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# The Motivation and Result of China's Monetary Policy since 2020

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**Abstract:**

As the influence of the epidemic and the international situation in 2020, the economic development in China is slowing down. However, it still has strong resilience and endogenous driving force for development. By comparing and summarizing the monetary policy of the central bank and analyzing China's current economic situation, this paper evaluates the structure and rationality of China's policy effect, and puts forward the optimal policy to solve the problem of China's economic development. This study discovered that The People's Bank of China's monetary policy primarily employs measures like decreasing the deposit reserve ratio, increasing liquidity, and reverse repurchase operations in the open market, depending on China's national conditions to promote the coordinated, healthy, and steady growth of China's economy. These measures are necessary to achieve the goals of ensuring price stability, achieving full employment, promoting economic growth, and maintaining a balanced balance of payments. The research shows that policy makers should focus on cultivating and developing new quality productive forces in the money market, maintaining reasonable and abundant capital liquidity, boosting residents' consumer confidence, solving the structural imbalance in the labor market, and strengthening macro-policy coordination. promote the development of green finance.

**Keywords:** Monetary policy, Economic growth, Monetary liquidity, Foreign exchange market.

## 1. Introduction

### 1.1 Research Background

Monetary policy is vital to economic growth. Central banks contribute to control inflation, maintain monetary stability, promote employment and ensure the stability of economic growth through monetary tools such as interest rates, currency rate intervention, deposit reserve ratio, open market operations, and credit rationing.

Since 2020, global economic growth has slowed but remained strong, which is benefit from the increase of emerging market around the world. The global economy is facing multiple challenges such as COVID-19, geopolitics, wars and conflicts, technological innovation and climate change, and the prospect for economic growth in the whole world is in recession that international trade is impacted, and trade protectionism is rising [1]. In reaction to the intricate and unpredictable economic conditions, central banks worldwide primarily implemented expansionary monetary policies, characterised by interest rate reductions and the implementation of quantitative easing. The global economy gradually is on the recovery, but the pressure of inflation is also emerging in this period. What's more, due to loose monetary policy liquidity, firms are able to allocate more financial resources, which is especially true for non-soes, slow-growing enterprises, and enterprises with significant operational risks [2].

Systemic financial risk products in China will rise as a result of monetary policies in the US, EU and Japan, which aim to expand the size of assets and liabilities. However, Japan will generate larger spillovers than the US and EU. The extent of assets and liabilities in the US and the EU has similar knock-on effects. Owing to the EU's interest rate cut policy, China's systemic economic vulnerability will increase sharply both during the current recession and during the pandemic. In the non-crisis period, the medium- -and-long-term interest rate reduction policy being implemented by the EU will contribute to the increase of China's export to Europe [3]. Under such circumstances, collaboration between national central banks and global organizations like the IMF and the World Bank, can effectively leverage the spillovers generated by central banks to address global financial risks.

In China, for example, policy makers at the people's Bank of China are under pressure to balance price stability and economic growth in order to deal with the uncertainty in financial markets. This research highlights the necessity for China's monetary policy to adapt to the changing landscape of financial development in China, incorporating innovative approaches, effective supervision, and control. It emphasizes the importance of aligning with the specific characteristics of China's economic development in the modern period. The People's Bank of China conducted comprehensive innovation across various aspects of monetary policy, including policy tools, operational targets, intermediary targets, supreme targets, and monetary policy transmission.The objective is to facilitate the advancement of superior economic growth and the tangible economy. This involves the establishment of a modern central banking system and monetary policy framework, as well as the coordination of policy innovation and market-oriented reform [4].

### 1.2 Research Objective and Significance

China ranks as the world's second-largest economy, and its monetary policy not only affects the domestic economy, but also has a significant impact on international trade, national capital flows, and global financial markets. Studying China's monetary policy and its motivations since 2020 is conducive to understanding how the Chinese economy works, forecasting its development trends, and assessing its impact on the global economy, so as to promote China to build a new development pattern, enhance new quality productivity, and achieve high-quality development.

The primary emphasis of this paper is to assess the effect of China's monetary policy implementation, evaluate the efficacy of monetary policy, offer recommendations and feedback to policymakers, facilitate the continuous improvement and refinement of fiscal policy, and subsequently enable more effective responses to domestic and international economic and financial challenges. Furthermore, it aims to strengthen economic resilience and provide guidance for China's future economic development.

### 1.3 Structural Arrangement

The rest structure of this paper is as followed: The second part, by sorting out the monetary policy reports since 2020, analyzes the basic facts related to the dynamic changes in the labor market, money market, consumer goods market, foreign exchange market and international trade market, and considers the underlying reasons behind the monetary policy decisions. The third part constructs a three-level minimalist analysis framework to analyze the policy effect objectives of the central bank and make suggestions for dealing with the global inflation crisis, preventing systemic financial risks and reasonably regulating the market money supply.

## 2. Stylized Facts

### 2.1 Macroeconomic (Financial) Data Indicators

#### 2.1.1 Total Retail Sales of Consumer Goods

The aggregate retail sales of consumer goods represent the overall consumption of tangible products among the entire society [5]. In March 2018, trade frictions between China and the USA broke out, and the economy entered a downward cycle. And the yearly retail sales of consumer goods amounted to 3.809869 billion yuan. It can be seen from Figure 1 that since 2018, yearly growth rate of the total retail sales of consumer goods has continued to decline. In 2020, as a result of the epidemic's influence, China's social production was shut down. By 2022, the yearly growth rate of total retail sales of consumer goods has fallen below -11.1% which results in an increase in social unemployment and a decrease in consumer confidence, contributing to a weak social and economic development state. As a blessing in curse, due to the disruption of world supply chains With regard to the influence of the global epidemic, Chinese industrial production quickly made up for the gap, and exports quickly drove employment and resumed production, contributing to the stability and improvement of the national economy. Chinese total retail sales of consumer goods reached 4,7149.52 billion yuan by the end of 2023, signalling a reversal of the previous falling trend and a steady rebound in China's macroeconomic performance.

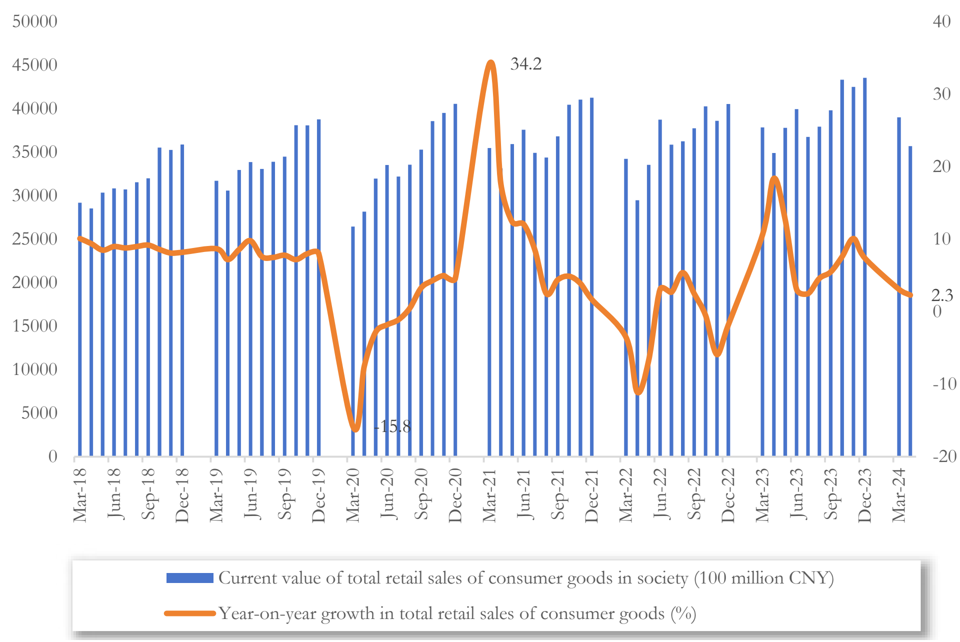


**Figure 1 Total retail sales of consumer goods from 2018 to 2024, monthly**

Data Sources: National Bureau of Statistics[6].

Photo credit: Original

### 2.1.2 Inflation Rate

Nowadays, the central bank exercises free control over the operation of the national economy, the market behavior has reflected rationality, and the inflation rate in China has remained at a low level. Figure 2 and figure 3 show the changes in inflation rates in China and G7 countries since 2018. In China, inflation was 2.1% in 2018, then rose to 2.9% in 2019, and stabilized at 2.5% in 2020. Mowever, the CPI index has an obvious lag. Due to the impact of the epidemic lockdown, the inflation rate fell to 0.9% in 2021, but rebounded to 2.5% in 2023. Therefore, except for major emergencies, China's inflation rate shows a relatively stable trend. Compared with G7 countries, Chinese economy has a higher degree of stability, with the central bank exerting robust supervision over the national economy.

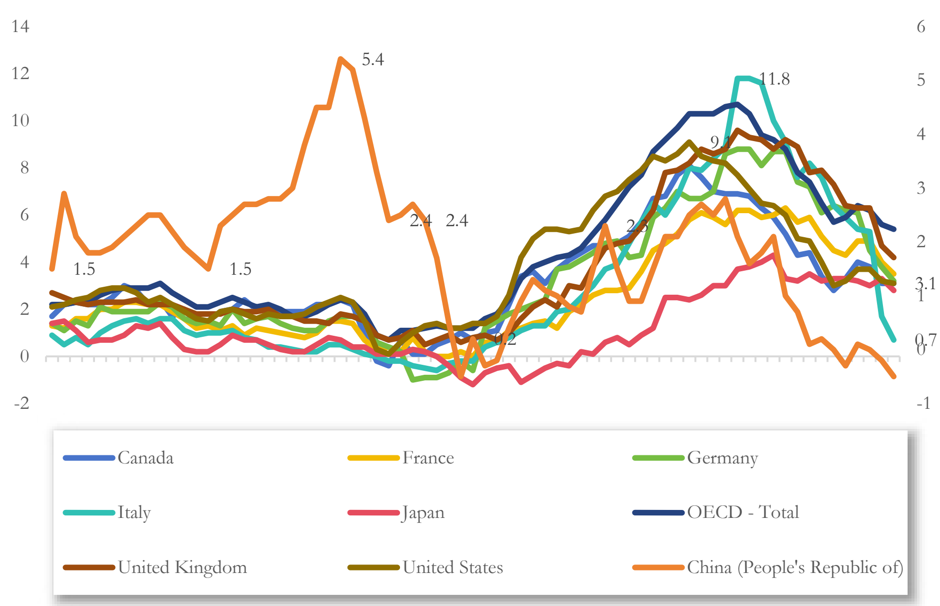


**Figure 2 Inflation (CPI) from 2018 to 2023, monthly**

Data Sources: OECD [7].

Photo credit: Original

Figure 4 shows the comparison of GDP of G7 countries from 2019 to 2022. China's economic development is marked by significant momentum and a steady enhancement of its worldwide political influence. What's more, the high growth rate shows while China is overcoming the pandemic, it's fostering the advancement and modernisation of domestic industries, nurturing innovative and high-quality productive capabilities, and cultivating new sources of economic expansion.

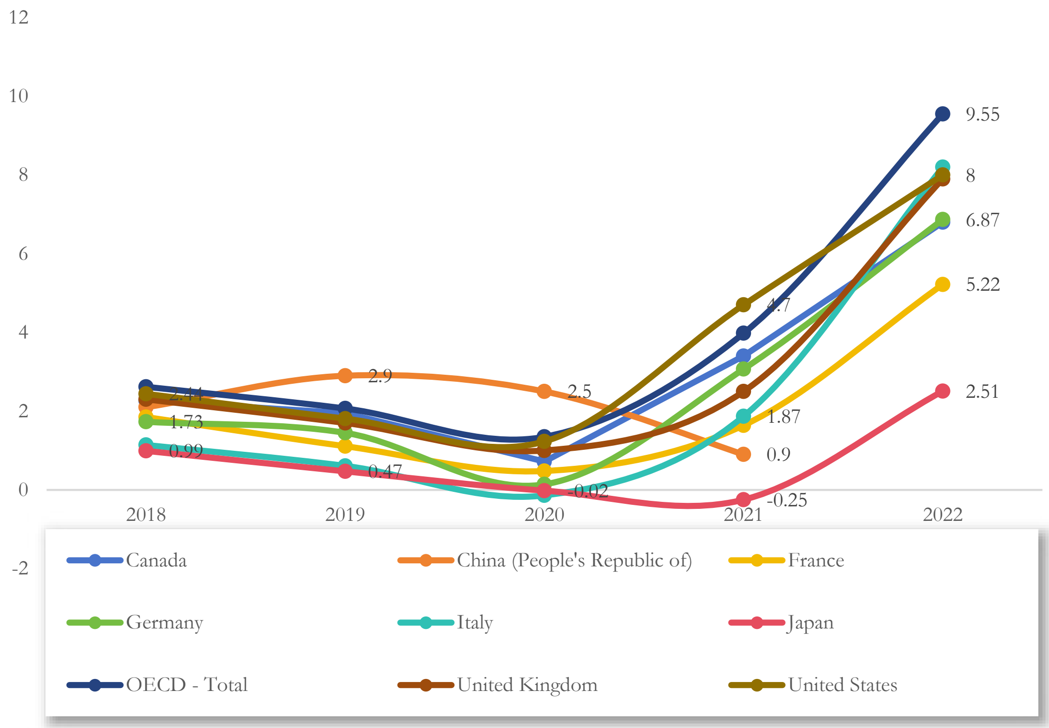


**Figure 3 Inflation (CPI) from 2018 to 2023, yearly**

Data Sources: OECD [7].

Photo credit: Original

As can be seen from the diagram, Chinese economy maintains a good momentum of recovery on the whole that the production and supply are rising steadily, regional economies are recovering well, market expectations are stable, and the resilience and vitality of the Chinese economy are increasing during the same period. As a result, the stability of the market economy to promote the harmony of labor market and the recovery of economic growth stimulate employment, which also promote the benign and efficient labor market circulation improve labor market environment and the process of structural reform.

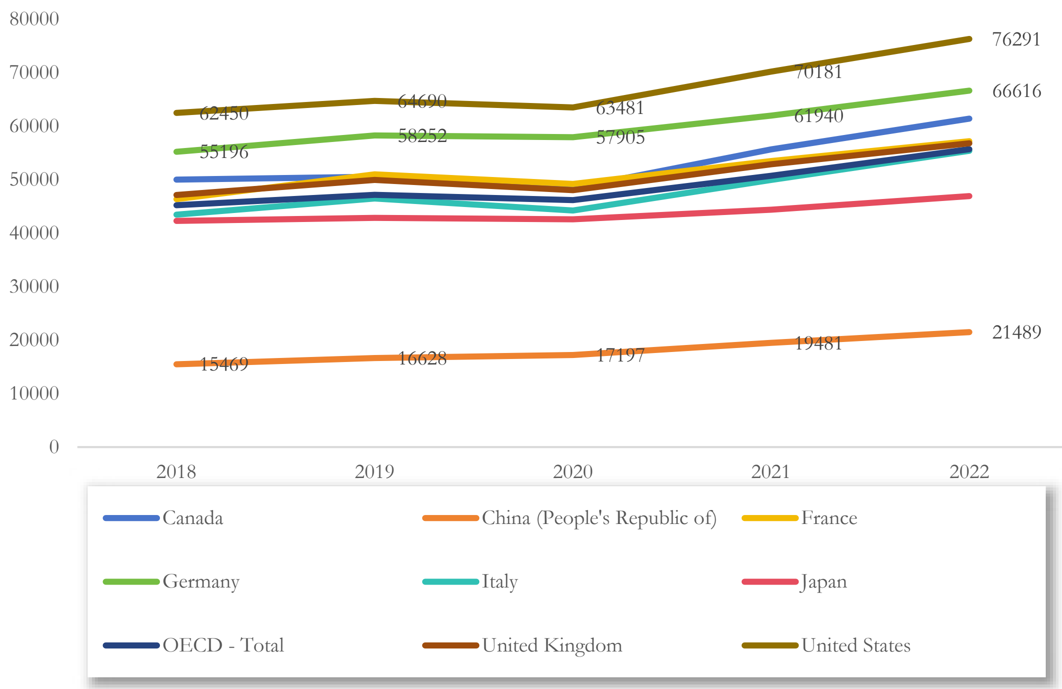


**Figure 4 Gross domestic product (GDP), yearly**

Data Sources: OECD [8].

Photo credit: Original

### 2.1.3 Money Supply

The Central Bank of China effectively controls and manages the money supply to facilitate the efficient functioning of the money market and meet the requirements of economic and social progress. This result is accomplished through the management of money issuance and the adjustment of interest rates.

Figure 5 shows that from 2018 to 2024, the issuance of China's broad Money supply M2 (money & Quasi-money) is on the rise from CNY 172,081,446 million to CNY 304,795,216 million, which is more than twice the money supply simultaneously in the United States, creating a record high. China's economic growth is commanded by investment, foreign trade and infrastructure construction. And government implement Quantitative easing monetary policy so that the Chinese economy maintains a fast growth rate despite the global economic slows down. However, China's inflation rate does not increase accordingly with the increase of money supply, but maintains a low level of development, resulting in a "liquidity trap"-- residents' future consumption expectations are poor, and the additional issuance of money supply can not stimulate consumption to boost domestic demand.

In the short term, additional issuance of money supply can accelerate the recovery of economic cycle. However, in the long run, only increasing monetary liquidity can not be effectively transformed into the endogenous driving force of economic growth, and may exacerbate the "liquidity trap" problem in the money market.

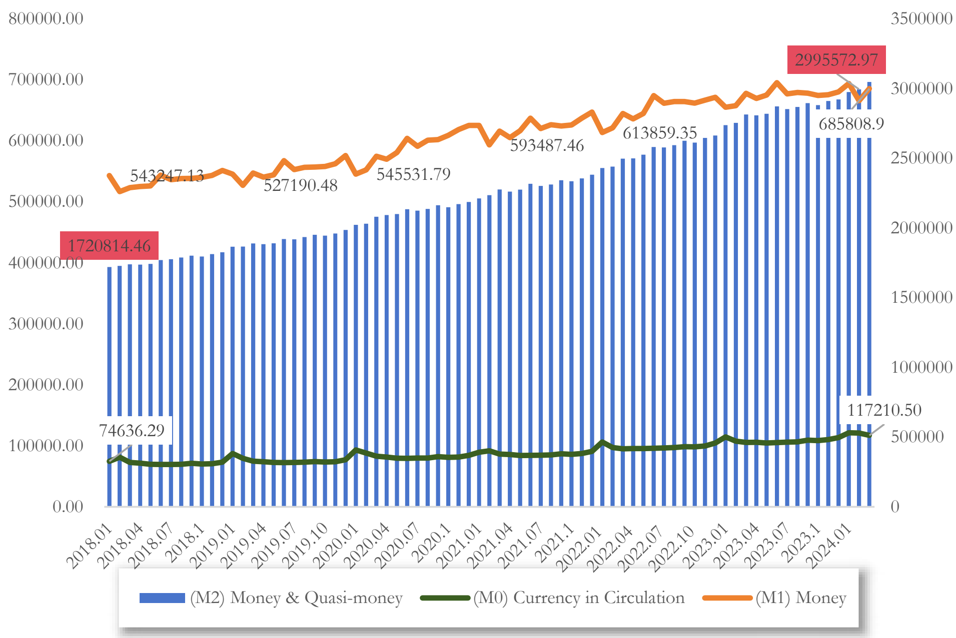


**Figure 5 Money Supply from 2018 to 2024 in China**

Data source: Statistics and Analysis Department in the people's bank of China [9].

Photo credit: Original

### 2.1.4 Aggregate Financing to the Real Economy

The stock of social financing in China maintains a relatively high growth rate, but the growth rate shows a downward trend. As shown in Figure 6, in January 2018, the stock of China's social financing scale was 185.77 trillion yuan, with a yearly growth decline. And in March 2024, the stock of social finance reached a record high of 390.32 trillion yuan, offering substantial financial assistance for the growth of actual economy. However, the year-on-year growth dropped to 8.7%, indicating a slower growth rate.

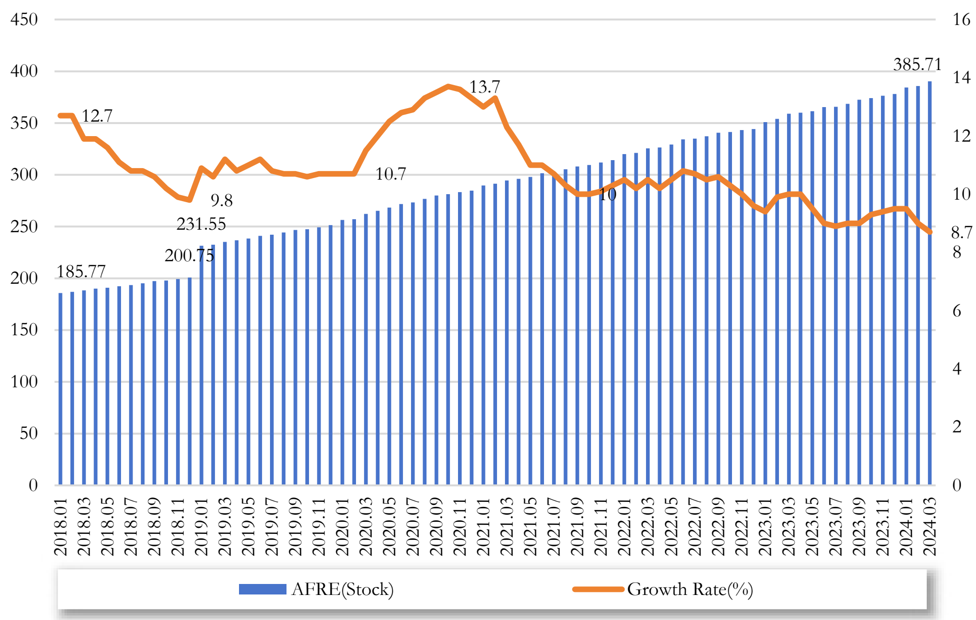


**Figure 6 Aggregate Financing to the Real Economy (Stock)**

from 2018 to 2024 in China

Data source: Statistics and Analysis Department in the people's bank of China [10].

Photo credit: Original

The growth of social financing scale also drives the development of real economy, which complement each other and interact with each other. The research indicates that the magnitude of social funding has significantly facilitated the expansion of the real economy. The rise in social financing contributed to a 5.2 percent increase in investment in fixed assets (Figure 7). This indicates that expanding the amount of social financing can greatly stimulate the growth of the actual economy. Nonetheless, the extent to which the scale of social financing can be extended to the real economy (stock) is limited. So, this indicates that only growth within a reasonable limit is more conducive to the development of the real economy [11].

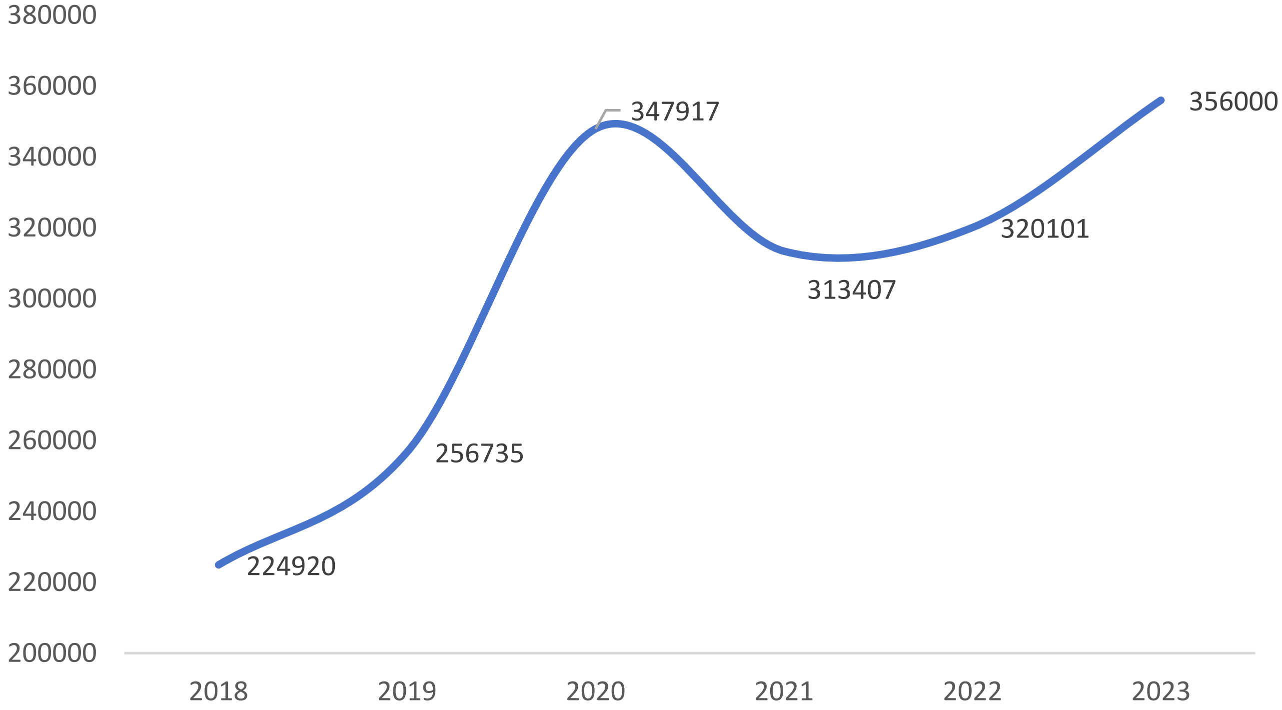


**Figure 7 Aggregate Financing to the Real Economy (Flow) from 2018 to 2023, yearly**

Data source: Statistics and Analysis Department in the people's bank of China [10].

Photo credit: Original

**2.1.5 Foreign Exchange Reserve**

Data shows that the foreign exchange reserves of the Chinese authorities remained basically stable from 2018 to 2022, effectively enhancing the international community's confidence in the nation's economic progress and safeguarding national financial security. The International Monetary Fund (IMF) recommends that developing countries keep at least three to four months 'worth of imports or 15 to 20 percent of GDP in foreign exchange reserves. According to the proportional analysis method represented by Robert, an American economist, the adaptive scale of foreign exchange reserves of various countries should be 40% [12]. China's foreign exchange reserves reached a substantial level of US $3,127.7 billion by the end of 2022, exceeding the minimum standard suggested by the IMF. This surplus of cash provides China with greater flexibility in implementing its monetary policies.

China's foreign exchange transactions are orderly, cross-border capital flows are more balanced. Morever, the foreign exchange market is performing steadily and improving, and the market is becoming more resilient. As shown by the data from the Foreign Exchange State Administration of China (Figure 8), Foreign exchange reserves of China amounted at US $320.8 billion by the end of April 2024. This represents a decrease of US $44.8 billion or 1.38% compared to the end of March. In April 2024, the US dollar index increased while global financial asset values typically declined due to the influence of macroeconomic data from key economies, expectations for monetary policy, and other factors. The combination of change rates and changes in asset prices resulted in a fall in the foreign exchange reserves during the month. China's economy has a stable foundation which is more strong resilience and great potential, so the size of its foreign exchange reserves remains basically stable [13].

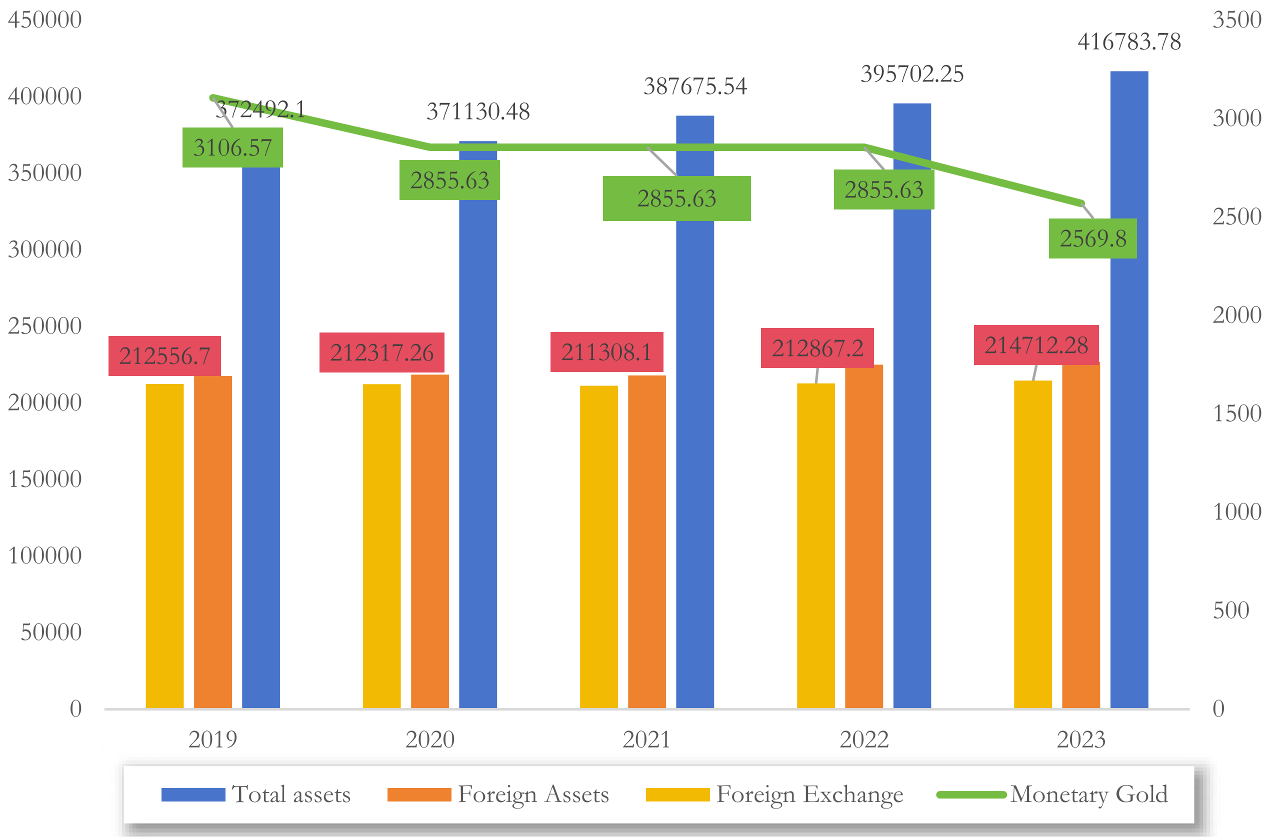


**Figure 8 Foreign Exchange Reserve from 2018 to 2022, yearly**

Data source: National Bureau of Statistics [14].

Photo credit: Original

**2.1.6 Import and Export**

Due to the impact of the pandemic and trade tensions between China and the USA, China's overall import and export volume stayed relatively steady. However, the yearly growth rate experienced significant fluctuations, particularly in February 2021, reaching a high of 67%. What's more, as the economy progresses, the continuous optimization of foreign trade development policies and the continuous adjustment of enterprises to the external development environment, so China's foreign trade momentum is increasing and the product structure is improving. According to Figure 9, China's overall import and export amount in the first quarter of 2024 is CNY 10,169.3 billion, representing a yearly growth at 5.0%. Additionally, the global competitiveness of products labelled as "Made in China" is steadily rising.

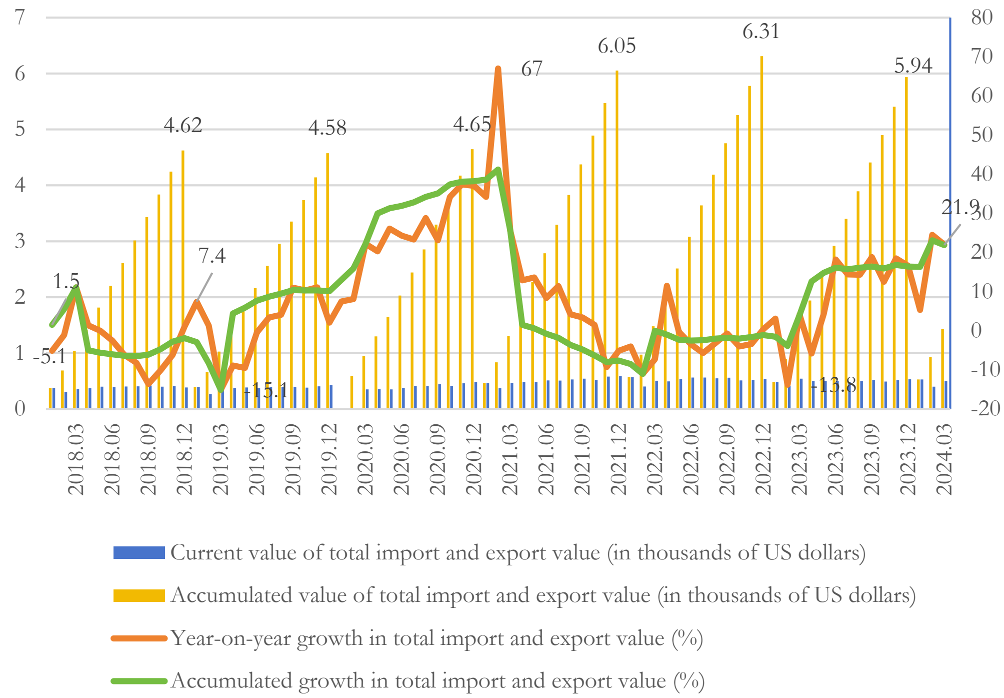


**Figure 9 The value of Import and export from 2018 to 2024, monthly**

Data source: National Bureau of Statistics [15].

Photo credit: Original

## 2.2 Monetary Policy Reports

Table 1 summarizes the monetary policy reports of China in recent years. According to the report, in the past five years, In consideration of the intricate and unpredictable global scenario and the repercussions of COVID-19, the Central Bank primarily implemented a cautious monetary policy by reducing the reserve requirement ratio and open market interest rate for financial institutions, and increasing the issuance of rediscount and re-lending quotas to promote the recovery of the national economy.

**Table 1 Government Currency Report**

| *REQUIRED RESERVED RATE* | *OPEN MARKET OPERATIONS* | *REDISCOUNT RATE* |
|---|---|---|
| Consolidate and sort out the deposit reserve ratio of rural commercial banks and rural credit cooperatives serving county areas | Open market reverse repo operating interest rate for the whole yea | Increase liquidity investment |
| Enhance the mandated reserve ratio for foreign currency deposits held by banking institutions. | Centralized issuance of government bonds | Keep the rediscount policy stable |
| Lower the deposit reserve ratio of financial institutions | Carry out the central bank bill swap (CBS) operation | Carry out targeted medium-term borrowing convenience (TMLF) operation |
| Establish a new framework of deposit reserve ratio of “three grades and two advantages” | Maintain a stable medium-term lending facility (MLF) winning interest rate. | Increase the special quota for rediscount and reloan |
| Implement targeted reserve reduction of inclusive finance | Reform and improve the operating mechanism of standing loan facility (SLF) | |
| Withdrawal of foreign exchange liquidity | | |

China's monetary policy framework involves three parts: the monetary policy target system, the monetary policy instrument, and the monetary policy transmission mechanism. Following that, this article will analyse the rationale behind the central bank's monetary policy, focusing on the three major monetary policy instruments utilised by the central bank, as well as key aspects of China's economic progress.

#### 2.2.1 Deposit reserve Rate

To facilitate the efficient functioning of the banking market, China's central bank adopted the quantitative easing fiscal policy of reducing the deposit reserve ratio. Concurrent with the COVID-19 epidemic, residents' consumption is sluggish, and there is a large gap in liquidity within the financial system. The central bank has guided moderate and steady growth of total credit and enhanced the stability and sustainability of loans by increasing money credit to support the economy, in order to create a favorable monetary and financial environment for economies, reduce financing costs for the real economy and increase medium - and long-term monetary liquidity.

Policy makers released about 100 million yuan of medium - and long-term liquidity for financial institutions by lowering the CNY and foreign exchange reserve ratios [16], which is helpful to boost the consumer confidence of the whole society, strengthen the capacity of financial institutions to utilize the Chinese Yuan (CNY) and foreign exchange markets, and optimize the supply structure of the financial market. What's more, it is also conducive to enhance the resilience and risk resistance of the financial market, so as to achieve the ultimate goal of stabilizing interest rates and exchange rates.

#### 2.2.2 Rediscount Rate

To ensure adequate liquidity and provide greater financial support to alleviate the impact of the COVID-19 epidemic, the central bank will lower the interest rates for commercial banks' borrowing and increase the borrowing or reducing options from the central bank. This will increase the money supply and the market interest rate. Firstly, China effectively utilized the policy of re-lending and rediscounting to its fullest potential and increased special subsidies to support enterprises in their orderly resumption of work and production, so as to promote economic recovery and development. Then by stabilizing the labor market, the government achieve the purpose of reducing the unemployment rate of the whole society, boosting consumer confidence, and increasing people's happiness and satisfaction in life.

#### 2.2.3 Open market operations

According to the monetary policy reports, we can see that the central bank flexibly carried out open market operations and lowered the bidding rate for 7-day repo operations in the open market, and paid close attention to the intensity of regulation operations. By giving full play to the transmission role of financial markets, policymakers reduce financing costs for enterprises, ensure the stability of financial markets, and enhance the efficiency and quality of the actual economy's development.

## 2.3 Monetary policy motivation

Since 2020, China's monetary policy has been implemented with three main motivations:

First of all, in order to promote precise and robust economic growth with appropriate amount and steady pace, the central bank ensures reasonable and abundant liquidity by implementing prudent monetary policies, promotes inter-cyclical adjustment, and ensures that the nominal economic growth rate is essentially matched by the rate of growth in the money supply and social financing.

The second purpose is to ensure reasonable and abundant liquidity, maintain internal and external balance, and promote reasonable growth of total money and credit in order to ensure steady and steady reduction of financing costs in the real economy. Chinese policymakers adopt many methods to provide liquidity in the monetary market, including re-lending and rediscounting, medium-term lending facility (MLF), and open market operations. These measures aim to guide financial institutions to extend loans logically and improve overall credit growth stability.

The third step is to utilise structural policy tools effectively, harnessing the incentive and guiding functions of structural monetary policy. Based on the development of the economic condition and the operation of financial institutions, the central bank modifies the support objects and conditions of structural monetary policy instruments in a timely manner. This is done to strengthen the incentive and constraint mechanism. After that, the central bank develops new instruments quickly and efficiently manages the speed and strength to effectively utilize its guidance and leverage capabilities, all while ensuring an acceptable and ample level of liquidity in the financial sector.

The final objective is to enhance the efficacy of allocating financial resources and create space for critical domains. Chinese government is committed to strengthening policy coordination and forming policy synergy. It is necessary to withdraw instruments that achieve phased policy objectives in an orderly manner and control the number of financial instruments at a reasonable level.

## 3. Policy Effects

### 3.1 Money Market

By implementing a prudent monetary policy, the Central Bank of China guides money market interest rates to operate smoothly around open market operation rates, providing conditions for reasonably abundant liquidity in the banking system and helping the financial sector support high-quality development of the actual economy. Figure 10 shows the seven-day reverse repurchase rate of the Central People's Bank of China in open market operations since 2018.

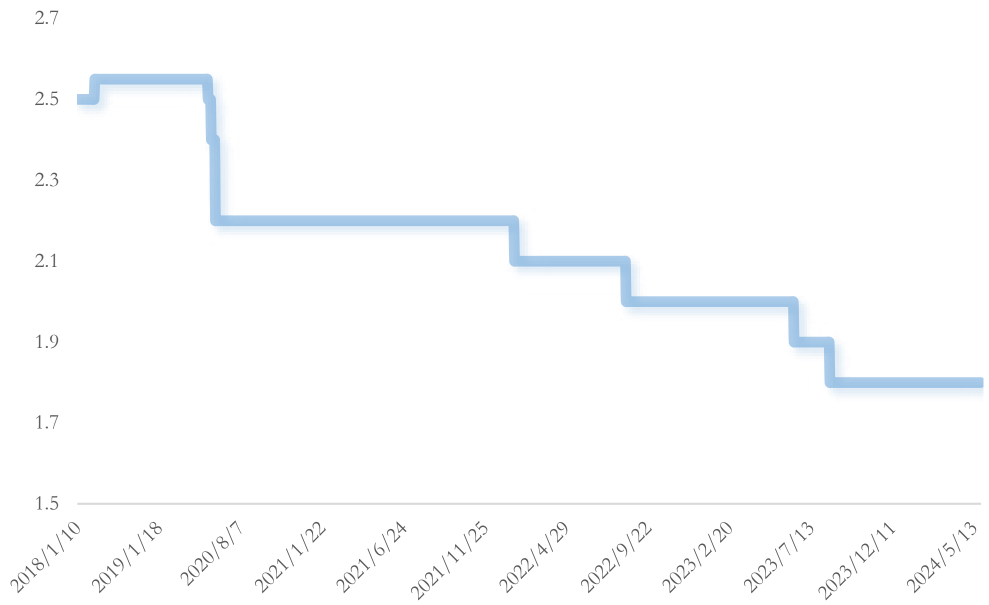


**Figure 10 Open market operation reverse repurchase rate: seven days**

from 2018 to 2024

Data source: Bank of China [17].

Photo credit: Original

In addition, the monthly central bank bill swap (CBS) operation conducted by the central Bank of China enhanced the liquidity of banks' perpetual bonds in the secondary market and contributed to the advancement of the offshore CNY bond market and money market in a positive manner. In the meantime, The People's Bank enhanced the oversight of the money market, improved the supervision mechanism of the money market fund and established a modern and efficient money market operation mechanism. And policy makers futher improved the safety of the money market financial products, enhanced the awareness of risk prevention, and created a good financial transaction environment.

### 3.2 Foreign Exchange Market

The central bank maintains stability in the foreign exchange market through the reduction of the reserve requirement ratio and other measures. The People's Bank of China continues to advance the market-oriented structural reform of the exchange rate. It also effectively utilized the foreign exchange market to play a decisive role which can be achieved through various macroeconomic measures such as reducing the foreign exchange reserve ratio, strengthening market expectation guidance, ensuring smooth cross-border capital flow, modifying the balance between the availability and require for different currencies in the foreign exchange market, and sustaining a reasonably stable and balanced level for the CNY exchange rate.

Unfortunately, influenced by the overestimation of the anticipation of a reduction in interest rates of the Federal Reserve, the US dollar index and US Treasury bond yields are increasing, the exchange rates of Asian currencies such as the yen hits record lows, so the CNY is under unprecedented pressure. In this regard, the Central Bank of China aims to ensure the stable and sound growth of the foreign currency market by continuously improving the structure of the market and enhancing its regulation.

### 3.3 International Trade Market

China's loose monetary policy devalued its currency. As the central bank's money supply increases and interest rates fall, Chinese investors seek higher-yielding assets, causing the country's currency to weaken. Depreciation of the currency will make its goods more competitive in the international market, which is better for promoting exports and promoting the prosperity of the international trade market, accelerating global economy growth. External demand will drive domestic demand, thus driving the development of China's domestic consumer goods market and labor market, helping to establish a novel development pattern that centres around the primary domestic cycle while incorporating both international and domestic cycles.

## 4. Conclusion

Looking forward, China's economy will keep getting better, the CNY exchange rate will stay essentially steady at a fair and balanced level, and new quality productive forces will grow and develop rapidly. But at the same time, China should also be alert to the risk of a "permanent decline" in consumption growth potential due to low confidence in future income and structural imbalances in the labor market. Therefore, this Venter puts forward the following suggestions:

In the future, the currency policy of China should continue to adhere to the main tone of steady, flexible, moderate and precise regulation.

Ensure adequate liquidity and facilitate the efficient functioning of money market interest rates through decreases in the reserve requirement ratio (RRR), the medium-term lending facility (MLF), and open market operations.

Prevent systemic financial risks in the financial system by enhancing the fundamental system construction of the financial market, preventing market risks, and creating a sustainable framework to proactively address and resolve financial concerns over an extended period.

Strengthen macro policy coordination: Strengthen coordination and cooperation with other macro policies, form policy synergy, and jointly promote high-quality economic development.

Promote the development of green finance: Strengthen business cooperation and rule convergence with Hong Kong in the field of green finance, support mainland financial institutions to issue various green financial products in Hong Kong, and support Hong Kong to develop into a green and sustainable financial center.

Cultivate and develop the new quality productivity of the money market: create a new type of labor force, make good use of new production tools, and enable the development of emerging industries. The central bank should shape production relations that adapt to new-quality productive forces, and strive to remove bottlenecks that hamper the development of new-quality productive forces through reform and opening up, so that all kinds of advanced and high-quality factors of production can flow smoothly and be efficiently allocated to the development of new-quality productive forces.

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