a consolidated basis. It enhanced supervision of shareholders, ownership structure, capital, corporate governance, risk management, related-party transactions, and other critical dimensions. Implementing market access management and regulation of FHCs is a major step forward in improving modern financial regulation and strengthening the framework for safeguarding financial stability. This move is conducive to regulating the integration of industry and finance from the source, containing the disorderly expansion of industrial capital in the financial sector, and curbing the spread of risks across institutions, industries, and markets. It also helps promote the well-regulated, sound, and sustainable development of FHCs, thereby enabling them to better serve the new development paradigm.

V. Giving full play to the leveraging and guiding role of structural monetary-policy instruments

Actively using central bank lending that supports rural development and MSBs, central bank discounts, pledged supplementary lending (PSL), and other policy instruments. Central bank lending to support rural development and MSBs was utilized to guide locally incorporated financial institutions to expand their credit supply for rural revitalization. Central bank lending for poverty alleviation was rolled over according to current regulations so as to consolidate the achievements in poverty alleviation. The PBOC promoted coordinated regional development by continuously guiding locally incorporated financial institutions in ten provinces to effectively use policy instruments, such as central bank lending, so as to expand credit supply for weak links within the region, including rural development, MSBs, and private enterprises. More relief and assistance was provided for MSBs, and locally incorporated financial institutions were guided to employ central bank lending for MSBs and self-employed businesses that were heavily hit by COVID-19 so as to reduce their financing costs. At end-March, outstanding central bank lending to support rural development posted RMB596.0 billion. Outstanding central bank lending for MSBs and for poverty alleviation posted RMB1.4331 trillion and RMB143.6 billion, respectively. Outstanding central bank discounts registered RMB606.1 billion, and outstanding PSL posted RMB3.1291 trillion.

Continuously utilizing instruments supporting inclusive MSB loans. As of end-March, through these instruments, the PBOC provided incentive funding of

RMB39.76 billion, increasing by RMB12.3 billion from the beginning of 2023. It supported an increase of RMB2.22535 trillion in inclusive MSB loans issued by locally incorporated financial institutions, up RMB619.95 billion from the beginning of 2023. Support for MSBs was strengthened.

Implementing both the carbon emission reduction facility (CERF) and the special central bank lending facility for the clean and efficient use of coal. At end-March, the outstanding amount through these two PBOC instruments registered RMB399.4 billion and RMB136.5 billion, respectively, an increase of RMB89.7 billion and RMB55.4 billion from the beginning of 2023. In order to maintain financial support for green development and energy supply guarantees, implementation of the CERF will be extended to end-2024 and implementation of the special central bank lending facility for the clean and efficient use of coal will be extended to end-2023.

Continuously implementing special central bank lending facilities for inclusive elderly care and the transport and logistics sectors, respectively. At end-March, outstanding central bank lending through the aforementioned two instruments posted RMB1 billion and RMB35.4 billion, respectively, an increase of RMB300 million and RMB11.2 billion from the beginning of 2023. Implementation of special central bank lending facilities for sci-tech innovation, equipment upgrading and renovation, and the loan support scheme to ensure deliveries of presold housing projects were concluded by end-March. Their outstanding amount posted RMB320 billion, RMB110.5 billion, and RMB500 million, respectively, an increase of RMB120 billion, RMB29.5 billion, and RMB500 million from the beginning of 2023, thereby continuously giving play to their incentive and guiding role. The incentive policies supporting the financial institutions' temporary interest rate reductions for inclusive small and micro loans and toll road loans expired, resulting in actual interest rate reductions of RMB26.9 billion and RMB8.3 billion, respectively by the relevant financial institutions.

Launching special central bank lending to provide relief for real estate development enterprises. In January, the PBOC issued *the Notice on Launching Central Bank Lending to National Financial Asset Management Corporations to Provide Relief for Real Estate Development Enterprises*. Following the principles of positive incentives and market-oriented approaches, the PBOC launched central bank lending to provide relief for real estate development enterprises with a quota of RMB80 billion. This special central lending adopts a “reimbursement” mechanism whereby financial institutions are “reimbursed” on a quarterly basis, thereby supporting financial asset management corporations to acquire existing housing projects of troubled real estate developers. In accordance with the principle of independent decision-making and risk-taking, the financial asset management corporations invest funds for the merger and acquisition of housing projects. For those qualified projects, the PBOC provides funding support equal to 50 percent of the actual invested funds, at a rate of 1.75 percent.

Launching the loan support scheme for rental housing purchases. In January, the PBOC issued the *Notice on Launching a Pilot Program of Loans Supporting Rental Housing Purchases,* launching a loan support scheme for rental housing purchases with a quota of RMB100 billion. This loan support scheme adopts a "reimbursement" mechanism whereby financial institutions are "reimbursed" on a quarterly basis, encouraging relevant financial institutions to issue rental housing purchase loans to eight pilot cities, namely, Chongqing, Ji'nan, Zhengzhou, Changchun, Chengdu, Fuzhou, Qingdao, and Tianjin. Following the principle of independent decision-making and risk-taking, financial institutions issue rental housing purchase loans, with an interest rate that, in principle, cannot surpass 3 percent. For qualified loans, the PBOC provides funding support equal to 100 percent of the principal, at a rate of 1.75 percent.

VI. Bringing into play the role of credit policy in structural guidance

Constantly improving the quality and effectiveness of financial services for MSBs. The PBOC deeply promoted the project to enhance financial services for micro, small, and medium enterprises (MSME), accelerated the establishment of the long-term mechanism for boosting the confidence, willingness, capacity, and professionalism of financial institutions to issue loans, improved the assessment of credit policy in terms of supporting MSBs, and continuously enhanced the willingness, capability, and sustainability of financial institutions to serve the MSBs. All these moves were aimed at promoting an increase in the aggregate, expanding the coverage, and reducing the price of MSB financing. At end-March, outstanding inclusive MSB loans and the number of inclusive MSBs granted loans registered a year-on-year increase of 26.0 percent and 14.4 percent, respectively, and the interest rate on newly issued inclusive MSB loans in March posted 4.72 percent.

Constantly improving financial services for rural revitalization. The PBOC earnestly implemented the strategic arrangements for rural revitalization in a comprehensive way. It continuously increased the supply of financial resources for major areas, such as a stable and secure supply of grain and key agricultural products, scientific and technological innovations in agriculture, and the high-quality development of rural industries. It also promoted innovation in financial products and services and made solid efforts to enhance financial services. At end-March, outstanding agro-related loans registered a year-on-year increase of 16.2 percent, reaching RMB53.04 trillion.

Continuously providing financial services for the manufacturing sector. The PBOC fully leveraged the role of the reporting mechanism for loans issued for the manufacturing sector and sci-tech innovation, enhanced supervision and guidance, and promoted the channeling of more financial resources to these two areas. It also strengthened information sharing with the administrative agencies of the relevant industries and guided financial institutions to provide more targeted support for major areas of high-quality development, namely, sci-tech innovation and the manufacturing sector. As of end-March, outstanding medium and long-term lending to the manufacturing sector grew by 41.2 percent year on year to RMB10.7 trillion, among which that to the high-tech manufacturing sector grew by 42.5 percent year on year to RMB2.3 trillion.

VII. Deepening the market-based interest rate reform

Continuously unleashing the benefits of the loan prime rate (LPR) reform and giving play to the role of the market-based adjustment mechanism in deposit interest rates. The benefits of the LPR reform have been continuously unleashed, and actual loan rates have remained stable with a slight decline. In March 2023, the one-year and over-five-year LPR stood at 3.65 percent and 4.30 percent, respectively. The overall lending rate dropped 0.31 percentage points year on year, with the interest rate for corporate loans decreasing 0.41 percentage points year on year. The PBOC continued to give play to the key role of market-based adjustments in deposit interest rates. Members of the self-regulatory mechanism for interest rate have been guided to adjust deposit rates reasonably in response to market rate changes. Most banks lowered their posted deposit rates last September and the rest have followed suit since this April.

Continuing to implement the dynamic adjustment mechanism for first-home mortgage interest rates. By the end of March 2023, a total of 83 cities had reduced the interest-rate floor on first-home loans, 10 to 40 basis points lower than the national floor, and 12 cities had removed the floor on first-home loans. The adjustment and improvement in the interest rate policy for first-home loans have brought down mortgage rates. In March, the newly issued weighted average interest rate for personal mortgages registered 4.14 percent, down 1.35 percentage points year on year.

VIII. Improving the regime for market-based formation of the RMB exchange rate

The PBOC 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. To ensure that the market plays a decisive role in determining the exchange rate the PBOC focused on guiding expectations and enhanced the flexibility of the RMB exchange rate while keeping it basically stable at an adaptive and equilibrium level. As a result, the exchange rate played the role of an auto stabilizer for macroeconomic management and for the balance of payments. In Q1, the highest and lowest RMB central parities against the US dollar were 6.7130 and 6.9666, respectively. During the 59 trading days, the RMB appreciated on 33 days and depreciated on 26 days. The biggest intraday appreciation and depreciation were 1.0 percent (654 bps) and 0.9 percent (630 bps), respectively. The RMB appreciated against the dollar and the Japanese yen, while it depreciated against other major currencies. As of end-March, the central parity of the RMB against the US dollar and the Japanese yen appreciated 1.4 percent and 1.3 percent, respectively, from end-2022, while the central parity of the RMB against the euro and the pound sterling depreciated 1.0 percent and 1.4 percent, respectively, during the same period. From 2005 when the reform of the RMB exchange-rate formation regime began to end-March 2023, the RMB appreciated cumulatively 20.4 percent, 33.6 percent, and 41.3 percent, respectively, against the US dollar, the euro, and the Japanese yen. Direct RMB trading was rather buoyant in the interbank foreign-exchange market with stable liquidity, the exchange costs for microeconomic entities were reduced, and bilateral trade and investment were promoted.

IX. Forestalling and defusing financial risks and deepening the reform of financial institutions

Continuously advancing the forestalling and defusing of financial risks. Remaining committed to addressing risks in a market- and law-based manner, the PBOC properly resolved some prominent financial risks. It carried out Central Bank Rating on over 4,000 banking financial institutions on a quarterly basis and established a differentiated management framework according to the rating results. For institutions rated Grades 1-7, the PBOC organized early warnings on a quarterly basis. For high-risk institutions rated Grades 8-10, it will distinguish previously identified institutions from newly identified institutions and it will take effective measures to reduce the number of high-risk institutions.

Continuously deepening the reform of development and policy financial institutions. The PBOC promoted comprehensive implementation of the reform plans for development and policy financial institutions, clarifying their responsibilities and business scopes, adopting classified accounting, improving corporate governance, strengthening restraint mechanisms, and preventing financial risks. It guided development and policy financial institutions to fulfill their responsibilities, focus on their main businesses, and play an effective role in supporting economic restructuring and high-quality development on the basis of strengthening risk prevention and mitigation.

Box 3 The Silicon Valley Bank (SVB) Event and Its Implications

1. The SVB bankruptcy process

The SVB was established in 1983, and it was the 16th largest bank in the US prior to its collapse. The bank mainly served small- and medium-sized start-ups and venture capital funds in the US. As of end-2022, the SVB had total assets of USD209 billion, with nearly USD120 billion in US Treasuries, mortgage-backed securities (MBS), and other securities investments on the asset side of its balance sheet, and approximately USD175.4 billion in deposits on its liability side. Against the backdrop of the steep rate hikes by the Fed, start-ups were running short of cash flows, leading to a continuous decrease in SVB deposits. As a result, the bank was forced to sell its securities assets to replenish its liquidity, reversing its unrealized gains to unrealized losses in securities holdings. The bank's huge losses triggered a large-scale run on its deposits, with a single-day draw from the SVB reaching USD42 billion on March 8, 2023. On March 10, the California regulator announced the shutdown of the SVB and the takeover of the bank by the Federal Deposit Insurance Corporation (FDIC) of the US. On March 12, the US Department of the Treasury, the Fed, and the FDIC jointly announced that all depositors of the SVB would receive full compensation for their deposits, and, in the meantime, the Fed introduced the Bank Term Funding Program (BTFP), offering liquidity support of up to one year to depository institutions. On March 26, the FDIC approved First-Citizens Bank & Trust Company as successful bidder to assume all deposits and loans of the SVB. The FDIC estimated that risk resolution of the SVB would cost the Deposit Insurance Fund (DIF) about USD20 billion.

Following the SVB incident, some of the small and medium-sized banks with unstable sources of deposits, large book losses of securities holdings, and low profitability suffered a lot from the spillover effects. For example, after the outbreak of the SVB risks, Signature Bank also faced a bank run and was taken over by the FDIC on March 12. The First Republic Bank experienced over USD100 billion of deposit outflows in Q1, 2023, and it was taken over by the FDIC on May 1, with JP Morgan Chase acquiring most of its assets and liabilities.

2. Implications for China

Financial institutions in China have small risk exposures to the SVB and the effects of the SVB bankruptcy on Chinese financial markets are controllable. At present, China's financial system is operating steadily, and the banking sector, which owns more than 90 percent of the total assets in the financial sector, is generally stable. The vast majority of financial institutions in the banking sector are within a safe boundary, while 24 large banks holding about 70 percent of the total assets of the sector have always maintained favorable ratings. Nevertheless, we should summarize and reflect on the lessons learned from the SVB incident.

First, monetary policy should avoid being extremely loose or extremely tight. During the COVID-19 pandemic, central banks in the advanced economies launched quantitative easing policies and implemented zero-interest-rate policies at a rapid pace. Later, they hiked interest rates and shrank their balance sheets in a rather swift manner due to the elevated inflation. Such policy measures motivated commercial banks to purchase low-yield assets at an accommodative stage, which had to be balanced by high interest rate liabilities during the tightening cycle, leading to large losses. In contrast, the PBOC stuck to a sound and normal monetary policy, with a balance between short-term and long-term objectives, economic growth and price stability, as well as internal and external equilibria. It also strengthened sustainable support to the real economy, effectively stabilized prices, promoted stable performance of the Chinese economy, and laid a solid foundation for financial stability.

Second, importance should be attached to supervision and regulation of small and medium-sized financial institutions. After the financial crisis of 2008, countries have generally strengthened their assessments, supervision, and regulation of systemically important financial institutions (SIFIs), but they have paid rather limited attention to small and medium-sized financial institutions. In 2018, the US decided to impose classified regulation on financial institutions. Prior to its bankruptcy, the SVB had been incorporated into Category IV, which applies rather relaxed prudential regulatory standards. Due to the transitional period arrangements and the stress test requirements on a biennial basis, the SVB had not conducted any stress test until its bankruptcy. In fact, small and medium-sized banks have weaker pressure-bearing capacities and greater vulnerabilities, which may also lead to systemic risks amid the accumulation of risks and market panic.

Third, the disposal of financial risks should be swift and strong. The risk resolution of the SVB was rather swift. The FDIC took over the SVB according to a 'Friday-Monday mechanism,' whereby the bank is announced to be under receivership on Friday, and it is reopened as a bridge bank on Monday. The US Department of the Treasury, the Fed, and the FDIC immediately took action following the legal procedures, and timely announced full coverage for all depositors of the SVB, thereby stabilizing market confidence. The relevant costs are to be recovered through special premiums levied by the FDIC on the banking industry. These experiences indicate that swift and strong responsive measures are crucial to stabilizing market confidence and resolving financial risks, while sufficient legal authorizations, ample policy instruments, and abundant resources for risk resolution are also of great importance. These lessons are worth learning.

Fourth, attention should be paid to the stability of the banks' asset-liability structure. On the liability side, most of the SVB's deposits were from start-ups, revealing high homogeneity among bank clients, and the proportion of savings deposits was quite low, with over 90 percent of the bank's deposits uninsured. The bank's liability structure was insufficiently stable. On the asset side, SVB loans represented only 35 percent of its total assets, and 57 percent of its assets were invested in US Treasuries and MBS, which lacked effective hedgi
ng arrangements against interest-rate risks. The instability of the asset-liability structure eventually led to liquidity risks. In view of this, banks should make the best of stress tests and other liquidity management tools, take various risk scenarios into full consideration, and arrange emergency plans for extreme situations, thereby matching their own risk management capabilities with the asset-liability structures.

3. Working approaches for the next step

Financial regulators will continue to reinforce the institutional arrangements that safeguard financial stability, holding firmly to the bottom line whereby no systemic risks will occur. **First**, accelerating the process of building a legal system that safeguards financial stability, promoting introduction of the *Financial Stability Law*, and improving the market-oriented and law-based mechanism for financial-risk resolution. **Second**, improving monitoring and early warnings of financial risks, and giving full play to the role of deposit insurance in early corrections and as a market-based platform for risk resolution. **Third**, continuing to enrich resources for financial-risk resolution and to improve the management mechanism of the Financial Stability Fund (the Fund). The Fund, along with the Deposit Insurance Fund and the relevant industry protection funds, comprise a 'two-tier' system, and their cooperation and coordination will jointly safeguard financial stability and security.

X. Improving capability to serve cross-border trade, investment, and financing

Promoting the coverage and quality of facilitation policies for quality enterprises. Support should be provided to more prudently compliant banks to implement facilitation measures for credit-worthy enterprises in handling trade and foreign-exchange transactions, aiming to continuously improve the ease of doing business for market entities. Facilitation policies have been implemented nationwide, and in the first quarter, facilitation-related transactions amounted to USD200 billion.

Deepening international monetary and financial cooperation. As of end-March 2023, under the bilateral currency swap agreements between the PBOC and the overseas monetary authorities, the overseas monetary authorities had utilized a total of RMB109.085 billion and the PBOC had utilized foreign currencies equivalent to

USD417 million. These operations have played an active role in promoting bilateral trade and investment.

Table 8 Trading Volume of the RMB Against Other Currencies in the Interbank Foreign Exchange Spot Market in Q1, 2023

RMB100 million

Currency	USD	EUR	JPY	HKD	GBP	AUD	NZD
Trading volume	151101.36	2044.54	1464.87	505.25	55.00	149.61	26.16
Currency	SGD	CHF	CAD	MYR	RUB	ZAR	KRW
Trading volume	18.64	14.54	118.37	1.33	11.07	0.20	10.47
Currency	AED	SAR	HUF	PLN	DKK	SEK	NOK
Trading volume	0.09	1.49	0.00	0.19	0.73	7.62	0.32
Currency	TRY	MXN	THB	KHR	KZT	MNT	IDR
Trading volume	0.00	0.20	9.04	0	0	0	6.58

Source: China Foreign Exchange Trade System.

Part 3 Financial Market Conditions

In Q1 2023, performance of the financial market was generally stable. Money market interest rates rebounded, with increasingly active market transactions. The interest rates of bond issuances were steady, with an increase in issuance volume. The stock market index went up, with turnover and the amount of funds raised decreasing year on year.

I. Financial market overview

1. Money market interest rates rebounded with increasingly active market transactions

In March 2023, the monthly weighted average interest rate for interbank lending was 1.7 percent, and the monthly weighted average interest rate for pledged repos posted 1.85 percent, both up 44 basis points from December 2022. The monthly weighted average interest rate for government-backed bond pledged repos among depository institutions posted 1.62 percent, 23 basis points lower than the monthly weighted average interest rate for pledged repos. At end-March, the overnight and 7-day Shibor posted 1.84 percent and 2.21 percent, respectively, down 12 basis points and 1 basis point from end-December 2022, respectively.

The level of market transaction activity increased. In Q1 2023, the cumulative volume of bond repos trading on the interbank market registered RMB353.1 trillion, representing an average daily turnover of RMB5.8 trillion and an increase of 20.6 percent year on year. The cumulative volume of trading for interbank lending registered RMB33 trillion, representing an average daily turnover of RMB540.8 billion and an increase of 6.7 percent year on year. In terms of the maturity structure, overnight repos accounted for 86.4 percent of the total turnover in bond repos, up 1 percentage point year on year, and overnight lending constituted 90 percent of the total turnover in interbank lending, up 2.3 percentage points year on year. The volume of bond repos trading on the exchange markets increased 17.1 percent year on year to RMB113.1 trillion.

Table 9 Fund Flows Among Financial Institutions in Q1 2023

Unit: RMB100 million

	Repos		Interbank lending	
	Q1 2023	Q1 2022	Q1 2023	Q1 2022
Chinese-funded large banks①	-1,420,541	-817,054	-109,762	-82,755
Chinese-funded medium-sized banks②	-298,799	-365,252	-20,546	-20,852
Chinese-funded small-sized banks③	91,660	-46,373	19,852	20,499
Securities institutions④	461,284	367,101	90,221	66,452
Insurance institutions⑤	46,201	39,034	254	93
Foreign-funded banks	14,474	20,756	-2,510	-3,549
Other financial institutions and vehicles⑥	1,105,721	801,787	22,492	20,113

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 eight other joint-equity commercial banks, Bank of Beijing, Bank of Shanghai, and Bank of Jiangsu. ③Chinese-funded small-sized banks refer to the 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 Deposits (CDs) and negotiable CD businesses operated orderly. In Q1 2023, about 6,928 interbank CDs were issued on the interbank market, raising RMB6.0 trillion. The total volume of trading on the secondary market registered RMB57.8 trillion. At end-March, outstanding interbank CDs reached RMB14.1 trillion. The weighted average interest rate of 3-month interbank CDs was 2.50 percent, 9 basis points higher than that of the 3-month Shibor. In Q1, about 21,000 negotiable CDs were issued by financial institutions, raising RMB5.5 trillion, an increase of RMB1.1 trillion year on year.

Interest rate swap transactions remained stable. In Q1 2023, the RMB interest rate swap market witnessed 84,000 transactions, increasing 52.5 percent year on year, with the volume of the notional principal totaling RMB8.0 trillion, an increase of 82.8 percent year on year. In terms of the maturity structure, contracts with maturities of up to one year traded most briskly, and the volume of the notional principal posted RMB5.6 trillion, accounting for 70.3 percent of the principal of all maturities. The 7-day fixing repo rate (FR) and the Shibor served as the main reference rates for the floating leg of the RMB interest rate swaps, accounting for 90.9 percent and 7.9 percent, respectively, of the total notional principal of the interest rate swaps. In Q1, interest rate swaps anchored to the loan prime rate (LPR) witnessed 457 transactions, with RMB76.63 billion of the notional principal.

Table 10 Interest Rate Swap Transactions in Q1 2023

	Transactions	Notional principal (RMB100 million)
Q1 2023	83,587	80,076.7
Q1 2022	54,795	43,812.8

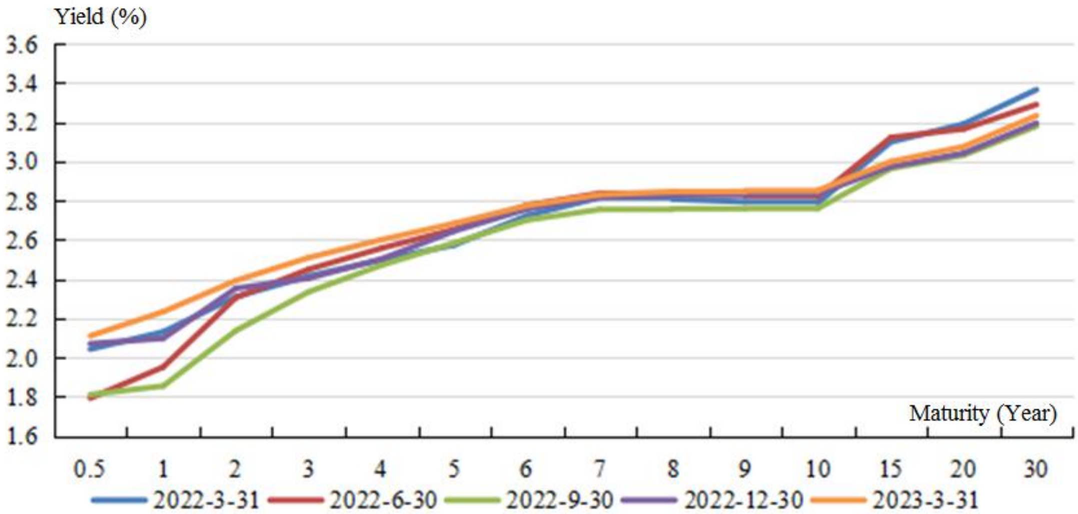
Source: China Foreign Exchange Trade System.

The interest rate options business developed at a steady pace. In Q1 2023, a total of 526 interest rate options transactions were concluded, totaling RMB84.12 billion. Specifically, 6 were interest rate swap transactions, amounting to RMB2 billion of the notional principal, and 520 were interest rate cap/floor transactions, amounting to RMB82.12 billion of the notional principal.

2. The coupon rates of bonds remained generally stable, while bond issuances and trading increased

The coupon rates of government securities and financial bonds remained generally stable. In March, the yield on 10-year government securities issued by the Ministry of Finance was 2.83 percent, unchanged from what was recorded in December 2022. The coupon rate of 10-year financial bonds issued by the China Development Bank (CDB) was 2.99 percent, 1 basis point lower than the rate in December 2022. The average rate of 1-year short-term financing bills (bond rating A-1) issued by AAA-rated enterprises was 3.08 percent, 106 basis points lower than the rate in December 2022.

Figure 3 Yield Curves of Government Securities in the Interbank Market



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

The yield on government securities edged up slightly with narrowed term spreads. At end-March, yields on 1-year, 3-year, 5-year, 7-year, and 10-year government securities increased by 14 basis points, 10 basis points, 4 basis points, 1 basis point, and 2 basis points, to 2.23 percent, 2.51 percent, 2.68 percent, 2.83 percent, and 2.85 percent from end-2022, respectively. The term spread between 1-year and 10-year government securities was 62 basis points, decreasing 12 basis points from end-2022.

Bond issuance increased year on year. In Q1, the cumulative value of bonds issued in Q1 grew by 8.8 percent year on year to RMB16.4 trillion, RMB1.3 trillion more than that in the same period of last year, mainly contributed by large increase in government securities and financial bond issuance. At end-March, outstanding bonds held in custody amounted to RMB147.5 trillion, representing an increase of 7.1 percent year on year.

The trading volume of spot bonds continued to grow. In Q1, the value of cash bonds traded on the bond market posted RMB74.9 trillion, registering an increase of 7.3 percent year on year. Specifically, the value of cash bonds traded on the interbank market was RMB66.1 trillion, representing an increase of 7 percent year on year. The value of cash bond transactions on the stock exchanges totaled RMB8.7 trillion, an increase of 9.7 percent year on year.

Table 11 Bond Issuance in Q1 2023

Unit: RMB100 million

Type of bond	Issuance	YOY change
Government securities	21,501	5,442
Local government bonds	19,147	901
Central bank bills	0	0
Financial bonds①	87,039	8,353
Of which: Financial bonds issued by the CDB and policy financial bonds	18,620	4,895
Interbank certificates of deposits	60,186	6,341
Corporate credit bonds②	35,742	-1,452
Of which: Debt-financing instruments of non-financial enterprises	23,683	-2,721
Enterprise bonds	1,293	-88
Corporate bonds	7,870	1,046
Bonds issued by international institutions	196	-44
Total	163,625	13,200

Notes: ①Including financial bonds issued by the CDB, policy financial bonds, bonds issued by commercial banks (including ordinary bonds, subordinated bonds, and hybrid bonds), bonds issued by securities firms, and interbank certificates of deposit. ② Including debt-financing instruments issued by non-financial enterprises, enterprise bonds, corporate bonds, convertible bonds, bonds with detachable warrants, privately offered SME bonds, and asset-backed securities on the Shanghai Stock Exchange and the Shenzhen Stock Exchange issued by non-financial enterprises.

Sources: The People's Bank of China, China Securities Regulatory Commission, and China Central Depository & Clearing Co., Ltd. Updated with the latest data from the providers.

3. Bill financing was generally stable with a slight decrease, and interest rates in the bill market saw growth

The bill acceptance business was generally stable with a slight shrinkage. In Q1, commercial drafts issued by enterprises totaled RMB5.9 trillion, falling 15.7 percent year on year. At end-Q1, outstanding commercial drafts stood at RMB16.7 trillion, increasing by 5.8 percent year on year. Outstanding commercial draft acceptances decreased. At end-March, outstanding commercial draft acceptances dropped by RMB705 billion from the beginning of 2023. Of the outstanding bankers' acceptances, 66.2 percent were issued by micro, small, and medium-sized enterprises (MSMEs).

Bill financing was generally stable, with a slight decline, and interest rates saw growth. In Q1, total discounts by financial institutions amounted to RMB10.8 trillion, falling 19.5 percent year on year. At end-March, the balance of bill financing was RMB11.8 trillion, up 11.0 percent year on year. The balance accounted for 5.2 percent of the total outstanding loans, down 0.1 percentage points year on year. In Q1, the interest rates on bill financing went up.

4. The stock indices grew, with turnover and the amount of funds raised on the stock markets decreasing year on year

The stock indices witnessed a gain. At end-March, the Shanghai Stock Exchange Composite Index closed at 3,273 points, increasing 5.9 percent from end-2022. The Shenzhen Stock Exchange Component Index closed at 11,726 points, increasing by 6.4 percent from end-2022. The turnover and the amount of funds raised on the stock markets declined year on year. In Q1, the combined turnover on the Shanghai Stock Exchange and the Shenzhen Stock Exchange reached RMB52 trillion, and the average daily turnover was RMB881 billion, representing a decrease of 12.7 percent year on year. In Q1, cumulative funds raised in the first quarter were RMB262.4 billion, a year-on-year decrease of 21.4 percent.

5. Premium income in the insurance sector increased year on year and the growth of assets accelerated

In Q1, total premium income in the insurance sector amounted to RMB1.9 trillion, up 9.2 percent year on year, an acceleration of 4.6 percentage points compared to that recorded in 2022. Claim and benefit payments totaled RMB493.2 billion, representing a year-on-year increase of 9.3 percent. Specifically, total property insurance claims and benefit payments increased by 10.9 percent year on year, and total life insurance claims and benefit payments increased by 8.2 percent year on year.

Table 12 Asset Allocations in the Insurance Sector, at End-March 2023

Units: RMB100 million, %

	Balance		As a share of total assets	
	End-March 2023	End-March 2022	End-March 2023	End-March 2022
Total assets	283,664	256,723	100.0	100.0
of which: Bank deposits	28,450	28,370	10.0	11.1
Investments	231,756	206,988	81.7	80.6

Source: China Banking and Insurance Regulatory Commission.

The growth of assets in the insurance sector accelerated. At end-March, total assets in the insurance sector increased 10.5 percent year on year to RMB28.4 trillion, an acceleration of 1.4 percentage points from end-2022. Specifically, bank deposits increased by 0.3 percent, while investment-linked assets increased by 12 percent year on year.

6. The turnover of foreign exchange swap and forward transactions declined year on year

In Q1, the cumulative turnover of spot RMB/foreign exchange transactions registered USD2.3 trillion, an increase of 17.5 percent year on year. The cumulative turnover of swap RMB/foreign exchange transactions totaled USD5 trillion, a decrease of 8.4 percent year on year. Specifically, cumulative overnight RMB/USD swap transactions posted USD3.2 trillion, accounting for 65.2 percent of the total swap turnover. The turnover of RMB/foreign exchange forward transactions totaled USD20.5 billion, decreasing 25.2 percent year on year. The turnover of foreign currency pair transactions totaled USD447.8 billion, increasing by 17.8 percent year on year. In particular, the EUR/USD pair registered the largest trading volume, accounting for 38.8 percent of the total market share.

7. The volume of gold trading expanded year on year, while international gold prices went up

At end-March, international gold prices closed at USD1,979.7 per ounce, representing an increase of 9.2 percent from end-2022. The Au99.99 on the Shanghai Gold Exchange closed at RMB440.7 per gram, increasing by 7.4 percent from end-2022. In Q1, the volume of gold traded on the Shanghai Gold Exchange was 11,600 tons, an increase of 20.7 percent year on year. The turnover posted RMB4.84 trillion, up 31.1 percent year on year.

II. Development of institutional arrangements in financial markets

1. Institutional arrangements in the money market

The regulation of important money market funds was strengthened. In February 2023, the China Securities Regulatory Commission (CSRC), together with the PBOC, released the *Interim Provisions on the Regulation of Important Money Market Funds*, which, in the following three aspects, improved the safety and liquidity of important fund products in the money market and effectively prevented risks. First, it specified relevant definitions as well as the prerequisites, criteria and procedures for the evaluation of important money market funds. The evaluation shall cover money market funds with more than 50 million investors, or a size exceeding RMB200 billion, or other features deemed important by the relevant authority. Second, it specified additional supervisory regulations that posed more stringent and prudent requirements on the managers, trustees, and sales institutions of such funds, in such aspects as business concept, risk management and investment ratio. Third, it specified the mechanism for risk prevention and resolution. Fund managers and relevant market entities shall develop a risk-response plan that is reasonable and effective. The CSRC, together with the PBOC and other relevant authorities, shall put in place information-sharing mechanisms and shall stipulate the sources of the risk-resolution funds, including fund managers' own funds and risk reserves, under different risk situations.

2. Reforms and institutional arrangements in the securities market

The reform towards a fully functional registration-based IPO system was advanced. On February 1, 2023, the CSRC officially launched the reform towards a fully functional registration-based IPO system, and on February 17, the CSRC released relevant provisions and rules which came into force upon promulgation. Supporting provisions and rules were introduced simultaneously by stock exchanges, the National Equities Exchange and Quotation (NEEQ), the China Securities Depository and Clearing Corporation (CSDC), the China Securities Finance Corporation (CSF), and the Securities Association of China. Aiming to improve and unify the institutional arrangements of the registration-based IPO system and covering all types of public offering of stocks, the reform is of great importance for improving the function of capital markets, implementing the innovation-driven development strategy, and better serving the high-quality development.

Application of information technology in the capital market was enhanced. In January, the CSRC and PBOC jointly released the *Electronic Specification for Information Disclosure of Publicly Offered Securities Investment Mutual Funds*. As a set of standards for the financial industry, the specification encouraged regulated, structural and datafied information disclosure underpinned by technology so as to improve efficiency in the generation, exchange, verification, and application of information. It is conducive to the open and transparent operation of mutual funds.

The two-way opening-up of the capital market continued. In February, the CSRC released the *Trial Administrative Measures of Overseas Securities Offering and Listing by Domestic Companies*, as well as five other supporting guidelines, to support lawful and compliant overseas securities offering and listing by domestic companies. In February, the CSRC and the Securities and Futures Commission (SFC) of Hong Kong approved adjustments to the trading calendar for the Stock Connect. The adjustments were to be conducted by the Shanghai Stock Exchange (SSE), the Shenzhen Stock Exchange (SZSE), the Stock Exchange of Hong Kong Limited (SEHK), the CSDC, and the Hong Kong Securities Clearing Company Limited (HKSCC) on April 24, 2023, enabling the Stock Connect to operate on trading days formerly closed due to unavailable clearing services. They deepened mutual access of trade between stock markets in the mainland and in Hong Kong.

3. Institutional arrangements in the insurance market

The comprehensive reform of auto insurance was deepened. In January 2023, the China Banking and Insurance Regulatory Commission (CBIRC) released the *Notice on Expanding the Floating Range of Independent Pricing Coefficients of Commercial Auto Insurance and Other Related Matters*, specifying that the floating range of the independent pricing coefficients of commercial auto insurance was to be expanded from [0.65, 1.35] to [0.5, 1.5]. The Notice required that the local offices of the CBIRC should steadily determine the implementation period of the policy in their respective jurisdictions, strengthen their supervision responsibilities, and guide companies to reasonably set the range of the average independent pricing coefficients and the upper limit of handling fees in each region. The Notice required that the relevant companies shall strictly implement regulatory requirements for auto insurance, improve and guarantee the supply of auto insurance products, and enhance the service of auto insurance underwriting and claim payment.

Information disclosure of life insurance products was further regulated. In January 2023, the CBIRC released the *Rules for Information Disclosure of Life Insurance Products with Terms of More Than One Year*, which will take effect on June 30, 2023. The Rules specified that specifications are required for life insurance products with terms of more than one year. According to different types of product designs, detailed disclosure is also required in terms of their promotional material, level of security, illustration of benefits, and other information. The disclosure shall fully reveal the products' long-term nature and risk characteristics as well as the method of payment and the losses arising from surrender.

Risk-reduction services were promoted in the property insurance industry. In January, the CBIRC released the *Opinions on Proactively Providing Risk-Reduction Services in the Property Insurance Industry*, requiring property insurance companies to enrich the content, expand the scope, diversify the form, and increase the supply of their risk-reduction services. Such services shall be provided upon consensus with the enterprise policyholders, and the accounting practices shall strictly follow accounting standards so as to protect the rights and interests of consumers.

The pilot business of switching liability between life insurance and long-term care insurance was conducted. In March, the CBIRC released the *Notice on Carrying out the Pilot Business of Switching Liability between Life Insurance and Long-term Care Insurance*, which was to take effect on May 1, 2023, and will initially last for two years. The Notice specified the definition and methods of the switch as well as duration and institutions for the pilot business. It also clarified requirements on internal management, risk control,protection of consumer rights, and other aspects.

Part 4 Macroeconomic Overview

I. Global economic and financial developments

Growth in the major economies has slowed down, the easing of inflation in Europe and the US has been slower than expected, and the collapse of Silicon Valley Bank (SVB) and Credit Suisse has wreaked havoc on global financial markets. Financial stability concerns have added to the hard trade-off between price stability and full employment faced by monetary policymakers. The risk of growing geopolitical tensions, coupled with rising protectionism and unilateralism, may further undermine the global economic order.

1. Economic performance and financial markets in the major economies

Economic growth slowed down. In March 2023, the manufacturing Purchasing Managers' Index (PMI) in the US, the euro area, and Japan posted 46.3, 47.3, and 49.2, respectively. It has stayed below 50 for five straight months in the US and Japan, while for nine months in the euro area. In March, retail sales grew by 2.9 percent year on year in the US, the lowest rate since the second half of 2020, while it dropped by 3.8 percent year on year in the euro area, contracting for six consecutive months. According to the latest forecast by the International Monetary Fund (IMF), the US and the euro area are projected to grow by 1.6 percent and 0.8 percent respectively in 2023, 0.5 and 2.7 percentage points lower compared with 2022.

Inflation has come down from a peak in the US and Europe, but remained elevated. In April, the US Consumer Price Index (CPI) was up by 4.9 percent year on year, falling for ten months in a row, and the core CPI has stayed at 5.5-5.6 percent since the beginning of this year, pointing to entrenched inflation. The Harmonized Index of Consumer Prices (HICP) in the euro area rose by 7.0 percent over the prior year, 0.1 percentage points higher compared with the previous month, while the core HICP stayed as high as 5.6 percent. The CPI in the UK maintained a double-digit growth year on year in March.

The tightness of labor market eased slightly. In the US, 236 thousand new jobs were added in March, a 27-month low. Job vacancies dropped below 10 million for the first time in 20 months, but it is still higher than the 7 million before COVID-19. The unemployment rate stayed at a historic low of 3.5 percent. The labor force participation rate edged up to 62.6 percent, still lower than the pre-COVID level of 63.4 percent. Going forward, performance of the labor market will depend on the relative changes in labor supply and demand.

The failure of SVB and acquisition of Credit Suisse pointed to rising strains in the US and European banking system. The SVB collapsed and was taken over by federal regulators on March 10 due to a run on the bank, making it the largest bank failure since the subprime mortgage crisis. The contagion leading to more bank failures caused market panic and further dented confidence in small and medium-sized banks. The European banking system also took a hit. The share price of Credit Suisse plummeted, losing 26 percent in the week from March 13 to March 17. As a result, the STOXX600 Banks Index dropped to one-year low. On March 19, Swiss regulators announced that the UBS would buy Credit Suisse for 3 billion Swiss francs.

Global financial markets witnessed large swings. After the collapse of SVB, the S&P 500 and Dow Jones Industrial Average fell by 3.3 percent and 2.7 percent respectively in the two days from March 9 to March 10. The market capitalization of US-listed banks shed over USD100 billion. In the following week, as panic spread to other regions and the commodity market, major stock indices in the euro area, the UK, and Japan fell by 3.9 percent, 5.3 percent, and 2.9 percent, respectively. Oil price once dropped below 70 for the first time since December 2021, whereas safe haven assets such as gold and government bonds gained a lot. From March 9 to the end of March, gold spot prices increased by over 8 percent, and the yield on 10-year and 2-year US Treasuries dropped by 50 basis points (bps) and 99 bps respectively to 3.48 percent and 4.06 percent.

Table 13 Macroeconomic and Financial Indicators in the Major Advanced Economies

Economy	Indicator	Q1 2022			Q2 2022			Q3 2022			Q4 2022			Q1 2023		
		Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
United States	Real GDP Growth (annualized quarterly rate, %)	-1.6			-0.6			3.2			2.6			1.1		
	Unemployment Rate (%)	4.0	3.8	3.6	3.6	3.6	3.6	3.5	3.7	3.5	3.7	3.6	3.5	3.4	3.6	3.5
	CPI (year-on-year, %)	7.5	7.9	8.5	8.3	8.6	9.1	8.5	8.3	8.2	7.7	7.1	6.5	6.4	6.0	5.0
	DJ Industrial Average (end of the period)	35132	33893	34678	32977	32990	30775	32845	31510	28726	32733	34590	33147	34086	32657	33274
Euro Area	Real GDP Growth (year-on-year, %)	5.5			4.4			2.5			1.8			1.3		
	Unemployment Rate (%)	6.9	6.8	6.8	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.6	6.6	6.5
	HICP (year-on-year, %)	5.1	5.9	7.4	7.4	8.1	8.6	8.9	9.1	9.9	10.6	10.1	9.2	8.6	8.5	6.9
	EURO STOXX 50 (end of the period)	4175	3924	3903	3803	3789	3455	3708	3517	3318	3618	3965	3794	4163	4238	4315
United Kingdom	Real GDP Growth (year-on year, %)	10.6			3.8			2.0			0.6			…		
	Unemployment Rate (%)	3.8	3.7	3.8	3.8	3.8	3.6	3.5	3.6	3.7	3.7	3.7	3.7	3.8	…	…
	CPI (year-on-year, %)	5.5	6.2	7.0	9.0	9.1	9.4	10.1	9.9	10.1	11.1	10.7	10.5	10.1	10.4	10.1
	FTSE 100 (end of the period)	7464	7458	7516	7545	7608	7169	7423	7284	6894	7095	7573	7452	7772	7876	7632
Japan	Real GDP Growth (annualized quarterly rate, %)	-1.8			4.7			-1.1			0.1			…		
	Unemployment Rate (%)	2.7	2.7	2.6	2.5	2.6	2.6	2.6	2.5	2.6	2.6	2.5	2.5	2.4	2.6	2.8
	CPI (year-on-year, %)	0.5	0.9	1.2	2.5	2.5	2.4	2.6	3.0	3.0	3.7	3.8	4.0	4.3	3.3	3.2
	Nikkei 225 (end of the period)	27002	26527	27821	26848	27280	26393	27802	28092	25937	27587	27969	26095	27327	27446	28041

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

2. Monetary policies of the major economies

The central banks in the major advanced economies slowed the pace of monetary tightening, but the policy stance remained unchanged. The Federal Reserve (Fed) raised rates in February, March, and May each by 25 bps, a slower pace compared with previous rate hikes. The federal funds rate is now at a target range of 5-5.25 percent, consistent with the median forecast for the federal funds rate at the end of 2023 in March dot plot. "Some additional policy firming may be appropriate" was removed from the Federal Open Market Committee (FOMC) statement in May. Fed Chair Jerome Powell said the Fed would take a data-dependent approach in determining the extent to which additional policy firming may be appropriate. In response to the collapse of SVB, the Fed created the Bank Term Funding Program (BTFP) to provide emergency liquidity to US depository institutions. The European Central Bank (ECB) increased the interest rate in February, March, and May by 50 bps, 50 bps, and 25 bps respectively, bringing the interest rate on its main refinancing operations, marginal lending facility, and deposit facility to 3.75 percent, 4 percent, and 3.25 percent, respectively. The ECB started to shrink its balance sheet from early March by a monthly average amount of EUR15 billion until the end of June. The pace of unwinding after Q2 is yet to be determined. The Bank of England raised rates by 50 bps in February, and by 25 bps in March and May respectively. Now, the Bank Rate is 4.5 percent. The Bank of Japan kept its policy rate unchanged and continued to implement Quantitative and Qualitative Monetary Easing with Yield Curve Control. In Q1, the Reserve Bank of Australia, the Reserve Bank of New Zealand, the Bank of Canada, and the Bank of Korea raised rates by a total of 50 bps, 50 bps, 25 bps, and 25 bps, respectively.

Monetary policies in emerging economies diverged. Some emerging economies continued to raise rates. In Q1, the central banks in Argentina and Egypt hiked rates by 300 bps and 200 bps respectively, while the central banks in Mexico, South Africa, India, and Indonesia increased their interest rates by 75 bps, 75 bps, 25 bps, and 25 bps. The central banks in Russia, Brazil, and Malaysia stood pat on rates.

3. Issues and trends that merit attention

Inflation remains stubbornly high. As energy prices fell and supply chains recovered, inflation in the US and Europe has come down in general, but some inflation data proved to be quite sticky. In March, the US core Personal Consumption Expenditures (PCE) price index rose by 4.6 percent year on year, the same as in December 2022. The core HICP in the euro area was 5.6 percent, the highest reading since records began. Inflationary pressures remain hard to ease, as unresolved labor shortage in the major advanced economies makes it unlikely for wage growth to falter very soon, plus services inflation remains high.

Financial stability risks have increased. Mismanagement is a direct cause for troubles faced by SVB and Credit Suisse. However, their failures also exposed some deep-rooted problems, and may aggravate financial stability risks. First, against the backdrop of rising interest rates, many banks face book losses in their portfolio investment. Second, as higher rates have increased the debt-service burden on non-financial enterprises, risks in the real sector may spread to the financial sector. Third, regulators typically focus on too-big-to-fail institutions while small and medium-sized ones are less regulated. However, the latter may also trigger wide financial risks.

Monetary policy uncertainties have increased. Banking strains including the collapse of SVB have put the Fed in a more difficult situation. Further tightening may push more small and medium-sized banks to distress and threaten financial stability, while a pause in rate hikes may prolong high inflation. As unstable market expectations may further heighten market volatility, policymakers should remain alert to potential risks.

Evolution of the global economic order may accelerate. The risk of an escalation in the conflict in Ukraine remains. As Western countries continue to impose massive sanctions on Russia, energy and other commodities may see a fresh round of shocks. With the concept of national security overstretched in the implementation of sanctions, the world may face risks from the reconfiguration of the existing international division of labor, and global industrial and supply chains are reshaping more rapidly towards regional and local chains.

II. Macroeconomic developments in China

In Q1 2023, faced with the complex and severe international environment and the arduous tasks of domestic reform, development, and stability, all regions and departments made active efforts to stabilize expectations, strengthen confidence, and focus on implementation, putting emphasis on stabilizing growth, employment, and prices. The COVID-19 containment transitioned to a new stage rapidly and steadily. The production demand stabilized and rebounded, and the national economy got off to a good start. According to preliminary statistics, GDP in Q1 2023 grew by 4.5 percent year on year to RMB28.4997 trillion on a comparable basis, up 2.2 percent quarter on quarter.

1. Consumption recovered steadily, investments grew stably, and imports and exports maintained their growth

Residents' income grew steadily and market sales recovered rapidly. In Q1, China's per capita disposable income reached RMB10870, increasing by 5.1 percent year on year in nominal terms, or 3.8 percent in real terms, an acceleration of 0.1 percentage points and 0.9 percentage points year on year, respectively. The structure of income distribution continuously improved. The nominal and real growth rates of rural residents' income were both 2.1 percentage points higher than those of urban residents. In Q1, total retail sales of consumer goods returned to positive territory and grew by 5.8 percent year on year. Consumption of basic living items saw stable growth, with retail sales of textile products, such as clothing, shoes, and hats, by enterprises (units) above the designated size increasing by 9.0 percent and retail sales of grain, oil, food, and beverages by enterprises (units) above the designated size increasing by 7.5 percent year on year. Sales of upgraded products increased significantly, with retail sales of gold/silver/jewelry and books/newspapers/magazines by enterprises (units) above the designated size increasing by 13.6 percent and 13.4 percent, respectively. According to the Urban Depositors' Survey conducted by the PBOC in Q1, 23.2 percent of residents were inclined to "consume more," up 0.5 percentage points from Q4 2022.

Investments grew steadily and investments in the high-tech industry expanded rapidly. In Q1, total fixed-asset investments throughout China (excluding those by rural households) increased by 5.1 percent year on year to RMB10.7282 trillion, which were basically flat with those in the previous year. In terms of sectors, investments in the manufacturing sector increased by 7.0 percent, 1.9 percentage points higher than the growth of total investments. Investments in infrastructure increased by 8.8 percent, 3.7 percentage points higher than the growth of total investments. Investments in real estate development decreased by 5.8 percent year on year, with the deceleration narrowing. Investments in the high-tech industry grew by 16.0 percent year on year, 10.9 percentage points higher than the growth of total investments. Social investments grew by 8.3 percent year on year. Specifically, investments in health and education grew by 21.6 percent and 6.2 percent, respectively, year on year.

Imports and exports maintained growth, with the trade structure continuously improved. In Q1, imports and exports of goods grew by 4.8 percent year on year to RMB9.8877 trillion, an acceleration of 2.6 percentage points from Q4, 2022. Specifically, exports grew by 8.4 percent year on year and imports grew by 0.2 percent year on year, with the trade surplus in goods posting RMB1.4090 trillion. The trade structure continued to improve. The share of imports and exports under general trade accounted for 65.3 percent of total imports and exports, increasing by 1.9 percentage points year on year. Imports and exports of private enterprises increased by 14.4 percent, accounting for 52.4 percent of total imports and exports. China's imports and exports with its trading partners continued to rise. Imports and exports to the ASEAN (Association of Southeast Asian Nations), China's largest trade partner, and the countries along the Belt and Road grew by 16.1 percent and 16.8 percent year on year, respectively.

Foreign direct investments (FDI) grew steadily and continued to be concentrated in the high-tech industries. In Q1, actually utilized FDI increased by 4.9 percent year on year to RMB408.5 billion. The structure of FDI continued to be optimized. In Q1, actually utilized FDI in the high-tech industries grew by 18 percent year on year to RMB156.7 billion. Specifically, the electronic and communications equipment manufacturing sector, technology achievement commercialization services sector, and research and development and design services sector grew by 55.7 percent, 50.3 percent, and 24.6 percent year on year, respectively.

2. Agricultural production made stable progress, industrial production continued to recover, and the service industry rebounded significantly.

In Q1, the value-added of primary industry totaled RMB1.1575 trillion, up 3.7 percent year on year. The value-added of secondary industry totaled RMB10.7947 trillion, up 3.3 percent year on year. The value-added of tertiary industry totaled RMB16.5475 trillion, up 5.4 percent year on year.

Agricultural production was stable, and animal husbandry grew steadily. In Q1, the value-added of agriculture (planting industry) increased by 3.6 percent year on year. The growth of winter wheat was generally normal and preparations for spring ploughing were carried out in a smooth and orderly manner. In Q1, output of pork, beef, lamb, and poultry grew by 2.5 percent year on year. In particular, output of pork grew by 1.9 percent. At end-Q1, the number of hogs in stock and the number of hogs for slaughter increased by 2.0 percent and 1.7 percent year on year, respectively.

Industrial production continued to recover, and expectations of enterprises were generally improved. In Q1, the value-added of the Industrial Enterprises Above a Designated Size (IEDS) increased by 3.0 percent year on year, an acceleration of 0.3 percentage points from Q4, 2022. Specifically, the value-added of the mining sector increased by 3.2 percent year on year. The manufacturing sector increased by 2.9 percent year on year. The production and supply of electricity, heat, gas, and water increased by 3.3 percent year on year. In terms of enterprise types, the value-added of state-owned holding enterprises increased by 3.3 percent while that of private enterprises increased by 2.0 percent. In terms of products, the output of solar cells and new energy vehicles grew by 53.2 percent and 22.5 percent year on year, respectively.

The service industry rebounded significantly, and the contact service industry grew rapidly. In Q1, the value-added of the service industry grew by 5.4 percent year on year, an acceleration of 3.1 percentage points from Q4, 2022. Specifically, the value-added of accommodations and catering, electronic information transmission/software/information technology services, and the financial sector grew by 13.6 percent, 11.2 percent, and 6.9 percent year on year, respectively. In March, the Index of Service Production (ISP) increased by 9.2 percent year on year, an acceleration of 3.7 percentage points from January and February 2023. Specifically, the ISP of accommodations and catering, electronic information transmission/software/information technology services, and transportation/storage/postal services increased by 29.9 percent, 12.0 percent, and 11.9 percent year on year, respectively. The Business Activities Index for the services industry reached 56.9 percent. The revenue of enterprises above a designated size in the service industry increased by 3.4 percent year on year.

3. The increase in consumer prices narrowed, and the decline in producer prices widened

The growth of consumer prices declined month by month. In Q1, the Consumer Price Index (CPI) increased by 1.3 percent year on year, down 0.6 percentage points from the previous quarter. Specifically, the CPI in January, February, and March increased by 2.1 percent, 1.0 percent, and 0.7 percent, respectively. In particular, due to the Spring Festival, prices of most fresh food first rose and then fell, and the increased supply of live pigs led to a continuous decline in pork prices. Coupled with the base effect, food prices increased by 3.7 percent year on year, a deceleration of 1.4 percentage points from the previous quarter. Affected by the fluctuations in international oil prices, domestic energy prices decreased slightly, with the average for the first quarter on par with that of 2022. Optimization of the COVID-19 containment measures drove the recovery of service demand, such as transportation, resulting in a year-on-year increase of 0.8 percent in the core CPI (food and energy excluded), up 0.2 percentage points from the previous quarter.

The decline in producer prices expanded month by month. Due to the decrease in energy prices and the effect of the high base in 2022, the year-on-year decline of the Producer Price Index (PPI) expanded month by month. In Q1, the PPI decreased by 1.6 percent year on year, widening 0.5 percentage points from the previous quarter. Specifically, the PPI in January, February, and March decreased by 0.8 percent, 1.4 percent, and 2.5 percent, respectively. In Q1, the Purchasing Price Index for Industrial Products (PPIRM) decreased by 0.7 percent year on year, widening 0.7 percentage points from the previous quarter. The Corporate Goods Price Index (CGPI) monitored by the PBOC decreased by 0.5 percent year on year, a deceleration of 4.0 percentage points from the previous quarter and a deceleration of 6.7 percentage points from Q1, 2022.

Box 4 China's Inflation Remains Subdued

Inflation depends on the overall balance of supply and demand in the real economy. The level of inflation is influenced by both supply and demand. It can be driven by demand-side factors such as consumption and is closely related to supply-side factors such as supply shocks and rising costs. The general balance between aggregate supply and aggregate demand is the basis for price stability. **In recent**

years, China has maintained an overall balance between supply and demand, and the price level has remained basically stable. Since the beginning of 2022, major developed economies have endured high inflation unseen in decades, which has had a significant impact on the monetary policy decisions of their central banks. On the contrary, China's inflation rate has remained within a moderate range, with an average annual CPI growth of around 2 percent last year and in the past five or ten years. On one hand, China has made great efforts to secure employment, stabilize businesses and ensure the people's livelihood amid effective COVID-19 containment, contributing to stable social productivity and smooth economic circulation. On the other hand, the PBOC has stuck to a sound monetary policy, and money and credit have enjoyed reasonable growth, laying a solid foundation for price stability.

Since the beginning of the 21st century, China has witnessed several episodes of CPI decline. Under the impact of unexpected factors, such as the global financial crisis from 2008 to 2009 and the outbreak of COVID-19 in 2020, China's CPI growth plummeted temporarily, even below 0 for a short period of time. The economy was under pressure in its stable development but stabilized quickly. The CPI also contracted temporarily in 2002, when the index lingered below 0 for ten consecutive months. The decline could be attributed to the abundant market supply from the overseas market after China's accession to the WTO. The macro economy maintained stable and relatively high-speed growth at that time. Despite temporary decline in CPI during other periods of the past decades, the overall trend of macroeconomic performance has not be significantly affected. Generally speaking, if the economy maintains normal growth, the impact of transitory decline in CPI should not be exaggerated.

Historically, the fluctuation of China's PPI was relatively large. As the supply and demand of industrial products such as crude oil and iron ore vary significantly over time, the index of PPI has fluctuated sharply. The year-on-year growth rates of PPI have been negative in nearly 40 percent of the months since 2000, and for a rather long period of time, the PPI growth rates have been negative. For instance, the year-on-year growth rates of PPI have been negative for over fifty consecutive months in the period from 2012 to 2016. However, the downward trend of PPI does not necessarily represent a sustained decline in overall price levels. The CPI is the main gauge of inflation globally.

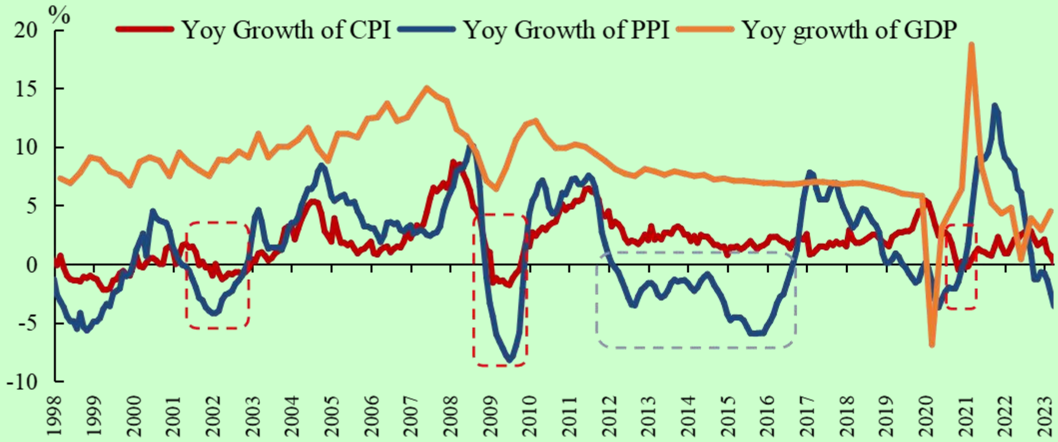


Figure: Periods of Obvious Price Decrease in China Since the Beginning of the 21st Century

Since the beginning of this year, temporary decline in price increase has been mainly due to the time lag between supply and demand recovery and the base effect. China's national economy made a good start with mild inflation. In month-on-month terms, the CPI has edged down with the index for April dropping to 0.1 percent, and the PPI has turned to a negative growth in recent months. The decline of price level can be attributed to the following factors. **The first one is strong supply capacity.** With the strong support from a package of policies to stabilize economy, the recovery of domestic production continues to speed up. The sub-items of manufacturing in the PMI operated within the economic boom range. Stable production of agricultural and sideline products and smooth logistics have ensured the sufficient supply for residents' "vegetable baskets" and "rice bags". **The second factor is a slow recovery of demand.** The production, distribution, circulation and consumption are sequenced parts of the real economy, and the "scar effect" of the COVID-19 has not yet subdued. As a result, the willingness of residents in shifting extra savings to consumption are constrained by income distribution differentiation and unstable income expectations. In particular, the demand for bulk consumption such as automobiles and home improvements remains weak. Recently, some residents repaid their loans in advance, which, to some extent, dragged down their current consumption. **The third factor is substantial base effect.** Crude oil price surged to almost USD140 per barrel last year, and has slipped to around USD80 per barrel since the beginning of this year. As a result, the transportation fuel costs and the water charge, electricity bills and gas fees of residents declined on a year-on-year basis. Although spring is traditionally the season with abundant vegetable supply, fresh vegetable prices went up last March amid containment measures of the COVID-19, which brought about a high base effect. Macroeconomic data such as GDP also have a substantial base effect. The GDP growth rate dropped to 0.4 percent in Q2 2022 due to the impact of the COVD-19, and will possibly witness an obvious rebound in Q2 2023.

The CPI will fluctuate at a low level and in a narrow range due to high base effect in the coming months. The CPI will remain at a low level from May to July this year as influenced by the high base of CPI growth of around 2.5 percent in the same period last year. However, it should be noted that as the base decreases and the policy effects are more evident, the role of the market will be brought into full play, the endogenous growth driver of the economy will be strengthened, and the gap between supply and demand will be likely to close. It is expected that the CPI may rise moderately in the second half of the year and may rebound to the average level in recent years at the year-end. **At present, the Chinese economy does not face the risk of deflation.** Deflation refers to a continuous fall in the general price level, often accompanied by a reduced money supply and economic recession. China is witnessing a mild price growth with the core CPI stable at around 0.7 percent on a yearly basis. Growth of M2 and the AFRE are relatively fast and the economy is on a solid recovery track, all of which are by no means the characteristics of deflation. In the medium-to-long term, as the aggregate supply and demand are generally balanced, the monetary conditions are reasonable and moderate, and residents' expectations are stable, there is no case for deflation or inflation in China in the long run.

Going forward, the PBOC will continue to implement a sound monetary policy, and ensure a moderate monetary aggregate with smooth-paced policy operations so as to improve the quality and efficiency of financial services for the real economy. It will also strengthen the coordination ad cooperation with fiscal policies, forge a policy synergy to expand demand, promote the sustained improvement in economic performance, and maintain the basic stability of prices.

4. Fiscal revenue rose steadily, and expenditures grew rapidly

In Q1, revenue in the national general public budget posted RMB6.2341 trillion, increasing 0.5 percent year on year. Specifically, central fiscal revenue decreased by 4.7 percent, whereas local fiscal revenue increased by 5.0 percent year on year. National tax revenue amounted to RMB5.1707 trillion, decreasing 1.4 percent year on year. Specifically, the domestic value-added tax increased by 12.2 percent year on year, and the corporate income tax increased by 9.3 percent year on year. The consumption tax and the personal income tax decreased by 22.2 percent and 4.4 percent, respectively. Non-tax income posted RMB1.0634 trillion, increasing 10.9 percent year on year.

In Q1, expenditures in the national general public budget posted RMB6.7915 trillion, increasing 6.8 percent year on year. Specifically, expenditures in the central level general public budget and the local level general public budget increased by 6.4 percent and 6.9 percent year on year, respectively. In terms of the expenditure structure, expenditures related to health, agriculture, forestry, and water conservancy, as well as social security and employment grew fairly rapidly, witnessing a year-on-year increase of 12.2 percent, 10.9 percent, and 9.6 percent, respectively.

5. The employment situation remained generally stable

The surveyed urban unemployment rate declined. In Q1, the average national surveyed urban unemployment rate posted 5.5 percent, decreasing 0.1 percentage points from the previous quarter. In March, the surveyed urban unemployment rate posted 5.3 percent, decreasing 0.3 percentage points from the previous month. Specifically, the surveyed unemployment rate for the population between the ages of 25 and 59 posted 4.3 percent, 1.0 percentage point lower than the national surveyed urban unemployment rate. The unemployment rate for the population between the ages of 16 and 24 posted 19.6 percent.

6. The balance of payments and the external debt

According to preliminary statistics, China's current account surplus registered USD82 billion in Q1, accounting for 2.0 percent of the Gross Domestic Product (GDP) and remaining within a reasonable range. Specifically, according to the balance of payments statistics, trade in goods recorded a surplus of USD129.9 billion, and trade in services recorded a deficit of USD47 billion. Two-way direct investments remained generally reasonable and orderly. Net outflow of overseas equity investment posted USD31.3 billion, and net inflow of foreign equity investment in China posted USD28.3 billion. At end-March 2023, foreign exchange reserves balance reached USD3.1839 trillion, an increase of USD56.2 billion compared with that at end-2022, which was mainly affected by non-transactional factors such as the exchange rate conversion and global asset price adjustments. Regarding external debt, at end-December 2022 the balance of full-caliber foreign debt (denominated in both domestic and foreign currencies) posted USD2.4528 trillion. Specifically, the short-term external debt balance posted USD1.338 trillion, accounting for 55 percent of the total external debt balance.

7. Analysis by sector

7.1 The real estate sector

In March 2023, among 70 medium and large-sized cities nationwide, newly built and second-hand residential housing prices decreased by 1.4 percent and 2.9 percent year on year, respectively, both down 0.9 percentage points from last year. From January to March, the total floor area of sold units decreased by 1.8 percent year on year. Housing sales increased by 4.1 percent year on year. Investments in real estate development decreased by 5.8 percent year on year. Specifically, investments in residential housing development decreased by 4.1 percent year on year.

Table 14 Floor Area of Newly Started, Under Construction, and Completed Real Estate Projects in Q1 2023

	Floor area (100 million square meters)	YOY change (%)	QOQ change (percentage points)
Floor area of newly started real -estate projects	2.4	-19.2	20.2
Floor area of real estate projects under construction	76.5	-5.2	2
Floor area of completed real estate projects	1.9	14.7	29.7

Source: National Bureau of Statistics of China.

At end-March 2023, outstanding real estate loans by major financial institutions (including foreign-funded financial institutions) grew by 1.3 percent year on year to RMB53.9 trillion. Specifically, outstanding individual housing loans grew by 0.3 percent year on year to RMB38.9 trillion. Outstanding housing development loans grew by 4.5 percent year on year to RMB10 trillion.

7.2 The transportation industry

Transportation is a fundamental, leading, and strategic industry in the national economy. It underpins the new development paradigm and serves as sound support for serving people's needs for better lives and promoting common prosperity. Since the outbreak of COVID-19, the transportation industry has been hard hit. However, it has been experiencing a continuous pick-up with improved COVID-19 containment measures, enhanced policy support, as well as economic and social recovery. **First, the recovery of domestic passenger traffic accelerated and domestic freight traffic surpassed pre-pandemic levels.** In Q1 2023, the volume of passenger traffic stood at 1.95 billion, returning to 43.9 percent of that in Q1 2019. Specifically, the volume of passenger railway traffic, water transport, and civil aviation all recovered to above 80 percent of that in Q1 2019. **Second, international freight traffic grew steadily and overseas flights continued to increase.** Based on the overall growth achieved during COVID-19, the volume of foreign trade freight handled by major coastal ports witnessed a growth of 1.19 billion tons in Q1 2023, increasing by 28.4 percent compared with Q1 2019. As of mid-April, flights connecting China with 59 countries had resumed, and the volume of flights had recovered to 29.4 percent of that before COVID-19. Third, growth of investment in the transportation industry accelerated, helping to build the new development paradigm. The transportation industry is a pillar for building a unified national market. As the pace of the latter quickened, the former has attracted higher investment. In Q1 2023, fixed asset investment in transportation, storage, and post services grew by 8.9 percent year on year, markedly higher than the 5.1 percent growth of overall fixed asset investment.

With a batch of railways, roads, and aviation programs completed in succession, the transportation industry will continue to grow in a stable manner.

However, it should also be noted that the unbalanced and inadequate development of the transportation industry remains salient. First, the layout of the transport network should be more balanced and reasonable. The levels of development across regions vary greatly, reflected by the lagging transport infrastructure in the rural areas as well as by the weakness in the intercity railways among major city clusters and suburb railways in key conurbations. There are some other problems as well, including insufficient supply of high-level transportation, predatory pricing, homogeneity competition, and many scattered market entities that are small and weak. **Second, the transportation industry should be greener and have more technological content.** The application of new technology should be widened and deepened. The transportation industry is still less digitalized and less intelligent, and is faced with insufficient development of Internet of Things. The capability for innovation in core and key products and technologies is still weak. Moreover, arduous tasks for green and low-carbon development require the widespread use of clean energy at a quicker pace. **Third, overseas supply chains should be more self-supporting.** Against the backdrop of disruptions and shocks in global industrial chains and supply chains triggered by COVID-19 and geopolitical conflicts, the logistics industry in China still lacks self-supporting international transport capacity. The construction of overseas logistics transfer stations is lagging behind in terms of overseas warehouses and the localized service network. Such poor logistics performance has limited the internationalization of manufacturing supply chains.

To build a country with strong transportation, China must establish a modernized comprehensive transport system that is safe, convenient, efficient, green, and economical. **First, the layout and function of the comprehensive transport infrastructure will be improved.** Measures will be taken to improve the comprehensive multi-level transport network, to strengthen integration of the transport infrastructure systems, to enhance the quality of transportation services, to accelerate the development of rural transport infrastructures and services, and to deepen the integrated development of rural and urban transportation. **Second, the transport technology innovation system should be optimized.** China will boost the construction of smart traffic, the development of key and core technology, the promotion of advanced transport equipment, the promulgation of standards that are in line with the building of a strong transportation industry, and the transition towards green and low-carbon transportation. **Third, the international transportation will be facilitated.** To achieve the higher-level opening-up of the industry, it is necessary to strengthen connectivity among transport infrastructures, to improve international cooperation mechanisms, to smooth domestic and cross-boarder logistics channels, and to fuel the integrated development of industrial chains and supply chains.

Part 5. Monetary Policy Outlook

I. Outlook for the Chinese economy

The Chinese economy saw better-than-expected growth. Since the beginning of 2023, with China fully resuming normal operations, the triple pressures from shrinking demand, supply shocks, and weakening expectations have been easing. Meanwhile, market demand is recovering and economic development is on track to make a turnaround. Looking ahead, the Chinese economy is expected to maintain its recovery momentum due to many favorable conditions. First, the potential for domestic demand will be further released, given the rebound in income growth, improvements in the consumer environment, the upswing in people's willingness to consume, and the generally stable employment situation. Second, major projects are making headway at a faster pace, with infrastructure investments continuing to play an important role in stabilizing growth. Moreover, China has increased investment in technological upgrades in the manufacturing sector, and the stabilizing real-estate sector will be less of a drag on total investments. Third, with complete industrial chains and supply chains and strong supporting capacities, China still enjoys structural advantages in exports. Fourth, the policy measures already introduced have continued to have effects. China has enhanced the intensity and effectiveness of its proactive fiscal policy while pursuing a sound monetary policy in a targeted and effective manner. These measures have scaled up support for the real economy and have created a favorable environment for supply-side structural reforms and high quality development. In general, the Chinese economy is expected to see a sustainable and overall turnaround. Due to the low base effect, Q2 growth will likely see a significant rebound to lay a solid foundation for achieving the annual growth target.

Currently, the external environment is becoming more severe and complicated, while the endogenous driving force for domestic economic growth is still weak and demand is insufficient. From an international perspective, global economic growth is slowing down, inflation remains elevated, and geopolitical conflicts are persistent. As spillovers from the monetary tightening by the major central banks are playing out, global financial markets have witnessed greater volatility. In a word, there are many destabilizing factors, uncertainties, and unforeseen factors. From a domestic perspective, the "scar effect" of the pandemic is lingering, income expectations are yet to pick up, employment pressures for young people are high, and the sustainability of the consumption recovery is faced with challenges. In addition, there are still constraints on the role of government investment in catalyzing social investments, and external demand is likely to remain subdued amid the global economic slowdown. **Nevertheless, it should be noted that the Chinese economy has strong resilience, huge potential, and ample vitality, with a tremendous market, a complete industrial system, rich human resources, and other advantages. Therefore, the fundamentals for China's sound economic growth over the long run remain unchanged.** We will strengthen confidence in advancing economic work and deepen the reform and opening-up in all respects. By adopting a package of steps, we will unleash the potential of domestic demand, stabilize foreign trade, and optimize its structure so as to promote a sustainable, overall turnaround in the economy.

Prices have increased mildly and are likely to pick up gradually in the second half of the year. Since the beginning of this year, China has seen increasingly smaller price rises, mainly due to food and energy prices. Specifically, CPI for food in Q1 remained unchanged from the previous quarter, in contrast with the increase of around 1 percent recorded in the past years. Moreover, large price reductions by auto companies had a short-term influence. However, the CPI for services posted a cumulative quarter-on-quarter increase that was close to pre-pandemic levels, with items relating to offline activities, such as air tickets, accommodations, and cultural and recreational spending, rebounding notably. The PPI remained low due to the high base effect. Given that the Chinese economy is still in the process of recovering and the lack of effective demand continues to be a dominant problem, CPI growth is likely to remain modest in Q2. As the policy effects materialize, market demand rises steadily, and the gap between supply and demand narrows, prices will receive a stronger boost. These factors, coupled with a fading base effect, are expected to push up inflation moderately in the second half of the year when the CPI will likely move close to its average level of past years. From a medium to long-term perspective, supply and demand in the Chinese economy will be generally balanced, China will continue to pursue a sound monetary policy, and inflation expectations will remain stable. Therefore, there is no basis for long-term deflation or inflation in China.

II. Outlook for monetary policy in the next stage

Guided by Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, the PBOC will thoroughly implement the guidelines of the 20th CPC National Congress, the Central Economic Work Conference, and the annual sessions of the National People's Congress and the National Committee of the Chinese People's Political Consultative Conference. Following the decisions and arrangements of the CPC Central Committee and the State Council, it will uphold the general principle of pursuing progress while ensuring stability, apply the new development philosophy fully, faithfully, and comprehensively, and play its part in accelerating the building of a new development paradigm and in advancing Chinese modernization. The PBOC will integrate implementation of the strategy to expand domestic demand with efforts to deepen the supply-side structural reform, and it will motivate business entities while ensuring policy effects. It will develop a modern central banking system and fully explore the efficacy of monetary and credit policies with a focus on stabilizing growth, employment, and prices. The PBOC will seize the good momentum to effectively upgrade and appropriately expand economic output.

The PBOC will pursue a sound monetary policy in a targeted and effective manner, properly managing both the aggregate and the pace. While ensuring proper intertemporal adjustments, it will keep liquidity adequate at a reasonable level, and it will ensure that the growth rates of M2 and the AFRE continue to be basically in line with nominal economic growth. It will back efforts to expand domestic demand to provide strong and solid support for the real economy, and, at the same time, it will balance short-term and long-term goals, economic growth and price stability, as well as internal and external equilibria, to improve sustainable support for the real economy. The PBOC will pay attention to marginal changes in prices, guide and stabilize social expectations, and contribute to developing an institutional mechanism for ample supply and stable prices of food and energy so as to maintain basic price stability. It will continue to deepen the market-oriented interest rate reform, optimize the central bank policy rate system, unleash the potential of the LPR reform, and give play to the important role of the mechanism for market-oriented deposit rate adjustments so as to keep interest rates at a reasonable level. The structural monetary policy tools will be targeted, appropriate, and flexible, and the central bank lending and discounts will remain stable. Meanwhile, the temporary instruments still in effect will be properly used to provide strong support for key areas and weak links, such as inclusive finance, sci-tech innovation, and green development. The PBOC will continue to tap into the policy-backed and development-oriented instruments and enhance the guiding role of government investment and policy motivation in a bid to stimulate private investment. Pursuing a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies and upholding the decisive role of the market in exchange rate formation, the PBOC will enhance the flexibility of the RMB exchange rate and improve expectation management so as to keep the RMB exchange rate basically stable at an adaptive and equilibrium level. It will coordinate financial support for the real economy and risk prevention, strengthen the system for maintaining financial stability, and prevent inward transmission of overseas risks, thereby firmly defending the bottom line whereby no systemic financial risks will occur.

First, the PBOC will maintain appropriate aggregates and a steady pace in the supply of money and credit. By using a mix of monetary policy tools, it will keep liquidity adequate at a reasonable level and it will ensure that the growth rates of money supply and the AFRE continue to be basically in line with nominal economic growth. It will guide financial institutions to properly manage the pace and intensity of credit supply and to meet the effective loan demand of the real economy based on market principles and the rule of law. Meanwhile, it will make the growth of credit aggregates more stable and sustainable to provide strong support for the healthy and sound development of the real economy. Closely following the economic and financial situations at home and abroad as well as the monetary policy shifts of the major central banks, the PBOC will strengthen monitoring and analysis of liquidity supply and demand and financial market movements. By doing so, it will conduct open market operations in a flexible manner and it will further improve their foresightedness, flexibility, and effectiveness.

Second, the PBOC will use structural monetary policy tools in a targeted, appropriate, and flexible manner. It will keep central bank lending and discount policies stable to continue providing inclusive and sustainable funding support to agro-related businesses, micro and small businesses (MSBs), and private businesses. It will effectively implement the inclusive MSB lending facility and improve financial services for MSBs to support efforts aimed at stabilizing businesses and securing employment. It will also implement the carbon emission reduction facility and the special central bank lending facility for clean and efficient use of coal, with a view to encouraging eligible financial institutions to provide funding at preferential interest rates for key projects that significantly reduce carbon emissions and for clean and efficient use of coal and coal-fired power. Furthermore, the PBOC will continue to implement the special central bank lending facility for inclusive elderly care services and for the transport and logistics sectors, and it will move forward with implementation of the special central bank lending facility for troubled property developers and the loan support scheme for rental housing.

Third, the PBOC will build the systems and mechanisms needed to provide effective financial support for the real economy. While continuing to evaluate the effectiveness of the credit policy for MSBs, it will urge and guide financial institutions to accelerate the establishment of long-term mechanisms for boosting their confidence, willingness, capacity, and professionalism to provide financial services for MSBs. These measures are aimed at increasing the availability of financing to MSBs and making the process more convenient. The PBOC will make further efforts to provide financial support for fields such as the development of the seed industry as well as the agricultural and rural infrastructures. It will work to enhance the capacity of providing financial services to better meet the diversified financing needs of agro-related sectors, thereby helping advance rural revitalization across the board and stepping up efforts to build up China's strength in agriculture. 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 PBOC will remain committed to keeping land prices, housing prices, and expectations stable. It will prudently implement the regulations for prudential management of real estate finance while taking concrete steps to ensure timely deliveries of presold housing projects, to secure the people's livelihood, and to maintain stability. Moreover, it will meet the reasonable financing needs of the real estate sector and promote restructurings, mergers, and acquisitions in the sector to effectively prevent and defuse the risks associated with the top high-quality developers and to improve their balance sheets. It will adopt city-specific measures to meet the rigid demand for housing and the needs to improve living conditions while accelerating steps to improve the system of financial policies for the rental of housing. All these efforts are aimed at promoting the stable and sound development of the real estate market as well as establishing a new development model for the real estate sector.

Fourth, the PBOC will deepen the market-oriented interest rate and exchange rate reforms, and it will focus on domestic conditions while balancing internal and external equilibria. Continuing to advance the market-oriented interest rate reform, it will optimize the central bank policy rate system, improve the market-oriented interest rate formation and transmission mechanism, and guide market rates to move around the policy rates. It will put into use the mechanism for market-oriented deposit rate adjustments to stabilize bank liability costs. It will also tap into the LPR reform to help stabilize and bring down overall financing costs for businesses and the costs of consumer credit for individuals. Taking steady steps to deepen the market-oriented exchange rate reform, the PBOC will improve the managed floating exchange rate regime that is based on market supply and demand with reference to a basket of currencies. Letting the market play a decisive role in the formation of exchange rates, the PBOC will enhance the flexibility of the RMB exchange rate and give play to the role of the exchange rate as an automatic stabilizer for the macro economy and the balance of payments. At the same time, it will strengthen expectation management, uphold bottom-line thinking, duly conduct monitoring and analysis of cross-border capital flows, and stress risk prevention so as to keep the RMB exchange rate basically stable at an adaptive and equilibrium level. In addition, the PBOC will continue to develop the foreign exchange market. Guiding both enterprises and financial institutions to be risk-neutral, it will offer guidance to financial institutions on providing services of exchange rate risk hedging for micro, small, and medium-sized enterprises with authentic needs based on a risk-neutral concept, thereby maintaining the stable and sound development of the foreign exchange market. Moreover, the PBOC will advance RMB internationalization in an orderly manner. It will further expand use of the RMB in cross-border trade and investment, deepen international monetary and financial cooperation, and promote the development of offshore RMB markets. It will steadily move ahead with the convertibility of the RMB under the capital account and the institutional opening-up of financial markets.

Fifth, the PBOC will make continued efforts to deepen the financial reforms, and

it will accelerate steps to advance institutional building in the financial market. Reform of development and policy financial institutions will move ahead. They will be required to carry out category-based business management and separate accounting, to strengthen capital constraints as well as risk management, to enhance incentives, and to fulfill their responsibilities so as to better play their important roles in serving the real economy and supporting national strategies. The PBOC will improve the legal system for the bond market and consolidate the legal basis for corporate credit bonds. It will further regulate bond underwriting and improve bond market-making while promoting the integration of bond underwriting and market-making services. With these efforts, it aims to enhance the synergy between the primary and secondary markets as well as the effectiveness of bond pricing and its function as a transmission channel. The PBOC will continue to expand the pilot programs for balance-based management and macro management of financial bonds. It will speed up development of the over-the-counter bond business and guide the market to be properly tiered so that the interbank bond market will operate more efficiently and its infrastructures will offer diversified services. Adhering to market principles and the rule of law, the PBOC will continue to adopt a zero-tolerance approach and intensify efforts to crack down on illegal and irregular conduct in the bond market. At the same time, it will remain firmly committed to advancing the opening-up of the bond market.

Sixth, the PBOC will work relentlessly to forestall and defuse financial risks. Further steps will be taken to improve the macro-prudential policy framework as well as the capacity for systemic risk monitoring, assessment, and early warning. It will also enrich the macro-prudential policy tools and steadily expand coverage of the macro-prudential policy. The PBOC will improve regulation of systemically important financial institutions. It will urge systemically important banks to meet the additional regulatory requirements as scheduled. Additionally, it will pick up pace in pushing China’s global systemically important banks to establish and improve their total loss-absorbing capacity so as to effectively enhance their risk prevention ability. It will improve the institutional framework for the regulation of financial holding companies so that their operations will comply with the laws and regulations. Meanwhile, the PBOC will keep a close watch on risks in key fields. Continuing to follow the principles of “maintaining overall stability, taking a coordinated approach, adopting differentiated measures, and defusing bombs with precision,” it will safeguard security in the pursuit of development and ensure that all concerned parties fulfill their respective responsibilities for the resolution of financial risks. It will reduce existing risks and strictly guard against emerging risks. Furthermore, the PBOC will accelerate steps to build a system that safeguards financial stability. It will improve legislation on financial stability and the regulations of the Financial Stability Fund. More work will be done to improve the long-term mechanisms for financial risk prevention, mitigation, and resolution in order to put in place a routine mechanism for risk resolution that is based on market principles and the rule of law. Better bringing into play the functions of deposit insurance, it will make early corrections steadily so that the identification, early warning, correction, and resolution of risks take place as early as possible. It will tap into the role of deposit insurance as a market-oriented and law-based resolution platform to support risk resolution in key areas and institutions. The PBOC will also improve the mechanism for financial risk accountability and hold accountable those responsible for major financial risks to effectively prevent moral hazards. It will firmly defend the bottom line whereby no systemic financial risks will occur.