

Makram EL-SHAGI, ZHENG Yizhuang (郑奕壮) and MA Yishuo (马怿硕)

## Only Mild Monetary Expansion Despite COVID-19 Challenges

In our MP Reports, we aim to provide a concise and timely analysis of Chinese monetary policy that makes it accessible for an international audience. With the world in the firm grip of the pandemic, many things – including our reports – were put on hold in 2020. So, we have to apologize with regard to the "timeliness" this time. This special report covers the entire year 2020 when we did not publish a quarterly analysis before we resume our regular (updated) schedule in April 2021 with the Q1 Report for 2021.

### The current economic background

In 2020, the world's most threatening challenge was the economic, social, and public health impacts of the COVID-19 pandemic. Even so, China is still the second largest global economy, the largest exporter, and has the largest exchange reserves in the world. However, even though China has one of the fastest-growing GDPs in the world, its economic growth was abruptly slowed to 1.9% in 2020, against 6.1% in 2019, due to the impact of the COVID-19 pandemic. Although the trade war with the US continued, it no longer was the most pressing issue for China in 2020. Yet, with two major shocks affecting the Chinese economy, it is

too early to quantify how much the trade war did affect the Chinese economy. The situation did put quite a significant pressure on the government budget; the budget balance reached a record low of -10.2% of GDP in 2020 compared to -5.9% the previous year. Debt has risen to 61.7%, and this number might have to be corrected upwards when the final numbers are in.

### Monetary policy in 2020: Overview

#### Policy Dashboard

Table 1 summarizes the key policy actions of the PBoC in the year 2020.



Makram EL-SHAGI



ZHENG Yizhuang



MA Yishuo

Table 1: Policy Dashboard

Jan 1 <sup>st</sup>	PBoC lowered the required reserve ratio (RRR) for financial institutions by 0.5 percentage points on January 6, 2020, to facilitate growth.
Jan 17 <sup>th</sup>	FSDC office under the State Council issued <i>Opinions of the Office of Financial Stability and Development Committee under the State Council on Establishing Local Coordination Mechanism</i> (Jinrongweibanfa [2020] No.1), to strengthen financial regulation, risk resolution, information sharing and protection of consumers' rights and interests.

- Feb 2<sup>nd</sup> PBoC, MOF, CBIRC, CSRC and SAFE jointly issued the notice of *Further Strengthening Financial Support for Containing Novel Coronavirus Outbreak*, to enable the financial sector to better support epidemic control by supporting the liquidity of the financial sector.
- Feb 25<sup>th</sup> CSRC, MOF, PBoC and CBIRC jointly released an announcement, *allowing qualified pilot commercial banks and insurers with proper investment management capacity to participate in the trade of treasury bond futures at the China Financial Futures Exchange*.
- Mar 12<sup>th</sup> PBoC, NDRC, MOF, CBIRC, CSRC and SAFE jointly released the *Work Plan for Coordinated Regulation of Financial Infrastructures*, to provide a starting point for joint macro prudential policies.
- Mar 13<sup>th</sup> PBoC implemented targeted RRR cuts by 0.5 to 1 percentage point for inclusive finance on March 16, 2020, lowering the RRR for banks that meet the assessment criteria.
- Apr 3<sup>rd</sup> PBoC cut the RRR by 1 percentage point for rural credit cooperatives, rural commercial banks, rural cooperative banks, village banks, as well as city commercial banks operating solely within provincial-level administrative regions.
- Apr 8<sup>th</sup> PBoC released the revised version of the *Measures of the People's Bank of China for the Implementation of Administrative Permits*, which improves and specifies the procedures for the acceptance, review and approval of administrative permit applications.
- May 8<sup>th</sup> PBoC and SAFE issued *the Regulations on Funds of Securities and Future Investment by Foreign Institutional Investors (PBoC & SAFE Announcement [2020] No.2)* to remove QFII / RQFII investment quotas and promote further opening-up of China's financial market, to bolster capital inflows into China's equity market and to stabilize foreign exchange reserves.
- Jun 4<sup>th</sup> PBoC, jointly with CBIRC, MOF, NDRC and MIIT issued two notices on support to micro, small, and medium-sized enterprises (MSMEs) in the context of the COVID-19 crisis. One notice extends the policy of phased deferment of loan principal and interest repayments for MSMEs while the other notice addresses increased credit support for micro and small businesses.
- Jun 30<sup>th</sup> PBoC, jointly with the Hong Kong Monetary Authority, and the Monetary Authority of Macau issued *the Cross-border Wealth Management Pilot Scheme in the Guangdong-Hong Kong-Macau Greater Bay Area ("GBA")*, to promote the cross-border investment in wealth management products by individual investors of the GBA.
- Jul 1<sup>st</sup> PBoC, NDRC and CSRC issued the *Notice of Concerning Disposal of Defaults on Corporate Credit Bonds*, to establish a sound bond default disposal mechanism, defuse risks in the bond market and protect investors' legitimate rights and interests.
- Jul 3<sup>rd</sup> PBoC, CBIRC, CSRC, and SAFE issued the *Rules for Recognition of Standard debt-based asset* to clarify the distinction between standard and non-standard debt-based assets.
- Jul 23<sup>rd</sup> PBoC and CSRC jointly issued *the Cooperation between Relevant Infrastructure Institutions in the Interbank Bond Market and the Exchange-traded Bond Market (Announcement [2020] No.7)*, in another step toward unifying the country's bond market.

- Aug 3<sup>rd</sup> PBoC, jointly with NDRC, MOF, CBIRC, CSRC, and SAFE decided upon deliberation to extend the transitional period of the *Guiding Opinions on Regulating the Asset Management Business of Financial Institutions* (Yinfa [2018] No.106) to the end of 2021.
- Aug 31<sup>st</sup> PBoC published the *White Paper Participating in International Benchmark Interest Rate Reform and Improving China's Benchmark Interest Rate System*, which covers plans of China to participate in the international interest rate benchmark reforms and its progress in this area.
- Sep 13<sup>th</sup> PBoC officially promulgated the *Trial Measures on Regulation of Financial Holding Companies* (PBoC Order [2020] No.4), to promote the standardized development of financial holding companies, effectively prevent and control financial risks, and better serve the real economy.
- Sep 22<sup>nd</sup> PBoC released *Implementation Measures of the People's Bank of China for the Protection of Financial Consumer Rights* (PBoC Order [2020] No.5), regulating the mobile payments space, especially, Alipay and WeChat Pay, to protect the personal financial information.
- Sep 28<sup>th</sup> PBoC, MIIT, MOJ, MOC, SASAC, SAMR, CBIRC, and SAFE jointly issued the *Opinions on Regulating the Development of Supply Chain Finance and Supporting the Stable Circulation, Improvement and Upgrading of Supply and Industrial Chains* (Yinfa [2020] No. 226), it requires financial institutions to develop supply chain finance to support micro, small and medium-sized enterprises financing.
- Oct 1<sup>st</sup> PBoC and CBIRC issued *a notice on establishing a mechanism of countercyclical capital buffer*.
- Oct 9<sup>th</sup> PBoC and CBIRC jointly released the *Measures for Assessment of Systemically Important Banks*, which will increase the number of lenders subject to additional capital and leverage requirements.
- Oct 10<sup>th</sup> PBoC lowered the foreign exchange risk reserve ratio for forward foreign exchange sales from 20 percent to zero, which could serve to keep the yuan's appreciation in check.
- Dec 14<sup>th</sup> PBoC and SAFE lowered the macro-prudential adjustment parameter for cross-border financing to 1 from 1.25, in order to facilitate cross-border financing for China's small and privately run firms.

#### Remarks

1. Titles written in *italic* are official translations by the PBoC.
2. Abbreviations of government agencies and committees

<b>PBoC</b>	People's Bank of China	<b>SAFE</b>	State Foreign Exchange Administration	<b>FSDC</b>	Office of Financial Stability and Development Committee under the State Council
<b>MOF</b>	Ministry of Finance		China Banking and Insurance Regulatory Commission	<b>CSRC</b>	China Securities Regulatory Commission
<b>NDRC</b>	National Development and Reform Commission	<b>CBIRC</b>			

## 2020 monetary policy stance

China has been resorting to a package of monetary and fiscal policies to support the country's SMEs, which were hardest hit by COVID-19. Counting the measures from the PBoC's macroprudential policy toolkit used in 2020 (following Sun 2017), we see that the Chinese monetary policy stance is easing in that regard.

1. **Macroprudential use of the required reserve ratio (RRR):** The PBoC implemented targeted cuts of the RRR three times in 2020, releasing long-term liquidity to the market. In the absence of no further sudden (global) risks, this should lower long-term interest rates.
2. **Window guidance:** The banking regulators have instructed several mid-sized banks to limit their structured deposit offerings, thereby cutting off an important carry trade that big companies have been playing. It has also instructed banks to monitor the use of their subsidized loans more closely.

3. **Housing policy:** The one-year prime rate (LPR) was kept at 3.85% and the five-year LPR remained at 4.65% since April 20, i.e., rates have been unchanged for eight months. For the year, the one-year LPR was down a total 30 basis points (bps), and the five-year rate – which is more important for mortgages – was cut by a total of 15 bps in two cuts in 2020.
4. **Supervisory pressure:** In 2020, the PBoC, alone or jointly with other regulators, issued three laws and regulations to constrain the monetary market, while two measure are expansionary in nature (see Table 3).

With slightly lower interest rates and money growth slightly increasing compared to the previous year but still below its long-term average (see next section for details), the entire monetary policy stance was neutral to moderately expansionary over the entire year.

Table 2: Recent changes of the required reserve ratio

Date	Large-scale Financial Institutions			Small-medium-scale Financial Institutions		
	Before	After	Adjustment	Before	After	Adjustment
2015.02.05	20.00%	19.50%	-0.50%	18.00%	17.50%	-0.50%
2015.04.20	19.50%	18.50%	-1.00%	17.50%	16.50%	-1.00%
2015.06.28	Part of banks RRR cut by 0.50%					
2015.09.06	18.50%	18.00%	-0.50%	16.50%	16.00%	-0.50%
2015.10.24	18.00%	17.50%	-0.50%	16.00%	15.50%	-0.50%
2016.03.01	17.50%	17.00%	-0.50%	15.50%	15.00%	-0.50%
2018.01.25	Part of banks RRR cut by 0.50-1.50%					
2018.04.25	17.00%	16.00%	-1.00%	15.00%	14.00%	-1.00%
2018.06.24	16.00%	15.50%	-0.50%	14.00%	13.50%	-0.50%
2018.10.07	15.50%	14.50%	-1.00%	13.50%	12.50%	-1.00%
2019.01.04	14.50%	13.50%	-1.00%	12.50%	11.50%	-1.00%
2019.06.06	1000 country level rural commercial banks RRR cut by 0.50-1.5%					
2019.09.06	13.50%	13.00%	-0.50%	11.50%	11.00%	-0.50%
2020.01.01	13.00%	12.50%	-0.50%	11.00%	10.50%	-0.50%
2020.03.13	12.50%	11.50%	-1.00%	10.50%	9.50%	-1.00%
2020.04.03	11.50	11.50	0.00%	8.50%	9.50%	-1.00%

Table 3: Supervisory pressure

Constrain	Mar 12 <sup>th</sup>	PBoC, NDRC, MOF, CBIRC, CSRC and SAFE jointly released <i>the Work Plan for Coordinated Regulation of Financial Infrastructures</i>
	May 8 <sup>th</sup>	PBoC and SAFE issued <i>the Regulations on Funds of Securities and Future Investment by Foreign Institutional Investors (PBoC &amp; SAFE Announcement [2020] No.2)</i> to remove QFII / RQFII investment quotas and promote further opening-up of China's financial market
	Sep 22 <sup>th</sup>	PBoC releases <i>Implementation Measures of the People's Bank of China for the Protection of Financial Consumer Rights (PBoC Order No. 5 [2020])</i>
Ease	Feb 25 <sup>th</sup>	CSRC, MOF, PBoC and CBIRC jointly released an announcement, <i>allowing qualified pilot commercial banks and insurers with proper investment management capacity to participate in the trading of treasury bond futures at the China Financial Futures Exchange</i>
	Dec 14 <sup>th</sup>	The PBoC and SAFE lower the macro-prudential adjustment parameter for cross-border financing to 1 from 1.25

## Monthly Chinese Divisia Monetary data

Overall, the average monthly year-over-year growth rate for Divisia M4 from Jan 2020 to November 2020 was 10.74%, and the average monthly year-over-year growth rate for M3 was 10.52%. For Chinese Divisia M0, Divisia M1, and Divisia M2, the average monthly year-over-year growth rates are 9.88%, 6.49% and 10.13%, respectively. Over time, the growth rates of 2020 fluctuated below the long-term average from 2005 to 2020. We observe particularly low Divisia M2 growth, which – given the higher growth rate of broader aggregates – seems to be driven by a portfolio reallocation between monetary assets. This might be a response to the strong focus on macroprudential policies of the PBoC in the past years.

*Makram EL-SHAGI is the director of the CFDS and Professor at Henan University. He has graduated from the University of Mannheim. He has been active in policy advice for many years, working as senior economist at the Halle Institute for Economic Research and consultant for the ECB.*

*ZHENG Yizhuang and MA Yishuo are doctoral students and researchers at the Center for Financial Development and Stability. Both are working on Chinese monetary policy.*

Figure 1: Chinese Divisia M3, M4 monthly year-over-year growth rate from Jan 2005 to Nov 2020

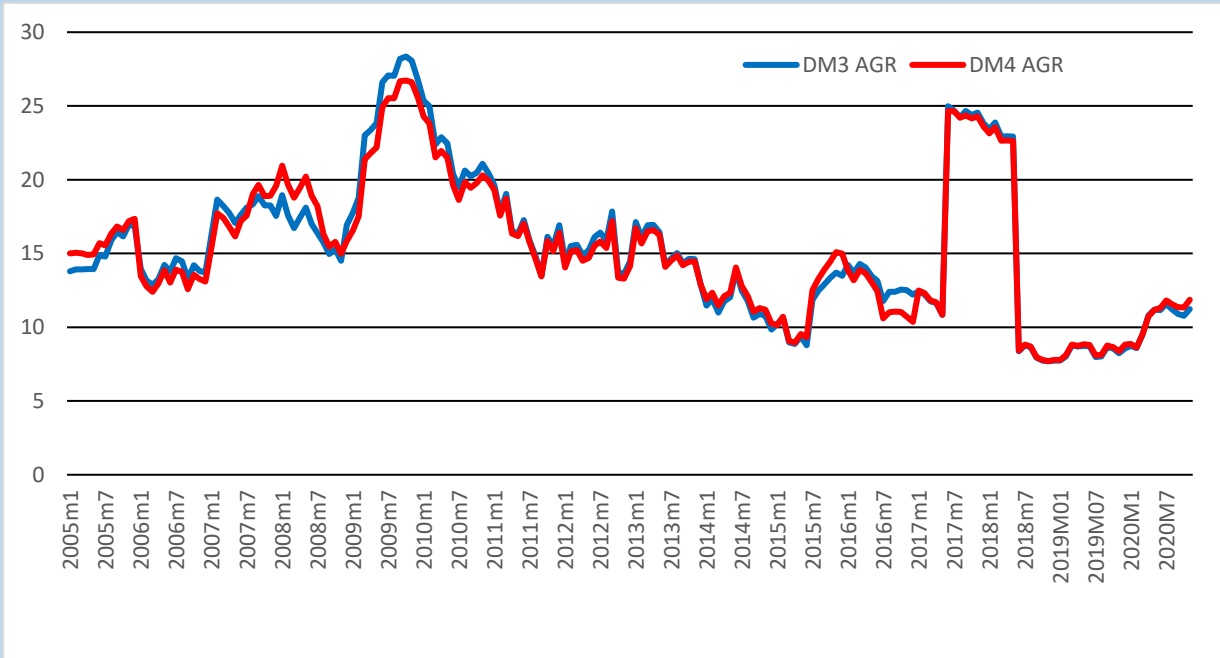


Figure 2: Chinese Narrow Divisia Monetary Aggregates M1, M2 monthly growth rate from Jan 2005 to Nov 2020

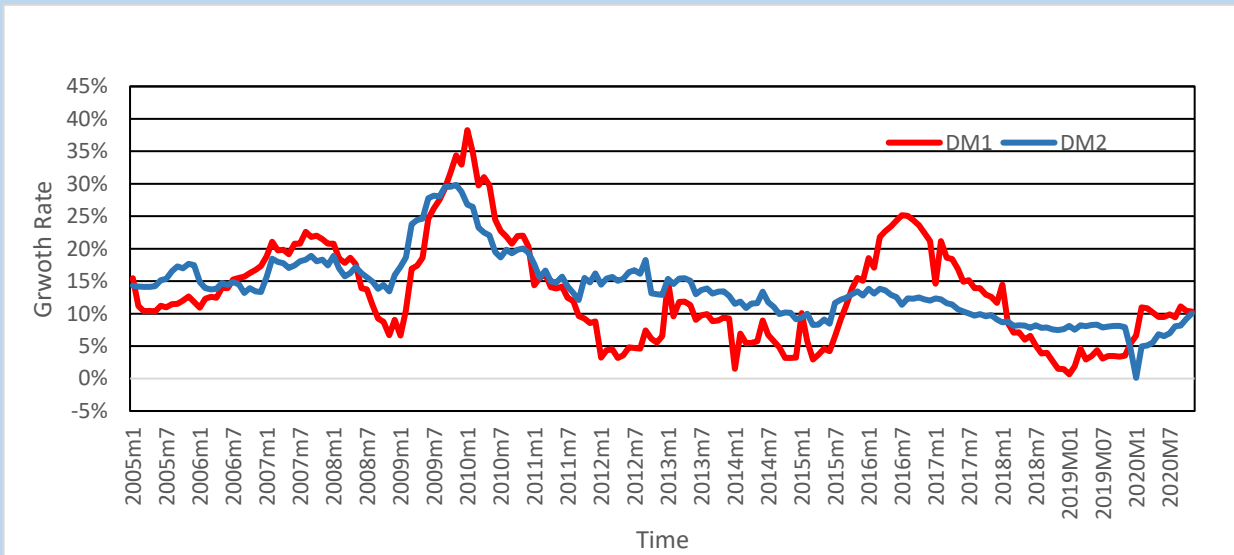


Figure 3: Chinese Divisia M0, M1, M2 Monetary Aggregates Level

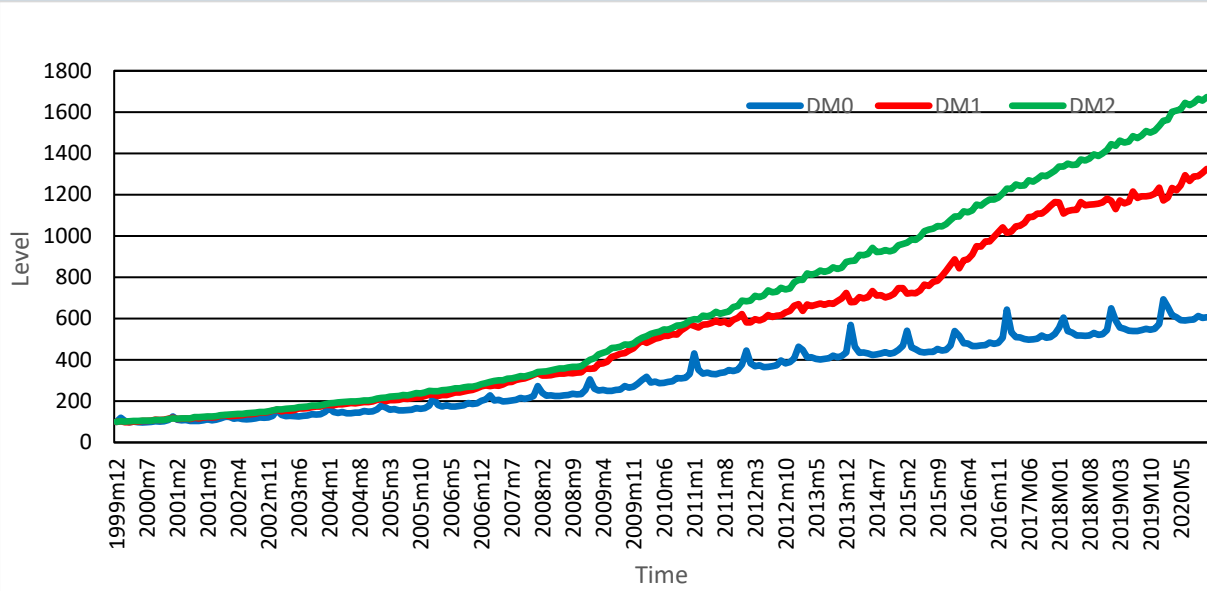


Figure 4: Chinese Divisia M3, M4 Aggregates Level

