

China Monetary Policy Report

Quarter Four, 2019

(February 19, 2020)

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

Executive Summary

In 2019, the performance of the Chinese economy was stable and the economic structure continued to improve. Employment remained stable and price rise was obviously structural. Downward pressures built up amid increased risks and challenges at home and abroad. In 2019, the gross domestic product (GDP) grew 6.1 percent year on year and the consumer price index (CPI) increased 2.9 percent year on year. Foreign exchange reserves remained above USD3 trillion.

Adhering to the basic requirement that the financial sector should serve the real economy, the People's Bank of China (PBC) implemented a sound monetary policy, enhanced countercyclical adjustments, and reached a dynamic balance among multiple targets. The PBC worked to maintain a reasonable growth of money and credit amid continued efforts to improve the credit structure, took reform measures to smooth the transmission of monetary policy, and made every attempt to lower the financing costs for enterprises. With all these efforts, the PBC provided a favorable monetary and financial environment for achieving the “six stabilities,” namely stability of employment, the financial sector, external trade, foreign investment, domestic investment, market expectations, and high-quality economic growth.

First, measures were taken to maintain ample and appropriate liquidity in the banking system. The PBC cut the required reserve ratio (RRR) three times, providing RMB2.7 trillion worth of long-term funds for financial institutions to support the real economy, and it conducted open market operations (OMOs) and Medium-term Lending Facility (MLF) operations in a flexible way to ensure a reasonable pace of liquidity injections. **Second**, efforts were made to stabilize the volume of credit while optimizing the credit structure. The RRR framework featuring “three tranches and two preferential treatments” was built and improved. Tools such as central bank lending, central bank discounts, and macroprudential assessment (MPA) continued to play a role in guiding financial institutions to step up credit support for micro and small enterprises (MSEs), private enterprises, and the manufacturing sector. **Third**, measures were taken to strike a balance between internal and external equilibria, with attention mainly focused on domestic conditions. The RMB exchange rate moved in both ways, and both the onshore and offshore RMB exchange rate went beyond 7 against the US dollar. The PBC has established a regular mechanism to issue central bank bills in Hong Kong and communicates through multiple channels to guide expectations. **Fourth**, reform measures were adopted to improve the transmission of monetary policy. The PBC proceeded with the market-based interest rate reform, improved the pricing mechanism

of the loan prime rate (LPR), and facilitated the shift in the pricing benchmark for outstanding floating-rate loans from the benchmark loan rate to the LPR or fixed rate, based on market-oriented and law-based principles. It also facilitated banks to replenish capital through issuing perpetual bonds so as to ease the capital constraints of bank credit. **Fifth**, efforts were made to maintain the bottom line for risk prevention. Financial risks were generally under control, with the risk resolutions of major financial institutions making a breakthrough. Targeted measures were rolled out to address the risks of some small and medium-sized banks. In order to ease the structural liquidity shortfall, the PBC increased the discount quota by RMB200 billion and the Standing Lending Facility (SLF) quota by RMB100 billion to provide liquidity support. In addition, the PBC established “four lines of defense”, namely liquidity injections through central bank discounts, the SLF, the RRR, and central bank lending, so as to promptly stabilize market confidence.

Overall, the sound monetary policy produced good results, and it proved to be forward-looking, precise, pro-active, and effective. At end-2019, broad money (M2) and aggregate financing to the real economy (AFRE) grew 8.7 percent and 10.7 percent, respectively, moderately higher than the nominal GDP growth. In 2019, inclusive MSE loans grew in both volume and coverage and were offered at lower prices. The financing conditions of private enterprises and the manufacturing sector obviously improved, and the overall financing costs for businesses declined substantially. The weighted average interest rate of new enterprise loans was 5.12 percent in December, a decrease of 0.48 percentage points from the peak in the previous year. The RMB exchange rate fluctuated in both directions and became more flexible.

China is still in an important period of strategic opportunities and will remain there for a long time. The impact of the novel coronavirus outbreak on the Chinese economy will be temporary, as the sound fundamentals and high-quality growth over the long term remain unchanged. Currently, the world economy continues to slow down amid profound post-crisis adjustments, so external uncertainties and destabilizing factors are on the rise. As the Chinese economy is transitioning from high-speed growth to high-quality development, the structural, institutional, and cyclical issues have become interwoven with one another, and the coexistence of an economic slowdown, the structural adjustments, and the impact from the previous stimulus policies are exerting more influence. While China’s economic growth remains resilient, it should be noted that downward pressures on the economy are still quite high. Going forward, under the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, the PBC will comprehensively implement the guidelines of the Fourth Plenary Session of the 19th Communist Party of China (CPC) Central Committee and the

Central Economic Work Conference as well as the decisions and arrangements of the CPC Central Committee and the State Council. Committed to achieving the target of completing the building of a moderately prosperous society in all respects and concluding the 13th Five-Year Plan, the PBC will adhere to the guiding principle of pursuing progress while ensuring stability, and it will take all-round measures to stabilize employment, the financial sector, foreign trade, foreign investment, domestic investment, and expectations. Upholding fundamental principles, promoting innovation, and living up to its responsibilities, the PBC will calibrate countercyclical adjustments in a scientific and prudent manner, conduct a sound monetary policy that is flexible and appropriate, intensify countercyclical adjustments, structural adjustments, and reforms, and keep prices basically stable. Measures will be taken to prevent and defuse major financial risks and to hold fast to the bottom line for preventing systemic financial risks. Taking epidemic control as the top priority under the current circumstances, the PBC will step up monetary and credit support to control the epidemic. A mix of monetary policy tools will be flexibly employed to maintain reasonable and adequate liquidity and to keep money and credit as well as the AFRE growing at a rate well-aligned with economic development. The PBC will facilitate banks to replenish capital through multiple channels, including the issuance of perpetual bonds, and it will enhance the banks' ability to serve the real economy as well as to forestall and defuse financial risks. The PBC will innovate and adopt structural monetary policy instruments to guide financial institutions to increase credit support for MSEs, private firms, the manufacturing sector, and industries and areas related to prevention and control of the epidemic. All-out support will be provided for the resumption of work and production on the condition that measures for epidemic prevention and control are in place. Measures will be taken to improve the transmission mechanism of the LPR and to promote the shift in the pricing benchmark for outstanding floating-rate loans. The PBC is determined to remove the implicit floor on loan rates and to smooth the transmission of monetary policy. The PBC will strike a balance among maintaining the elasticity of the RMB exchange rate, improving macroprudential policies on cross-border capital flows, and strengthening international coordination of macro policies, so as to keep the RMB exchange rate basically stable at an adaptive and equilibrium level.

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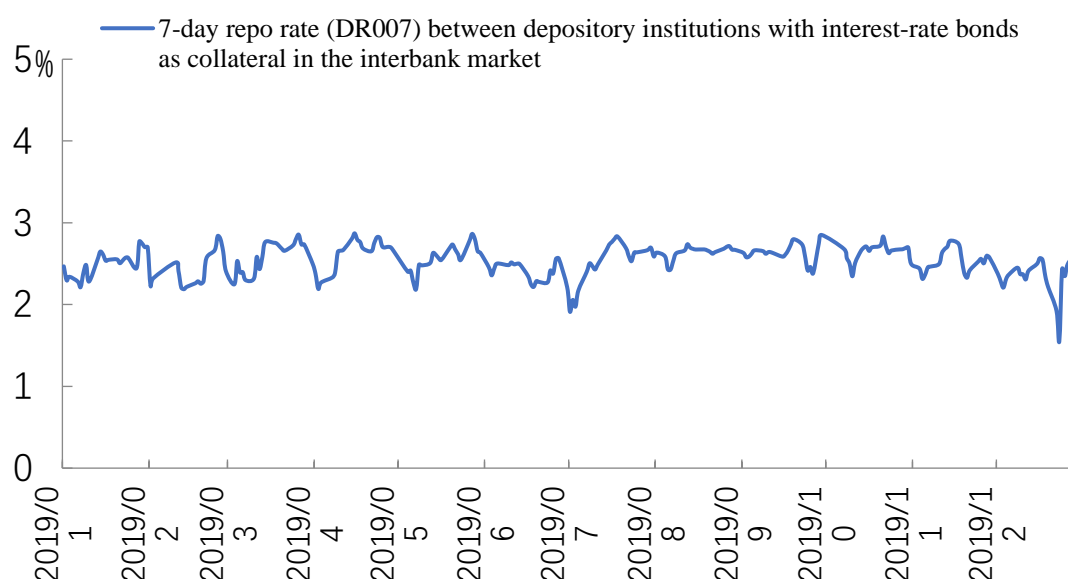
Part 1. Money and Credit Analysis

In 2019, liquidity in the banking system was reasonable and adequate. Growth of M2 and aggregate financing to the real economy (AFRE) was slightly higher than that of nominal GDP. Loans increased rapidly, and the credit structure was further optimized. Lending rates saw a decrease. The RMB exchange rates remained basically stable.

I. Liquidity was reasonable and adequate in the banking system

In the midst of multiple uncertainties, such as mounting risks and challenges both at home and abroad in 2019, the PBC implemented sound monetary policies, employed a monetary policy toolkit that included open market operations, the Medium-term Lending Facility (MLF), the required reserve ratio, central bank lending, central bank discounts, and the Standing Lending Facility (SLF), and strengthened countercyclical adjustments to maintain reasonable and adequate liquidity and to guide the smooth operation of money market rates. At the end of 2019, the excess reserve ratio for financial institutions registered 2.4 percent, equal to that at the end of the previous year.

Figure 1 Interest Rates in the Money Market



Source: www.chinamoney.com.cn.

II. Lending by financial institutions grew relatively rapidly, with lending rates moving downwards

Lending grew relatively rapidly, providing stronger support for the real economy. At the end of 2019, outstanding loans by financial institutions in domestic and foreign currencies grew 11.9 percent year on year to RMB158.6 trillion, up RMB16.8 trillion from the beginning of the year and an acceleration of RMB698.7 billion from the corresponding period of the previous year. Outstanding RMB-denominated loans grew 12.3 percent year on year to RMB153.1 trillion.

The credit structure was further optimized, and loans to micro and small enterprises (MSEs) increased rapidly. Since 2019, the PBC has encouraged financial institutions to enhance their credit support to MSEs, which has yielded good results. Inclusive MSE loans rose by RMB2.1 trillion in 2019, with an increment 1.7 times that in 2018. Outstanding MSE loans at the end of 2019 grew by 23.1 percent year on year, up 7.9 percentage points over that in the previous year. The growth of RMB loans to the household sector slowed down, registering 15.5 percent at the end of 2019, down 2.7 percentage points from end-2018. Loans to non-financial enterprises and public entities witnessed greater growth as compared with the previous year. Medium and long-term loans grew by RMB11.3 trillion from the beginning of the year, an acceleration of RMB798.6 billion from the corresponding period of 2018 and accounting for 67.3 percent of the total new loans, up 2.3 percentage points year on year.

Table 1 The Structure of RMB Loans in 2019

RMB100 million

	Outstanding amount at end-December	Year-on-year growth	Increase from the beginning of the year	Year-on-year acceleration
RMB loans to:	1531123	12.3%	168144	6439
Households	553191	15.5%	74303	662
Non-financial enterprises and public entities	962737	10.9%	94481	11399
Non-banking financial institutions	9827	-8.7%	-933	-5334
Overseas	5368	5.8%	293	-288

Source: The People's Bank of China.

Table 2 New RMB Loans by Financial Institution in 2019

RMB100 million

	Increase from the beginning of the year	Year-on-year acceleration
Chinese-funded large-sized banks ¹	67720	4332
Chinese-funded small and medium-sized banks ²	100471	2556
Small-sized rural financial institutions ³	20866	864
Foreign-funded financial institutions	1030	122

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).

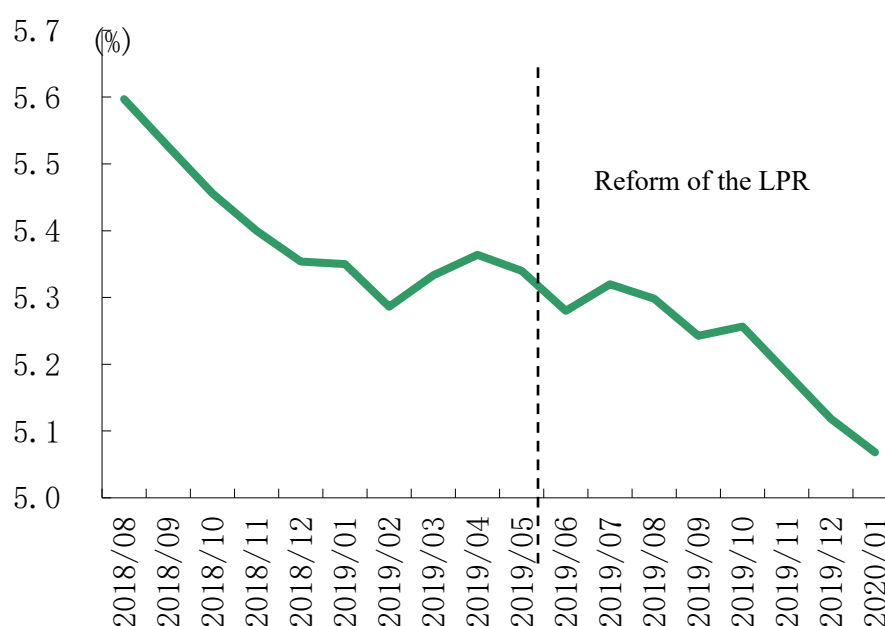
2. Chinese-funded small and medium-sized banks refer to banks with total assets (both in domestic and foreign currencies) of less than RMB2 trillion (according to the amount of total assets in both domestic and foreign currencies at end-2008).

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 Loan Prime Rate (LPR) dipped slightly, and the weighted average interest rates on loans declined. In November, the one-year LPR fell by 5 bps to 4.15 percent and the over-five-year LPR fell from October by 5 bps to 4.80 percent. In December, the weighted average interest rate on new loans stood at 5.44 percent, down 0.18 percentage points from September and 0.2 percentage points year on year. From the beginning of the year to July, the weighted average interest rate on new corporate lending hovered around 5.30 percent, but lending rates saw a significant decrease after the reform of the LPR formation mechanism. The weighted average interest rate on newly issued corporate lending in December reached its lowest level of 5.12 percent since Q2 2017, down 0.2 percentage points compared with that in July when the LPR reform had not kicked in, a drop clearly exceeding that of the LPR (see Figure 2). This showed that the LPR reform began to act to strengthen the independent pricing capacities of financial institutions, improve the competitiveness of loan markets, and to cut down the lending rates.

Figure 2 Weighted Average Interest Rate for Corporate Lending



Source: The People's Bank of China.

Table 3 Weighted Average Interest Rates for New Loans in December 2019

		%	
	December	Change compared with September	Year-on-year change
Weighted average interest rate on new loans	5.44	-0.18	-0.2
Ordinary loans	5.74	-0.22	-0.17
Bill financing	3.26	-0.07	-0.58
Individual housing loans	5.62	0.07	-0.13

Source: The People's Bank of China.

In December, the share of ordinary loans with rates above, at, or below the LPR registered 76.81, 1.32, and 21.87 percent, respectively. The LPR premium generally decreased in general compared with that in September. Amid a drop in the LPR, the proportion of real interest rates below the LPR was still expanding.

Table 4 Shares of RMB Lending Rates at Different Levels in 2019

%

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
August	15.55	0.32	84.13	20.26	26.96	16.69	10.46	9.76
September	16.40	0.55	83.04	21.11	26.67	16.25	10.15	8.86
October	16.28	1.03	82.69	19.62	25.19	16.39	11.06	10.42
November	18.91	1.33	79.75	19.42	23.82	16.98	10.56	8.97
December	21.87	1.32	76.81	19.53	22.72	17.08	9.67	7.82

Source: The People's Bank of China.

Rate cuts by the Federal Reserve and other factors prompted a dip in interest rates on foreign-currency deposits and loans. In December, the weighted average interest rates on demand and large-value USD-denominated deposits with maturities within 3 months registered 0.30 percent and 1.93 percent respectively, down 0.09 and 0.32 percentage points from September. The weighted average interest rates of USD-denominated loans with maturities within 3 months and with maturities between 3 months (including 3 months) and 6 months both registered 3.01 percent, down 0.30 percentage points and 0.03 percentage points respectively from September.

Table 5 Average Interest Rates of Large-Value USD-Denominated Deposits and Loans in 2019

Month	Large-value deposits						Loans				
	Demand deposits	Within 3 months	3–6 months (including 3 months)	6–12 months (including 6 months)	1 year	Over 1 year	Within 3 months	3–6 months (including 3 months)	6–12 months (including 6 months)	1 year	Over 1 year
January	0.42	2.74	3.40	3.64	3.77	3.77	3.94	4.06	3.72	3.99	4.90
February	0.45	2.70	3.29	3.44	3.63	3.53	3.62	3.90	3.58	3.79	4.32
March	0.44	2.67	3.26	3.38	3.39	3.58	3.63	3.59	3.87	3.66	4.65

April	0.46	2.61	3.12	3.28	3.37	3.48	3.73	3.71	3.40	3.68	4.43
May	0.42	2.55	3.13	3.50	3.11	3.33	3.68	3.54	3.34	3.70	4.31
June	0.32	2.60	3.04	2.93	3.04	3.04	3.65	3.36	3.21	3.22	4.38
July	0.35	2.55	2.93	2.78	3.02	2.86	3.59	3.29	3.13	2.94	4.37
August	0.38	2.39	2.78	2.91	2.88	3.46	3.40	3.12	2.82	3.00	4.24
September	0.39	2.25	2.66	2.83	2.64	2.87	3.31	3.04	2.83	3.22	3.76
October	0.34	2.08	2.44	2.76	2.64	2.50	3.22	3.05	2.92	3.28	3.67
November	0.34	1.84	2.51	2.97	2.66	3.03	3.03	2.99	2.79	3.01	3.94
December	0.30	1.93	2.37	2.55	2.70	2.64	3.01	3.01	2.73	2.93	3.88

Source: The People's Bank of China.

Growth of deposits was stable. At the end of 2019, outstanding deposits in domestic and foreign currencies in all financial institutions posted RMB198.2 trillion, up 8.6 percent year on year, 0.8 percentage points higher than that at the end of the previous year. Outstanding RMB deposits registered RMB192.9 trillion, up 8.7 percent year on year, 0.5 percentage points higher than that at the end of the previous year. Outstanding deposits in foreign currencies stood at USD757.7 billion, an increase of USD30.1 billion from the beginning of the year and an acceleration of USD93.5 billion year on year.

Table 6 The Structure of RMB Deposits in 2019

RMB100 million

	Deposits at end-December	Year-on-year growth	Increase from the beginning of the year	Year-on-year acceleration
RMB deposits:	1928785	8.7%	153618	19569
Households	813017	13.5%	97042	25072
Non-financial enterprises	595365	5.8%	32942	11358
Public entities	296831	4.1%	11387	-9775
Fiscal	40840	0.7%	301	897

Non-banking financial institutions	171429	7.3%	11536	-8033
Overseas	11304	4.4%	409	48

Source: The People's Bank of China.

III. Money supply and the AFRE increased reasonably

Growth of M2 and the AFRE were slightly higher than nominal GDP growth, demonstrating intensified countercyclical adjustments. At the end of 2019, outstanding M2 stood at RMB198.6 trillion, up 8.7 percent year on year, an acceleration of 0.6 percentage points from the end of 2018. Moderate growth of money supply bolstered high-quality economic development. Outstanding M1 stood at RMB57.6 trillion, a year-on-year growth of 4.4 percent and 2.9 percentage points higher than that at the end of the previous year. Outstanding M0 reached RMB7.7 trillion, up 5.4 percent year on year. In 2019, RMB398.1 billion of net cash was injected into the economy, a rise of RMB141.8 billion year on year.

According to preliminary statistics, the outstanding AFRE reached RMB251.31 trillion at the end of 2019, up 10.7 percent year on year and an acceleration of 0.4 percentage points over the previous year. In 2019, the incremental AFRE reached RMB25.58 trillion, an increase of RMB3.08 trillion year on year. Growth of the AFRE was characterized by the following: First, RMB loans saw a larger year-on-year increase. Second, entrusted loans, trust loans, and undiscounted bankers' acceptances showed a decelerating trend. Third, corporate bond financing witnessed a significant increase, whereas equity financing saw a slight slowdown in growth compared with that in 2018. Fourth, government bonds registered a year-on-year deceleration. Fifth, asset-backed securities by deposit-taking financial institutions dropped from the previous year, whereas loan write-offs recorded a year-on-year acceleration.

Table 7 Aggregate Financing to the Real Economy in 2019

	At the end of 2019		In 2019	
	Stock (RMB trillion)	Year-on-year change	Flow (RMB trillion)	Year-on-year change (RMB100 million)
The AFRE	251.31	10.7	255753	30833

Of which: RMB loans	151.57	12.5	168835	12123
Foreign currency loans (RMB equivalents)	2.11	-4.6	-1275	2926
Entrusted loans	11.44	-7.6	-9396	6666
Trust loans	7.45	-4.4	-3467	3508
Undiscounted bankers' acceptances	3.33	-12.5	-4757	1586
Corporate bonds	23.47	13.4	32416	6098
Government bonds	37.73	14.3	47204	-1327
Domestic equity financing by non-financial enterprises	7.36	5.0	3479	-127
Other financing	6.66	27.0	14148	-1756
Of which: Asset-backed securities of depository financial institutions	1.68	31.5	4034	-1906
Loans written off	4.07	35.1	10551	396

Notes: 1. The AFRE (Stock) refers to the outstanding financing provided by the financial system to the real economy at the end of a period. The AFRE (Flow) refers to the volume of financing provided by the financial system to the real economy within a certain period of time.

2. Since December 2019, the PBC has further improved the AFRE statistics by incorporating “treasury bonds” and “local government general bonds” into the AFRE and combining them with the existing “local government special bonds” under the item “government bonds.” The value of this indicator is the face value of the bonds under custody.

3. The PBC has further improved the “corporate bonds” statistics contained in the AFRE since September 2019 by incorporating them into the “exchange-traded asset-backed corporate securities.” The PBC incorporated “local government special bonds” into the AFRE in September 2018 and incorporated “asset-backed securities of depository financial institutions” and “loans written off” into the AFRE statistics under the item “other financing” in July 2018 to improve the statistical AFRE method.

4. Year-on-year statistics in the table are on a comparable basis.

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

Box 1 Calibrating the Countercyclical Adjustments of Macro Policies in a Scientific and Prudent Manner

At the Central Economic Work Conference, it was pointed out that it is necessary to calibrate the countercyclical adjustments of macro policies in a scientific and prudent manner, enhance the vitality of micro entities, and embody the main line of supply-side structural reforms throughout the macro adjustments. Efforts should be made to keep the sound monetary policy flexible and appropriate, the liquidity reasonable and adequate, and the growth of aggregate financing to the real economy (AFRE) well-aligned with the economic development so as to reduce the overall financing costs.

In 2019, facing the downward pressures on the economy and the local social credit contractions, the PBC gave full play to the potential of banks to create currency and to support the real economy, took effective measures to solve the constraints of liquidity, interest rates, and capital, and connected the real economy with the flowing water of financial support, which achieved good results. First, the PBC cut the required reserve ratio three times, providing RMB2.7 trillion worth of long-term funds for financial institutions to support the real economy, and it conducted open market operations (OMOs) and Medium-term Lending Facility (MLF) operations in a flexible manner to keep liquidity reasonable and adequate. Second, as a breakthrough, the PBC enabled banks to replenish capital by issuing perpetual bonds, with issuances totaling RMB 569.6 billion throughout the year. Third, the PBC worked to smooth the monetary policy transmission, reform and improve the formation mechanism of the loan prime rate (LPR), and promoted the shift in the pricing benchmark of outstanding floating-rate loans. The decline witnessed in the bid-winning rates of MLFs and OMOs significantly drove down the real lending rates and stimulated the demand of the real economy for loans. In general, the growth rate of M2 and the AFRE in 2019 was slightly higher than the nominal GDP growth. The sound monetary policy was flexible and appropriate and the loan structure continued to improve, which created an appropriate monetary and financial environment for high-quality development.

In line with the arrangements of the CPC Central Committee and the State Council, in 2020 the PBC will adhere to the guiding principle of seeking progress amid stability, uphold the New Development Concept, and calibrate the countercyclical adjustments of monetary policy in a scientific and prudent manner so as to ensure that the

economy operates within a reasonable range.

First, having a scientific grasp of aggregates. At the current stage, the intermediate target of monetary policy has shifted to keeping the growth rates of broad money M2 and the AFRE basically in line with the nominal GDP growth, and it is the key point for calibrating the countercyclical adjustments of monetary policy scientifically and prudently, good not only for economic growth but also for price stability. As the rise of economic downward pressures often goes together with the contraction of social credit and the two may reinforce each other, the growth rate of M2 and the AFRE slightly higher than the nominal GDP growth reflects the efforts by the PBC to strengthen the countercyclical adjustments, support high-quality development with moderate monetary growth, and thus prevent the risk of a vicious circle between social credit contractions and economic downward pressures. The design of this mechanism may also help to maintain the basic stability of the macro leverage ratio, which at present remains at a high level, making it difficult for it to rise over 10 percentage points annually as it did from 2009 to 2017.

Second, being effective in adjusting the structure. The PBC will adopt structured monetary policies for accurate liquidity provision, give full play to the role of the RRR framework featuring “three tranches and two preferential treatments,” make effective use of targeted RRR, central bank lending, central bank discounts, macroprudential assessment, and other tools, and intensify structural adjustments so as to support and promote supply-side structural reforms. The PBC will guide the funds to flow toward the areas featuring multiplier effects where both the supply and the demand side may benefit, such as advanced manufacturing, livelihood improvements, and the weak links in infrastructure development, so as to promote both industrial and consumption upgrading and to support high-quality economic development. Also, the PBC will continue to strengthen support of monetary policy for the prevention and control of the novel coronavirus epidemic. During the period of epidemic control, list-based management has been adopted for key enterprises directly engaged in the production, transportation, and sale of key medical supplies and daily necessities, according to which the PBC will provide the enterprises on the list with credit support at preferential interest rates through low-cost special central bank lending and interest subsidies from the central treasury.

Third, intensifying the reforms and further deepening the market-oriented reforms of the interest rate and the exchange rate. The PBC will smooth the monetary policy transmission by means of reform, strengthen the market-oriented mechanisms for the formation, transmission, and adjustment of the interest rate. The PBC will improve the LPR pass-through mechanism, proceed with the shift in the

pricing benchmark of outstanding floating-rate loans, resolutely remove the implicit floor of loan rates, and promote a reduction of the overall financing costs in the society, so as to address the difficulties and high costs of financing for micro and small enterprises (MSEs). While focusing on the domestic situation, the PBC will also take into account the external balance and will strike a balance between efforts to maintain the elasticity of the RMB exchange rate, to improve the macroprudential policy for cross-border capital flows, and to strengthen international coordination of macro policies. The PBC will continue to enable the market to play a decisive role in the formation of the exchange rate and to keep the RMB exchange rate basically stable at an adaptive and equilibrium level.

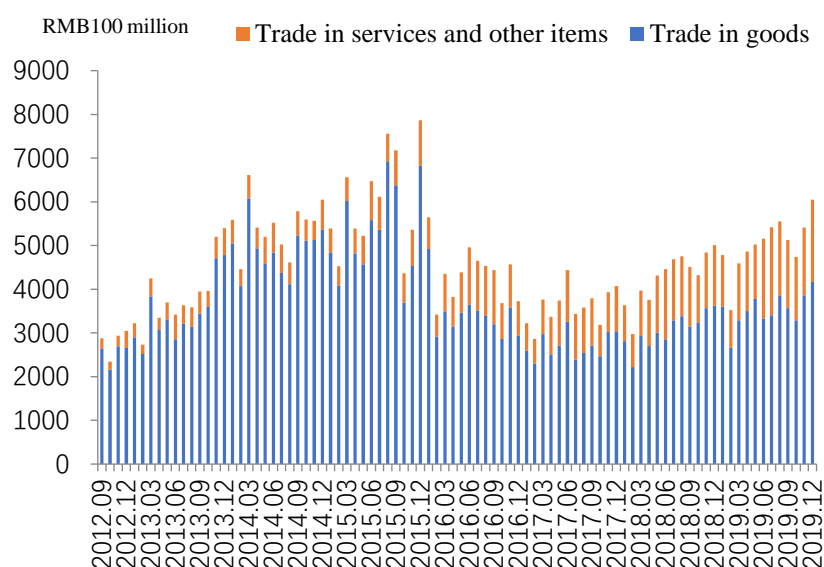
IV. The RMB exchange rate remained basically stable

In 2019, cross-border capital flows and foreign exchange supply and demand were basically in equilibrium and market expectations were generally stable. Based on market supply and demand, the RMB exchange rate moved in both directions and remained basically stable at a reasonable equilibrium level. During the first four months, due to the stable operation of the Chinese economy at the beginning of 2019, the accumulation of positive factors in the market, and the increase in the holding of domestic stocks by foreign investors, the RMB exchange rate appreciated. Since May, affected by the world economic and financial climate and protectionist measures, the RMB exchange rate against the USD depreciated. At the beginning of August, the RMB went beyond 7 per USD driven by market forces amid escalating China-US trade tensions. From September, picking-up market expectations pushed up the RMB exchange rate against the USD and against a basket of currencies. The offshore and onshore RMB exchange rate against the USD went beyond 7 more than once and stabilized within 7 after December. Across the year, the RMB exchange rate showed stronger flexibility and played their role in adjusting the macro economy and the balance of payments as an “automatic stabilizer.”

In 2019, the RMB exchange rate devalued slightly with sustained flexibility. At the end of 2019, the China Foreign Exchange Trade System (CFETS) RMB exchange-rate index and the RMB exchange-rate index based on the special drawing rights (SDRs) basket closed at 91.39 and 91.81, down 2.03 and 1.43 percent from end-2018, respectively. According to calculations by the Bank for International Settlements (BIS), from end-2018 to end-2019, the nominal effective exchange rate (NEER) and the real effective exchange rate (REER) of the RMB depreciated by 1.50 percent and appreciated by 1.11 percent, respectively. From 2005 when the reform of the exchange-rate formation regime began to end-December 2019, the NEER and REER of the RMB appreciated by 32.31 percent and 46.69 percent, respectively. At the end of 2019, the central parity of the RMB against the USD was 6.9762, a depreciation of 1.62 percent from end-2018. From the launch of the reform of the

exchange-rate formation regime in 2005, the central parity of the RMB against the USD appreciated by 18.64 percent on a cumulative basis. In 2019, the annualized volatility rate of the RMB exchange rate against the USD was 4 percent, basically equal to that of the major international currencies.

Figure 3 Monthly RMB Payments and Receipts under the Current Account



Source: The People's Bank of China.

Cross-border RMB transactions continued to grow with generally balanced receipts and payments. In 2019, cross-border receipts and payments in RMB totaled RMB19.7 trillion, up 23 percent year on year. In particular, RMB receipts and payments registered RMB10 trillion and RMB9.7 trillion, respectively. RMB cross-border receipts and payments under the current account grew 18 percent over the previous year to RMB6 trillion. In particular, settlement of trade in goods registered RMB4.2 trillion, whereas settlement of trade in services and other items registered a cumulative RMB1.8 trillion. RMB cross-border receipts and payments under the capital account posted RMB13.6 trillion, up 26 percent year on year.

Part 2. Monetary Policy Operations

In 2019, in accordance with the decisions and arrangements of the CPC Central Committee and the State Council, the PBC adhered to the fundamental requirements for the financial sector to serve the real economy, implemented a sound monetary

policy, and integrated reforms with adjustments, short-term with long-term perspectives, and an internal with an external equilibrium. By intensifying countercyclical adjustments, structural adjustments, and reforms, maintaining reasonable growth of money and credit, and promoting continuous improvements in the credit structure, the PBC smoothed the transmission of monetary policy by means of reforms and lowered comprehensive financing costs for enterprises. All these efforts helped to cultivate a proper monetary and financial environment for keeping employment, the financial sector, foreign trade, foreign and domestic investment, and expectations stable and for achieving high-quality economic growth.

I. Conducting Open Market Operations in a flexible manner

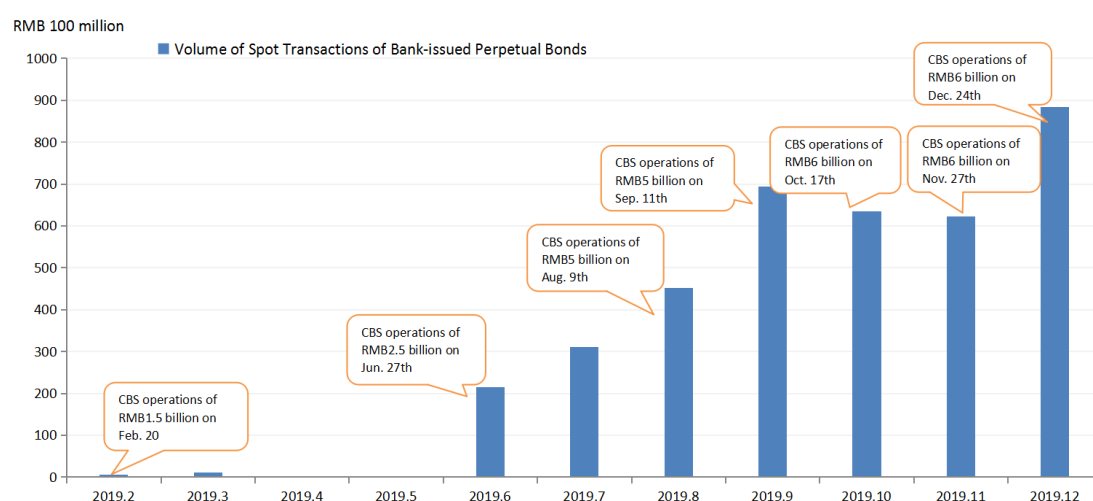
Maintaining reasonable and adequate liquidity in the banking system with the flexible use of short-, medium-, and long-term monetary policy tools. In 2019, on the basis of making comprehensive use of the required reserve ratio (RRR) cut, the targeted RRR cut, the Medium-term Lending Facility (MLF), and other policy tools for injecting medium- and long-term liquidity, the PBC conducted open market operations (OMOs) flexibly, mainly through 7-day repos, to make the operations more forward-looking, targeted, and proactive, and to keep liquidity reasonable and adequate. Since the beginning of the fourth quarter, the PBC has arranged repo operations of different terms in a reasonable way, and thus precisely offset short-term factors that may disturb liquidity, such as tax payment peaks, cash demand before holidays, and year-end supervisory assessments. Starting from mid-December, the PBC conducted 14-day repo operations in succession to inject cross-year liquidity in advance, which provided a favorable liquidity environment for all kinds of market entities to smoothly enter the new year.

The OMO interest rates dropped slightly, and the money market rates remained steady. In 2019, the bid-winning rates of the MLF and repo operations both dropped 5 basis points, which was conducive to releasing the signal of countercyclical adjustments and further reducing the financing costs for the real economy through LPR transmissions. With the OMO interest rates going down slightly, the money market interest rates also declined somewhat. The 7-day repo rate (DR007), which is the funding rate between depository institutions and pledged by interest rate bonds in the interbank market, moved smoothly within a reasonable range, with the average rate standing at 2.54 percent in 2019, 20 basis points lower than that in 2018. At the end of the year, money market rates moved steadily with less volatility. At the end of December, the DR007 was 2.81 percent, 23 basis points lower than that at the end of 2018.

Conducting successive central bank bill swap (CBS) operations. In order to

improve the market liquidity of perpetual bonds issued by banks, support banks to replenish capital through perpetual bond issuances, and enable the financial sector to better serve the real economy, the PBC conducted CBS operations seven times in 2019, totaling RMB32 billion. Of the bonds swapped with the PBC, there were not only perpetual bonds issued by large-sized commercial banks and joint-stock banks but also perpetual bonds issued by urban commercial banks. This played a positive role in improving the liquidity of bank-issued perpetual bonds, as the PBC launched the tool of CBS in time and carried out continuous operations upon the issuance of the bank-issued perpetual bonds.

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



Source: China Foreign Exchange Trade System.

Issuing central bank bills in Hong Kong on a regular basis. In 2019, the PBC gradually established a regular mechanism for the issuance of RMB-denominated central bank bills in Hong Kong. The year witnessed 12 issues in the city, totaling RMB150 billion and reaching a balance of RMB80 billion. The issuance enriched RMB assets with high credit ratings in the offshore market, improved the offshore market structure, and promoted the sound development of the offshore RMB money market, and thus it was conducive to promoting RMB internationalization.

II. Conducting Standing Lending Facility and Medium-term Lending Facility Operations

Standing Lending Facility (SLF) operations were conducted in a timely manner to provide sufficient short-term liquidity to meet the demand of locally

incorporated financial institutions. In 2019, the PBC conducted a total of RMB546.5 billion in SLF operations, with the amount for each quarter registering RMB75.3 billion, RMB123.9 billion, RMB119 billion, and RMB228.4 billion, respectively. At the end of 2019, the outstanding SLF posted RMB102.1 billion. The SLF rate has played a role as the ceiling of the interest rate corridor, and has promoted the smooth operation of the money market. In the fourth quarter, the SLF rate was lowered by 5 basis points, after which the overnight, 7-day, and 1-month SLF rates registered 3.35 percent, 3.50 percent, and 3.85 percent, respectively.

The PBC conducted MLF operations on a regular basis to promote the steady growth of the economy and to guarantee the supply of base money. In 2019, the PBC conducted a total of RMB3.69 trillion of MLF operations, all with a maturity of one year. In the first quarter, the funds released by the RRR cut were used to replace the matured MLFs, hence there were no MLF operations for financial institutions. The following three quarters witnessed MLF operations in the amount of RMB 1.14 trillion, RMB1.15 trillion, and RMB1.4 trillion, respectively. At the end of the year, the outstanding MLF registered RMB 3.69 trillion, a decrease of RMB 1.2415 trillion from the beginning of the year. MLF operations were conducted through bidding. On November 5, 2019, the bid-winning rate declined by 5 basis points, and on February 17, 2020, the bid-winning rate declined by 10 basis points to 3.15 percent.

III. Enhancing monetary and credit support to prevent and control the novel coronavirus epidemic

In order to earnestly implement the spirit of the *Notice on Strengthening the Chinese Communist Party's Leadership and Providing a Solid Political Guarantee for Winning the Battle of Novel Coronavirus Epidemic Prevention and Control* issued by the CPC Central Committee and the arrangements of the CPC Central Committee's Leading Group on Combating the Novel Coronavirus Epidemic, the PBC, the Ministry of Finance, the China Banking and Insurance Regulatory Commission, the China Securities Regulatory Commission, and the State Administration of Foreign Exchange jointly released the *Notice on Further Enhancing Financial Support for the Prevention and Control of the Novel Coronavirus Epidemic* (Yinfa No.29 [2020]) on February 1, 2020, with the aim of further strengthening financial support for epidemic prevention and control. The priority is to enhance monetary and credit support, maintain reasonable and adequate liquidity, reinforce financial support to the manufacturers of essential medical supplies and daily necessities, better satisfy the people's normal demand for financial services, and provide strong support for winning the battle of epidemic prevention and control and for safeguarding overall economic stability and development.

Above all, special central bank lending is ready to support sectors and enterprises essential to epidemic prevention and control. In order to win the battle of epidemic control, on January 31 the PBC issued the *Notice on Issues Regarding the Issuance of Special Central Bank Lending to Support Prevention and Control of Novel Coronavirus Epidemic* (Yinfa No. 28 [2020]). According to the *Notice*, the PBC will provide low-cost special central bank lending in a total amount of RMB300 billion to major national banks and selected locally incorporated banks in ten key provinces (municipalities) including Hubei. List-based management will be adopted for major enterprises that participate directly in the production, transportation, and sales of essential medical supplies and daily necessities for epidemic prevention and control and financial institutions will be encouraged to provide credit support at preferential interest rates to enterprises on the list.

Second, efforts are being made to maintain reasonable and adequate liquidity and to ensure sound countercyclical adjustments. In order to address the impact of the epidemic on market liquidity and to stabilize market expectations, the PBC announced on February 2, the final day of the Spring Festival holiday, that it would conduct reverse repo operations in the amount of RMB1.2 trillion on the following day to inject liquidity into the market. On the morning of February 3, the 7-day and 14-day reverse repo rates registered 2.40 percent and 2.55 percent respectively in the PBC's open market operations, both down by 10 basis points. On February 4, the PBC again conducted reverse repo operations in an extra amount of RMB500 billion. Altogether, a total amount of RMB1.7 trillion was injected into the market within two days. This would drive down money market and bond market rates and consequently push lending rates lower, which would help reduce funding costs, alleviate financial pressure on enterprises, especially micro and small-sized enterprises (MSEs), and expand financing and support to the real economy.

Third, financial institutions are encouraged to strengthen credit support for epidemic prevention and control. The PBC urges its local subsidiaries and branches as well as financial institutions to take the initiative in strengthening service connections with hospitals, medical research institutes, and related enterprises. An adequate credit supply will be provided to fully meet the reasonable financing needs of relevant entities and enterprises in health and epidemic prevention, manufacturing and purchase of medical supplies, public health infrastructure construction, scientific research, and technological transformation. The financial supply capacity will be upgraded in regions heavily hit by the epidemic. Inappropriate withdrawals, cutoffs, or delays in lending are prohibited with regard to heavily hit industries, such as wholesale and retail, accommodations and catering, logistics and transportation, culture and tourism, and enterprises that are promising but temporarily impacted by the epidemic, especially MSEs.

IV. Lowering the required reserve ratio for financial institutions

In 2019, the PBC conducted three rounds of RRR cuts for financial institutions and established an RRR framework featuring “three tranches and two preferential treatments”. Specifically, the RRR was lowered across the board for financial institutions by altogether 1.5 percentage points in January and September, releasing around RMB2.3 trillion of long-term liquidity. Starting in May, the PBC conducted successively three targeted RRR cuts for rural commercial banks serving counties, bringing down their RRR by a total of 2–3.5 percentage points to the tranche for rural credit cooperatives. Starting in October, a targeted RRR cut of 1 percentage point was carried out in two phases for city commercial banks operating solely within provincial-level administrative regions. About RMB400 billion of liquidity was freed up by the targeted RRR cuts and was used entirely for lending to MSEs and private enterprises. Targeted RRR cuts are aimed at encouraging small and medium-sized financial institutions to serve local development and to support the sound development of the real economy. Meanwhile, based on the size of financial institutions as well as their characteristics and effectiveness in providing support for the real economy, a clearer, simpler framework of China’s RRR system took shape, which features roughly three tranches of benchmark RRRs supplemented by two preferential RRR policies.

In January 2020, an RRR reduction was carried out to support the development of the real economy. On January 6, 2020, the PBC lowered the RRR for financial institutions (excluding finance companies, financial leasing companies, and auto finance companies) by 0.5 percentage point, unleashing over RMB800 billion in long-term funding and cutting the funding cost for banks by about RMB15 billion. This move effectively increased the stable supply of funds that financial institutions needed to support the real economy and reduced their fund costs for supporting MSEs and private enterprises. At the same time, as this RRR cut would offset the cash injections ahead of the Spring Festival, the sound monetary policy stance remained unchanged.

Box 2 A Rational Perspective on the Profit Growth of Commercial Banks

Despite a general slowdown in recent years, profit growth of China’s commercial banks has remained relatively high, which has raised widespread concern and discussion. This calls for a rational perspective. As of end-Q3 2019, the market capitalization of all listed banks on the A-share market accounted for 16.56 percent of that of all listed companies, with their total profits making up 39.01 percent of that of listed companies. During the first three quarters of 2019, China’s commercial banks posted net profits of RMB1.65 trillion, increasing by 9.19 percent year on year.

In terms of the use of profits, commercial banks have used most of their profits for capital replenishments, which are conducive to enhancing their capacity to support the real economy and to prevent risks. Given the predominance of indirect financing in China's financial system, the real economy is funded primarily through banks. Commercial banks have witnessed continuous profit growth while providing sustained support for the real economy. In recent years, as they have further stepped up credit support for the real economy, commercial banks have played an important role and have achieved some progress in increasing credit support for MSEs and private enterprises, reducing the real costs of corporate financing and promoting structural adjustments. The profits of commercial banks are mainly used to pay income tax and dividends and to serve as general reserves, surplus reserves, and undistributed retained profits, with the latter three items all used to replenish core Tier 1 capital. According to the past three years' data of listed banks on the A-share market, about 17 percent of commercial banks' profits have been used for income tax payments, 23 percent for the payment of common stock dividends, and the remaining 60 percent for the replenishment of core Tier 1 capital. This shows that banks have used much of their profits, which come from the real economy, to replenish bank capital and then to scale up credit support for the real economy through the leverage effect of capital, thereby serving the real economy and in return promoting stable economic development. Currently, banks need capital to increase credit support for the real economy and also to defuse risks. However, there is a big shortage of capital as replenishing bank capital is faced with constraints, such as limited channels, many difficulties, and slow progress. Therefore, it is particularly important that banks maintain their endogenous ability to replenish capital while broadening channels from the outside. Sustaining profit growth at a certain level will help banks replenish capital and enhance their capacity to support the real economy and prevent risks. It will also be conducive to meeting international regulatory standards and to maintaining the confidence of domestic and overseas investors in the Chinese economy.

In terms of the sources of profits, profit growth of China's commercial banks has to do with their large scale of assets and their low cost of management. In 2018, the net interest rate spread for China's commercial banks averaged 2.2 percent, a medium level globally, which was higher than that in the Asian banking sector but lower than the US and European level. Nevertheless, large commercial banks in China have a big asset size while their cost of management is lower than that of the world's major banks. In terms of asset size, the Big Five state-owned commercial banks in China rank high among banks in the world. In 2017 and 2018, the average cost-to-income ratio for China's commercial banks remained below 30 percent, while that for most of the world's major banks was above 50 percent. On the one hand, this is attributable to staff costs. China's commercial banks have lower staff costs per

capita than the world's major banks, while their asset size per capita is medium-ranked globally, which is about 1.5 times that in the Asian emerging market countries. This shows they have reached the same level of asset management as the world's major banks but with lower staff costs. On the other hand, the reason lies in the commercial banks' preference for big customers. As quite a number of bank loans are extended in substantial amounts to large state-owned enterprises and local government platforms characterized by implicit guarantees and low risks, the average cost of management declined. Moreover, with 0.9 times the benchmark interest rates previously assumed as the implicit floor of lending rates, banks were reluctant to offer lower rates as interest rates trended down, which was also a contributing factor to the persistence of interest rate spreads.

The role of banks should be further explored to serve the real economy and to promote a virtuous cycle between the economy and the financial sector. Currently, it is widely felt that there are still many problems regarding the financing difficulties and high financing costs faced by MSEs and private enterprises. Highly concerned about these problems, the CPC Central Committee and the State Council have repeatedly urged for more effective efforts. Given their sheer number and the wide range of sectors they cover, MSEs are primary contributors to economic development and job creation that can help stabilize growth and employment. As China is at a pivotal stage of transforming its growth model, optimizing its economic structure, and fostering new drivers of growth, banks should make better use of their high profits to further step up support for the real economy, particularly for MSEs, address major problems at low costs, and channel more financial resources to MSEs. Resolute measures should be taken to remove the implicit floor of lending rates and to reduce corporate financing costs. Banks should duly lower their demands on short-term profit growth, sacrifice part of their profits for the benefit of the real economy and promote a virtuous cycle between the economy and the financial sector. From a medium and long-term perspective, energizing micro entities such as MSEs will contribute to high-quality economic development, which will benefit the real economy, banks, and eventually the long-term sustainable growth of banks profits.

V. Further improving the macroprudential policy framework

The role of the macroprudential assessment (MPA) was effectively brought into play to optimize the credit structure and to promote the financial supply-side structural reform. In Q1 2019, the PBC added to the MPA some special indicators, including private enterprise financing, MSE financing, and medium and long-term loans and credit-based loans to the manufacturing sector, in an effort to enhance the role of the MPA in encouraging lending to MSEs and private enterprises. In Q2 and Q3, to echo the targeted RRR cuts for rural commercial banks serving counties and city commercial banks operating solely within provincial-level administrative regions,

the PBC incorporated into the MPA the extension of loans to MSEs and private enterprises with the funds released by the RRR cuts, so that relevant financial institutions would be guided to use all the freed funds for MSE loans and private enterprise loans and to bring down their lending rates. In Q3, application of the Loan Prime Rate (LPR) and the competitive setting of lending rates were incorporated into the pricing conduct assessment under the MPA. The move was aimed at promoting the use of the LPR among banks and reducing financing costs for the real economy via reform measures.

Work was underway to improve the framework for regulating systemically important financial institutions. To implement the *Guidelines on Improving the Regulation of Systemically Important Financial Institutions* and to make implementation rules by sector and step by step, in 2019 the PBC started an assessment of systemically important banks (SIBs) and led the formulation of the *Evaluation Measures for Systemically Important Banks (Exposure Draft)*, which was released on November 26 with the approval of the State Council to solicit public opinions. The *Assessment Measures* preliminarily bring into shape an indicator system for the assessment of SIBs in China based on their size, interconnectedness, substitutability, and complexity.

Research was conducted to formulate regulatory rules for financial holding companies. With a view to promoting the regulated development of financial holding companies, preventing financial risks effectively, and better serving the real economy, the PBC led the drafting of the *Trial Measures for the Supervision and Administration of Financial Holding Companies (Exposure Draft)*, which was released to solicit public opinions. In line with macroprudential management concepts, the *Measures* strengthen regulatory constraints by placing special emphasis on enhancing regulation of financial holding companies invested primarily by non-financial enterprises so as to foster a virtuous cycle between the economy and the financial sector.

VI. Giving full play to the role of structural monetary policy instruments

The PBC actively leveraged credit policy instruments to support central bank lending, central bank discounts, Pledged Supplementary Lending (PSL), and other policy tools, and to guide financial institutions to enhance support for the key areas of the national economy and the weak links, such as MSEs, private firms, agriculture, rural areas, and rural residents, as well as poverty alleviation. First, the quotas of central bank discounts and the Standing Lending Facility (SLF) were increased by RMB200 billion and RMB100 billion respectively to support the liquidity of small and medium-sized banks. Second, efforts were made to comprehensively implement and further optimize the pricing mechanism for loans

using funds from central bank lending for poverty alleviation. Financial institutions were guided to properly determine the interest rates on such loans. Third, central bank lending to support special poverty alleviation projects was set up in a bid to increase credit supply in areas of extreme poverty, including three autonomous regions, i.e., Tibet, four prefectures in southern Xinjiang, and the Tibetan areas in four provinces and three autonomous prefectures, i.e., Linxia in Gansu, Liangshan in Sichuan, and Nujiang in Yunnan, and cut down on the financing costs in these areas. Fourth, measures were taken to reinforce management of the collateral of central bank lending and the SLF. Collateral was classified based on its credit rating and liquidity, and differentiated requirements for collateral were specified according to the demands of monetary policy operations. At end-2019, outstanding central bank lending and central bank discounts accumulated to RMB1014.8 billion, a growth of RMB181.5 billion over that at the beginning of the year, and RMB88.1 billion more as compared with end-Q3. To be specific, outstanding central bank lending to support agriculture, rural areas, and rural residents (including RMB164.2 billion of central bank lending for poverty alleviation) stood at RMB260.2 billion at year-end. Outstanding central bank lending and central bank discounts for MSEs posted RMB283.2 billion and RMB471.4 billion, respectively. In 2019, the PBC provided RMB157.8 billion of net PSLs to policy and development-oriented banks, of which RMB20.4 billion was provided in the fourth quarter, with the outstanding volume at end-2019 registering RMB3.5374 trillion.

The Targeted Medium-term Lending Facility (TMLF) was conducted. The TMLF provided a stable and long-term funding source for financial institutions to expand credit supply to private firms and MSEs at preferential interest rates. In January, April, and July 2019, the PBC conducted three one-year TMLF operations, with the same interest rate of 3.15 percent and volumes of RMB257.5 billion, RMB267.4 billion, and RMB297.7 billion, respectively. At the end of the year, the total outstanding balance of the TMLF stood at RMB822.6 billion.

VII. Leveraging the structural guidance role of credit policies

The PBC stepped up efforts to guide funds into areas that were mutually beneficial for suppliers and demanders and of multiplier effect, including the advanced manufacturing sector, people's livelihood construction, and weak links in infrastructure facilities, so as to promote the upgrading of both the industry and consumption. **First**, financial services were provided to deepen targeted poverty alleviation. Continuous efforts were made to monitor microfinance in support of poverty elimination and to promote both the quality and efficiency of targeted financial poverty alleviation. Financial institutions were encouraged to intensify efforts to increase the supply of funds to extremely poor areas, including three autonomous regions and three autonomous prefectures, and to enhance financing

support to these areas. **Second**, financial services were enhanced to support rural revitalization. Commercial banks were encouraged to actively endeavor to innovate financial products and services based on their own business orientation and advantages in a bid to build a comprehensive and featured financial service system in support of rural revitalization and to meet the diversified financing demands in this regard. **Third**, financial services were reinforced to support MSEs and private firms. Stepped-up efforts were made to bring into full play the guiding role of macroprudential assessment and assessments of a credit policy orientation toward MSEs. Financial institutions were urged to build up their capability to provide financial services for MSEs and to increase financing support for private enterprises. Commercial banks were backed up to issue special financial bonds to support MSEs so as to broaden the source of credit funds. A total of RMB204.8 billion of financial bonds to support MSEs were issued across the year. **Fourth**, the PBC effectively supported employment and business start-ups through financial assistance. Efforts were made to facilitate secured loans for business start-ups and to support special social groups, including veterans, college graduates and migrant workers, to start their own businesses or to secure job opportunities. Financial assistance to the elderly service industry, tourism, and the housekeeping industry was also reinforced, contributing to greater employment. **Fifth**, the PBC continued to enhance financial support for industrial transformation and upgrading and to improve the guiding role of financial policies in regional development. **Sixth**, the PBC went all out to provide a mix of financial services for epidemic prevention and control. Backbone enterprises for the production, transportation, and sales of important medical and daily supplies were given increased credit support, which helped meet the financing demands of these enterprises.

Box 3 Remarkable Achievements in Optimizing the Credit Structure

In 2019, in line with the fundamental requirement of the financial sector to serve the real economy, the PBC implemented a prudent monetary policy and maintained reasonable and adequate liquidity. Moreover, the PBC provided a targeted supply of credit based on a structural monetary policy, facilitated structural adjustments, and smoothed the transmission of monetary policy so as to support high-quality development of the economy.

First, the RRR framework featuring “three tranches and two preferential treatments” was established. The coverage of the preferential policy for a targeted RRR cut of financial inclusion credits was broadened at the beginning of 2019. The assessment standard for MSE loans in such a targeted RRR cut was adjusted from “credit line less than RMB 5 million for a single enterprise” to “credit line less than RMB 10 million for a single enterprise.” On May 6, the PBC announced a preferential RRR for rural commercial banks operating solely within the county-level

administrative regions, which equaled that for rural credit cooperatives after three cuts, with a reduction of 2 to 3.5 percentage points in total. On September 6, an extra RRR cut of 1 percentage point for urban commercial banks operating solely within the provincial-level administrative regions was announced, which was implemented in two phases. The targeted RRR cut was expected to free up approximately RMB400 billion of liquidity, all of which would be employed as credit supply for MSEs and private enterprises. The third tranche of the RRR, which was applied to small-sized banks, was 6 percent at the lowest tranche. From May to July, the amount of newly issued loans for MSEs and private enterprises by rural commercial banks that enjoyed the preferential policy of the targeted RRR cut was 2.8 times the amount of funds released by the targeted RRR cut, while the average interest rate of the loans was 0.3 percentage points lower as compared with that in the first four months of the year. From September to November, the amount of newly issued loans for MSEs and private enterprises issued by urban commercial banks that enjoyed the preferential policy of the targeted RRR cut was 4.5 times the amount of funds released by the targeted RRR cut, while the average interest rate of the loans was 0.7 percentage points lower as compared with that from January to August.

Second, the role of central bank lending and central bank discounts in providing targeted credit supply was brought into full play. The PBC made stepped-up supporting efforts to guide financial institutions to increase credit supply for agro-linked enterprises, poverty alleviation, MSEs, and private firms. The PBC also increased the quotas of central bank discounts and the SLF so as to enhance liquidity support for small and medium-sized banks. Efforts were made to comprehensively implement and further optimize the pricing mechanism for loans using the funds from central bank lending for poverty alleviation. Financial institutions were guided to properly determine the interest rates of loans using the funds from central bank lending for poverty alleviation. Central bank lending to support special poverty alleviation projects was set up in a bid to increase the credit supply in areas of extreme poverty, including three autonomous regions and three autonomous prefectures, and to cut down on the financing costs in these areas. The quotas of central bank discounts and the SLF were increased by RMB200 billion and RMB100 billion, respectively, across the year. At end-2019, outstanding central bank lending and central bank discounts accumulated to RMB1014.8 billion (including RMB164.2 billion of central bank lending for poverty alleviation), growth of RMB181.5 billion over that at the beginning of the year.

Third, the MPA played a role in guiding the credit structure. Loans for MSEs and private enterprises issued by rural commercial banks and urban commercial banks that enjoyed the preferential policy of a targeted RRR cut with funds released from the RRR cut were incorporated into the assessment. Special assessments were made of

the financing of private enterprises and MSEs as well as of the mid and long-term loans and credits granted to the manufacturing sector. Moreover, financial services provided by small and medium-sized banks to grassroots units and the real economy were also brought into the assessment. All these endeavors contributed to the optimization of the credit structure and the advancement of supply-side structural reform of the financial sector. The outstanding balance of mid- and long-term loans to the manufacturing sector witnessed year-on-year growth of 14.9 percent, the highest level since 2012, 4.4 percentage points higher than that in the previous year. An additional RMB502.1 billion of mid- and long-term manufacturing loans were issued across the year, RMB180.4 billion more as compared with 2018, bolstering recovery of investment in the manufacturing sector.

Fourth, innovative measures were adopted for the implementation of the TMLF. Large-scaled commercial banks and joint-stock commercial banks were encouraged to provide long-term stable funds to MSEs and private enterprises, with the volume of the TMLF linked to their support for these entities and the interest rate lower than that of the MLF, helping mid- and large-scaled banks play a leading role in lowering the financing costs of MSEs and private enterprises. A total of three TMLF operations were conducted in 2019 and the outstanding balance of the TMLF stood at RMB822.6 billion at the end of the year.

On the whole, the structural monetary policy instruments have achieved positive results with increasing support for MSEs and private enterprises. Financial inclusive loans to MSEs featured growing volume, expanding coverage, and lower interest rates. Specifically, such loans witnessed a growth of RMB 2.1 trillion in 2019, 1.7 times that in 2018, while the annual growth rate climbed 7.9 percentage points to reach 23.1 percent. A total of 27.04 million MSEs received policy support, year-on-year growth of 26.4 percent. The interest rates of newly issued MSE loans by the five large-scale banks, including the Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, China Construction Bank, and Bank of Communications, averaged 4.7 percent, down 0.74 percentage points as compared with that in the previous year. In 2019, loans for private enterprises grew by RMB3.8 trillion year on year, RMB1.1 trillion more than that in the previous year. The growth accounted for 42.5 percent of that of enterprise loans as a whole, up 7 percentage points from 2018.

The PBC will continue to implement a sound monetary policy and intensify efforts to promote structural adjustments. Keeping in mind current and long-term needs, the PBC will implement reform measures to optimize the efficiency of financial resource allocations. The role of the RRR framework featuring “three tranches and two preferential treatments,” especially the targeted RRR cut of financial inclusion, will

be brought into full play. Moreover, the PBC will continue to make full use of the MLF, central bank lending, central bank discounts, the MPA, and other instruments. The LPR mechanism will be leveraged to guide the decrease in enterprise financing costs and to bolster the financing of MSEs and private enterprises.

VIII. Deepening the market-oriented interest rate reform

The PBC reformed and improved the formation mechanism of the LPR and improved the transmission of monetary policy. On August 17, 2019, the PBC announced improvements in the LPR formation mechanism by introducing new LPR quoting principles, formation mechanism, maturity types, quoting banks, quoting frequency, and application requirements. This move has enhanced the banks' autonomy in loan-pricing, provided an incentive for banks to improve their operations, resolutely removed the implicit floor on loan rates, and improved the market-based interest rate transmission channels.

The PBC proactively promoted and supervised application of the LPR and steadily advanced replacement of the pricing benchmark for outstanding loans. With the share of new bank loans using the LPR in price-setting incorporated into the MPA, banks were encouraged to apply the LPR in pricing in an active and orderly manner and to shift their traditional pricing mindset. Thus, the effects of the lowered LPR were effectively transmitted to the lending rates. At end-2019, new bank loans applying the LPR in price-setting accounted for 90 percent. On December 28, 2019, the PBC released an announcement on shifting the pricing benchmark for existing floating-rate loans, which advanced the shift in the pricing benchmark for existing loans from the original benchmark lending rates to the LPR, or fixed rates, in line with market-oriented and law-based principles.

The role of the LPR reform in lowering corporate financing costs was unfolding. In the first seven months of 2019, the weighted average of corporate lending rates continued to fluctuate at about 5.3 percent, which suggested inefficient transmission from decreasing market interest rates to corporate lending rates. Since August, the National Interbank Funding Center has published the LPR under the new mechanism on six occasions, with the one-year LPR down by 20 basis points as compared with the benchmark lending rate of the same maturity. As the LPR quotation remained generally stable with a slight decline, the corporate lending rates witnessed a notable decrease.

IX. Improving the RMB exchange rate regime

The PBC continued to advance the market-oriented exchange rate reform and to

improve the managed floating exchange-rate regime based on market supply and demand with reference to a basket of currencies. It maintained exchange rate flexibility and gave play to the exchange rate as an automatic stabilizer to adjust the macro economy and the balance of payments. Meanwhile, the PBC emphasized guiding expectations and maintaining the RMB exchange rate basically stable and at an adaptive and equilibrium level. In 2019, the highest and lowest CNY central parities were 6.6850 and 7.0884 against the USD, respectively. During the 244 trading days, the RMB appreciated on 113 days, depreciated on 130 days, and remained unchanged on 1 day. The biggest intraday appreciation and depreciation were 0.70 percent (469 bps) and 0.66 percent (458 bps), respectively. The RMB exchange rate against other major international currencies floated two-ways with both appreciations and depreciations. As of end-2019, the central parities of the RMB against the dollar, the pound, and the Japanese yen depreciated 1.62 percent, 5.18 percent and 3.43 percent respectively from the end of 2018, while the RMB appreciated 0.41 percent against the euro. From the RMB exchange-rate regime reform in 2005 to end-2019, the RMB against the dollar, the euro, and the Japanese yen appreciated by a cumulative total of 18.64 percent, 28.13 percent, and 14.00 percent, respectively. Direct RMB trading was buoyant on the interbank foreign exchange market with increased liquidity, which lowered the conversion costs for market participants and facilitated bilateral trade and investment.

Table 8 Trading Volume of the RMB Against Other Currencies in the Interbank Foreign Exchange Spot Market in 2019

RMB100 million

Currency	USD	EUR	JPY	HKD	GBP	AUD	NZD
Trading volume	525157.06	13638.07	3549.57	1919.77	776.78	658.73	140.04
Currency	SGD	CHF	CAD	MYR	RUB	ZAR	KRW
Trading volume	1332.04	73.28	290.32	26.40	134.13	0.61	114.74
Currency	AED	SAR	HUF	PLN	DKK	SEK	NOK
Trading volume	10.88	26.42	0.66	0.79	14.80	36.53	9.03
Currency	TRY	MXN	THB	KHR	KZT	VND	MNT
Trading volume	1.28	0.72	282.26	0	0.06	0.03	0.01

Source: China Foreign Exchange Trade System.

In 2019, under the bilateral currency-swap agreements between the PBC and foreign monetary authorities, the latter utilized a total of RMB 32.922 billion, and the former utilized an equivalent of USD 2.254 billion denominated in foreign currencies. These operations played a positive role in promoting bilateral trade and investment.

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

The PBC took the lead in implementing an action plan for fighting the tough battle of forestalling and defusing major financial risks, with breakthroughs in resolving the risks of key financial institutions. Facing structurally tightened liquidity, the PBC established “four lines of defense”, namely, central bank discounts, the SLF, deposit reserves, and central bank lending of liquidity, so as to forestall liquidity risks of small and medium-sized banks. This move stabilized market confidence in a timely manner.

Risk resolution of the Baoshang Bank was promoted in a prudent and orderly manner. Since the Baoshang Bank was taken over due to its severe credit risk, steady progress has been made in this process under the joint efforts of all the relevant parties. Acquisitions and transfers of large-value debts during the first phase, and asset liquidation and capital verification during the second phase, have been successfully completed. Based on the previous achievements, market-oriented reforms and restructuring are being promoted in an orderly manner during the third phase. In general, the decisive takeover played the role of a timely “hemostasis” and avoided further deterioration of the bank’s risks. It has ensured maximum protection of the legitimate rights and interests of its depositors and its clients, and it has safeguarded overall social stability. Meanwhile, in line with the laws and regulations, it has put an end to the practice of de facto guaranteed repayments. The resolution has helped strictly exercise market discipline, guard against moral hazards, foster stratification of credit in the financial market, and promote reasonable pricing of market risks. During the process of resolution, the PBC has fully exerted its role as “lender of last resort” by injecting liquidity in a timely and appropriate manner, which has timely stabilized market confidence and prevented the risk of contagion from the Baoshang Bank to other small and medium-sized banks, thus managing to defend the bottom line of no systemic risks.

The PBC actively promoted the reform and restructuring of Hengfeng Bank and the Bank of Jinzhou and prevented the spread of risks. Under guidance by the local government and the regulatory authorities, Hengfeng Bank formulated and implemented a two-step reform plan, namely a plan of “stripping off non-performing

assets, introducing strategic investors and increasing capital,” in accordance with market-oriented and law-based principles. On December 31, 2019, Hengfeng Bank successfully completed the establishment of accounts for the stock reform, which marked the basic achievement of its market-oriented restructuring. In June 2019, according to the unified arrangements of the CPC Central Committee and the State Council, the PBC and the CBIRC, together with the Liaoning provincial government, pushed forward the reform and restructuring of the Bank of Jinzhou, which strengthened market confidence in the bank, improved market expectations on the soundness of small and medium-sized financial institutions, and contained the spread of risks to other small and medium-sized financial institutions. Currently, the PBC, in cooperation with other agencies, is guiding the bank to dispose of substantial risky assets in a market-oriented and law-based approach and simultaneously to increase capital and to enlarge shares, so as to fix its balance sheet and enhance its capacity for risk-resistance.

Implementation of the reform plans for development and policy financial institutions was comprehensively promoted. The PBC, together with members of the Reform Working Group, promoted the carrying out of reform measures in an orderly manner, such as establishing and enhancing the boards of directors, improving the governance structure, and refining the scope of business. New boards of directors of the China Development Bank, the Export-Import Bank of China, and the Agricultural Development Bank of China have been established and are functioning effectively. The PBC will continue to encourage these three banks to clarify their functions and to improve their risk management and control so as to better serve the national strategies.

XI. Deepening the reforms of foreign exchange administration

The foreign exchange administration has served the real economy. First, with the aim of facilitating trade and investment, *Circular on the State Administration of Foreign Exchange Further Promoting Cross-Border Trade and Investment Facilitation* was published, rolling out 12 measures to facilitate cross-border trade and investment. The *Notice* streamlined relevant business operations and allowed banks, enterprises, and other market participants to conduct foreign exchange business in a more convenient way. **Second**, electronic filing of taxation was comprehensively implemented in the area of foreign exchange payments for trade in services, helping to realize online operation of electronic filing. **Third**, foreign exchange accounts were streamlined with the release of *the Notice of the State Administration of Foreign Exchange on Streamlining Foreign Exchange Accounts*, so as to effectively improve the operational efficiency of market participants.

Reforms in key areas of foreign exchange administration were deepened. First, *Circular of the People's Bank of China and the State Administration of Foreign Exchange on Further Facilitating Investments by Foreign Institutional Investors in Interbank Bond Markets* was formulated, which improved the opening-up policies of the interbank bond market and facilitated investments by foreign institutional investors in the market. **Second**, a pilot program on cancellation of part of the application materials for foreign exchange administrative licensing items was launched in the free trade zones, further optimizing the business environment.

Supervision was strengthened in the foreign exchange market. Special programs for cracking down on transfers of illegal funds by underground banks were carried out with the cooperation of other related departments. Efforts were made to strengthen cross-border regulatory cooperation, to continuously combat illegal online foreign exchange trading in a forceful manner, and to relentlessly clamp down on irregularities and crimes related to foreign exchange.

Part 3. Financial Market Conditions

In 2019, the financial market operated generally smoothly. Money market transactions were active. The coupon rates of all types of bonds declined, and the volume of cash bond issuances and transactions increased. Stock market indices went up with an increased year-on-year turnover and size of financing. The growth of premium income in the insurance sector picked up and asset growth in the insurance sector accelerated.

I. Financial market overview

1. Money market interest rates remained at a low level and market transactions were active

Liquidity in the banking system was at an ample and appropriate level, and money market interest rates remained at a low level. In December 2019, the monthly weighted average interest rate of interbank lending and pledged repos posted 2.09 percent and 2.10 percent, respectively. The monthly weighted average interest rate of government-backed bond repos among deposit-taking institutions posted 1.98 percent. At end-2019, the overnight and 7-day Shibor posted 1.69 percent and 2.74 percent, respectively.

The market saw active repo transactions and interbank lending. In 2019, the

cumulative trading volume of bond repos on the interbank market reached RMB819.6 trillion, representing an average daily turnover of RMB3.3 trillion and a year-on-year increase of 14.3 percent. The volume of cumulative trading of interbank lending reached RMB151.6 trillion, with an average daily turnover of RMB606.5 billion and a year-on-year increase of 9.7 percent. In terms of the maturity structure, overnight repos and overnight lending accounted for 85.2 percent and 91.4 percent, respectively, of the total turnovers in bond repos and interbank lending, increasing 3.6 percentage points and 1.3 percentage points year on year. The volume of bond repos traded on the exchange markets increased 3.4 percent year on year to RMB238.9 trillion.

Table 9 Fund Flows among Financial Institutions in 2019

RMB100 million

	Repos		Interbank lending	
	2019	2018	2019	2018
Chinese-funded large banks ^①	-1,918,715	-1,669,110	-280,598	-290,833
Chinese-funded medium-sized banks ^②	-744,800	-920,274	-148,506	-134,766
Chinese-funded small-sized banks ^③	132,798	438,495	111,408	184,557
Securities institutions ^④	861,901	692,711	258,387	201,362
Insurance institutions ^⑤	84,960	74,081	175	930
Foreign-funded banks	89,211	68,718	-21,598	-18,563
Other financial institutions and vehicles ^⑥	1,494,646	1,315,380	80,733	57,313

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, the China Merchants Bank, and the eight other joint-equity commercial banks, the Bank of Beijing, Bank of Shanghai, and Bank of Jiangsu.

③Chinese-funded small-sized banks refer to Hengfeng Bank, China Zheshang Bank, China Bohai Bank, other city commercial banks, rural commercial banks, rural cooperative banks, private banks, and village and township banks.

④Securities institutions include securities firms and fund-management 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.

The interbank CD and negotiable CD businesses witnessed orderly development. In 2019, a total of 28,000 interbank CDs were issued on the interbank market, raising RMB17.9 trillion. The trading volume on the secondary market totaled RMB145 trillion. By end-2019, outstanding interbank CDs reached RMB10.7 trillion. In 2019, the average weighted interest rate of 3-month interbank CDs was 2.97 percent, 14 basis points higher than that of the 3-month Shibor. A total of 50,400 negotiable CDs was issued by financial institutions, raising RMB12.0 trillion and with a gain of RMB2.8 trillion year on year.

Interest rate swaps were active. In 2019, the RMB interest rate swap market witnessed 237,700 transactions, increasing 26 percent year on year, with the volume of the notional principal totaling RMB18.1 trillion, a decrease of 16 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 RMB11.12 trillion, accounting for 61.27 percent of the principal of all maturities. The 7-day fixing repo rate and the Shibor served as the reference rates for the floating leg of the RMB interest rate swaps, accounting for 72 percent and 26.4 percent, respectively, of the total notional principal of the interest rate swaps. After improvement in the LPR formation mechanism, interest rate swaps anchored to the LPR have increased, amounting to 654 transactions with RMB75.1 billion of the notional principal.

Table 10 Transactions of Interest Rate Swaps in 2019

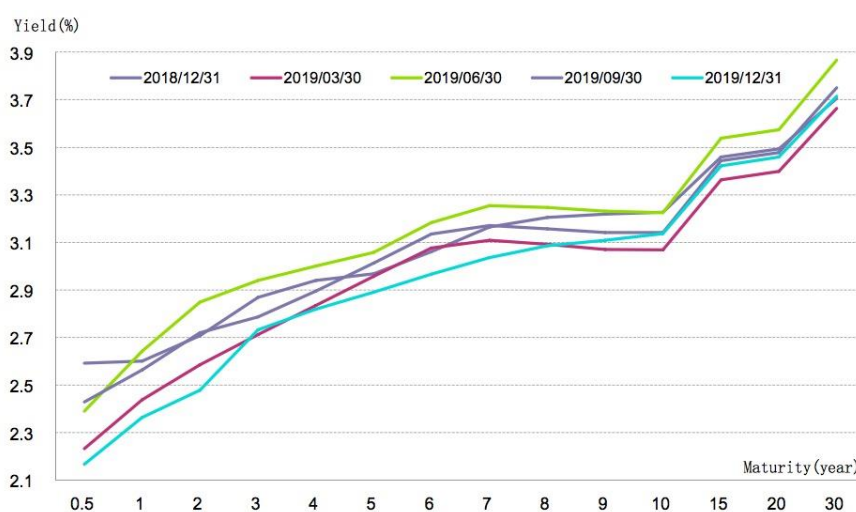
	Transactions	Notional principal (RMB100 million)
2019	237,654	181,394
2018	188,459	214,911

Source: China Foreign Exchange Trade System.

2. The coupon rate of bonds declined, and transactions and the issuance of cash bonds expanded

The government bond yield curve moved downward steeply, and the bond market indices went up. At end-2019, the yields of 1-year and 10-year government bonds posted 2.36 percent and 3.14 percent, respectively, decreasing 24 basis points and 9 basis points, respectively, from end-2018.

Figure 5 Yield Curves of Government Securities on the Interbank Market



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

The coupon rates of all types of bonds fell. The coupon rate of 10-year government bonds issued in December 2019 was 3.13 percent, 12 basis points lower than the rate in December 2018. The coupon rate of 10-year financial bonds issued by the China Development Bank was 3.48 percent, 11 basis points lower than the rate in December 2018. The average rate of 1-year short-term financing bills (bond rating A-1) issued by AAA-rated non-financial enterprises was 3.47 percent, 55 basis points lower than the rate in December 2018.

The volume of cash bond transactions increased rapidly. In 2019, the cumulative volume of cash bond trading on the interbank market posted RMB213.7 trillion, representing an average daily turnover of RMB855 billion and an increase of 42.9 percent year on year. The volume of cash bond transactions on the stock exchanges totaled RMB8.2 trillion, registering an increase of 29.4 percent year on year.

Table 11 Bond Issuances in 2019

RMB100 million

Type of bond	Issuances	Year-on-year change
Government securities	41,563	4,937
Local government bonds	43,624	1,973
Central bank bills	0	0
Financial bonds①	259,360	-14,696
Of which: Financial bonds issued by the China Development Bank and policy financial bonds	36,187	2,585
Interbank certificates of deposit	179,713	-31,120
Corporate debenture bonds②	107,058	29,152
Of which: Debt-financing instruments of non-financial enterprises	68,076	10,138
Enterprise bonds	5,256	444
Corporate bonds	23,594	9,039
Bonds issued by international institutions	468	-251
Total	452,073	21,114

Notes: ① Including financial bonds issued by the China Development Bank, policy financial bonds, bonds issued by commercial banks (including ordinary bonds, subordinated bonds, and hybrid bonds), bonds issued by securities firms, and interbank certificates of deposit.

② Including debt-financing instruments issued by non-financial enterprises, enterprise bonds, corporate bonds, convertible bonds, bonds with detachable warrants, privately placed MSE 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.

The volume of bond issuances increased year on year. In 2019, a total of RMB45.2 trillion of bonds was issued with a year-on-year increase of RMB2.1 trillion. At end-2019, the total volume of all types of outstanding bonds posted RMB99 trillion, with an increase of 15.1 percent year on year.

3. Bill financing rose rapidly, and interest rates fluctuated downwards

The bill acceptance business witnessed rapid growth. In 2019, commercial drafts issued by enterprises totaled RMB20.4 trillion, rising 11.6 percent year on year. At end-2019, outstanding commercial drafts increased 15.3 percent year on year to RMB12.7 trillion,. Outstanding commercial draft acceptances continued to expand rapidly by RMB1.7 trillion from the beginning of the year and by RMB291.9 billion from end-September; 70.2 percent of the outstanding bankers' acceptances were issued by medium and small enterprises.

Bill financing expanded rapidly, while interest rates dropped slightly. In 2019, total discounts by financial institutions amounted to RMB34.3 trillion, growing 25.2 percent year on year. At end-December, bills outstanding rose 31.8 percent year on year to RMB7.6 trillion, accounting for 5.0 percent of total outstanding loans, which was 0.7 percentage points higher than the figure in the previous year. In 2019, interest rates in the bill market fluctuated downwards.

4. Stock indices rebounded, year-on-year turnover and the size of financing increased

Stock indices rose. At end-2019, the Shanghai Stock Exchange Composite Index closed at 3,050 points, increasing 22.3 percent from end-2018. The Shenzhen Stock Exchange Component Index closed at 10,431 points, rising 44.1 percent from end-2018. The turnover on the stock markets increased significantly. In 2019, the combined turnover of the Shanghai and Shenzhen Stock Exchanges reached RMB127.4 trillion and the average daily turnover was RMB522.2 billion, with an increase of 40.7 percent year on year. The size of financing increased year on year. In 2019, RMB614.8 billion was raised on the A-share market, increasing 11.2 percent year on year.

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

Table 12 Asset Allocations in the Insurance Sector at End-September 2019

RMB100 million, %

	Outstanding value		As a share of total assets	
	End-2019	End-2018	End-2019	End-2018
Total assets	205,645	183,309	100.0	100.0
Of which: Bank deposits	25,227	24,363	12.3	13.2
Investments	160,043	139,725	77.8	76.2

Source: China Banking and Insurance Regulatory Commission.

In 2019, total premium income in the insurance sector amounted to RMB4.3 trillion, with a year-on-year increase of 12.2 percent, 13.7 percentage points higher than the growth rate in 2018. Claim and benefit payments totaled RMB1.3 trillion, with a year-on-year increase of 4.8 percent. Specifically, total property insurance claim and benefit payments increased 10.3 percent year on year, while total life insurance claim and benefit payments fell 0.1 percent year on year. At end-2019, total assets in the insurance industry increased 12.2 percent year on year to RMB20.6 trillion, an acceleration of 2.8 percentage points from end-2018. Among this total, outstanding bank deposits increased 3.5 percent year on year and investment-linked assets increased 14.5 percent year on year.

6. Foreign exchange transactions remained generally stable

In 2019, turnover of spot RMB/foreign exchange transactions reached USD7.9 trillion, an increase of 4 percent year on year. Turnover of RMB/foreign exchange swap transactions totaled USD16.4 trillion, a decrease of 0.5 percent year on year. Specifically, overnight RMB/USD swap transactions posted USD9.5 trillion, accounting for 57.9 percent of total swap turnovers. Turnovers on the RMB/foreign exchange forward market totaled USD76 billion, dropping 13.2 percent year on year. Turnovers of foreign currency pair transactions totaled USD475.6 billion, rising 154.7 percent year on year. In particular, the EUR/USD pair registered the largest trading volume, accounting for 57.4 percent of the total market shares.

Participants on the foreign exchange market expanded further. At end-2019, there were 711 members on the foreign exchange spot market, 245 members on the foreign exchange forward market, 239 members on the foreign exchange swap market, 197 members on the currency swap market, and 146 members on the foreign exchange options market. There were 30 market makers on the spot market and 27 market makers on the forward and swap markets.

7. The gold market operated steadily with an overall rise in prices

Gold prices showed an overall upward trend. In 2019, international gold prices closed at USD1,523 per ounce, representing a gain of 18.83 percent from end-2018. At end-2019, the Au9999 on the Shanghai Gold Exchange closed at RMB340.8 per gram, increasing 19.75 percent from end-2018.

Trading volume on the Shanghai Gold Exchange grew steadily. In 2019, the cumulative volume of gold trading on the Shanghai Gold Exchange was 68,860 tons, representing a gain of 1.63 percent year on year. The turnover posted RMB21.49 trillion, increasing 17.43 percent year on year.

II. Development of institutional arrangements in the financial markets

1. Institutional arrangements in the bond market

In May 2019, the PBC and the China Securities Regulatory Commission (CSRC) jointly issued the *Notice on the Pilot Work of Innovation in Open-End Securities Investment Funds Based on Bond Indexes*, for the purpose of boosting the development of bond index mutual funds on the interbank market and the exchange market. In August, the *Opinions on Supporting Commercial Banks to Issue Financial Bonds for Innovation and Entrepreneurship* were released to encourage commercial banks to issue financial bonds for innovation and entrepreneurship and to increase credit supply in the innovative and entrepreneurial sector. In October, the *Rules for the Recognition of Standard Credit Assets (Exposure Draft)* were issued to clarify the scope, recognition standards, and regulatory arrangement of standardized debt-based assets. In December, the PBC drafted the *Notice on the Disposal of Corporate Debenture Bond Defaults (Exposure Draft)* to promote the investor protection system to meet international conventions, and the PBC officially introduced the mechanism for the transfer of defaulted matured bonds to diversify the channels for disposing of defaulted bonds. In December, the *Administrative Measures for Information Disclosures of Corporate Debenture Bonds (Exposure Draft)* were drafted to expedite the introduction of information disclosure standards for corporate debenture bonds.

2. Improving institutional arrangements in the capital market and the securities and futures industry

Improving the institutional arrangements in the capital market. The Science and Technology Innovation Board made its debut on June 13, 2019. A total of 70 companies were listed on the Science and Technology Innovation Board in 2019. A new round of reforms began on the New OTC Market as the CSRC specified the introduction of public offerings to the New OTC Market in December. In December, the CSRC issued the *Provisions on the Pilot Program of Subsidiaries Detached from Listed Companies for Domestic IPOs*.

Improving regulatory rules of the securities and futures industry. In June 2019, after revision the CSRC released the *Measures for the Supervision and Administration of Futures Companies*, which added requirements of net capital for controlling shareholders and the largest shareholders, specified requirements for overseas shareholders, and improved the regulatory requirements for subsidiaries of futures companies. In July, the *Administrative Provisions on the Equity of Securities Companies* were issued. In December, the *Administrative Provisions on Liquidity Support of Securities Investor Protection Fund* were released.

3. Improving institutional arrangements in the insurance market

Enhancing the capability of the insurance industry to serve the real economy. On February 25, 2019, the CBIRC issued the *Notice on Further Strengthening Financial Services Provided to Private Enterprises*, requiring that insurance institutions provide more flexible loan guarantee insurance services to private enterprises, encouraging insurance institutions to enhance investments in private enterprise bonds, and supporting insurance funds' participation in resolving and addressing risks concerning the pledged stocks of listed private companies.

Strengthening asset-liability management, forestalling the risks of imbalanced matching, and improving the consumer protection mechanism. On July 24, the CBIRC issued the *Interim Measures for the Administration and Supervision of Insurance Assets and Liabilities*. The *Measures* require insurance companies to assume primary responsibility for asset-liability management, to enhance the asset-liability management system, and to continuously improve the management of assets and liabilities. On November 4, the CBIRC issued the *Guiding Opinions on Strengthening the Construction of Systems and Mechanisms Concerning Consumer Protection in Banking and Insurance Institutions*, which required banking and insurance institutions to incorporate the protection of consumer rights and interests into all aspects of corporate governance, to establish a review mechanism for

consumer protection, and to improve the internal assessment mechanism for consumer protection.

Promoting high-quality development of the insurance industry. On December 30, the CBIRC issued the *Guiding Opinions on Promoting High-quality Development of the Banking and Insurance Industries* and proposed the formation of a multi-layered, widely covered, and diversified system of insurance institutions with an improved financial structure by 2025.

Applying tax preferences for insurance companies. On May 28, the Ministry of Finance (MOF) and the State Taxation Administration (STA) issued the *Announcement of the Policy of Pre-Tax Deductions of Service Charges and Commissions for Insurance Companies*, which raised the proportion of pre-tax deductions of service charges and commissions for life insurance companies and property insurance companies, on the condition that the service charges and commissions are related to their business activities.

4. Further opening up the financial sector

On July 20, 2019, the Financial Stability and Development Committee under the State Council announced eleven measures concerning the further opening-up of China's financial sector. The opening-up focused on substantially easing the restrictions on market access in the banking, securities, and insurance industries, moving forward with the removal of the foreign ownership cap to year 2020, and broadening their business scope as well as further facilitating foreign institutional investors to invest in the interbank bond market. In April and September 2019, Chinese bonds were added successively to major international bond indexes, such as the Bloomberg Barclays Global Aggregate Index and the JPMorgan GBI-EM Global Diversified Index. The CSRC officially approved the application for Chinese products in the China-Japan ETF Connect. On June 17, the CSRC and the Financial Conduct Authority (FCA) issued a joint statement and officially launched the global depository receipts (GDR) business on the Shanghai-London Stock Connect.

5. Enhancing coordinated supervision of the financial infrastructure

In September 2019, the *Work Plan for Overall Supervision of the Financial Infrastructure* was reviewed and passed at the 10th meeting of the Central Comprehensively Deepening Reforms Commission. The work plan proposed that overall supervision shall be strengthened over the financial infrastructure with unified regulatory standards, sound access management, an optimized infrastructure layout,

and improved governance arrangements, for the purpose of forming a well-organized, effective, advanced, reliable, and resilient financial infrastructure system.

Part 4. Macroeconomic Overview

I. Global economic and financial developments

1. Global economic growth moderated and downside risks still merit attention despite stabilizing signs

Since the beginning of 2019, the International Monetary Fund (IMF) has persistently revised downward its growth forecast for 2019. In its *World Economic Outlook* published in January 2020, the IMF projected that the global economy would grow merely 2.9 percent in 2019, a record low since the global financial crisis. The growth was projected to rebound to 3.3 percent in 2020, a downward revision by 0.1 percentage point compared to its October forecast. In its November forecast, the Organization for Economic Co-operation and Development (OECD) also issued a similar forecast of only 2.9 percent. The IMF noted that downside risks to global growth remain elevated, citing, among others, rising geopolitical tensions, escalating social turbulence, and mounting trade frictions between certain countries. In its January *Global Economic Prospects*, the World Bank pointed out that global trade and investment had shown a slight recovery, but risks were still tilted to the downside. The global economy is moderating amid deep post-crisis adjustments, and sources of turbulence and risks have increased significantly, which merits attention and research.

Table 13 Macroeconomic and Financial Indicators in the Major Advanced Economies

Country	Indicator	2018 Q4			2019 Q1			2019 Q2			2019 Q3			2019 Q4		
		Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.
United States	Real GDP Growth (annualized quarterly rate, %)	1.1			3.1			2.0			2.1			2.1		
	Unemployment Rate (%)	3.8	3.7	3.9	4.0	3.8	3.8	3.6	3.6	3.7	3.7	3.7	3.5	3.6	3.5	3.5
	CPI (year-on-year, %)	2.5	2.2	1.9	1.6	1.5	1.9	2.0	1.8	1.6	1.8	1.7	1.7	1.8	2.1	2.3
	DJ Industrial Average (end of the period)	25116	25538	23327	25000	25916	25929	26593	24815	26600	26864	26403	26917	27046	28051	28538
Euro Area	Real GDP Growth (annualized quarterly rate, %)	1.2			1.4			1.2			1.2			1.0		

	Unemployment Rate (%)	8.0	7.9	7.8	7.8	7.8	7.7	7.6	7.6	7.5	7.6	7.5	7.5	7.5	7.5	7.4
	HICP (year-on-year, %)	2.3	1.9	1.5	1.4	1.5	1.4	1.7	1.2	1.3	1.0	1.0	0.8	0.7	1.0	1.3
	EURO STOXX 50 (end of the period)	3198	3173	3001	3159	3298	3352	3515	3280	3474	3467	3427	3569	3604	3704	3745
United Kingdom	Real GDP growth (year-on year, %)	1.4			2.0			1.3			1.2			1.1		
	Unemployment Rate (%)	4.1	4.0	4.0	3.9	3.9	3.8	3.8	3.8	3.9	3.8	3.9	3.8	3.8	3.8	...
	CPI (year-on-year, %)	2.4	2.3	2.1	1.8	1.9	1.9	2.1	2.0	2.0	2.1	1.7	1.7	1.5	1.5	1.3
	FTSE 100 (end of the period)	7128	6980	6728	6969	7075	7279	7418	7162	7426	7587	7207	7408	7248	7347	7542
Japan	Real GDP Growth (annualized quarterly rate, %)	2.1			2.6			1.9			0.5			-6.3		
	Unemployment Rate (%)	2.4	2.5	2.4	2.5	2.3	2.5	2.4	2.4	2.3	2.2	2.2	2.4	2.4	2.2	2.2
	CPI (year-on-year, %)	1.4	0.8	0.3	0.2	0.2	0.5	0.9	0.7	0.7	0.5	0.3	0.2	0.2	0.5	0.8
	NIKKEI 225 (end of the period)	21920	22351	20015	20773	21385	21206	22259	20601	21276	21522	20704	21756	22927	23294	23657

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

Growth moderated in most advanced economies. In 2019, growth in the advanced economies, such as the US and Europe, decelerated, but it has shown stabilizing signs, supported by monetary easing. The US economy grew at a slower pace but remained sound. The labor market was persistently tight. Growth in the euro area bottomed out and then leveled off, supported by stable growth in France, while that in Germany slowed down notably in 2019. Brexit accelerated, which would help reduce uncertainties. Japan's economy moderated after a rebound during the first half of 2019.

Growth in the emerging market economies moderated to varying degrees, with uncertainties lingering down the road. The IMF projected that the emerging market economies would grow 3.7 percent in 2019, lower than the 4.5 percent in 2018, but that they would rebound to 4.4 percent in 2020. Growth in India slowed down, that in Brazil and Russia rebounded after bottoming out, but growth in South Africa remained sluggish.

2. Major central banks shifted to an easing monetary policy

In 2019, the US Fed and the European Central Bank (ECB) shifted to policy easing, and many economies followed suit by cutting rates. The US Fed stopped its rate hike in early 2019 amid concerns about the economic outlook and the policy rate remained close to the neutral rate. It cut the rates three times and resumed repurchase operations and purchases of Treasury bills. The ECB continued to adjust forward guidance regarding rate hikes since the start of 2019, cut the interest rate on the deposit facility by 10 basis points to –0.50 percent in September, the first rate cut since 2016, and it resumed the asset purchase program, kicking off a fresh round of targeted longer-term refinancing operations. In the meantime, over 40 economies, including Australia, New Zealand, South Korea, India, Brazil, Mexico, Russia, and Turkey, lowered their rates either to prop up economic growth or to achieve the inflation target. In some economies, the policy rate has reached or has been close to a record low.

Rate cuts by the major central banks contributed to the rally in global financial markets, but global debt burdens increased. The yield on a growing number of bonds fell into negative territory. In 2019, panic caused by US-China trade frictions and the global economic performance led to an inverted US Treasury yield curve, as a result of which the yield on government bonds in many European economies dipped to or even below zero. On the back of rate cuts around the globe, financial markets rebounded, with major stock indices rising and major government bond yields trending downwards compared with the beginning of 2019. **The global debt burden mounted.** According to the Institute of International Finance, as of Q3 2019 the global debt-to-GDP ratio hit a new all-time high of 322 percent. By breakdown, the non-financial sector debt-to-GDP ratio posted 243.6 percent. The public debt increased and remained at high levels in the advanced economies, while in the emerging market economies, there was a broad-based increase in all types of debts, in particular, debts of non-financial enterprises rose sharply and the external debt-to-GDP ratio also jumped. **The number of bonds with negative yields increased, and this persisted for an extended period.** In 2019, the size of bonds with a nominal negative yield at one time reached US\$ 17 trillion. A negative rate may cause a number of issues, including asset bubbles, a debt overhang, a narrower spread between bank deposits and loans, and weaker bank profitability.

3. Issues and trends that merit attention

First, although the global economy has seen stabilizing signs, downward pressures remain elevated. Leading indicators such as the PMI signal subdued economic activity,

and policy room has been diminishing. **Second**, risk from trade frictions has abated, but uncertainties persist. According to the IMF forecast, the volume of global trade would add 1 percent in 2019, a significant drop compared with 2018. It is expected to rebound to 2.9 percent in 2020. **Third**, risk factors may trigger a sudden spike in risk aversion amid rising vulnerabilities, which may undermine financial stability. **Fourth**, low growth, low inflation, low rates, and low productivity gains pose a challenge to monetary policy adjustments, which require stronger international monetary policy coordination. **Fifth**, the global economic slowdown may further aggravate regional geopolitical conflicts in some parts of the world. Climate change and environmental factors are also having a growing impact on the economy and finance.

II. Macroeconomic developments in China

In 2019, the national economy was generally stable, with the economic structure continuously improving and high-quality development making solid progress. Consumption became a greater force in driving economic growth, industrial production and investment were relatively stable, and imports and exports expanded. Employment was largely stable, and price levels witnessed an obvious structural rise. According to preliminary statistics, the GDP and CPI in 2019 grew by 6.1 percent and 2.9 percent year on year respectively, and the surplus in goods trade reached RMB2.915 trillion.

1. Consumption grew steadily, investment stabilized while slowing down, and imports and exports expanded

Consumption contributed more to economic growth. In 2019, per capita disposable income posted RMB30733, up 8.9 percent in nominal terms and 5.8 percent in real terms year on year. The income distribution structure continued to improve, with the per capita income of rural residents continuing to grow at a faster pace than that of urban residents. According to the *Urban Depositors' Survey* conducted by the PBC in 2019 Q4, 28.0 percent of consumers were inclined to “consume more,” down 0.6 percentage points from the same period of 2018. The contribution of final consumption expenditures to economic growth remained high, reaching 57.8 percent in 2019, 26.6 percentage points higher than the Gross Capital Formation (GCF). Total retail sales of consumer goods rose by 8.0 percent year on year and online retail sales grew by 16.5 percent year on year to RMB10.6 trillion, maintaining rapid growth.

Investment in fixed assets stabilized while decelerating. In 2019, fixed-asset investments throughout China (excluding those by rural households) grew by 5.4 percent year on year, 0.5 percentage points lower than that in 2018. By investment areas, investment in the manufacturing industry increased by 3.1 percent year on year, 6.4 percentage points lower than in 2018, of which the growth in December picked up slightly. Growth of investment in infrastructure reached 3.8 percent, which was on a

par with that in 2018. Real estate investment registered year-on-year growth of 9.9 percent, 0.4 percentage points higher than that in 2018. Investment by the private sector grew by 4.7 percent year on year, down 4.0 percentage points from 2018, and investment by state-owned enterprises grew by 6.8 percent, up 4.9 percentage points.

Imports and exports expanded. In 2019, imports and exports of goods rose by 3.4 percent year on year to RMB31.54 trillion, 6.3 percentage points lower than in 2018. Specifically, exports increased by 5.0 percent and imports increased by 1.6 percent, which expanded the trade surplus by 25.4 percent year on year to RMB2.92 trillion. Exports moved further up the value chain. Private enterprises became more vigorous, with their imports and exports rising by 11.4 percent. The layout of the international market became more diversified. Trade with the EU, ASEAN, the US and Japan grew by 8 percent, 14.1 percent, -10.7 percent, and 0.4 percent respectively, while trade with the countries along the Belt and Road grew by 10.8 percent to reach RMB9.27 trillion.

Utilized foreign investment grew steadily. In 2019, actually utilized foreign investment grew by 5.8 percent year on year to RMB941.5 billion, and over 40,000 new foreign-funded companies were established nationwide, making China still the world's second largest recipient of foreign investment. Outward investment cooperation was carried out in a stable and orderly manner. Non-financial outward direct investments dropped by 8.2 percent year on year to USD110.6 billion. Investments in countries along the Belt and Road reached USD15 billion, accounting for 13.6 percent of total outward investments, 0.6 percentage points higher compared with that in 2018.

2. Agricultural production was fairly satisfactory, and industrial production was generally stable

In 2019, the value-added of the primary, secondary, and tertiary industries grew by 3.1 percent, 5.7 percent, and 6.9 percent respectively, accounting for 7.1 percent, 39.0 percent, and 53.9 percent of GDP respectively.

Agricultural production was fairly satisfactory. Total grain output grew by 0.9 percent year on year to 663.84 million tons in 2019, and annual output has been over 650 million tons for five years in a row. During the year, the output of pork, beef, mutton, and poultry decreased by 10.2 percent year on year to 76.49 million tons, among which the output of pork plunged by 21.3 percent to 42.55 million tons.

Industrial production continued to make progress. In 2019, the value-added of Industrial Enterprises Above a Designated Size (IEDS) increased by 5.7 percent year on year. The value-added of the high-tech manufacturing industries and the strategic emerging industries grew by 8.8 percent and 8.4 percent, respectively, 3.1 percentage

points and 2.7 percentage points higher than that of the IEDS. In December, the Expected Production and Business Activities Index for the manufacturing industry was 54.4 percent, which was in a higher economic range. In 2019, the total profits of the IEDS reached RMB6.1995 trillion, down 3.3 percentage points from the previous year. According to the survey conducted in the fourth quarter by the PBC on 5,000 entrepreneurs, the Business Climate Index posted 55.5 percent, up 2.2 percentage points from the previous quarter, and the Profitability Index registered 57.3 percent, up 2.0 percentage points from the previous quarter.

The service sector grew rapidly. In 2019, the Index of Service Production (ISP) grew by 6.9 percent year on year. Specifically, sectors such as information communications, software, and IT services developed rapidly. From January to November 2019, the business revenue of Enterprises Above a Designated Size (EDS) in the service sector grew by 9.4 percent, among which the business revenue of the strategic emerging enterprises, scientific and technological enterprises, and high-tech enterprises grew by 12.4 percent, 12.0 percent, and 12.0 percent, respectively. Business profits of the EDS in the service sector increased by 3.5 percent. In December, the Expected Business Activities Index for the service industry reached 59.1 percent, showing a good momentum of growth.

3. Growth of consumer prices accelerated, and producer prices moved down year on year

The growth of consumer prices witnessed an obvious structural acceleration. In 2019, the CPI rose by 2.9 percent year on year, an acceleration of 0.8 percentage points from the previous year. Specifically, the price of pork rose rapidly by 42.5 percent year on year, which drove the prices of beef and mutton up by 12.1 percent and 11.9 percent, respectively. Food prices throughout the year rose by 9.2 percent year on year, an acceleration of 7.4 percentage points compared with 2018. Non-food prices went up by 1.4 percent year on year, a deceleration of 0.8 percentage points compared with 2018. The core CPI (CPI less food and energy) rose moderately by 1.6 percent, a deceleration of 0.3 percentage points compared with 2018.

Producer prices dropped year on year. In 2019, the Producer Price Index (PPI) edged down by 0.3 percent year on year, a deceleration of 3.8 percentage points compared with 2018, with both November and December witnessing a narrowed decline. The Purchasing Price Index for Industrial Products (PPIRM) declined by 0.7 percent year on year, a deceleration of 4.8 percentage points compared with 2018. The Corporate Goods Price Index (CGPI) monitored by the PBC edged down by 0.2 percent, a deceleration of 3.2 percentage points compared with 2018. By products, the year-on-year price growth of primary and end products accelerated, while the prices of intermediate products continued to decrease year on year.

4. Growth of fiscal expenditures was fairly rapid, and the employment situation was generally stable

In 2019, revenue in the national general public budget totaled RMB19.0382 trillion, up 3.8 percent year on year, registering a deceleration of 2.4 percentage points from 2018. Specifically, tax revenue amounted to RMB15.7992 trillion, up 1 percent year on year; non-tax revenue reached RMB3.239 trillion, up 20.2 percent year on year. The domestic value-added and consumption tax grew by 1.3 percent and 18.2 percent year on year, respectively. The corporate income tax saw a year-on-year increase of 5.6 percent, while the personal income tax dropped 25.1 percent year on year.

Fiscal expenditures maintained fairly rapid growth. In 2019, expenditures in the national general public budget hit RMB23.8874 trillion, up 8.1 percent year on year, registering a deceleration of 0.6 percentage points from 2018. In terms of the structure, expenditures on infrastructure investments saw substantial growth, with expenditures on urban and rural communities, science and technology, and energy conservation and environmental protection climbing by 16.1 percent, 14.4 percent, and 18.2 percent year on year, respectively.

In 2019, budgetary revenue from nationwide government-managed funds totaled RMB8.4516 trillion, up 12 percent year on year. In particular, revenue from land sales grew by 11.4 percent year on year. Budgetary expenditures from nationwide government-managed funds increased by 13.4 percent year on year to RMB9.1365 trillion.

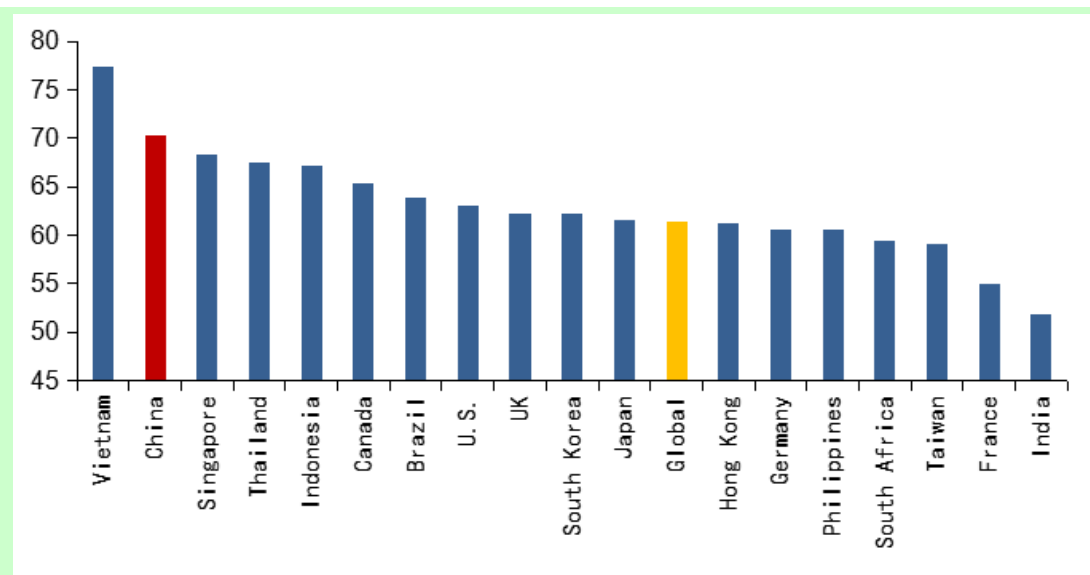
The employment situation remained stable, and the surveyed unemployment rate in the urban areas met the target. In 2019, a total of 13.52 million new jobs were created in the urban areas, which was well beyond the annual target of 11 million, or equivalent to 122.9 percent of the annual target. The annual amount of new jobs created in the urban areas has been over 13 million for seven years in a row. The surveyed unemployment rate in the urban areas reached 5.2 percent in December and ranged from 5.0 percent to 5.3 percent in each month of 2019. As of end-2019, the number of employed persons totaled 774.71 million. In 2019, the population of migrant workers grew 2.41 million to reach 290.77 million, a year-on-year increase of 0.8 percent. According to the Survey of Urban Depositors conducted by the PBC in Q4, the Employment Sentiment Index posted 44.5 percent in the fourth quarter, down 0.9 percentage points from the previous quarter, while the Employment Expectation Index reached 51.9 percent in the fourth quarter, down 0.7 percentage points from the previous quarter.

Box 4 A Look at China's Labor Market and Its Future Trends from the Perspective of the Composition of Employment

Given that employment is the foundation of people's livelihood and the origin of wealth, it is necessary to strengthen the research and evaluation of the employment situation and keep employment stable with multi-pronged measures. At present, China's employment is generally stable. In 2019, a total of 13.52 million new jobs were created in the urban areas, which was 2.52 million more than the projected target and which marked the seventh consecutive year above 13 million. Throughout the year, the surveyed unemployment rate in the urban areas remained stable in the range of 5.0–5.3 percent. In the meantime, the composition of employment has improved, with a gradual increase in the proportion of employment by the service sector.

In the medium and long run, China will enjoy steady tailwinds in achieving full employment amid high-quality development. On the demand side, the demand for highly skilled labor by equipment manufacturers and consumption-goods manufacturers remains strong. Meanwhile, the service sector demonstrates an increasingly large potential to absorb employment and it is expected to become a major pillar for generating new jobs. On the supply side, the labor-participation rate and the working-age population are trending down, which will alleviate labor supply pressures. In 2018, China's labor participation rate stood at around 70 percent, which was high by international standards (see Figure 6). With extended years of schooling for adolescents and the deepening of the aging of the population, China's labor participation rate is expected to decline continuously, and it might in the future converge toward that of the advanced economies like the US and Japan and come close to the global average. In terms of labor supply, the working-age population in China, which is defined as those between the ages of 16 and 59, declined by over 23 million from 2013 to 2019, and it is expected to remain stable albeit with a slightly downward bias.

Figure 6 Labor Participation Rates of the Major Economies in 2018



Source: Wind.

Nonetheless, various parties in China still feel a certain degree of employment pressures, which is mainly due to the prominent structural conflicts in employment. Above all, labor demand in some sectors has declined. In recent years, machines have been replacing people at an accelerated pace. As a result, the growth of labor productivity in the secondary sector led by manufacturing and construction has accelerated, which, combined with the economic downward pressures, has reduced the capacity of the secondary sector to absorb employment. Labor-intensive industries in the service sector, led by accommodations and catering as well as wholesale and retail, have become major sectors to absorb employment. Employment in the secondary sector since 2013 has begun to decline. The employment number was 18.50 million lower in 2018 compared with the peak in 2012. Second, the labor supply of major groups is rigid. A large number of university graduates, military veterans, and rural migrant workers seek jobs each year. In addition, adults of prime age have a strong tendency to look for jobs in the urban areas. All these factors increase employment pressures to some degree. Third, there is a misalignment between labor supply and demand. While it is difficult to find jobs, it is also difficult to recruit staff. On the one hand, there is a general shortage of ordinary workers at the front lines and a shortage of high-tech talents. On the other hand, it is increasingly difficult for new generations in the labor force to accept the life and working style of traditional industrial workers. Instead, they care more about occupational development and realization of their own value, and they mainly prefer industries with high salaries and high productivity. Therefore, there is a mismatch between labor supply and demand. Fourth, due to large external uncertainties, the foreign trade sector might face larger structural employment pressures. The world economy is still undergoing profound adjustments in the wake

of the global financial crisis, presenting more and more risks and challenges. Also, there has emerged a trend for industries to shift operations outside China, in particular, industries with labor-intensive enterprises. All these might exert a negative impact on foreign-trade enterprises.

According to preliminary estimates, there can still be more than 11 million new jobs created in the urban areas each year for the next several years. Considering the obvious structural characteristics of China's employment pressures, efforts to stabilize employment should not only focus on aggregate employment but also on improving the composition of employment. During the next stage, action should be taken to tap the synergy of various policies, alleviate the structural employment pressures, and promote full employment.

5. The balance of payments and external debt

The balance of payments remained basically in equilibrium. According to preliminary data, China's current account surplus stood at USD177.5 billion in 2019. To be specific, the surplus in trade of goods increased, whereas the deficit in trade of services declined. Under the capital and financial account, direct investments witnessed a net inflow of USD59.1 billion and securities investments registered a surplus of approximately USD60 billion. At end-2019, foreign exchange reserves stood at USD3.1079 trillion, up USD35.2 billion from end-2018. As of the end of September 2019, the balance of full-caliber foreign debt (including domestic and foreign currencies) posted USD2.0325 trillion. Among this, the short-term external debt balance was USD1.2055 trillion, accounting for 59 percent of the total external debt balance.

6. Analysis by sector

6.1 The real estate sector

In 2019, growth of total floor area of sold units and housing sales nationwide slowed down, while regions with rising housing prices were reduced substantially, with the year-on-year growth of housing prices declining. Investments in real estate development remained stable with a modest rise, and the growth of real estate loans continued to moderate.

At end-2019, among the 70 medium and large-sized cities nationwide, newly built and second-hand residential housing prices increased by 6.8 percent and 3.7 percent year

on year, down 3.7 percentage points and 4 percentage points from the same period of the previous year, respectively. The total floor area of sold units leveled off as compared with the previous year and housing sales increased by 6.5 percent year on year, a deceleration of 5.7 percentage points from end-2018.

Investments in real estate development grew steadily and newly started real estate projects saw a mild slowdown. In 2019, real estate investments in China increased by 9.9 percent year on year, an acceleration of 0.4 percentage points from 2018. Specifically, investments in residential housing development reached RMB9.7 trillion, up 13.9 percent year on year and an acceleration of 0.5 percentage points from 2018, accounting for 73.4 percent of total investments in real estate development.

Table 14 Floor Area of Real Estate Projects that were Newly Started, under Construction, and Completed in 2019

	Floor area (trillion square meters)	Year-on-year growth (%)	Year-on-year acceleration (percentage points)
Floor area of newly started real estate projects	22.7	8.5	-8.7
Floor area of real estate projects under construction	89.4	8.7	3.5
Floor area of completed real estate projects	9.6	2.6	10.4

Source: National Bureau of Statistics.

Growth of real estate loans moderated. At end-2019, outstanding real estate loans by major financial institutions (including foreign-funded financial institutions) stood at RMB44.41 trillion, up 14.8 percent year on year and a deceleration of 5.2 percentage points from 2018. Outstanding real estate loans accounted for 29 percent of total lending. Specifically, outstanding individual housing loans amounted to RMB30.2 trillion, up 16.7 percent year on year, representing a deceleration of 1.1 percentage points from end-2018. Outstanding housing development loans posted RMB8.4 trillion, rising 14.6 percent year on year and a deceleration of 17.3 percentage points from end-2018. Outstanding land development loans decreased by 7.1 percent year on

year to RMB1.28 trillion, representing a deceleration of 11 percentage points as compared with that at end-2018.

Growth of loans for government-subsidized housing slowed down. Due to the impact of replacing loans for government-subsidized housing development with special bonds issued by local governments, outstanding loans for government-subsidized housing development totaled RMB4.6 trillion at end-2019, up 6.7 percent year on year and a deceleration of 22.8 percentage points from end-2018. New loans for government-subsidized housing development in 2019 reached a cumulative RMB287.8 billion, a deceleration of RMB696 billion as compared with 2018, accounting for 25.5 percent of all new real estate development loans.

6.2 The steel sector

Due to countercyclical adjustments, the steel sector enjoyed stable operations in 2019, with continued efforts to exploit the potential of energy conservation by following advanced international standards of production and enhancing efficiency with lower costs. **First**, steel production maintained a growth momentum. In 2019, the output of pig iron, crude steel, and rolled steel increased by 5.3 percent, 8.3 percent, and 9.8 percent year on year, respectively. **Second**, investments in fixed assets of the steel industry continued to grow in 2019. Investments in the fixed assets of smelting and rolling ferrous metals and mining and processing of ferrous metals grew by 26 percent and 2.5 percent year on year respectively in 2019. **Third**, the price of steel products rebounded and stabilized, and the price of raw steel materials moderated in Q4 2019. **Fourth**, the standards for ultra-low emissions have been officially implemented and green development has been promoted.

In the context of the continuing deceleration of global economic growth and the increasing downward pressures on the Chinese economy, the steel industry in China is still facing mounting challenges. **First**, profits of the steel industry have decreased year on year as a result of increasing costs. The price of raw steel materials fluctuated at a high level, while investments in environmental protection increased, squeezing the profit margin of the steel industry as a whole. In 2019, sales of member enterprises of the China Iron and Steel Association (CISA) increased 10.1 percent year on year, while total profits declined by 30.9 percent year on year. **Second**, due to the impact of trade frictions and trade protectionism in the international market, total imports and exports of steel products decreased. In 2019, the export of steel products decreased 7.3 percent year on year to 64.293 million tons, and the import of steel products decreased 6.5 percent to 12.304 million tons. **Third**, the steel industry is still facing problems, including growing pressures for environmental protection and

existing technical difficulties in the implementation of ultra-low emission standards, calling for cross-sectoral cooperation.

Going forward, the steel sector will go to great lengths to promote reform and innovation and to enhance the competitiveness of steel enterprises in line with the requirement for deepening the supply-side structural reforms. Efforts will be made to support technical improvements, structural adjustments, and green development of competitive steel enterprises based on a differentiated credit policy. Efforts will also be made to give full play to the capital market in promoting the merger and reorganization of steel enterprises and to encourage steel enterprises to deleverage and reduce costs through direct financing so as to bolster the high-quality development of the sector.

Part 5. Monetary Policy Outlook

I. Outlook for the Chinese economy

For the next period, the Chinese economy will be somewhat affected by the novel coronavirus epidemic. However, the impact will be temporary and limited as the fundamentals of sound and high-quality growth over the long term remain unchanged. Meanwhile, it should be noted that the Chinese economy still faces various challenges.

China is still in an important period of strategic opportunities and will remain there for a long time. Not only has China built up strong material and technological foundations since the reform and opening-up, but it also enjoys the advantages of a super-scale market, huge potential in domestic demand, and extraordinary human capital as well as a pool of talent. In recent years, the “three tough battles” to forestall and defuse major risks, conduct targeted poverty alleviation, and reduce pollution are making key progress. The supply-side structural reforms continue to be deepening. Economic growth remains resilient. Employment is generally stable, household income is witnessing steady growth, and the people's livelihood continues to improve. All these factors have contributed to sustained and healthy economic development and social stability. In addition, the proactive fiscal policy and the sound monetary policy have gradually shown an effect. Money and credit as well as aggregate financing to the real economy (AFRE) have grown at a rate well-aligned with economic development. As a result, the macro leverage ratio has been basically stable, and financial support for the real economy, especially for MSEs and private

enterprises, has been continuously intensified. With prudent and decisive measures taken to prevent financial risks, the financial system has been generally healthy and capable of defusing various risks. The quality and efficiency of providing financial support for the real economy have been improving. The RMB exchange rate has remained basically stable at an adaptive and equilibrium level, and the capacity of the economy to cope with external shocks has been enhanced.

With the economy undergoing adjustments both at home and abroad, the downward pressures on the Chinese economy are quite high. The world economy continues to slow down amid profound post-crisis adjustments, so external uncertainties and destabilizing factors are on the rise. As the Chinese economy is transitioning from high-speed growth to high-quality development, the structural, institutional, and cyclical issues are interwoven with one another, and the coexistence of an economic slowdown, structural adjustments, and the impact from the previous stimulus policies are exerting more influence. Although China's economic growth has remained resilient, it is still faced with significant downward pressures. Corporate investment growth is still weak. With more credit risks exposed, the risk appetite of some small and medium-sized financial institutions has declined. The novel coronavirus epidemic will have some impact on economic growth in the short run, as mainly reflected by the fall in consumption and the delayed resumption of business operations. It is necessary to view these developments from an objective and rational perspective, to remain confident, and to keep firm. We need to be fully prepared and exert ourselves to do our part well. Efforts will be made to promote the stable growth of consumption, increase effective investment, and release the potential of domestic market demand.

Inflation is generally under control and expectations are basically stable, with future developments to be watched closely. Throughout 2019, the rises in consumer goods prices were apparently structural and mainly driven by the rapid rise in food prices, such as the price of pork. As multiple measures have been rolled out successively to guarantee supply, stabilize prices, and guide expectations, CPI growth is generally controllable, while inflation expectations have been prevented from diverging and they remain stable. In the meantime, with the weakening of the base figure effect, the year-on-year PPI decline has somewhat narrowed. Over the short term, factors such as the novel coronavirus epidemic are likely to affect prices, which warrant continued monitoring and analysis. However, judging by the fundamentals, China's economic performance is generally stable, and aggregate supply and demand are basically in equilibrium, providing no grounds for persistent inflation or deflation.

II. Outlook for monetary policy in the next stage

Under the guidance of Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, the PBC will comprehensively implement the guidelines of the Fourth Plenary Session of the 19th Communist Party of China (CPC) Central Committee and the Central Economic Work Conference as well as the decisions and arrangements of the CPC Central Committee and the State Council. Committed to achieving the target of completing the building of a moderately prosperous society in all respects and concluding the 13th Five-Year Plan, it will adhere to the guiding principle of pursuing progress while ensuring stability, uphold the new development philosophy, and take all-round measures to stabilize employment, the financial sector, foreign trade, foreign investment, domestic investment, and expectations. Meanwhile, it will calibrate countercyclical adjustments in a scientific and prudent manner and conduct a sound monetary policy that is flexible and appropriate. By upholding the fundamental principles, promoting innovation, and living up to its responsibilities, it will properly cope with short-term downward pressures on the economy while refraining resolutely from an indiscriminate large-scale stimulus, so as to ensure that the economy performs within a reasonable range. It will try to reach a dynamic balance among multiple targets and carry out reforms to smooth the transmission of monetary policy. By combining reforms and adjustment measures and accommodating both short-term and long-term considerations as well as internal and external equilibria, it will further intensify countercyclical adjustments, structural adjustments, and reforms to keep prices basically stable. Taking epidemic control as the top priority under the current circumstances, the PBC will step up monetary and credit support to control the epidemic. The PBC will defend the bottom line of risk prevention and will continue to forestall and defuse risks in the course of promoting high-quality development, thereby fostering a virtuous cycle between the economy and the financial sector. Work will be done to guide expectations, strengthen macro policy coordination, coordinate RMB and foreign exchange policies, and strike a balance between internal and external equilibria. Efforts will be made to deepen the financial supply-side structural reforms, establish a modern central banking system, and make the modern financial system more adaptable, competitive, and inclusive to foster a virtuous cycle in the national economy.

First, the PBC will effectively implement a sound monetary policy, calibrate countercyclical adjustments in a scientific and prudent manner, and keep liquidity reasonable and adequate so that the growth of money and credit as well as the AFRE is in line with economic growth. A mix of monetary policy instruments will be flexibly employed to support high-quality economic development with appropriate monetary growth and to effectively keep the economy performing within a reasonable range. Macro management will be more forward-looking, precise, proactive, and effective. Preemptive adjustments and fine-tunings will be carried out in line with economic growth and price developments, and they will be carefully

calibrated to enhance guidance of expectations and to maintain China's status as one of the few major economies in the world that pursues a normal monetary policy. Work will be done to improve the sustainable mechanism for capital replenishment, encourage banks to replenish capital through multiple channels, such as the issuance of perpetual bonds, and expand the scope of perpetual bond investors to diversify risks. In particular, measures will be taken to support capital replenishment by small and medium-sized banks, enhance the ability of banks to serve the real economy as well as to forestall and defuse financial risks, and prevent the risk of social credit contraction.

Second, the PBC will take epidemic control as the top priority under the current circumstances and step up monetary and credit support for it. Major national banks and locally incorporated banks in the ten hard-hit provinces and municipalities are required to make full use of the special central bank lending to support, in a rapid and precise way, those enterprises directly engaged in epidemic control. Management of the special central bank lending will be based on a list of key enterprises directly engaged in the production, transportation, and sale of vital medical supplies and daily necessities, and financial institutions will be encouraged to provide credit support at preferential interest rates for the enterprises on the list. Moreover, financial institutions will be guided to better meet the needs of hospitals, medical research institutions, and relevant enterprises by providing sufficient credit resources. They must not blindly withdraw, terminate, or reduce loans issued to the industries that are severely affected by the epidemic, such as wholesale, retail, catering, logistics, and culture and tourism, as well as MSEs that have promising prospects but are facing temporary difficulties. Extensions or renewals of loans will be granted for enterprises having trouble with repayments on time due to the epidemic. All-out support will be provided for the resumption of work and production on the condition that the measures for epidemic prevention and control are in place. The PBC will help relevant enterprises overcome the impact of the epidemic by duly lowering loan rates, increasing credit-based lending and medium and long-term lending, as well as other possible measures. Financial services related to epidemic control will be improved, with preferential treatment applied to heavily afflicted regions, industries, and enterprises on a differentiated basis.

Third, the PBC will give play to the role of monetary policy in promoting economic structural adjustments, with a view to better serving the real economy. Work will be done to further improve the RRR policy framework featuring “three tranches and two preferential treatments” and to establish a long-term mechanism of increasing bank loans to MSEs. A mix of monetary policy instruments, such as targeted RRR cuts, central bank lending, central bank discounts, and macroprudential assessment (MPA), will be properly employed so that financial institutions will be

guided to step up credit support for MSEs, private enterprises, and the manufacturing industry. Banks will be urged to cut surcharges on loans so as to ensure a reduction in the financing costs of MSEs and to better serve the real economy. Policy coordination will be enhanced so that financial resources will be channeled to the fields that will benefit both the demand and supply sides and produce a multiplier effect, such as advanced manufacturing, livelihood improvement, and weak links in infrastructure development, thereby promoting industrial and consumption upgrading. Efforts will be made to advance poverty alleviation based on both financial support and industrial development, so as to boost the endogenous growth drive for impoverished regions. Research will be conducted to roll out measures for the assessment of commercial bank services for rural revitalization so as to promote better services accordingly. Policies on guaranteed loans for business start-ups will be improved to provide better financial services for groups such as veterans, college graduates, and rural migrant workers starting their own businesses. In line with the principle that housing is for living in, not for speculation, and that relevant policies should be introduced on a city-specific basis, steps will be accelerated to establish a long-term mechanism for the management of real estate financing while refraining from using the real estate market to provide a short-term stimulus to the economy.

Fourth, the PBC will make more efforts to deepen the market-based interest rate reform and the reform of the RMB exchange rate formation mechanism so as to enhance the efficiency of financial resource allocations. The PBC will further develop the system of benchmark lending rates and market-based interest rates by improving the loan prime rate (LPR) transmission mechanism, moving ahead with the conversion of the pricing benchmark for existing floating-rate loans, motivating banks to apply the LPR in an orderly way, and transforming the old mentality of pricing so as to remove the implicit floor of loan rates and to smooth the transmission of monetary policy. The PBC will make effective use of the self-regulatory mechanism for market interest rate pricing, maintain fairness in pricing, and strictly implement the requirements for explicit indications of annualized loan rates so as to protect the rights and interests of consumers. The market-oriented exchange rate reform will be carried out steadily, with work continuing to be done to improve the managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies, maintain the flexibility of the RMB exchange rate, and explore the role of the exchange rate as an automatic stabilizer for the balance of payments and the macro economy. The PBC will enhance macroprudential management to stabilize market expectations and to keep the RMB exchange rate basically stable at an adaptive and equilibrium level. Steps will be accelerated to develop the foreign exchange market and to provide services of exchange rate risk management for import and export companies with authentic needs. Enterprises will be guided to be risk neutral in financial management and to manage exchange rate risks with foreign exchange derivatives for the purpose of locking up foreign exchange costs and

reducing uncertainties in production and operations. Efforts will be made to steadily advance the convertibility of the RMB under the capital account, improve the policy framework and the infrastructure for cross-border use of the RMB, and promote use of the RMB in cross-border trade and investment.

Fifth, the PBC will further improve the financial market system and enable the financial markets to play a better role in stabilizing growth, promoting structural adjustments, advancing reform, and guarding against risks. Measures will be taken to support bond financing by private enterprises and to strengthen the ability of the financial sector to serve the real economy. Work will be done to push for uniform standards for information disclosures of corporate debenture bonds and to improve the relevant regulations. The mechanism of bond default risk prevention and resolution will be improved in line with market-based and law-based principles. Coordination and interconnectivity between financial market infrastructures will be enhanced, and the building of custodian institutions and the trading report database will take steps forward to ensure that financial markets are generally stable and perform safely and efficiently. Active but prudent steps will be taken to promote the opening-up of the bond market at an institutional and systemic level and to introduce more medium and long-term investors into the market.

Sixth, the PBC will deepen the financial supply-side structural reform and improve the modern financial system that is expected to be highly adaptable, competitive, and inclusive. Reforms of financial institutions will be further pushed ahead. More work will be done to promote full implementation of the reform plans for development financial institutions and policy banks so as to improve their governance system and to explore their role in line with the practice for the operation of financial institutions. Reforms of large commercial banks and other large financial enterprises will continue to go deeper so as to improve their corporate governance, regulate the relationship between the general meeting of shareholders, the board of directors, the board of supervisors, and management, and improve the regulations on authorized management, thereby giving rise to effective decision-making, implementation, as well as checks and balances, and enhancing their business management and risk control capabilities. The opening-up of the financial sector will be further expanded.

Seventh, the PBC will make continued efforts to fight the tough battle of forestalling and defusing major financial risks. Under the leadership of the Financial Stability and Development Committee under the State Council, while keeping in mind the importance of consolidating the success already achieved, the PBC will take a more holistic and forward-looking approach in addressing risks and will continue to do a good job in “precise bomb removal” for high-risk institutions in

key areas. The division of duties for all parties concerned will be further clarified to ensure that financial institutions are held chiefly responsible; local governments will assume the responsibility for risk resolution in their respective jurisdictions and primary responsibility for maintaining local stability; financial regulatory agencies will assume the responsibility for supervision, and the PBC will assume the responsibility as the lender of last resort; and moral hazards will be closely guarded against. Efforts will be made to improve the long-term mechanism of forestalling and defusing financial risks and to promote high-quality development of the financial sector by means of reform, while firmly defending the bottom line that no systemic risk should occur.