Structural Monetary Policy Instruments Delivering Relief to Businesses and Boosting the Real Economy Through Targeted Efforts

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Confronted with profound changes unseen in a century and intertwined with the COVID-19 pandemic, all localities and government departments, guided by the *Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era* and under the strong leadership of the CPC Central Committee with Xi Jinping at its core, have effectively balanced pandemic control with economic and social development since the beginning of 2022. The economy is off to a stable start, showing much resilience and vitality, and the fundamentals for sound growth in the long run remain unchanged. Still, the complex and grim developments abroad and the scattered COVID-19 flare-ups at home create considerable downward pressure on the macroeconomy, compounding the challenges faced by businesses. The pandemic is particularly disruptive to contact-intensive service sectors represented by the wholesale, retail, hotel, and restaurant industries, and cross-regional sectors such as transport and logistics. With declining income but fixed expenses, many small and medium-sized enterprises (SMEs) are struggling.

Responding to the CPC Central Committee's requirements of "keeping the pandemic under control, the economy stable, and our progress secure" under the current COVID-19, economic, and financial realities, the People's Bank of China (PBC) has taken a proactive approach by effectively tapping into the effect of monetary policy tools on aggregates and structure, securing the fundamentals of the macroeconomy, and making policies more targeted and direct. The aim is to provide relief to the stricken industries and micro- and small businesses (MSBs), boost support to the real economy, and keep economic indicators within an appropriate range.

I. Structural monetary policy instruments have unique advantages in promoting economic development

In responding to COVID-19, structural monetary policy instruments have become a consensus among the major monetary authorities for injecting liquidity to the financial system and the real economy. Likewise in China, these instruments have helped the financial sector to directly support the real economy and strengthened the key and underdeveloped areas of the national economy as a whole.

Incentive-compatible mechanism are established to leverage their unique advantage of providing targeted support to the real economy, The PBC has introduced a slew of innovative structural monetary policy instruments since the pandemic outbreak. In 2020, it launched RMB1.8 trillion of central bank lending and discounts to support rural development and MSBs, as well as two monetary policy instruments directly supporting the real economy (one for deferred repayment of inclusive MSB loans and the other for inclusive unsecured MSB loans). In 2021, it rolled out the carbon emission reduction facility (CERF) and the central bank lending for clean and efficient use of coal, and updated the arrangements for the two aforementioned monetary policy instruments directly supporting the real economy. In April 2022, it initiated two special central bank lending facilities to support sci-tech innovation and inclusive elderly care services.

Each of these structural monetary policy instruments was accompanied by a carefully designed incentive-compatible mechanism, to directly and quantitatively link the incentive funds of the PBC with the targeted credit support of financial institutions. These mechanisms allow those instruments to function quickly and effectively, thereby precisely channeling financial resources to areas of the economy that need them the most. In terms of effect, these structural monetary policy instruments have increased the volume and coverage, and lowered the cost, of inclusive loans to MSBs. As of end-Q1 2022, the outstanding balance of these loans reached RMB20.8 trillion (+24.6 percent YOY), benefiting 50.39 million MSBs (+42.9 percent YOY). The interest rate fell 0.25 percentage points for loans newly issued in Q1 compared with the beginning of the year.

Structural monetary policy instruments help the banking system maintain an appropriately ample level of liquidity and support credit growth. Through the orderly introduction of structural monetary policy instruments, the PBC has injected a total of RMB2.3 trillion of monetary base into the economy since 2020. This has helped to keep the liquidity in the banking system adequate at a reasonable level and supported steady credit growth. Through their multiplier effect, these structural monetary policy instruments are also powering China's economic recovery. In Q1 2022, incremental loans of financial institutions reached RMB8.3 trillion, RMB425.8 billion more than that in the same period last year.

II. Structural monetary policy instruments have achieved remarkable results in providing relief to businesses and boosting the real economy

The PBC's adaptive use of structural monetary policy instruments has brought clear benefits to the beleaguered businesses and the real economy.

First, central bank lending and discounts have supported the recovery and development of the real economy by delivering financial support specifically to the sectors hit hard by COVID-19.

Central bank lending and discounts are structural monetary policy instruments that support the long-term mechanism of inclusive finance. They can direct locally incorporated financial institutions to enhance credit support to agricultural businesses, MSBs, and the private sector, channeling financial resources to the "capillaries" of the economy.

The PBC has increased the use of central bank lending and discounts since the COVID-19 outbreak. At the end of 2021, it updated the two monetary policy instruments directly supporting the real economy by (1) converting the instrument supporting deferred repayments on inclusive MSB loans into one supporting inclusive MSB loans generally, under which the PBC incentivizes financial institutions at 1 percent of the incremental balance of their inclusive MSB loans; and (2) folding the inclusive program for unsecured MSB loans into the central bank lending program that supports rural development and MSBs. Entering 2022, in addition to boosting inclusive finance, the PBC has leveraged central bank lending and discounts to enhance support to the worst-affected sectors such as wholesale and retail, hospitality, logistics and transport, and cultural and tourism. At the end of March 2022, China's outstanding central bank lending and discounts amounted to RMB2.47 trillion (+RMB526.3 billion YOY), composed of RMB516.1 billion (+RMB73.9 billion YOY) of central bank lending for rural development, RMB1.3 trillion (+RMB402 billion YOY) of central bank lending for MSBs, and RMB624.7 billion (+RMB50.3 billion YOY) of central bank discounts.

Second, the CERF and the central bank lending for clean and efficient use of coal were launched in rapid succession to support green economic development and achieve carbon emissions peak and carbon neutrality in a scientific and orderly manner.

In 2020 China pledged to achieve carbon emissions peak before 2030 and carbon neutrality by 2060. To this end, China must further upgrade the energy production and consumption structure, vigorously develop clean energies and energy-efficiency and environmental industries, and improve the emissions reduction technologies, so as to lead the global green and low-carbon transition. Just as important, China must capitalize on its rich endowment in coal resources and the fundamental role of coal and coal-fired power, to vigorously promote clean and efficient production and use of coal and ensure the country's energy security.

To promote both the dual carbon goals and the smooth transition of China's energy mix, in November 2021 the PBC launched the CERF and the RMB200 billion central bank lending targeting clean and efficient use of coal. Specifically, for qualified emissions reduction loans and clean coal energy loans, the lending financial institutions would receive funding support from the PBC equivalent to 60 percent and 100 percent of the loan principal, thus both clean energy and the clean and efficient use of coal and coal-fired power are given financial support. In early May 2022, the PBC raised the quota of the special central bank lending by another RMB100 billion, to back the mining and use of coal, enhance China's storage capacity for coal reserves, ensure the safe and stable supply of energy, and help keep economic indicators within an appropriate range.

To date, the PBC has provided a cumulative RMB161.1 billion of funding support through the two instruments, consisting of RMB138.6 billion under the CERF program and RMB22.5 billion of special central bank lending for clean and efficient use of coal, translating into RMB231 billion and RMB22.5 billion of qualified loans by financial institutions in the areas of carbon emissions reduction and clean coal energy, respectively.

Third, the two special central bank lending facilities for sci-tech innovation and inclusive elderly care services are established to help China build a strong tech industry and tackle population aging.

Based on the decisions of the executive meetings of the State Council, the PBC rolled out, at the end of April 2022, the special central bank lending facilities for sci-tech innovation and for inclusive elderly care services, two instruments dedicated to the key agenda items in China's new development stage.

The new era has further highlighted the importance of sci-tech innovation. The central bank lending for sci-tech innovation provides low-cost credit to financial institutions that issue qualified loans designated for that purpose, with an amount equaling 60 percent of the loan principal. It encourages financial institutions to ramp up support for innovative enterprises and thereby improves China's capacity for independent technological innovation.

China has a fast-aging population. Outside policy-based and market-oriented elderly care models, there is a significant shortage of inclusive elderly care services for the general public. To address this, the PBC has created a special central bank lending facility for inclusive elderly care services, such that financial institutions would receive low-interest rate credit at 100 percent of the qualified loans they issue. Financial institutions are thus incentivized to offer preferential loans to inclusive elderly care organizations, reducing the latter's cost of financing and improving the availability of elderly care services. In short, the instrument empowers China to build an inclusive aging services system so that seniors in need are cared for.

On the whole, China has established a structural monetary policy system appropriate for its national conditions. Operating under an aggregate-based policy framework, the PBC has introduced a variety of structural monetary policy instruments as appropriate, and timely adjusted the priority support areas based on the evolving needs of the economy. These instruments have contributed significantly to delivering relief to businesses and boosting the real economy. Per the decisions of the executive meetings of the State Council, the PBC will soon unveil an RMB100 billion central bank lending facility to support the transport, logistics and warehousing sectors as a response to the key issues and difficulties in COVID-19 control.

Working under the guidance of the *Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era* and in line with the decisions of the CPC Central Committee and the State Council, the PBC will continue to tap into the aggregate and structural functions of monetary policy tools to steadily optimize its structural monetary policy system, effectively manage the total amount of liquidity injected through structural monetary policy instruments, balance the long-term goal of promoting financial inclusion with supporting the evolving priorities of the economy, and ensure the structural monetary policies are duly implemented. Additionally, the PBC will coordinate monetary policy with fiscal and industry policies to jointly build market confidence, stimulate growth drivers, and better support the real economy to help China achieve stable growth.