Content

Chart

Table

Abstract

During the first half of 2021 the COVID-19 epidemic continued to spread throughout the world. The global economy recovered unevenly, and international financial markets were complex and changeable. China continued to consolidate and expand its achievements in epidemic control and economic and social development, and the domestic economy enjoyed a momentum of steady strengthening and steady growth. The overall operation of China's foreign-exchange market was stable, and the RMB exchange rate fluctuated in both directions and remained basically stable at an appropriate and balanced level.

China's balance of payments maintained a basic equilibrium during the first half of 2021 and foreign-exchange reserves stabilized at about USD 3.2 trillion. The current account still recorded a surplus, accounting for 1.5 percent of GDP, continuing within a reasonable equilibrium range. In particular, trade in goods maintained a surplus at a certain scale, reflecting the comparative advantage of domestic production and supply and the supporting role of external demand. The deficit in trade in services continued to be at a low level, and expenditures for cross-border travel and study abroad were still affected by the epidemic. Cross-border two-way investments under the capital account remained active, and capital inflows and outflows were relatively balanced. On the one hand, China's economic development maintains a positive momentum of growth and the attraction of RMB assets continues to increase. Foreign investments in China reached USD 442.8 billion, a year-on-year increase of 1.7 times, which was a high level for recent years. On the other hand,

outward investments totaled USD 414 billion, a year-on-year increase of 1.1 times, reflecting a continuous release of demand for diversified asset allocations by domestic entities. By the end of June 2021, China's external financial assets and liabilities had increased by 3.7 percent and 7.4 percent, respectively, over the end of 2020, and net external assets reached nearly USD 2 trillion.

In the second half of 2021, the global epidemic will continue to evolve, with still many unstable and uncertain factors in the world economy and financial markets. However, the long-term trend in China's economic fundamentals still looks positive, the comprehensive deepening of reform and opening-up has been continuously promoted, and the flexibility of the RMB exchange rate has been enhanced and has remained basically stable, which will continue to establish a solid foundation for an equilibrium in the balance of payments. It is expected that the current account surplus will remain within a reasonable range, and cross-border capital flows will continue their overall balanced situation in both directions. The foreign- exchange administration department will better coordinate development and security, continue to promote reform and opening-up in the field of foreign exchange, actively serve development of the real economy, continue to improve the market-oriented regulation mechanism and the management of cross-border capital flows, maintain smooth operations in the foreign-exchange market, and keep a basic equilibrium in the balance of payments.

I. Overview of the Balance of Payments

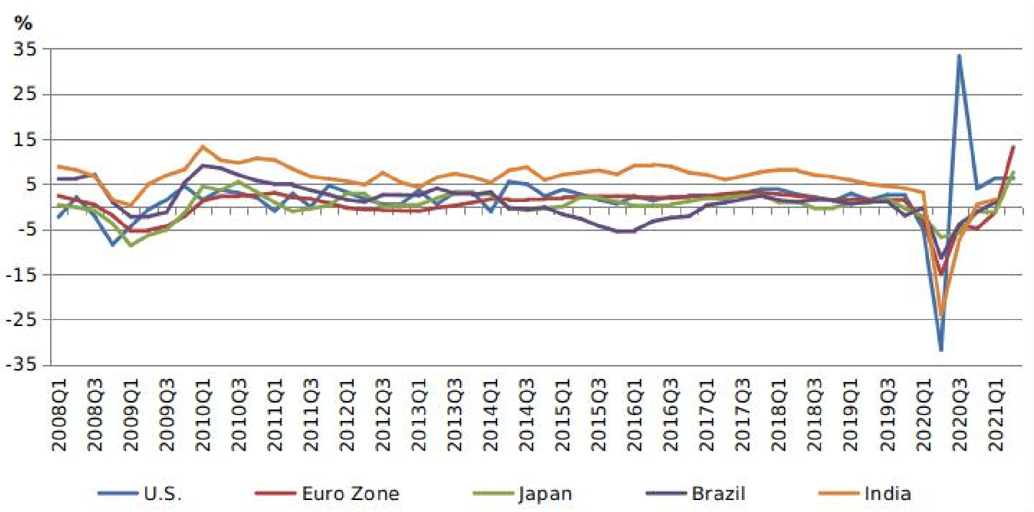
（I）The Balance-of-Payments Environment

In the first half of 2021, the global economic recovery differed among countries. Inflation expectations significantly increased and the recent rebound of the epidemic in many countries brought new uncertainties to the global economic outlook. China continues to consolidate and expand its achievements in epidemic prevention and control as well as its achievements in economic and social development. China’s economy continues to recover steadily, production demand continues to rise, employment and prices are generally stable, and economic development shows a steady and positive trend.

The global economy is recovering unevenly. The momentum for an economic recovery in some developed economies is good. U.S. GDP reached 6.3 percent and 6.5 percent in the first and second quarters of the year, respectively. Although real GDP in the first quarter in the Euro zone and Japan decreased year on year, they increased by 13.2 percent and 7.6 percent, respectively, in the second quarter (see Chart 1-1). Among the emerging economies, Brazil and India, which were greatly affected by the epidemic, had a year-on-year GDP growth rate of only 1.0 percent and 1.6 percent, respectively, in the first quarter. India's Manufacturing Purchasing Managers Index (PMI) in June decreased by 8.2 percentage points, compared with that at the beginning of the year, to 48.1 percent. The International Monetary Fund (IMF) predicted that global economic growth will reach 6.0 percent in 2021, with the forecast for economic growth in the developed economies rising by 0.5 percentage point to 5.6 percent and the forecast for economic growth in the emerging markets and the developing economies lowering by 0.4 percentage point to 6.3 percent. In addition, the delta variant, which is more infectious, has become the main Covid strain in many countries. The shock waves brought about by the epidemic have impacted the various countries, and pressure for global epidemic prevention and control has increased, dragging down progress in the recovery of the world economy.

The monetary policies of the main developed and emerging economies are diverse. In order to support a more comprehensive economic recovery, the major developed economies generally maintain loose monetary policies. In the first half of the year, the Federal Reserve kept the target range of the policy interest rate and the scale of bond purchases unchanged, but at the interest rate meeting in June, there were discussions about reducing bond purchases. At the same time, it technically raised the interest rate on excess reserves and the interest rate on overnight reverse repurchase instruments by 5 basis points, respectively. The European Central Bank kept the policy interest rate unchanged, reiterating that it would accelerate the speed of bond purchases, revise the monetary policy framework, and adjust the inflation target to "a symmetrical target of 2 percent over the medium term." Some emerging economies began to raise interest rates to cope with pressures such as inflation, capital outflows, and exchange rate depreciations. Since 2021 (the end of September), the central banks in Russia and Brazil have raised their interest rates on five occasions. The differences among the monetary policies in the global economies may have a negative impact on progress for an economic recovery and aggravate imbalances in the global economic recovery.

Chart 1-1 Growth Rate of the Main Economies

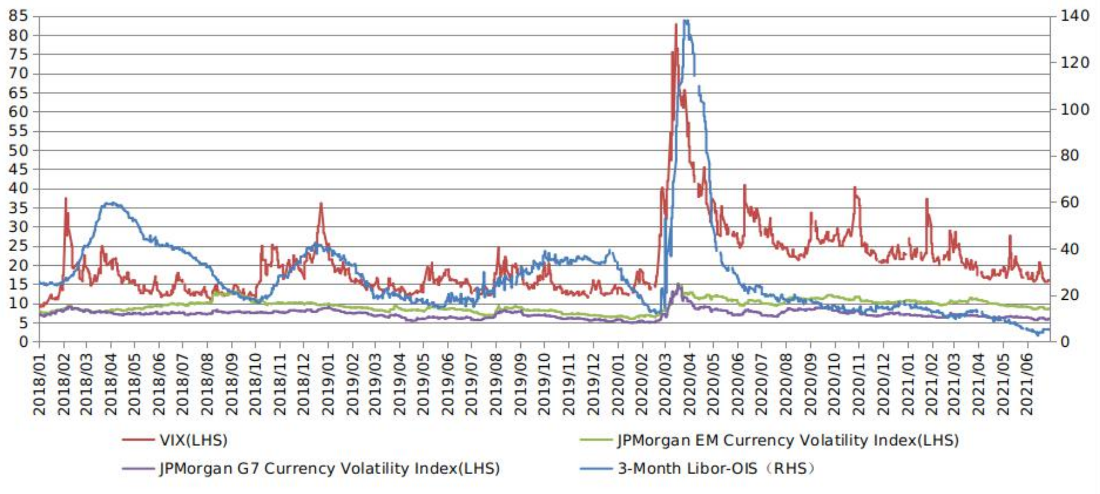


Note: The U.S. growth rate is the annualized quarterly growth, whereas the rates of the other economies are the quarterly growth rates year on year.

Source: Huanya economic database.

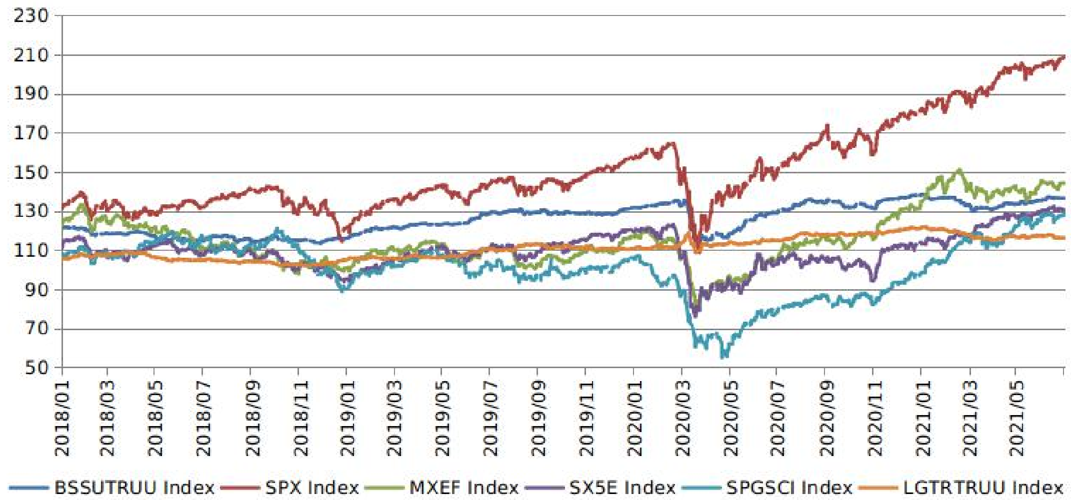
International financial markets were complex and changeable. In the first half of the year, the recovery of the global labor market was relatively slow, inflation expectations increased significantly, and the rebound of the epidemic in many countries brought new uncertainties to the economic outlook and international financial markets. Affected by factors such as the dislocation of production and demand as well as ample liquidity, global commodity prices rose significantly. Brent crude oil futures prices rose by 24.3 percent and 16.6 percent, respectively, in the first and second quarters, and the S&P GSCI Commodity Price Index rose by 30.9 percent in the first half of the year. Treasury bond yields in the developed economies fell after rising significantly, and volatility increased. In the first half of the year, the USD Index showed range-bound fluctuations, up by 2.3 percent. The Emerging Market Currency Index (EMCI) fell by 1.1 percent. The stock indexes of the major economies rose as a whole. The S&P 500 Index, the Euro Zone Stoxx 50 Index, and the MSCI Emerging Market Stock Index rose 14.4 percent, 14.4 percent, and 6.5 percent, respectively (see Chart 1-2 and Chart 1-3).

Chart 1-2 Interest Rates in International Financial Markets and Volatility Ratios of International Currencies



Source: Bloomberg.

Chart 1-3 Global Stocks, Bonds, and Commodity Market Prices

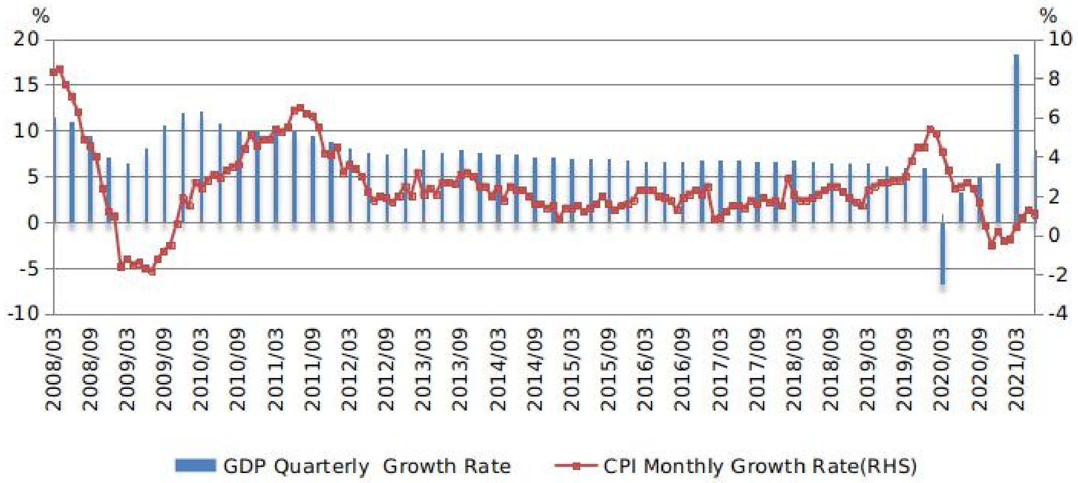


Note: BSSUTRUU and LGTRTRUU are the Bloomberg Barclays Emerging Market Index and the Developed Country Sovereign Bond Index, respectively, MXEF is the MSCI Emerging Market Index, SPX is the S&P 500 Index, SX5E is the Euro STOXX 50 Index, and SPGSCI is the S&P GSCI Commodity Price Index, all of which were 100 at the beginning of 2015.

Source: Bloomberg.

The domestic economy is operating steadily. In the first half of the year, China comprehensively promoted epidemic prevention and control as well as economic and social development. The economy continued to recover steadily, production demand continued to rise, employment prices were generally stable, new drivers grew rapidly, quality and efficiency improved steadily, market players expected improvements, and economic development showed a trend of strengthening and improving steadily. According to the preliminary accounting of the National Bureau of Statistics (NBS), GDP in the first half of the year was 53.2 trillion yuan, a year-on-year increase of 12.7 percent at comparable prices and an average increase of 5.3 percent in the two years. Affected by the recovery of residents' travel, the rise of gasoline and diesel prices, and the decline in pork prices, the Consumer Price Index (CPI) rose moderately by 1.1 percent year on year in June (see Chart 1-4).

Chart 1-4 Growth Rate of China's Quarterly GDP and Monthly CPI



Source: NBS.

Box 1

The Shift in Global Ultra-loose Monetary Policy

In the first half of 2021, the central banks of the main developed economies maintained ultra-loose monetary policies to help with the economic recovery. With extensive vaccinations and the normalization of economic activities, economic growth in many countries has improved, inflation pressures in some economies have risen, and the loose monetary policy is facing a shift. The Federal Reserve will probably begin to reduce bond purchases at the end of the year, and some emerging economies have taken the lead in raising interest rates. However, the current employment gap in the United States is still large and the mutant viruses are dragging down progress in the economic recovery. It is expected that the pace of a tightening monetary policy by the Federal Reserve will be relatively slow. In addition, the Fed has sufficient communications with the market and market institutions generally believe that the risks of "reducing panic" in international financial markets are controllable.

In the first half of 2021, the monetary policy of the central banks in the main developed economies remained loose. The Federal Reserve kept the policy interest rate at 0 percent to 0.25 percent and kept the purchase rate of US Treasury bonds and mortgage-backed securities (MBS) at USD 120 billion per month. The ECB maintained an average bond purchase rate of EUR 90 billion per month. The short-term interest rate of the Central Bank of Japan will remain unchanged at negative 0.1 percent, and the target of 10-year Treasury bonds will be anchored at near 0 percent. By the end of June 2021, the size of the balance sheets of the central banks in the United States, Europe, Japan, and Britain had increased by 7.2 percent to USD 25.6 trillion compared with that at the end of 2020.

Global vaccinations have been rolled out in an orderly manner, economic growth has improved, and inflation pressures in some economies have risen. In terms of economic growth, the annual growth rate of GDP in the first and second quarters of 2021 reached 6.3 percent and 6.5 percent, respectively, and the comprehensive Purchasing Managers Index (PMI) hit a record high of 63.8. In the second quarter of 2021, the Euro zone promoted a rapid recovery in economic momentum after the lifting of its closure, and the PMI remained at a high level of more than 60. Boosted by the global trade-expansion cycle, Japan’s exports also remained strong. In terms of inflation, from April to August 2021, U.S. inflation rose rapidly, the year-on-year growth rate of CPI remained above 5 percent, and the growth rate of core CPI was also greater than 4 percent, both at a historic high . Inflation in the emerging economies, such as Brazil, Russia, and Turkey, also remained at a high level.

The ultra-loose monetary policies of the global central banks are facing a shift. In June and September 2021, the Federal Reserve continuously raised the 2023 forecast for the policy interest rate, from 0.1 percent to 1 percent, and released a signal that it would start to reduce bond purchases at the end of the year. The ECB expects to reduce the rate of debt purchases in the fourth quarter of 2021 and to withdraw from the emergency anti-epidemic debt purchase plan (PEPP) in 2022. The Bank of England has reduced the speed of bond purchases, and the attitude at the September meeting turned further to an "eagle" mindset, releasing a signal that interest rates may be increased before the end of bond purchases at the end of the year. Under the framework for yield curve control, the Bank of Japan seized the opportunity to reduce the scale of asset purchases. Some emerging economies took the lead in raising interest rates. Under pressures of high inflation, by the end of September the central banks of Brazil, Russia, and Mexico had raised interest rates by 425, 250, and 50 basis points, respectively, in 2021, and they may raise them further in the future.

In the short term, the risks of market turmoil caused by the tightening of Fed policy are controllable. Currently, the employment gap in the United States is still large, the mutant virus has dragged down the pace of economic recovery, and the Federal Reserve regards the recent high inflation caused by the mismatch between supply and demand as temporary. Under the framework of an average inflation target system, the Federal Reserve does not control inflation proactively, but it tries to maintain loose policies to facilitate an employment recovery. Considering that the fiscal burden and the valuation of the financial market in the United States are at historic high level, it is expected that the pace of monetary policy tightening by the Federal Reserve will be relatively slow. In addition, Fed Chairman Powell has recently frequently communicated with the market on reducing bond purchases, and international financial markets fully expect a Fed policy shift. It is generally believed that the Fed will start reducing bond purchases at the end of 2021 and raise interest rates for the first time at the end of 2022 or early 2023. Therefore, the risks of international financial market shocks caused by a tightening of the Fed policy in the short term are controllable. In the medium term, the moderate recovery of the U.S. economy is expected to continue, it will be difficult for the contradiction between supply constraints and demand recovery to subside quickly, and inflation may remain high in the future. It is necessary to continue to pay attention to the impact of inflation trends on the pace of interest rate increases by the Federal Reserve.

（II）The Main Characteristics of the Balance of Payments

The current account maintained a surplus, and the non-reserve financial account maintained an overall equilibrium. In the first half of the year, the current account recorded a surplus of USD 122.7 billion, and the non-reserve financial account posted a surplus of USD 28.8 billion (see Table 1-1).

Table 1-1 Structure of the BOP Surplus

USD 100 Million

Item	2014	2015	2016	2017	2018	2019	2020	2021H1
Current account balance	2360	2930	1913	1887	241	1029	2740	1227
As a % of GDP	2.3%	2.6%	1.7%	1.5%	0.2%	0.7%	1.9%	1.5%
Financial account excluding reserve assets	-514	-4345	-4161	1095	1727	73	-778	288
As a % of GDP	-0.5%	-3.9%	-3.7%	0.9%	1.2%	0.1%	-0.5%	0.4%

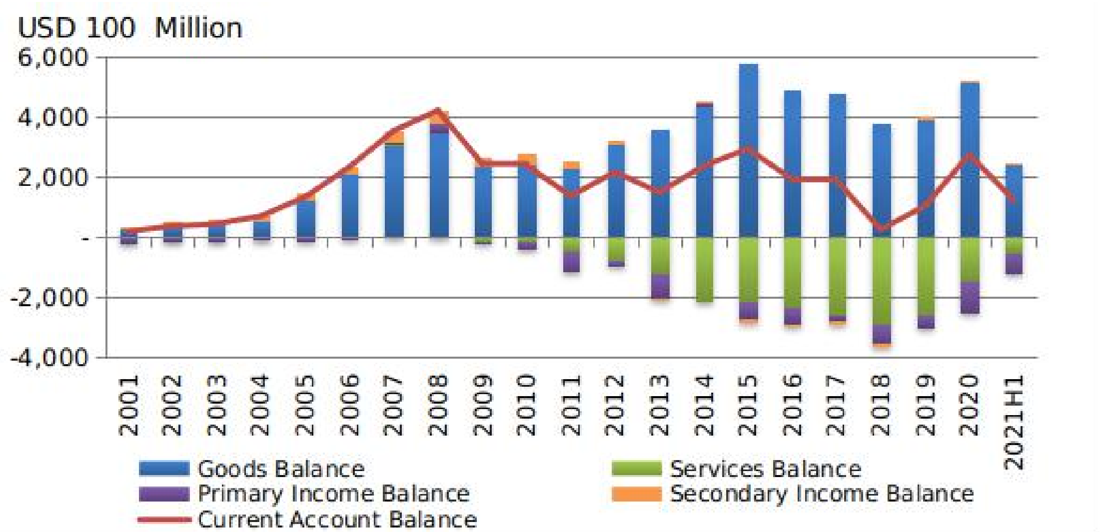
Sources: SAFE, NBS.

Trade in goods maintained a surplus at a certain scale. Based on balance-of-payments statistics,[1] in the first half of the year exports of

[1] BOP statistics and statistics of the General Administration of Customs with respect to trade in goods can be reconciled by the following: First, trade in goods in the BOP statistics only

trade in goods totaled USD 1456.4 billion, up 37 percent. Affected by the low base, the year-on-year growth rate of exports in the first quarter was higher. In the first half of the year, imports of trade in goods totaled USD 1218.2 billion, up 36 percent, mainly affected by the rise in commodity prices and the rebound in consumer demand. Trade in goods recorded a surplus of USD 238.2 billion, or up 40 percent (see Chart 1-5).

Chart 1-5 Major Items under the Current Account



Source: State Administration of Foreign Exchange..

The deficit in trade in services was at a low level. In the first half of the year, revenue from trade in services totaled USD 149.1 billion, up

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records those goods whose ownership has been transferred (such as general trade or processing trade with imported material), and goods whose ownership has not been transferred (such as processing trade with supplied material or outward processing trade) are not recorded in the trade in goods, but rather are recorded in the trade in services. Second, as far as the valuation is concerned, the BOP statistics require that the values of the imports and exports of goods are recorded on a FOB basis, while the Customs statistics record the export value of goods on the FOB price but the import value of goods on the CIF price, so the BOP statistics obtain the international freight and premium expenditures from the import value of goods in the Customs statistics and bring them into the trade in services statistics of the BOP statistics. Third, some import and export return data are supplemented. Fourth, the net export data of goods under resale trade not counted by the Customs are supplemented. Fifth, the differences in caliber caused by the differences in the special OEM mode and the valuation method are adjusted.

35 percent, and expenditures totaled USD 199.6 billion, up 7 percent. Trade in services recorded a deficit of USD 50.5 billion, down 34 percent (see Chart 1-5). In particular, transportation recorded a deficit of USD 13.7 billion, down 28 percent, due to the rapid growth of transportation revenue. The travel deficit totaled USD 44.4 billion and remained low since the second quarter of 2020, reflecting the continuing global impact of the COVID-19 epidemic. The revenue and expenditures of charges for the use of intellectual property and financial services increased rapidly, reflecting more active cross-border transactions in relevant fields.

Both revenue and expenditures of primary income[2] increased rapidly. In the first half of the year, revenue from primary income totaled USD 155.6 billion, up 52 percent, and expenditures totaled USD 227.2 billion, up 60 percent. Primary income thus recorded a deficit of USD 71.6 billion (see Chart 1-5). In particular, investment income was the main item. Expenditures for inward investments, including profits and dividends, totaled USD 217 billion, and revenue from outward investments totaled USD 145.3 billion. Investment income posted a deficit of USD 71.6 billion.

The surplus in secondary income increased. In the first half of the year, the revenue from secondary income totaled USD 22.7 billion, up 31 percent. The expenditures for secondary income were recorded at USD

[2] The IMF's *Balance of Payments* and *International Investment Manual* (Sixth Edition) renamed the income item under the current account as primary income and renamed current transfers as secondary income.

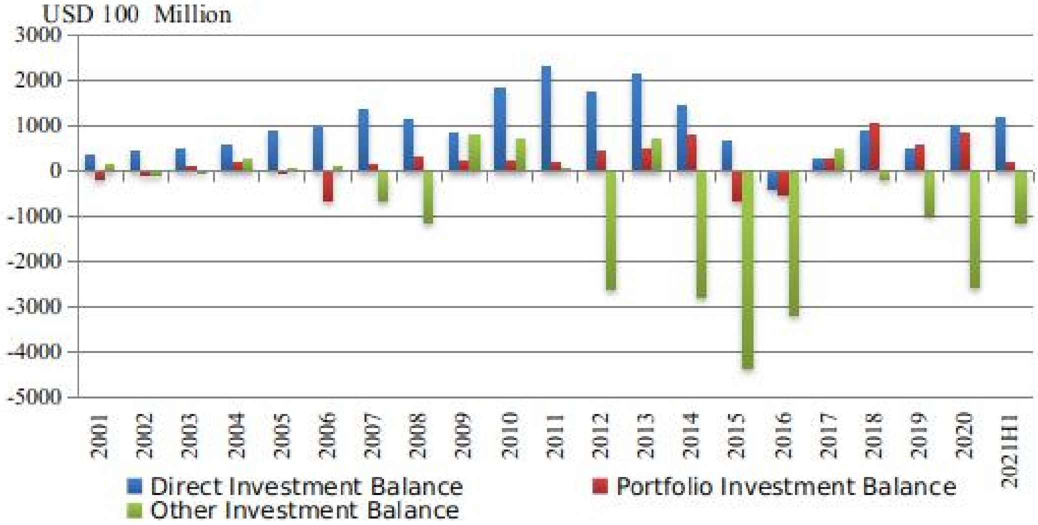
16 billion, up 8 percent. Secondary income thus recorded a surplus of USD 6.7 billion, or an increase of USD 4.2 billion (see Chart 1-5).

The surplus in direct investments increased. Based on the balance-of-payments statistics,[3] in the first half of the year direct investments posted a surplus of USD 121.3 billion, compared with a surplus of USD 21 billion in the same period of the previous year (see Chart 1-6). In particular, outflows of outward direct investments (the net increase in direct-investment assets) amounted to USD 55.7 billion, up 18 percent. Inflows of foreign direct investments (the net increase in direct-investment liabilities) totaled USD 177 billion, 1.5 times higher than that in 2020.

Portfolio investments recorded a small surplus. In the first half of the year, portfolio investments posted a surplus of USD 19.7 billion (see Chart 1-6), compared with a small deficit recorded during the previous year. In particular, outflows of outward portfolio investments (the net increase in assets) totaled USD 98.6 billion, up 31 percent, and inflows of inward portfolio investments (the net increase in liabilities) totaled USD 118.4 billion, up 84 percent.

[3]The BOP compiles and reports direct investments following balance-sheet rules, whereas the Ministry of Commerce compiles and reports direct investments by direction, with differences between the principles for reverse investments and investments among affiliates. In addition, direct investments based on the BOP statistics also include unpaid and unremitted profits, retained earnings, shareholders' loans, foreign capital utilized by financial institutions, and real-estate purchases by non-residents.

Chart 1-6 Major Items under the Capital and Financial Account



Source: State Administration of Foreign Exchange.

Other investments continued to record a deficit. In the first half of the year, other investments, including loans, trade credits, and deposits, posted a deficit of USD 113.8 billion (see Chart 1-6), reflecting the characteristics of the various two-way cross-border capital flows. In particular, net outflows of outward other investments (the net increase in assets) totaled USD 265.3 billion, an increase of 2.8 times. Net inflows of inward other investments (the net increase in liabilities) totaled USD 151.5 billion, 3.3 times higher than that in the last year.

Reserve assets remained stable. In the first half of 2021, reserve assets involving transactions (excluding the effects of non-transactional values, such as exchange rates and prices) increased by USD 85 billion. In particular, foreign-currency reserves involving transactions increased by USD 85.2 billion. By the end of June 2021, China's foreign-currency reserves reached USD 3214 billion, taking into account transactions, exchange rates, changes in asset prices, and other factors.

Table 1-2 China’s Balance of Payments in the First Half of 2021

USD 100 million

Item	Line No.	2021H1
1. Current account	1	**1227**
Credit	2	17837
Debit	3	-16610
1.A Goods and services	4	**1876**
Credit	5	16055
Debit	6	-14178
1.A.a Goods	7	**2382**
Credit	8	14564
Debit	9	-12182
1.A.b Services	10	**-505**
Credit	11	1491
Debit	12	-1996
1.A.b.1 Manufacturing services on physical inputs owned by others	13	**66**
Credit	14	69
Debit	15	-3
1.A.b.2 Maintenance and repair services n.i.e	16	**18**
Credit	17	35
Debit	18	-17
1.A.b.3 Transport	19	**-137**
Credit	20	489
Debit	21	-626
1.A.b.4 Travel	22	**-444**
Credit	23	57
Debit	24	-501
1.A.b.5 Construction	25	**17**
Credit	26	65
Debit	27	-47
1.A.b.6 Insurance and pension services	28	**-47**
Credit	29	27
Debit	30	-74
1.A.b.7 Financial services	31	**4**
Credit	32	24
Debit	33	-21
1.A.b.8 Charges for the use of intellectual property	34	**-156**
Credit	35	59
Debit	36	-216
1.A.b.9 Telecommunications, computer, and information services	37	**42**
Credit	38	244

Debit	39	-202
1.A.b.10 Other business services	40	**151**
Credit	41	406
Debit	42	-256
1.A.b.11 Personal, cultural, and recreational services	43	**-10**
Credit	44	7
Debit	45	-16
1.A.b.12 Government goods and services n.i.e	46	**-9**
Credit	47	8
Debit	48	-17
1.B Primary income	49	**-716**
Credit	50	1556
Debit	51	-2272
1.B.1 Compensation of employees	52	**-12**
Credit	53	86
Debit	54	-99
1.B.2 Investment income	55	**-716**
Credit	56	1453
Debit	57	-2170
1.B.3 Other primary income	58	**13**
Credit	59	16
Debit	60	-3
1.C Secondary income	61	**67**
Credit	62	227
Debit	63	-160
1.C.1 Personal transfers	64	7
Credit	65	28
Debit	66	-20
1.C.2 Other secondary income	67	60
Credit	68	199
Debit	69	-140
2. Capital and financial account	70	**-562**
2.1 Capital account	71	**0**
Credit	72	1
Debit	73	-1
2.2 Financial account	74	**-562**
Assets	75	-4990
Liabilities	76	4428
2.2.1 Financial account excluding reserve assets	77	**288**
Financial assets excluding reserve assets	78	-4140
Liabilities	79	4428

2.2.1.1 Direct investment	80	**1213**
2.2.1.1.1 Assets	81	**-557**
2.2.1.1.1.1 Equity and investment fund shares	82	-432
2.2.1.1.1.2 Debt instruments	83	-125
2.2.1.1.1.a Financial sector	84	-166
2.2.1.1.1.1.a Equity and investment fund shares	85	-160
2.2.1.1.1.2.a Debt instruments	86	-6
2.2.1.1.1.b Non-financial sector	87	-392
2.2.1.1.1.1.b Equity and investment fund shares	88	-272
2.2.1.1.1.2.b Debt instruments	89	-119
2.2.1.1.2 Liabilities	90	**1770**
2.2.1.1.2.1 Equity and investment fund shares	91	1522
2.2.1.1.2.2 Debt instruments	92	248
2.2.1.1.2.a Financial sector	93	59
2.2.1.1.2.1.a Equity and investment fund shares	94	73
2.2.1.1.2.2.a Debt instruments	95	-14
2.2.1.1.2.b Non-financial sector	96	1711
2.2.1.1.2.1.b Equity and investment fund shares	97	1449
2.2.1.1.2.2.b Debt instruments	98	262
2.2.1.2 Portfolio investment	99	**197**
2.2.1.2.1 Assets	100	**-986**
2.2.1.2.1.1 Equity and investment fund shares	101	-724
2.2.1.2.1.2 Debt securities	102	-262
2.2.1.2.2 Liabilities	103	**1184**
2.2.1.2.2.1 Equity and investment fund shares	104	394
2.2.1.2.2.2 Debt securities	105	789
2.2.1.3 Financial derivatives (other than reserves) and employee stock options	106	**17**
2.2.1.3.1 Assets	107	56
2.2.1.3.2 Liabilities	108	-40
2.2.1.4 Other investment	109	**-1138**
2.2.1.4.1 Assets	110	**-2653**
2.2.1.4.1.1 Other equity	111	-4
2.2.1.4.1.2 Currency and deposits	112	-899
2.2.1.4.1.3 Loans	113	-1385
2.2.1.4.1.4 Insurance, pension, and standardized guarantee schemes	114	-27
2.2.1.4.1.5 Trade credit and advances	115	-41
2.2.1.4.1.6 Other accounts receivable	116	-297
2.2.1.4.2 Liabilities	117	**1515**
2.2.1.4.2.1 Other equity	118	0
2.2.1.4.2.2 Currency and deposits	119	837
2.2.1.4.2.3 Loans	120	340

2.2.1.4.2.4 Insurance, pension, and standardized guarantee schemes	121	22
2.2.1.4.2.5 Trade credit and advances	122	144
2.2.1.4.2.6 Other accounts payable	123	171
2.2.1.4.2.7 Special drawing rights	124	0
2.2.2 Reserve assets	125	**-850**
2.2.2.1 Monetary gold	126	0
2.2.2.2 Special drawing rights	127	-1
2.2.2.3 Reserve position in the IMF	128	3
2.2.2.4 Foreign exchange reserves	129	-852
2.2.2.5 Other reserve assets	130	0
3.Net errors and omissions	131	**-666**

Notes:

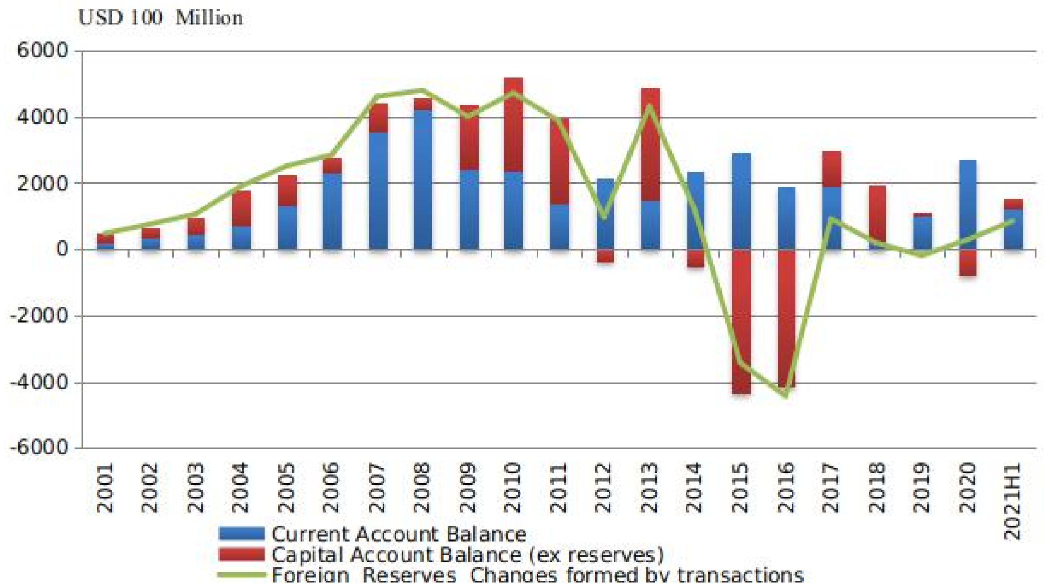
1. This chart was compiled according to the *Balance of Payments Manual* (Sixth Edition). The statistics are for all economic transactions between Chinese residents and non-residents. Chinese residents follow the principle of economic entity, excluding institutions and individuals in Hong Kong, Macao SAR, and Taiwan of China. Therefore, the trade and investment transactions between mainland China and the above three regions are recorded as cross-border transactions.
2. "Credits" are shown as positive values and "debits" are shown as negative values, with the balance equal to the "credits" plus the "debits." Except for the items marked "credit" and "debit," all other items in this table refer to the balance.
3. This chart is based on rounding principles.

Source: State Administration of Foreign Exchange.

(III) Evaluation of the Balance of Payments

A steady strengthening of domestic economic fundamentals and China's balance of payments maintained a basic equilibrium. In 2021, the world was still facing the challenges from the COVID-19 epidemic. The global economy was recovering unevenly, and international financial markets were complex and changeable. China continued to consolidate and expand its achievements in epidemic control and economic and social development, and the domestic economy recovered and was steadily strengthened, building a solid foundation for maintaining the equilibrium in the balance of payments. During the first half of 2021, the current account continued to be within a reasonable equilibrium range, cross-border two-way investments increased rapidly, and foreign-exchange reserves remained stable at about USD 3.2 trillion (see Chart1-7).

Chart 1-7 Structure of China's BOP

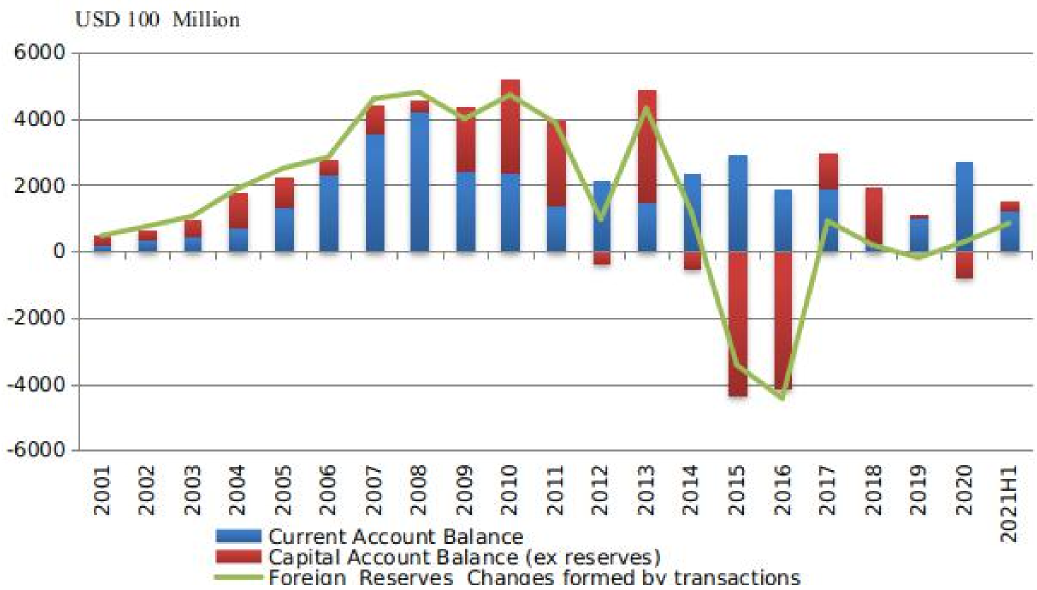


Source: State Administration of Foreign Exchange.

The current account maintained a certain surplus, which continued to be within a reasonable equilibrium range. The current account recorded a surplus of USD 122.7 billion in the first half of 2021, accounting for 1.5 percent of GDP compared to 1.9 percent in 2020, showing that at present the current account is more balanced. In terms of the main items, the surplus of trade in goods totaled USD 238.2 billion, reflecting the comparative advantages of domestic production and supply and the supporting role of foreign demand. The deficit in trade in services remained at a low level of USD 50.5 billion, narrowing by 34 percent, and expenditures for cross-border travel and study abroad were still greatly restrained. Income from foreign investments and outward investments rebounded, and investment income continued to show a deficit.

Both outward and foreign investments under the capital account remained active, at a scale of relatively balanced inflows and outflows. In terms of capital inflows, in the first half of 2021 foreign investments reached USD 442.8 billion, which was a high level in recent years, up 1.7 times. In particular, foreign direct investments increased rapidly by 1.6 times, fully reflecting the attraction of China's momentum for good economic development, complete industrial system, and huge domestic demand market for foreign investors. Foreign portfolio investments increased by 84 percent year on year, but the growth rate was more stable than that in the second half of 2020, indicating that the pace of foreign investments in domestic RMB assets was steadier. In terms of capital outflows, outward investments totaled USD 414 billion, an increase of 1.1 times over the same period of the previous year. In particular, outward direct investments and portfolio investments increased by 18 percent and 31 percent, respectively, reflecting the demand of domestic entities for diversified asset allocations. Other investments, such as deposits and loans, increased by 2.8 times, continuing the trend in rapid growth since the second half of the previous year. Against the background of abundant domestic foreign-currency liquidity, on their own initiative domestic entities adjusted the allocation of assets and liabilities and balanced the capital inflows of other investments, thus contributing to the independent equilibrium in the balance of payments (see Chart 1-8).

Chart 1-8 Structure of China's Cross-Border Capital Flows in the First Half of 2021



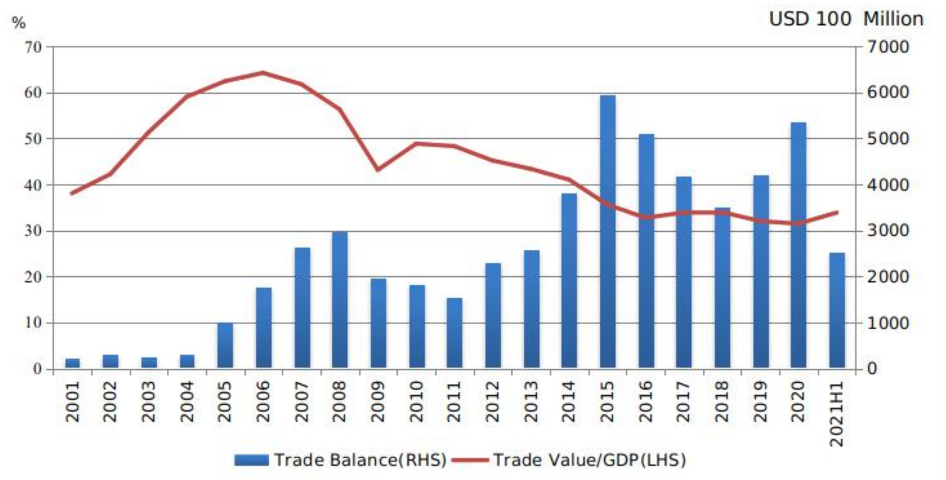
Source: State Administration of Foreign Exchange.

II. Analysis of the Major Items in the Balance of Payments

(Ⅰ) Trade in Goods

The surplus of trade in goods grew rapidly, and the degree of dependence on foreign trade rose steadily. Since 2021, the domestic economy has recovered steadily and enterprises have resumed work and production in an orderly manner. Due to the continuous recovery of the global economy and the increase in external demand as well as the low foreign trade base in 2020, China's foreign trade volume and surplus have grown rapidly. According to Customs statistics (the same below), in the first half of 2021, China’s foreign trade totaled USD 2.8 trillion, a year-on-year increase of 37 percent; the surplus reached USD 251.5 billion, an increase of 53 percent. China's foreign trade dependence (i.e., the ratio of foreign trade to GDP) was 34 percent, an increase of 2.5 percentage points from 2020 (see Chart 2-1).

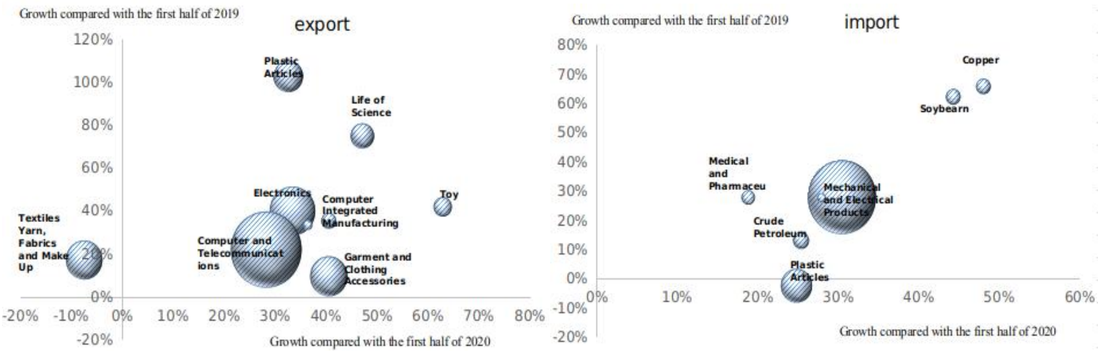
Chart 2-1 The Balance of Trade in Goods and Dependence on Foreign Trade



Sources: General Administration of Customs, NBS.

Trade in high value-added products continued to develop well, and the foreign trade structure was further optimized. In the first half of 2021, China’s exports amounted to USD 1.5 trillion, a year-on-year increase of 39 percent. Exports of high-tech products were outstanding. Exports of computer and communications technology, electronic technology, and products related to the life sciences increased by 28 percent, 34 percent, and 47 percent year on year, respectively (see Chart 2-2). During the same period, China's imports amounted to USD 1.3 trillion, a year-on-year increase of 36 percent. Imports of mechanical and electrical products increased by 31 percent year on year, accounting for 38 percent of the increase in imports and mainly reflecting the steady recovery of the domestic economy and the gradual restoration of production capacity in the advanced economies. The increase in commodity prices led to a year-on-year increase of 86 percent in the import of iron ore and of 26 percent in the import of crude oil, contributing 13 percent and 7 percent, respectively, to the growth in imports.

Chart 2-2 The Volume and Growth Rate of Exports and Imports of Major Commodities

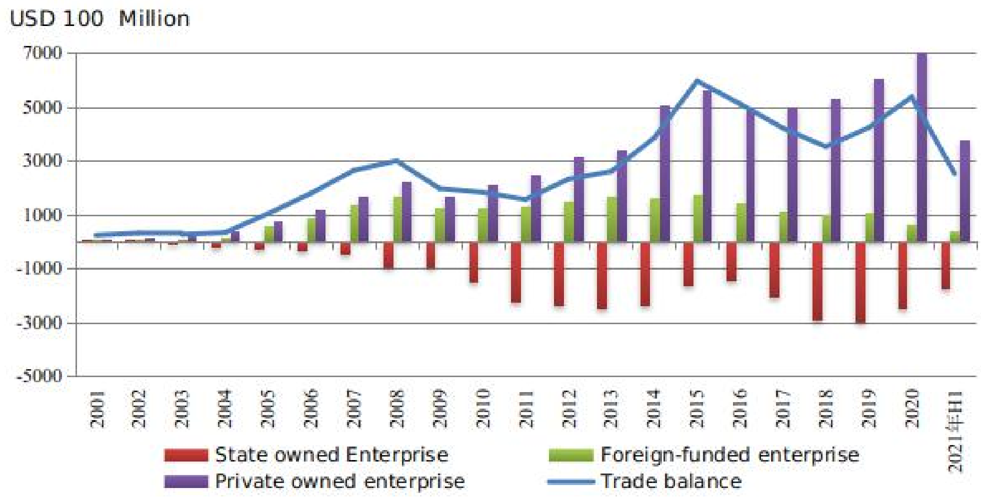


Note: The circle represents exports or imports of commodities. The larger the area, the larger the exports or imports, and vice versa.

Source: General Administration of Customs.

The position of private enterprises as the main contributor to trade has been strengthened, and the trade surplus by foreign-funded enterprises has increased significantly. In recent years, supported by the continuous strengthening of internal driving forces for China's foreign trade, private enterprises have gradually become the largest operating entity in China's foreign trade. In the first half of 2021, exports and imports by private enterprises totaled USD 1.3 trillion, a year-on-year increase of 47 percent, equivalent to 46 percent of total trade and up 3 percentage points compared with the first half of 2020. At the same time, the trade surplus by private enterprises was USD 379.5 billion, a year-on-year increase of 48 percent (see Chart 2-3). In the first half of 2021, exports and imports by foreign-invested enterprises totaled USD 1.0 trillion, an increase of 29 percent year on year; the surplus was USD 38.7 billion, an increase of 79 percent and 26 percentage points higher than the overall growth rate.

Chart 2-3 The Balance of Trade in Goods in Terms of Contributors

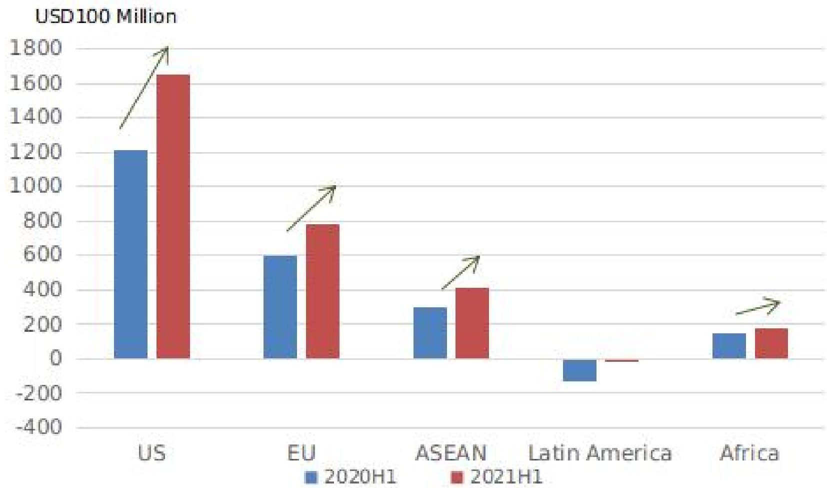


Source: General Administration of Customs.

China's trade surplus with the United States, the European Union, and ASEAN grew rapidly. In the first half of 2021, China’s trade with its top three trade partners, ASEAN, the European Union, and the United States, amounted to USD 410.2 billion, USD 388.4 billion, and USD 341 billion, respectively. The surplus reached USD

41.3 billion, USD 78 billion, and USD 165.1 billion, respectively, a year-on-year increase of 37 percent, 30 percent, and 37 percent, reflecting China's contribution to the global supply of commodities in the context of the epidemic (see Chart 2-4). During the same period, China's exports and imports to the "Belt and Road" economies increased by 27.5 percent, and exports and imports to its trade partners in the Regional Comprehensive Economic Partnership (RCEP) increased by 22.7 percent. Bilateral trade has become increasingly prosperous.

Chart 2-4 China's Trade Surplus with Its Major Trade Partners

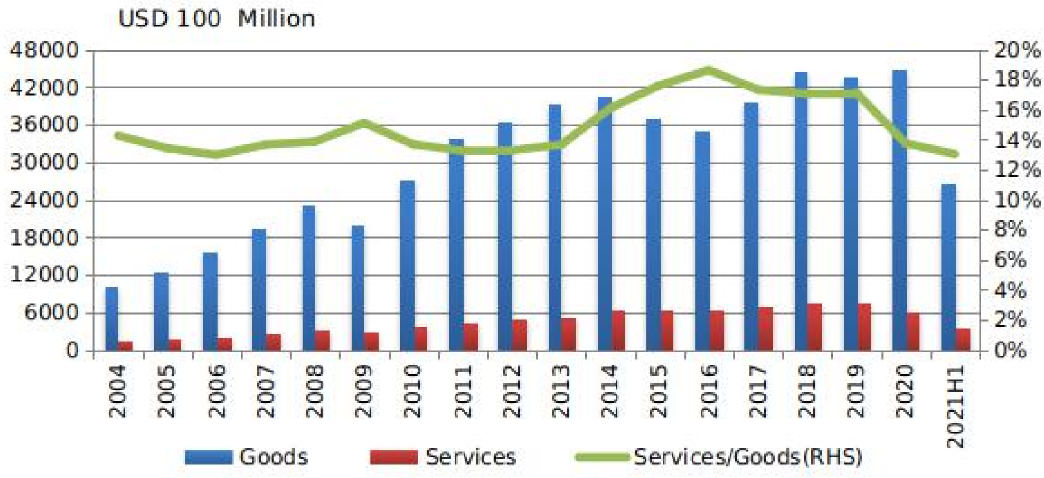


Source: General Administration of Customs.

(Ⅱ) Trade in Services

The volume of trade in services picked up, with a more diversified driving force. In the first half of 2021, China's trade in services totaled USD 348.7 billion, a year-on-year increase of 17 percent, and the ratio of trade in services to trade in goods was 13 percent. Since 2020, the volume of trade in services declined, mainly due to a decrease of 29 percent on travel in the context of the border controls among the various economies (see Chart 2-5). For other major items, China’s revenue and expenditures from transportation increased by 64 percent, due to various factors including China being the first major economy to resume its exports, the increase in China’s export shipping capacity, and the rising international freight rates. China’s revenue and expenditures from other commercial services increased by 16 percent.

Chart 2-5 Comparison of the Total Volume of Trade in Goods and Trade in Services



Source: State Administration of Foreign Exchange.

Box 2

China's Transportation Services Have Developed Well in Recent Years

China's transportation services started late but developed rapidly. In recent years, the volume has continued to increase and China’s share in the global market has gradually increased. At the same time, with its strengthening in international competitiveness, China’s deficit in transportation services has narrowed. In the future, China will continue to transform and upgrade its transportation services, gradually deepen the integration of transportation services with various industrial chains, and continuously promote the high-quality development of transportation services.

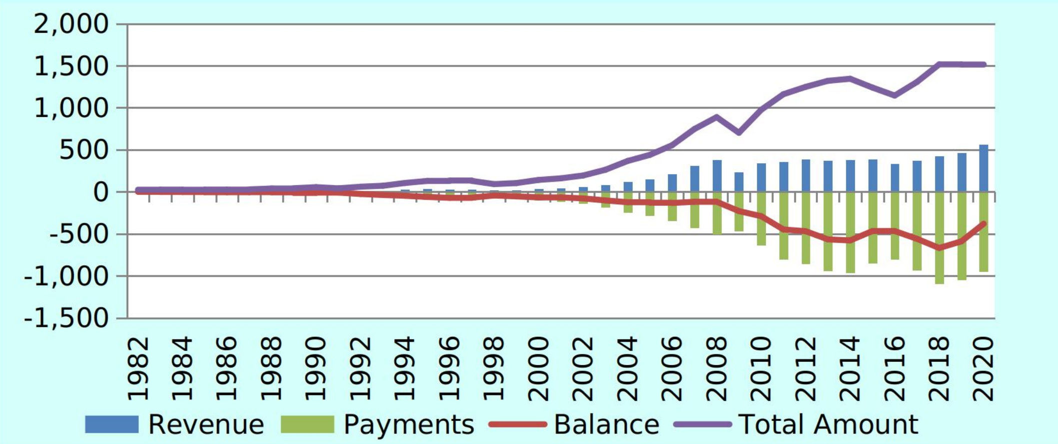
I China's transportation services have grown rapidly since the beginning of this century

Global transportation services have steadily increased. Transportation is an important component of traditional productive services, mainly shipping, air transportation, railways, pipelines, and postal delivery. In recent years, global transportation has been relatively stable. According to statistics of the World Trade Organization, in the early 1980s, global transportation amounted to approximately USD 300 billion. In 2019, this figure was at USD 2.3 trillion, but in 2020, due to the epidemic, it dropped to USD 1.8 trillion.

The proportion of China's transportation in global transportation has increased. From 2000 to 2020, China's transportation services increased from USD 14.1 billion to USD 151.3 billion, with an average annual growth rate of 13 percent. China’s share in global transportation services increased from 2 percent to 8 percent (see Chart C2-1). From 2014 to 2019, China's transportation services ranked the second largest in the world. In 2020, in the context of the continuous spread of the epidemic, China’s foreign trade was the first major economy to recover and China’s transportation services have remained basically stable, for the first time becoming the largest worldwide contributor (see Chart C2-1). In the first half of 2021, global transportation services amounted to approximately USD 1.1 trillion, among which China contributed USD 111.6 billion.

Chart C2-1 Development of China's Transportation Services

(unit: USD 100 million)



Source: State Administration of Foreign Exchange

C2-1 Transportation Services in the Major Economies in 2019 and 2020

(unit: USD 100 million)

Country	2019			2020			
	Volume	Global Share	Rank	Volume	Global Share	Rank	Year-on-Year
United States	2038	9%	1	1291	7%	2	-37%
China	1513.3	7%	2	1513.4	8%	1	0.01%
Germany	1385	6%	3	1156	6%	3	-17%
Singapore	1271	6%	4	1057	6%	4	-17%
France	992	4%	5	890	5%	5	-10%
India	891	4%	6	746	4%	7	-16%
Netherlands	852	4%	7	642	4%	8	-25%
Denmark	790	3%	8	755	4%	6	-4%
United Kingdom	735	3%	9	420	2%	11	-43%
Japan	604	3%	10	489	3%	10	-19%
South Korea	571	3%	11	491	3%	9	-14%
Total	11642	51%	-	9450	52%	-	-19%
Global Total	22819	100%	-	18259	100%	-	-20%

Sources: World Trade Organization, State Administration of Foreign Exchange

Ⅱ China's deficit in transportation services has gradually narrowed in recent years

The advanced European economies have significant comparative advantages in international transportation. For a long time, the advanced European economies had significant comparative advantages in transportation services based on their geographic and shipping economic advantages. For instance, in terms of the total volume of transportation services, five out of the top ten countries (regions) are located in Europe. In terms of the balance in transportation services, eight out of the top ten countries (regions) are located in Europe. Denmark, the Netherlands, and Turkey are among the leading economies in terms of volume and surplus of transportation services.

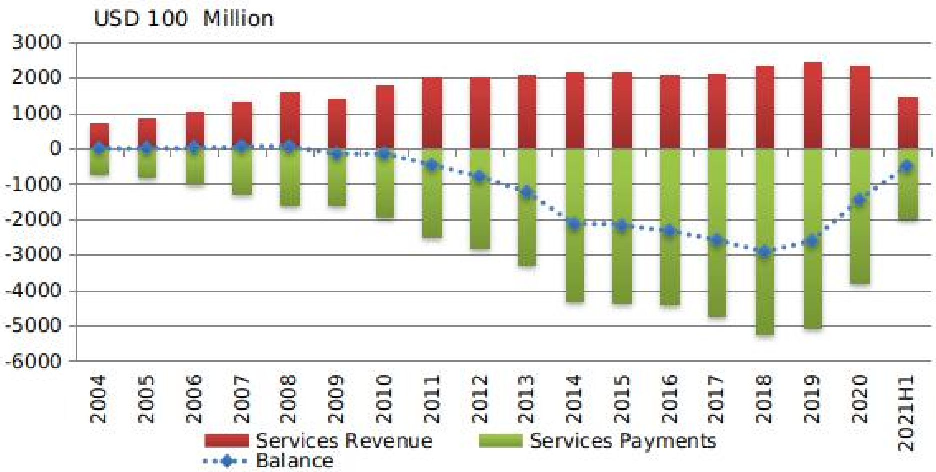
In recent years, China's revenue from transportation has increased and expenditures have declined. For a long period, China’s transportation services were operating with a deficit. With the continuous improvements in transportation capacity in recent years, China’s revenue from transportation has gradually increased and expenditures have declined. The deficit has thus narrowed amidst fluctuations. In 2015, China's deficit in transportation services decreased by 19 percent year on year, and the year-on-year decline for 2019 and 2020 was 12 percent and 35 percent, respectively. In the first half of 2021, China's foreign trade and freight capacity grew steadily, and the deficit in transportation services narrowed to USD 13.7 billion.

The overall competitiveness of China's transportation services has improved. In 2020, China's exports of transportation services accounted for 7 percent of the global total, 2.4 percentage points higher than that in 2015. The ratio of China's net transportation services to the total volume of transportation services was 25 percent, a decrease of 12.6 percentage points from 2015. Judging from the modes of transport, China has become an important contributor to global transportation by sea. According to statistics of the Ministry of Transport, as of the end of 2020, China's marine transport fleet had a capacity of 310 million deadweight tonnage, ranking second largest in the world. As to land transport, China-Europe freight trains are playing an increasingly important role in railway transportation. In 2020, the frequency of China-Europe freight trains exceeded 10,000, a year-on-year increase of 50 percent. In the first half of 2021, 7,377 trains were operating, a year-on-year increase of 43 percent. As to transportation by air, China's cargo aircraft, range of reachability, and carrying capacity have increased significantly in recent years. However, compared with the advanced economies, there is still a lot of room for improvements in China's transport by air..

Affected by the global spread of the epidemic, since the second half of 2020, imbalances between supply and demand in the global transportation market have emerged, and international transportation prices have generally and sharply increased, thus affecting the transportation industries and international trade. In this context, China’s prevention and combat against the epidemic have achieved remarkable results. China’s economic activities and trade were the first to recover, the comparative advantages of the complete industrial chain and the development of the transportation industries have become obvious and its international competitiveness has steadily improved. In the future, China will seize the strategic-opportunities to promote the innovative development of transportation services to digital and intelligent models. China will also expand and extend to the fields of manufacturing and retail activities, transform and upgrade its integration and specialization, and continuously improve the technical level and core advantages of its transportation services. The target is to transform China from a large trading nation to a strong trading nation.

Revenue from trade in services increased significantly. In the first half of 2021, revenue from trade in services totaled USD 149.1 billion, an increase of 35 percent year on year (see Chart 2-6). Among the major items, revenue from transportation was USD 48.9 billion, up 1.01 times year on year and accounting for 33 percent of total revenue. Revenue from other commercial services was USD 40.6 billion, up 22 percent year on year and accounting for 27 percent of total revenue. Revenue from telecommunications and computer and information services was USD 24.4 billion, up 37 percent year on year and accounting for 16 percent of total revenue.

Chart 2-6 Revenue and Expenditures in Trade in Services

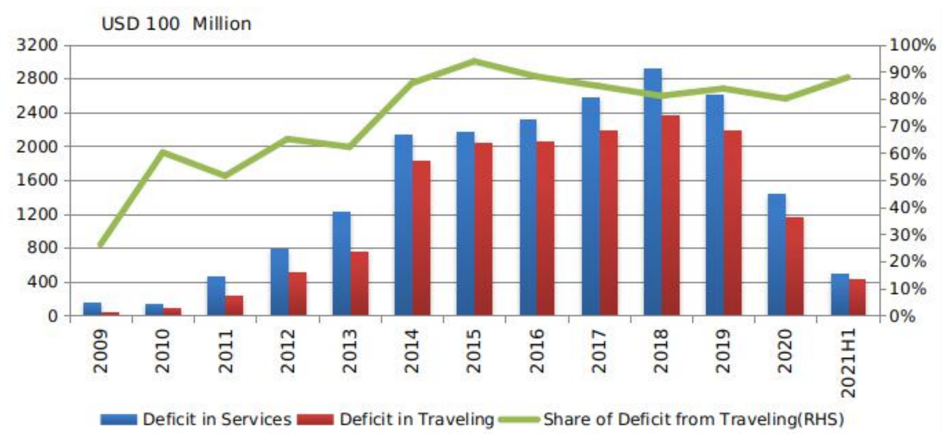


Source: State Administration of Foreign Exchange.

Expenditures for trade in services increased slightly. In the first half of 2021, expenditures for trade in services were USD 19.6 billion, up 7 percent year on year. Among the major items, transportation recorded expenditures of USD 62.6 billion, up 44 percent year on year and accounting for 31 percent of total expenditures. Travel recorded expenditures of USD 50.1 billion, down 29 percent year on year and accounting for 25 percent of total expenditures. Other businesses, such as consultancy services and technical-related services, recorded expenditures of USD 25.6 billion, up 8 percent and accounting for 13 percent of total expenditures.

The trade-in-services deficit narrowed. In the first half of 2021, the deficit in trade in services was USD 50.5 billion, down 34 percent year on year. Travel continued to be the main source of the deficit (see Chart 2-7). In the first half of the year, the travel deficit amounted to USD 44.4 billion, down 28 percent, as the adverse effects of the epidemic on cross-border personnel flows continued. The use of intellectual property and transportation were the second and third, respectively, largest deficit items under trade in services. The deficit in the use of intellectual property amounted to USD 15.6 billion, up 21 percent, mainly due to the increase in expenditures. The transportation deficit amounted to USD 13.7 billion, down 28 percent.

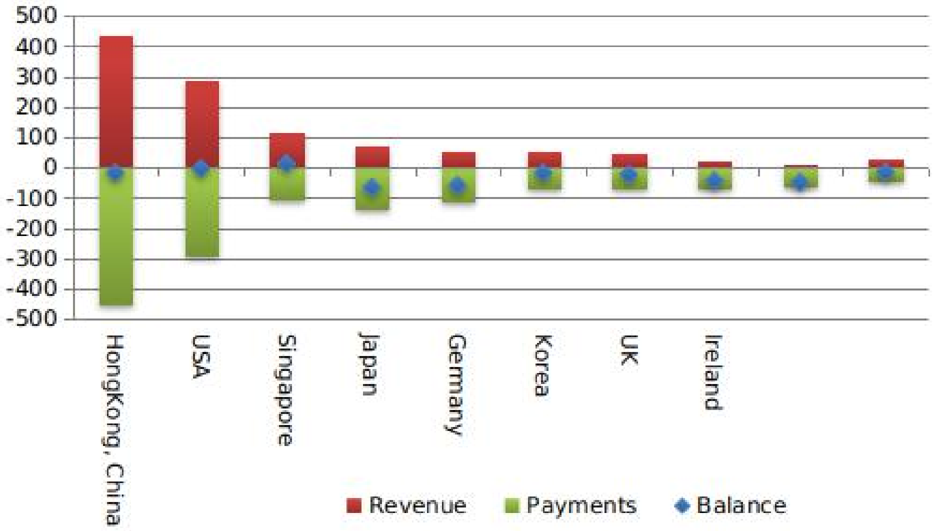
Chart 2-7 The Contribution of Travel to the Deficit in Trade in Services



Source: State Administration of Foreign Exchange.

China's trade partners continued to be highly concentrated and stable. In the first half of 2021, China's top ten partners in terms of trade in services were Hong Kong SAR, the United States, Singapore, Japan, Germany, South Korea, the United Kingdom, Ireland, Canada, and Taiwan Province, which were basically the same as those in 2020. Trade with these partners totaled USD 254.6 billion, accounting for 73 percent of China's total trade in services. With the exception of a slight surplus with Singapore, China posted deficits with its nine other trade partners (see Chart 2-8), but China's deficits with its trade partners were generally narrowing.

Chart 2-8 China's Trade in Services in Terms of Trade Partners in the First Half of 2021



Source: State Administration of Foreign Exchange.

Box 3

Strengthening International Cooperation in Intellectual Property and Promoting Mutual Benefit and Win-Win Results

Intellectual property is a core element in international competitiveness. The balance-of-payments statistics show that China's imports and exports of intellectual property have increased steadily during the past 20 years. Trade in intellectual property has become an important part of China's international services trade, which has not only effectively promoted the high-quality development of the economy and society but also has fully demonstrated the positive results of China's promotion of international cooperation in intellectual property.

I China has become the fifth largest intellectual property trading economy in the world

During this era of economic globalization, intellectual property has been a key factor in international competitiveness and an important resource in global trade. Since the 21st century, international trade in intellectual property has grown rapidly. The trade volume expanded from USD 150 billion in 2000 to nearly USD 1 trillion in 2020, accounting for 9 percent of total global trade in services. At present, the United States has the highest trade volume of intellectual property rights, followed by the Netherlands, Japan, Germany, and China.

The quantity and quality of intellectual property rights are important indicators to measure a country's economic competitiveness and to determine the distribution of global intellectual property trade. In 2020, the world's top 10 countries with a trade surplus in intellectual property rights were all developed countries. The total surplus of the top three surplus countries, including the United States, Germany, and Japan, accounted for 83 percent of the total worldwide surplus, reflecting their leading positions in the global manufacturing system and the competitive advantage of a large number of well-known international brands. In 2020, half of the world's top 10 intellectual property trade-deficit countries were emerging economies. The introduction of intellectual property from the developed economies is an important way for the emerging economies to realize technology accumulation.

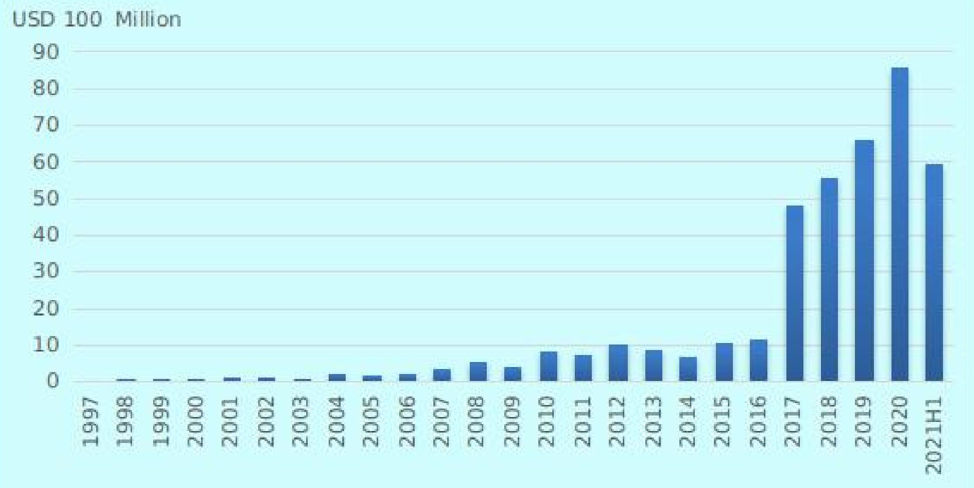
China has become an important participant in global intellectual property trade, actively promoting international cooperation and competition in the field of intellectual property. In 1997, the scale of imports and exports of China's intellectual property rights was less than USD 1 billion. It increased to USD 46.3 billion by 2020, accounting for 8 percent of its total international trade in services during the same period, which is equivalent to a global level.

Ⅱ The introduction of China's intellectual property has achieved mutual benefits and win-win results

The introduction of intellectual property rights is a beneficial way to boost high-quality economic development. At present, to build a new development pattern with domestic circulation as the main body and domestic and international dual circulation promoting each other, we need to better attract global resources. This will not only meet domestic demand but will also improve the level of the development of China's industrial technology and form new advantages from participating in international economic cooperation and competition.

China is a big country in terms of the introduction of intellectual property rights from the rest of world. Before 2000, China's intellectual property imports were small. After China's entry into the WTO in 2001, China deeply participated in economic globalization and its intellectual property imports began to grow rapidly. From 2002 to 2020, China's intellectual property imports increased by 15 percent annually, including 22 percent annually from 2002 to 2008. In 2020, the import volume reached USD 37.8 billion, accounting for 10 percent of China's imports of trade in services during the same period. The United States, Germany, and Japan are the main providers of China's imports of intellectual property rights. The imports from the United States are mainly communications technology and automobile technology, and the imports from Germany and Japan are mainly automobile technology. A large part of the importers in China consists of foreign-invested enterprises, in line with the distribution of bilateral resources and the structure of economic and trade investment. China's huge domestic market and strict intellectual property rights protection have played an important role in promoting the flow and economic cooperation of global intellectual property rights.

Chart C3-1 China’ s Cross-border Expenditures From the Charges for the Use of Intellectual Property from 1997 to the first half of 2021



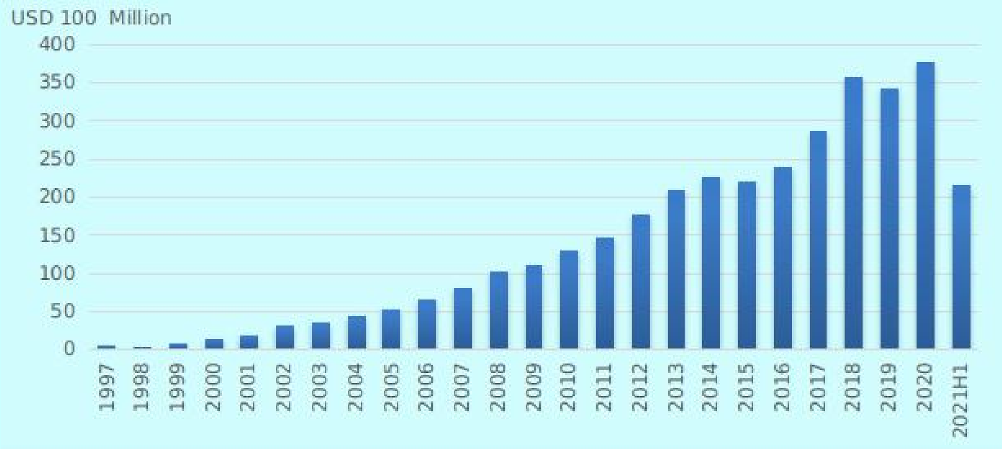
Source: State Administration of Foreign Exchange.

III China's transformation into a big country in terms of the creation of intellectual property

The level of development of an "integrated chain" in China's intellectual property creation, protection, and application has improved greatly. According to the 2020 Global Innovation Index released by the World Intellectual Property Organization in 2020, among the world’s 131 economies, China's innovation capacity ranked among the top 15 in the world for two consecutive years and it was the only middle-income economy in the top 30.

China's global intellectual property market has shifted from an import orientation to two-way import and export growth. Before 2015, China's exports of intellectual property rights were less than USD 1 billion per year. This figure began to grow significantly in 2015, with an average annual growth rate of 51 percent from 2015 to 2020, and the volume of exports reached USD 8.6 billion in 2020. The proportion of exports and imports of intellectual property rights increased from 5 percent in 2004 to 23 percent in 2020. At present, China's intellectual property exports cover 143 economies around the world, including both the developed and emerging economies and the Belt and Road Initiative countries and regions. Among its counterpart countries, the United States is the most important export market for China, indicating that international cooperation and knowledge-sharing are the development trend in the era of economic globalization.

Chart c3-2 China's Cross-border Revenue from Charges for the Use of Intellectual Property from 1997 to the First Half of 2021



Source: State Administration of Foreign Exchange.

Protection of intellectual property is protection of innovation. At present, China is changing from a big country that brings in intellectual property to a big country that creates intellectual property. Imports and exports of intellectual property will play a more important role in China's foreign trade and international economic cooperation. China is not only an important participant in global intellectual property trade but also an active contributor to promoting the construction of a global intellectual property governance system. The foreign-exchange management department will continue to improve the management of foreign exchange from trade in intellectual property, implement high-standard data statistics, and ensure and fully reflect the development of China's intellectual property trade.

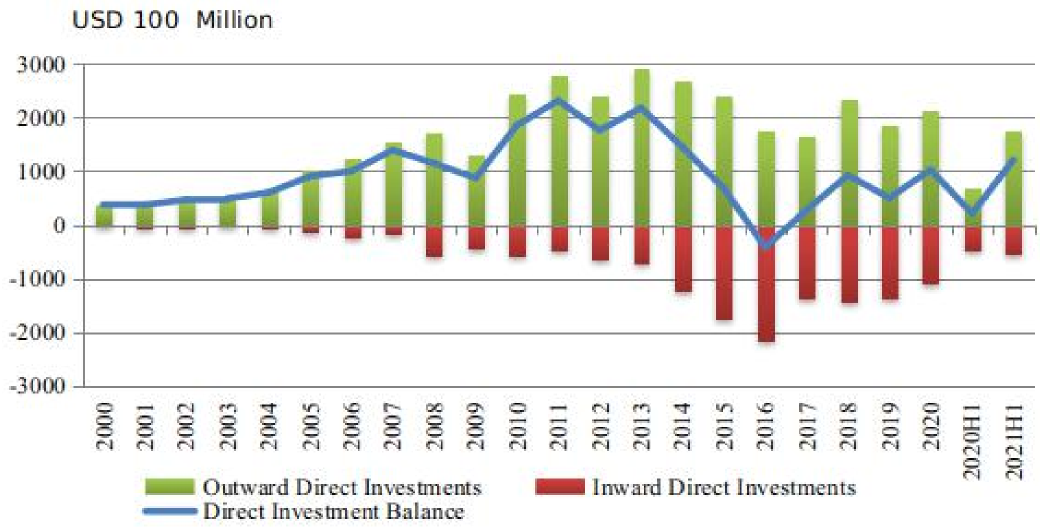
(III) Direct Investments

Direct investments showed net inflows.[4] In the first half of 2021, net inflows of direct investments in China's balance of payments

[4] Net flows of direct investments refer to the gap between the net increase in direct-investment assets (net outflow of funds) and the net increase in direct-investments liabilities (net inflows of funds). When the net increase in direct-investment assets is more than the net increase in direct-investment liabilities, a net outflow is recorded, and vice versa.

totaled USD 121.3 billion (see Chart 2-9), exceeding those in 2020.

Chart 2-9 China's Direct Investments



Source: State Administration of Foreign Exchange.

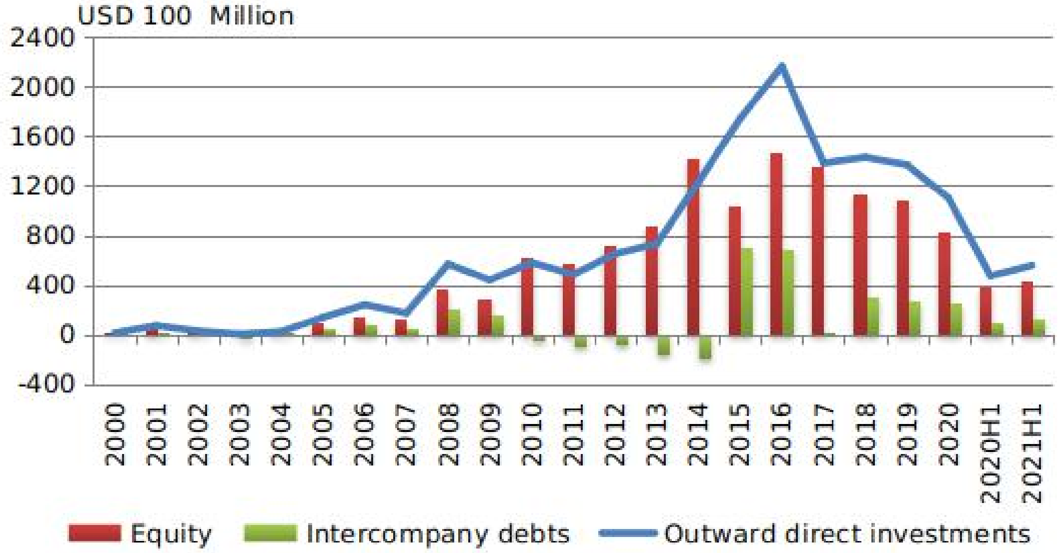
Outward direct investments (ODI) grew. In the first half of 2021, China's ODI (net increase in direct-investment assets)[5] reached USD 55.7 billion, an increase of 18 percent year on year (see Chart 2-10). China's ODI of domestic enterprises continued to remain rational.

In terms of the composition of direct investments, equity investments constituted the major part, supplemented by loan assets. First, equity investments amounted to USD 43.2 billion, an increase of 13 percent year on year, at USD 19.8 billion and USD 23.4 billion, respectively, in the first and second quarters. Second, net outflows of loans to affiliates amounted to USD 12.5 billion, down 39 percent year

[5] A major component of direct-investment assets is outward direct investments. This includes, reverse investments by domestic foreign-funded enterprises to their parent companies. The net increase in direct-investment asset transactions, which is negative in the balance-of-payments statement, represents a net outflow.

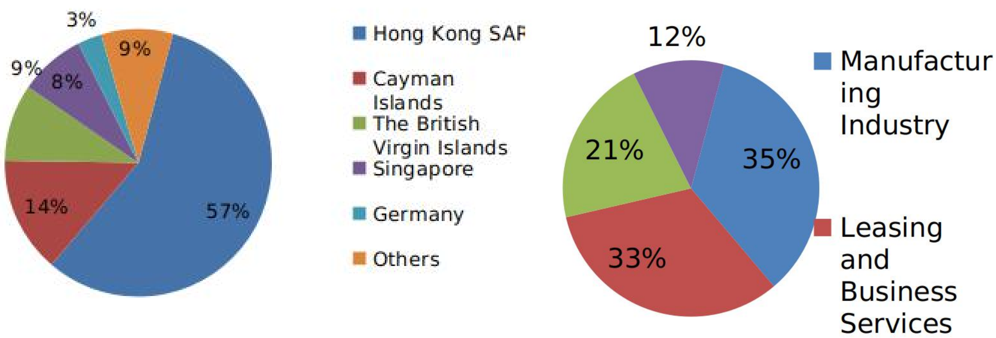
on year, at USD 2.1 billion and USD 10.4 billion, respectively, in the first and second quarters, and cross-border lending and investments of domestic entities remained generally stable.

Chart 2-10 China's Direct-Investment Assets



Source: State Administration of Foreign Exchange.

Chart 2-11 Distribution of China's ODI by the Non-Financial Sectors in the half of 2021 (by Investment Destination and Domestic Industry)



Source: State Administration of Foreign Exchange.

In terms of sectors, outward direct investments by China's non-financial sector and financial sector remained stable, with those in the financial sector increasing steadily. First, direct-investment assets by the non-financial sector amounted to USD 39.2 billion, basically the same as that in the first half of 2020. Among the "going out" industries, manufacturing accounted for 35 percent, ranking first (see Chart 2-11). Second, direct investments by the financial sector reached USD 16.6 billion, doubling that in the first half of 2020 and with increasing capital injections and profit reinvestments in overseas subsidiaries.

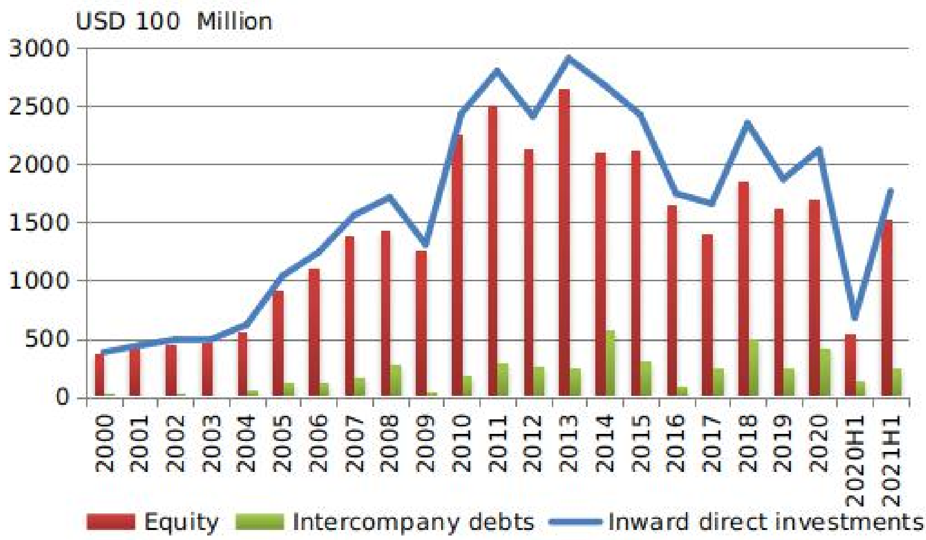
Inward foreign direct investments in China showed large net inflows. In the first half of 2021, net inflows of inward direct investments (net increase in liabilities)[6] in China totaled USD 177 billion, with a year-on-year increase of 1.6 times and an increase of 84 percent over the first half of 2019. China's economic operations have been strengthened and have improved steadily, and foreign capital has maintained strong confidence in investments and operations in China.

In terms of the composition of inward foreign direct investments, both equity investments and loans from foreign affiliates increased. First, net inflows of equity investments in China totaled USD 152.2 billion (see Chart 2-12), an increase of 1.8 times year on year and an increase of 81 percent over the first half of 2019. Equity investments and earnings reinvestments in the form of capital increased and the

[6] Direct-investment liabilities are mainly composed of foreign direct investments. This includes reverse investments to domestic parent companies by overseas subsidiaries. The net increase in direct-investment liability transactions, which is positive in the balance-of-payments statement, represents a net inflow.

profitability of foreign-invested enterprises grew steadily in 2021, driving the reinvestment of profits far higher than that during the same periods of 2019 and 2020. Second, China received loans from foreign affiliates in the amount of USD 24.8 billion, an increase of 80 percent and also a significant increase compared with those in the same period of 2019.

Chart 2-12 Direct-Investment Liabilities



Source: State Administration of Foreign Exchange.

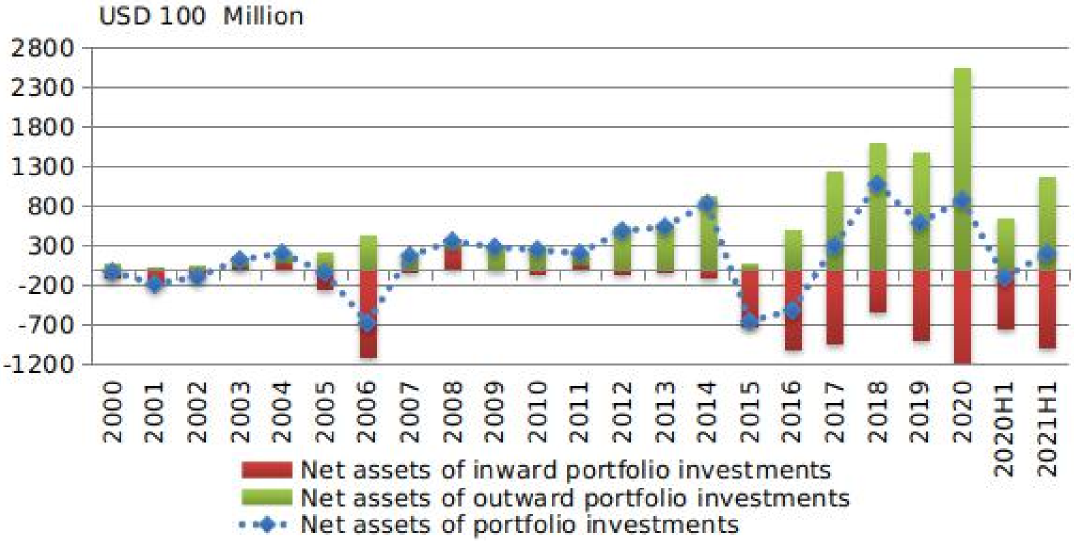
In terms of sectors, direct investments in China are mainly absorbed by the non-financial sectors. In the first half of 2021, China's non-financial sectors absorbed USD 171.1 billion of direct investments in China. Among these, leasing and commercial services absorbed the most foreign direct investments, accounting for 24 percent. The information technology services industry and the manufacturing industry were the second and third non-financial sectors absorbing direct investments in China, accounting for 23 percent and 13 percent of inward direct investments in China, respectively. At the same time, the non-financial sectors in China mainly absorbed direct investments from Hong Kong, accounting for 80 percent, followed by the Cayman Islands and Singapore, which together accounted for 7 percent of the direct investments in the non-financial sectors. The financial sectors absorbed USD 5.9 billion of direct investments in China, an increase of 22 percent.

（IV）Portfolio investments

Portfolio investments showed a small net inflow. In the first half of 2021, net inflows of portfolio investments in China totaled USD 19.7 billion, compared with net outflows of USD 10.8 billion in the first half of 2020 (see Chart 2-13). In the first and second quarters, net inflows totaled USD 3.5 billion and USD 16.2 billion, respectively, showing active two-way flows of cross-border portfolio investments and an overall balance.

China's outward portfolio investments were active. In the first half of 2021, China's net outward portfolio investments (net increase in assets) totaled USD 98.6 billion, a year-on-year increase of 31 percent mainly due to net outflows of USD 72.4 billion, an increase of 58 percent, in equity investments. Net bond investments were USD 26.2 billion, a decrease of 10 percent.

Chart 2-13 Net Flows under Portfolio Investments



Note: Positive outward portfolio investments indicate a decrease in equity or bond outward investments, and vice versa. Positive inward portfolio investments indicate an increase in equity or bond inward investments, and vice versa.

Source: State Administration of Foreign Exchange.

In terms of major channels for outward portfolio investments, first, domestic residents invested USD 60 billion in overseas equities, especially Hong Kong listed stocks, via the Shanghai–Hong Kong Connect and the Mutual Recognition of Funds; second, domestic banks and other financial institutions invested USD 35.3 billion in overseas securities; third, qualified domestic institutional investors (QDII and RQDII) invested USD 4.7 billion in stocks and bonds issued by non-residents. In the first half of 2021, supported by the loose monetary policies of the foreign economies, major stock markets generally performed well and attracted global investors. In the first quarter, China's net outflows of outward portfolio investments recorded a historic high.

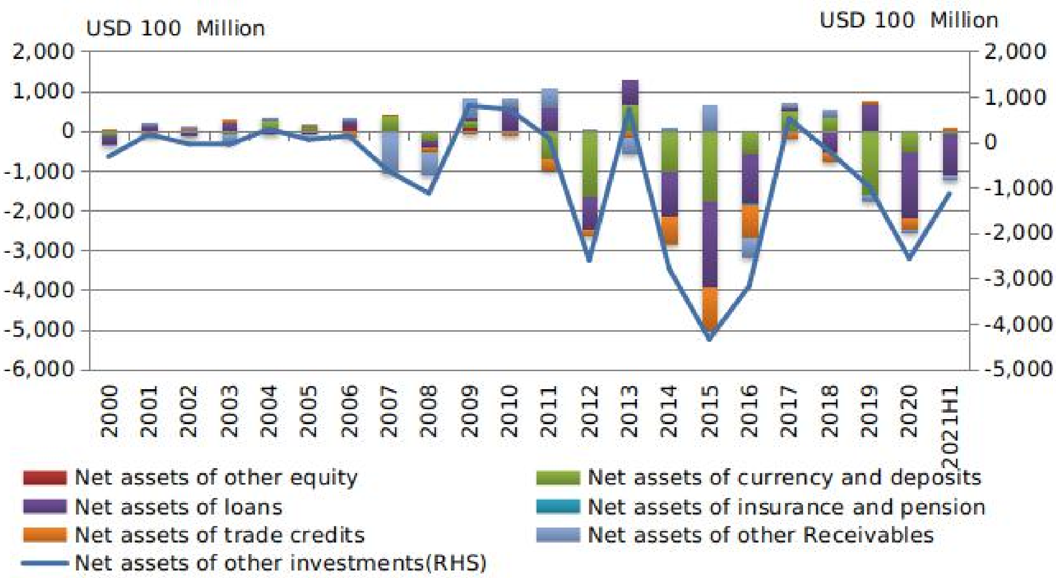
Inward portfolio investments continued their net inflows. In the first half of 2021, China’s inward portfolio investments (net increase in liabilities) recorded net inflows of USD 118.4 billion, a year-on-year increase of 84 percent. Among these, net inflows of China’s equities totaled USD 39.4 billion, compared with USD 16.7 billion in the first half of 2020; net inflows of China’s bonds totaled USD 78.9 billion, an increase of 66 percent.

In terms of the major channels for inward portfolio investments, first, foreign investors invested USD 65.4 billion in the domestic bond market, mainly via the Bond Connect, the direct-investment channel in the inter-bank bond markets, and in China’s bonds issued abroad (including RMB central bank bills issued by the central bank in Hong Kong SAR); second, investments via the Stock-Connect totaled USD 34.6 billion; third, QFIIs and RQFIIs recorded a total net inflow of USD 9.3 billion. With China's economy taking the lead in recovering, the continuous opening-up of the bond market, the good returns on RMB assets, and the gradual enhancement of risk-averse properties, China’s bonds are favored by foreign investors. In October 2021, China’s government bonds will be officially included in the FTSE Russell World Bond Treasury Bond Index. RMB bonds will then been included in mainstream international portfolio indexes. It is expected that the attractiveness of RMB assets will increase steadily in the future.

(V). Other Investments

The deficit in other investments was widened. In the first half of 2021, net outflows (increase in net assets) of other investments totaled USD 113.8 billion, an increase of 2.2 times year on year (see Chart 2-14). In particular, net outflows of currency and deposits totaled USD 6.2 billion, net outflows of loans registered USD 104.5 billion, net outflows of trade credits totaled USD 10.3 billion, and net outflows of other receivables and payables totaled USD 12.6 billion.

Chart 2-14 Net Flows of Other Investments



Source: State Administration of Foreign Exchange.

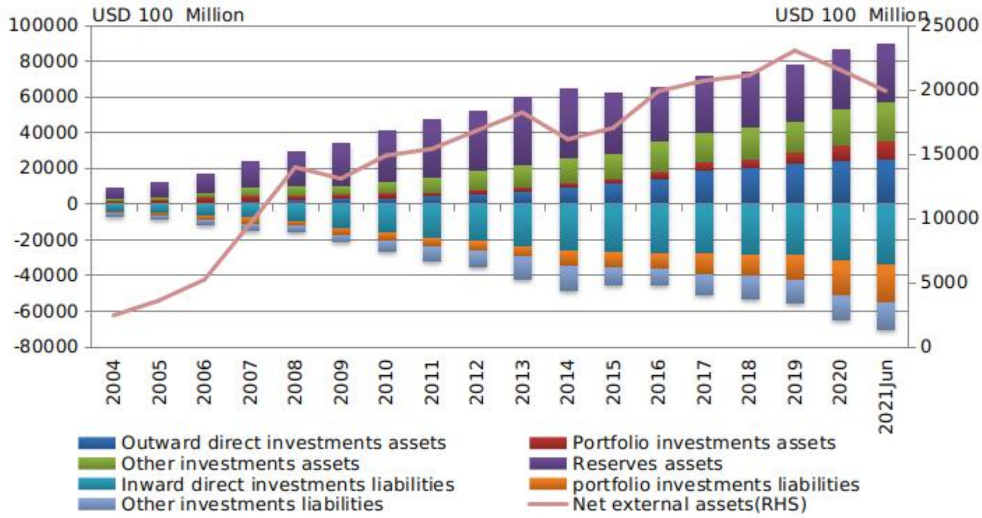
External assets under other investments increased. In the first half of 2021, China's net outflows (net increase in assets) of other investments totaled USD 265.3 billion, an increase of 2.8 times year on year. In particular, net outflows of currencies and deposits totaled USD 89.9 billion, an increase of 1.9 times, mainly due to the increase in overseas deposits by domestic entities in need of capital liquidity management. Loan assets increased by USD 138.5 billion, an increase of 1.6 times. The increase in exports led to a net outflow of trade credit assets, such as export receivables of USD 4.1 billion, compared with the net inflow of USD 31.3 billion in the first half of 2020. Net outflows of other receivables totaled USD 29.7 billion, an increase of 100 percent year on year.

Net inflows in liabilities under other investments increased. In the first half of 2021, China's net inflows of other investments (net increase in liabilities) totaled USD 151.5 billion, an increase of 3.3 times year on year. In particular, currency and deposit liabilities registered net inflows of USD 83.7 billion, an increase of 1.6 times, mainly due to the increase in deposits from non-resident enterprises and individuals. Liabilities under loans recorded net outflows of USD 34 billion, an increase of 63 percent. Affected by the increase in imports, net inflows of trade credit liabilities, such as enterprise import payables, totaled USD 14.4 billion, compared with net outflows of USD 40.3 billion in the first half of 2020. Net inflows of other liabilities payable totaled USD 17.1 billion, a decrease of 18 percent year on year.

III. International Investment Position

China's external financial assets and liabilities[7] were both on the rise. At the end of June 2021, China's external financial assets reached USD 9027.8 billion, up 3.7 percent from end-2020; external liabilities reached USD 7041.8 billion, up 7.4 percent; and net assets reached USD 1986.0 billion, remaining at a high scale (see Chart 3-1).

Chart 3-1 External Financial Assets, Liabilities, and Net Assets



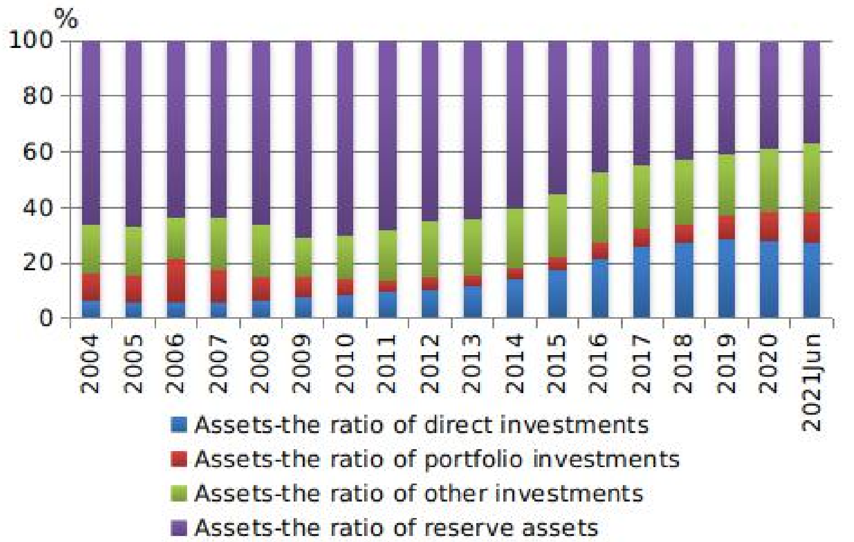
Source: State Administration of Foreign Exchange.

Reserve assets remained the largest component of total external assets, and private-sector holdings continued to rise. Among the external financial assets, at the end of June 2021 reserve assets amounted to USD 3345.9 billion, down 0.3 percent from end-2020. As the largest

[7] External financial assets and liabilities include direct investments, portfolio investments, and other investments, such as deposits and loans. Outward direct investments are included as financial assets because the equity issued by non-resident direct-investment enterprises and held by domestic investors is the same type of financial instrument as the equity investments in portfolio investments. The difference is that direct investments require a higher threshold of equity holdings to reflect a significant influence or control over production and operations of the enterprises. Inward direct investments belong to external financial liabilities because foreign investors hold equity in foreign-owned companies.

component of external financial assets, reserve assets accounted for 37 percent of China's total external financial assets, down 1.5 percentage points from end-2020. Direct-investment assets amounted to USD 2462.0 billion, accounting for 27 percent of total assets, down 0.5 percentage point from end-2020. Portfolio-investment assets amounted to USD 1013.2 billion, accounting for 11 percent, up 0.9 percentage point. Financial-derivative assets amounted to USD 13.4 billion, accounting for 0.2 percent. Other investments, such as loans and trade credits, amounted to USD 2192.3 billion, accounting for 24 percent, up 1.1 percentage points from end-2020 (see Chart 3-2).

Chart 3-2 Changes in the Structure of China's External Financial Assets



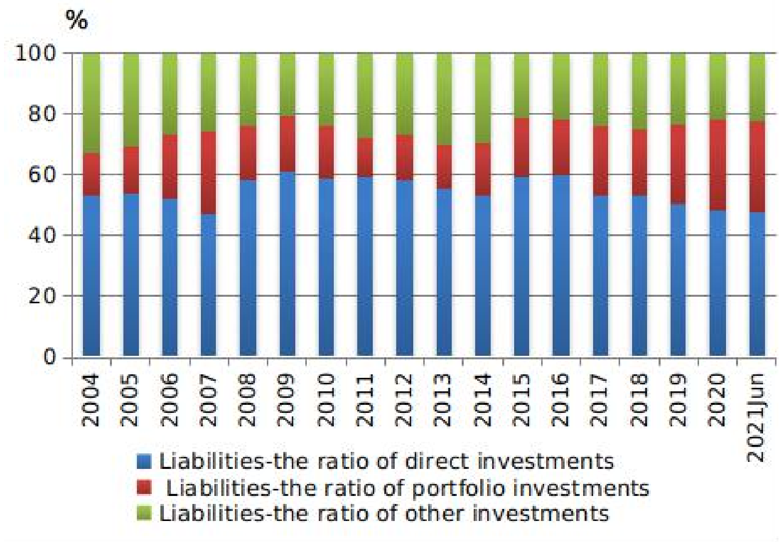
Source: State Administration of Foreign Exchange.

Foreign direct investments remained the major item in external liabilities, and the proportion of other investments and portfolio investments in the domestic market grew steadily. Among the external liabilities, FDI[8] totaled USD 3365.0 billion at the end of June 2021, up

[8]The inward FDI position includes FDI stocks of both the non-financial sector and the financial sector. The position also reflects the impact of revaluation factors.

5.8 percent from end-2020, accounting for 48 percent of total external liabilities and remaining the largest component of external liabilities. Foreign portfolio-investment liabilities amounted to USD 2109.0 billion, up 7.9 percent from end-2020, accounting for 30 percent, up 0.1 percentage point from end-2020. Foreign investments in China's domestic securities market continued to increase. At the end of June 2021, foreign investors' holdings of China's domestic securities totaled approximately USD 1207.8 billion. Among these, foreign holdings of stocks accounted for 5.4 percent of the total market value of A-shares; holdings of bonds accounted for 3.1 percent of the total domestic bonds under custody, up 0.1 percentage point from end-2020. Other investment liabilities, such as loans and deposits, amounted to USD 1559.3 billion, accounting for 22 percent, up 0.7 percentage point from end-2020 (see Chart 3-3).

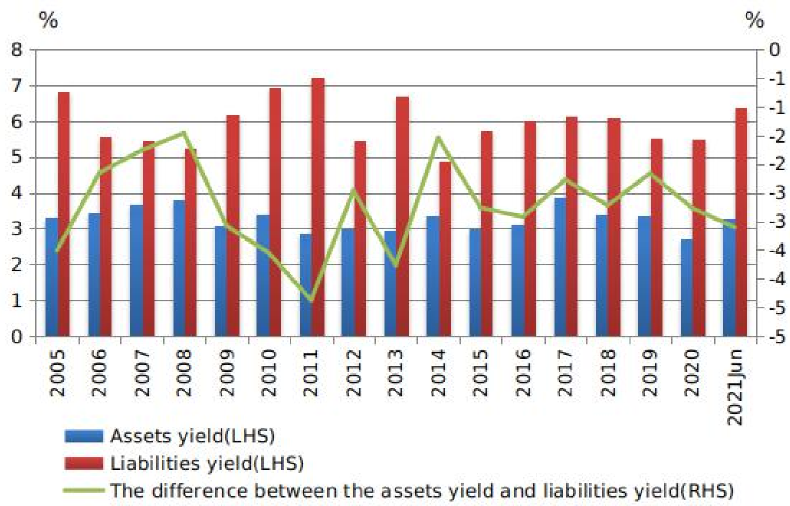
Chart 3-3 The Structure of External Liabilities



Source: State Administration of Foreign Exchange.

Two-way investment income in China and abroad was generally stable. On the income payment side, in the first half of 2021 income payments for absorbing foreign investments recorded USD 217.0 billion, at a stable rate of return of about 6.4 percent (see Chart 3-4). Since the beginning of 2021, China's economic operations have been improving and strengthening steadily, the driving force for economic development has been further enhanced, and, as a whole, the operating profits of foreign-invested enterprises have been better. At the same time, the current rate of return on RMB assets is relatively stable, and foreign investors have maintained high investment enthusiasm for RMB equity and bonds. On the income revenue side, the global economy generally recovered in 2021, and the foreign investment income of domestic entities has increased rapidly. In the first half of the year, foreign investment income was USD 145.3 billion, with a rate of return of about 3.3 percent.

Chart 3-4 Changes in the Rate of Return on China's External Assets and Liabilities



Notes: 1. Yields of assets (liabilities)

$$= \frac{\text{annualized revenue(payments) of investment income}}{\text{(positions at the reference year-end + positions at the previous year-end)/2}}$$

.

2. The difference between the yields of assets and liabilities = the yield of assets – the yield of liabilities.

Source: State Administration of Foreign Exchange.

Table 3-1 China's International Investment Position at the End of half of 2021

	Line No.	end of 2021H1
Net International Investment Position[9]	**1**	**19860**
Assets	**2**	**90278**
1 Direct investments	**3**	**24620**
1.1 Equity and investment fund shares	**4**	21180
1.2 Debt instruments	**5**	3440
1.a Financial sector	**6**	3359
1.1.a Equity and investment fund shares	**7**	3250
1.2.a Debt instruments	**8**	110
1.b Non-financial sector	**9**	21261
1.1.b Equity and investment fund shares	**10**	17930
1.2.b Debt instruments	**11**	3331
2 Portfolio investments	**12**	**10132**
2.1 Equity and investment fund shares	**13**	6949
2.2 Debt securities	**14**	3183
3 Financial derivatives (other than reserves) and employee stock options	**15**	**143**
4 Other investments	**16**	**21923**
4.1 Other equity	**17**	93
4.2 Currency and deposits	**18**	4795
4.3 Loans	**19**	9836
4.4 Insurance, pensions, and standardized guarantee schemes	**20**	195
4.5 Trade credits and advances	**21**	6013
4.6 Other accounts receivable	**22**	990
5 Reserve assets	**23**	**33459**
5.1 Monetary gold	**24**	1105
5.2 Special drawing rights	**25**	114
5.3 Reserve position in the IMF	**26**	103
5.4 Foreign currency reserves	**27**	32140
5.5 Other reserve assets	**28**	-3

[9] Net position refers to assets minus liabilities; "+" refers to net assets; "-" refers to net liabilities. The notations in this table are based on the principle of rounding.

Liabilities	**29**	**70418**
1 Direct investments	**30**	**33650**
1.1 Equity and investment fund shares	**31**	30593
1.2 Debt instruments	**32**	3056
1.a Financial sector	**33**	1896
1.1.a Equity and investment fund shares	**34**	1710
1.2.a Debt instruments	**35**	186
1.b Non-financial sector	**36**	31754
1.1.b Equity and investment fund shares	**37**	28883
1.2.b Debt instruments	**38**	2870
2 Portfolio investments	**39**	**21090**
2.1 Equity and investment fund shares	**40**	13534
2.2 Debt securities	**41**	7557
3 Financial derivatives (other than reserves) and employee stock options	**42**	**85**
4 Other investments	**43**	**15593**
4.1 Other equity	**44**	0
4.2 Currency and deposits	**45**	6217
4.3 Loans	**46**	4755
4.4 Insurance, pensions, and standardized guarantee schemes	**47**	220
4.5 Trade credits and advances	**48**	3863
4.6 Other accounts payable	**49**	438
4.7 Special drawing rights	**50**	100

Net position refers to assets minus liabilities; "+" refers to net assets; "-" refers to net liabilities. The notations in this table are based on a rounding principle.

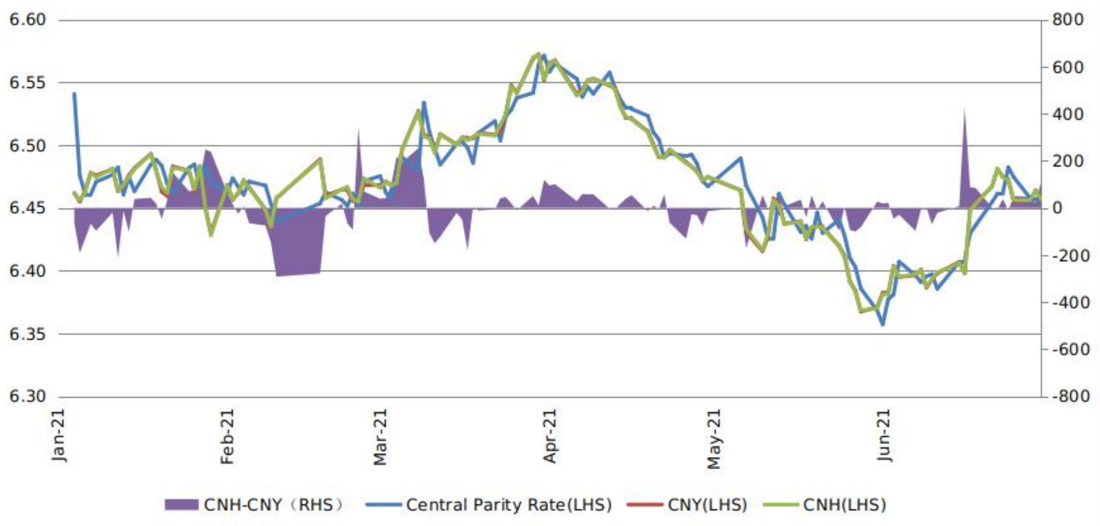
Source: State Administration of Foreign Exchange.

IV. Operation of the Foreign-Exchange Market and the RMB Exchange Rate

(I) Trends in the RMB Exchange Rate

The exchange rate of the RMB against the USD fluctuated in both directions. At the end of June 2021, the central parity of the RMB against the USD was 6.4601, an appreciation of 1.0 percent compared with the end of the previous year. The central parity rate remained relatively stable from January to February, then depreciating by 1.5 percent in March, appreciating by 3.2 percent in April to May, and then depreciating again by 1.4 percent in June. In the first half of this year, spot prices in the CNY and CNH markets appreciated by 1.2 percent and 0.7 percent, respectively (see Chart 4-1), and the average daily spread in the domestic and foreign markets was 72 basis points, lower than the average daily spread in the entire year of 2020 (94 basis points). In 2021, although international markets remained complex and volatile, the exchange rate of the RMB against the USD showed a trend of two-way fluctuations, indicating steady performance among global currencies (see Chart 4-2).

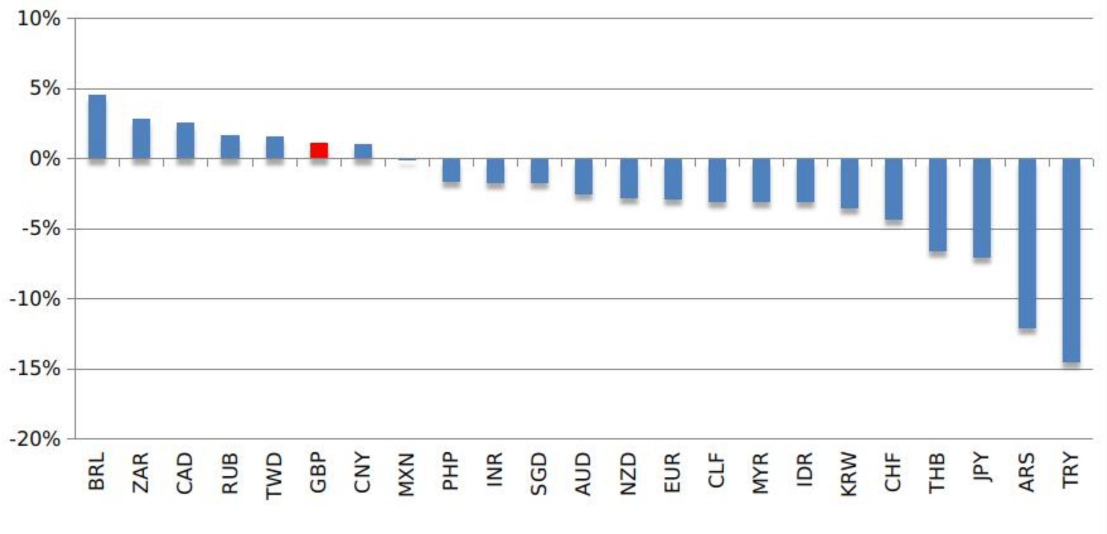
Chart 4-1 Trends in the RMB Spot Exchange Rate Against the USD in the Domestic and Offshore Markets, First Half of 2021



Sources: CFETS, Bloomberg.

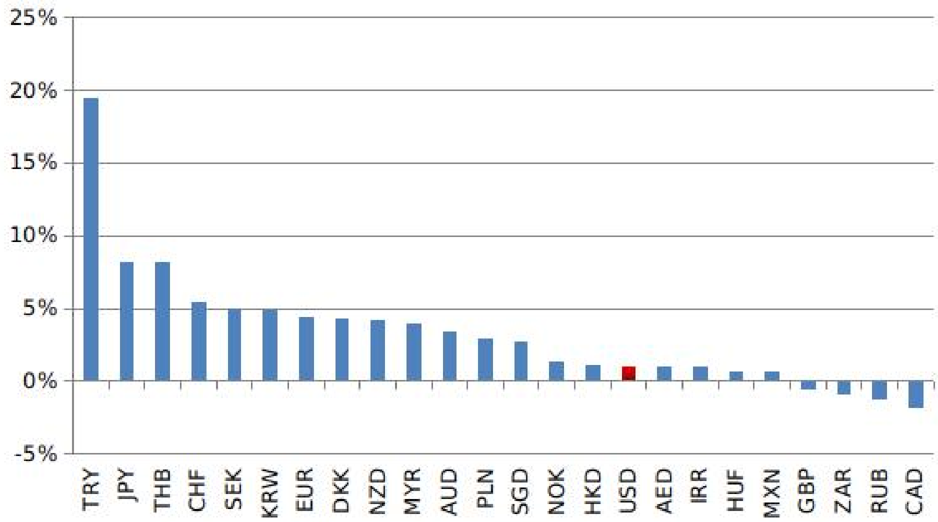
The RMB exchange rate versus those of the other major currencies went in different directions. At the end of June 2021, the mid-price of the RMB against the EUR, 100JPY, GBP, AUD, and CAD stood at 7.6862, 5.8428, 8.941, 4.8528, 5.1161, and 5.2097, respectively, an appreciation of 4.4 percent, an appreciation of 8.2 percent, a depreciation of 0.6 percent, an appreciation of 3.4 percent, and a depreciation of 1.8 percent, respectively, compared with the previous year (see Chart 4-3).

Chart 4-2 Changes in the Bilateral Exchange Rates of the Major Developed Economies and the Emerging Markets against the USD in the First Half of 2021



Source: Bloomberg.

Chart 4-3 The Rise and Fall of the RMB Against the Central Parity of the Currencies of the Major Developed Economies and the Emerging Markets

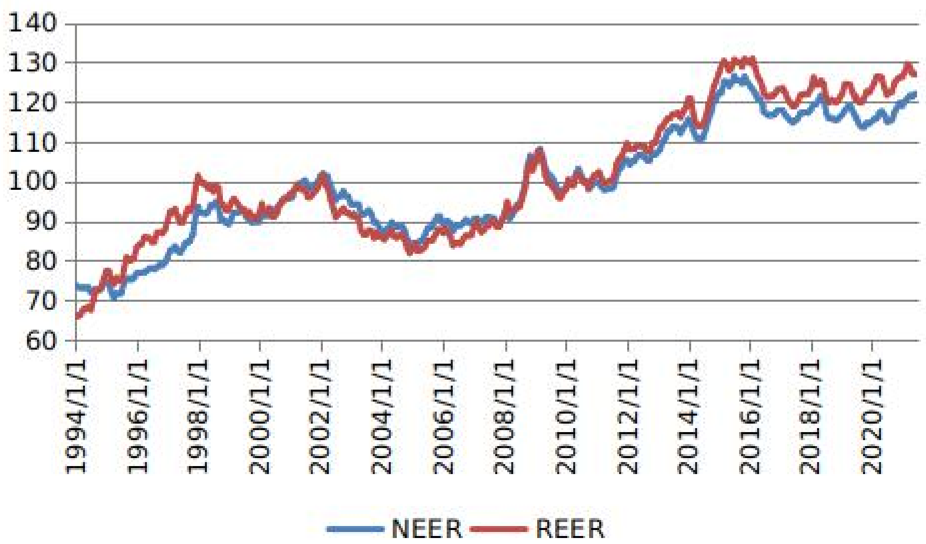


Source: CFETS.

The RMB exchange rate was basically stable against a basket of currencies. According to CFETS data, at the end of June 2021, the RMB exchange-rate indexes of the CFETS, the BIS basket of currencies, and the SDR basket of currencies were 98.00, 102.01, and 96.77, respectively, an appreciation of 3.3 percent, 3.4 percent, and 2.7 percent, respectively, compared with that at the end of 2020.

According to the BIS, the nominal effective exchange rate of the RMB appreciated by 2.9 percent in the first half of 2021. Deducting for inflation, the real effective exchange rate of the RMB depreciated by 0.4 percent (see Chart 4-4).

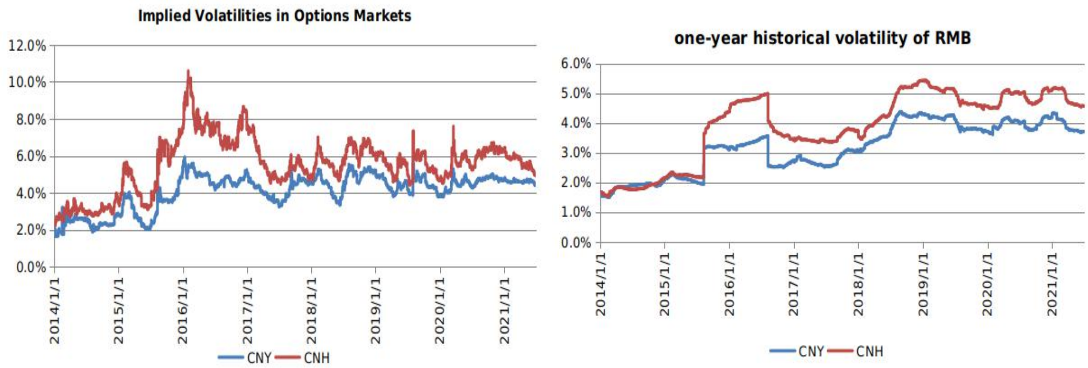
Chart 4-4 Trends in the Effective RMB Exchange Rate (according to the BIS)



Source: BIS.

The RMB exchange rate remained flexible. The RMB exchange rate is based on market supply and demand, with market expectations remaining stable on the whole and continuing to float in both directions. By the end of June 2021, the one-year historic volatility of the RMB against the USD in domestic and foreign markets was 3.7 percent and 4.6 percent, respectively. By the end of June 2021, the one-year historic volatility of the RMB exchange rate against the USD in the domestic and foreign markets was 3.7 percent and 4.6 percent, respectively, still at a historically high level. The implied volatility of the option market was 4.4 percent and 5.0 percent, respectively (see Chart 4-5).

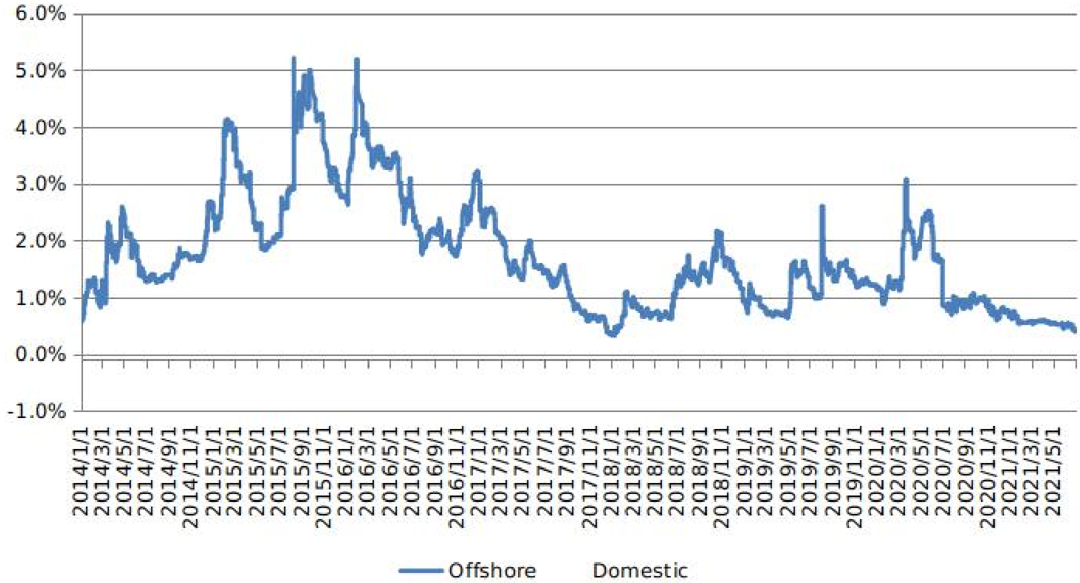
Chart 4-5 One-Year Volatility of the RMB against the USD Exchange Rate in the Domestic and Foreign Markets



Source: Bloomberg.

RMB exchange-rate expectations were stable. At the end of June 2021, domestic and offshore risk reversals (the difference between the volatility of the USD call / RMB put options and the USD put /RMB call options) were 0.42 percent and 0.77 percent, and 0.66 percent and 1.31 percent at the end of the previous year, indicating stable exchange-rate expectations.

Chart 4-6 The 1-Year Risk Reversals of the RMB Against the USD in the Domestic and Offshore Options Markets



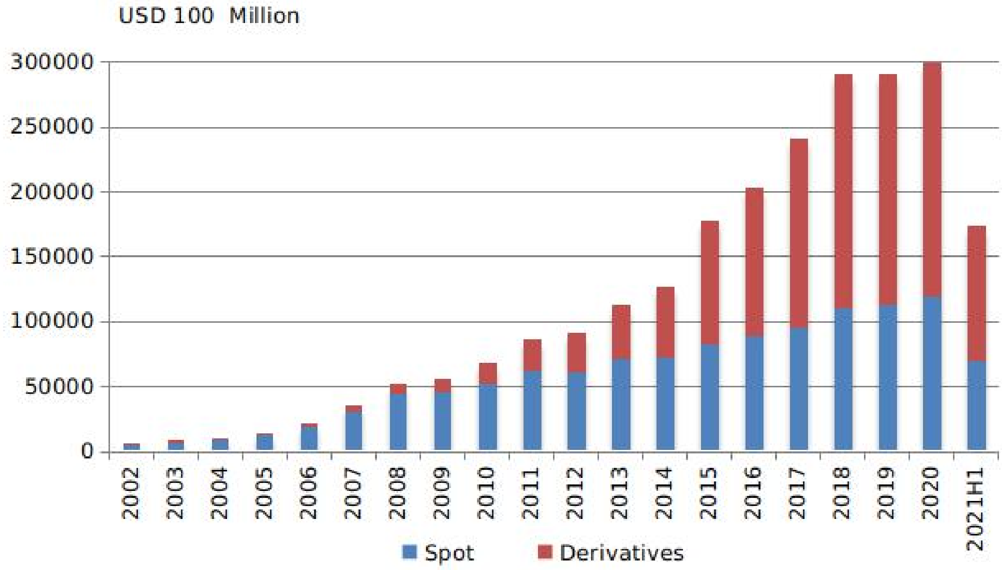
Source: Bloomberg.

(II) Transactions in the Foreign-Exchange Market

In the first half of 2021, the cumulative trading volume of the RMB/foreign-currency market totaled USD 17.4 trillion, an increase of 32 percent compared with that in 2019, with an average daily trading volume of USD 147.5 billion (Chart 4-7). The total trading volume in the client market and the inter-bank market were USD 2.7 trillion and USD 14.8 trillion, respectively.[10] Spot and derivative transactions witnessed a trading volume of USD 6.9 trillion and USD 10.5 trillion, respectively (see Chart 4-7). Derivatives accounted for 60 percent of the total transactions in the foreign-exchange market (see Chart 4-8).

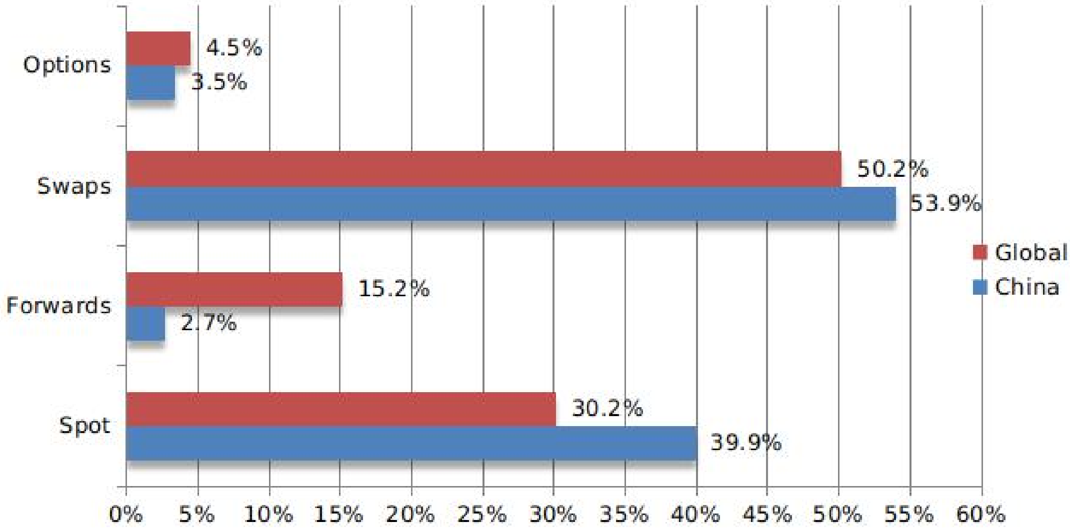
[10]The bank adopts the total amount of foreign exchange traded by customers in the customer market and the unilateral transaction volume in the inter-bank foreign-exchange market, the same as below.

Chart 4-7 Trading Volume in China' s Foreign-Exchange Market



Sources: SAFE, CFETS.

Chart 4-8 Comparison of the Structure of Products in the Domestic and Global Foreign-Exchange Markets



Note: Data for China are for the first half of 2021; the global data have been adopted from the BIS survey in April 2019.

Sources: SAFE, CFETS, BIS.

Spot foreign-exchange transactions grew steadily. In the first half of 2021, the spot market saw a trading volume of USD 6.9 trillion, up 36 percent from 2019. In terms of market distribution, spot purchases and sales of foreign exchange in the client market totaled USD 2.0 trillion (including the banks' proprietary trading, but excluding the performance of forwards), up 19 percent compared with 2019. The spot inter-bank foreign-exchange market saw a trading volume of USD 5.0 trillion, up 44 percent. The share of USD transactions was 96 percent.

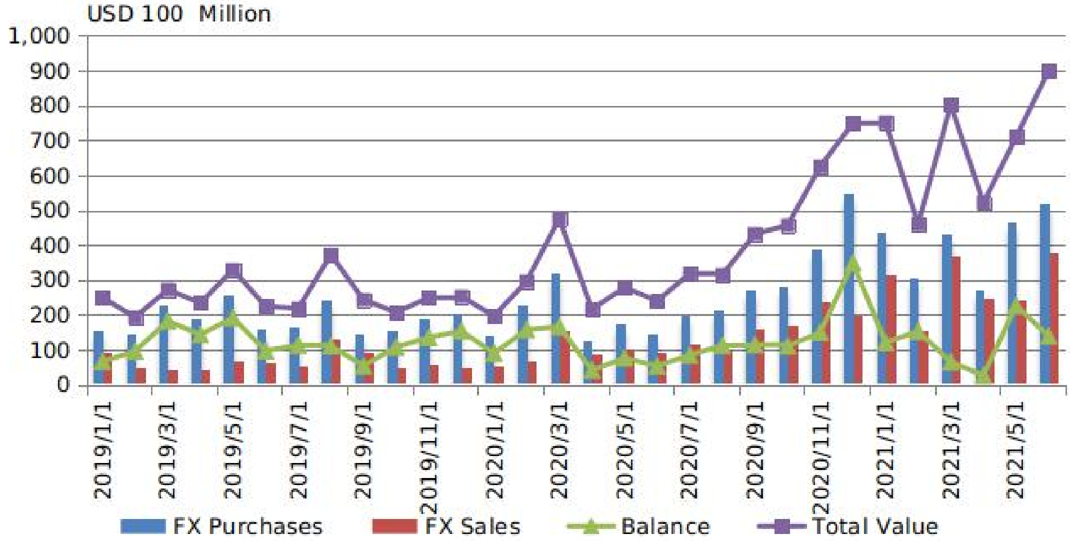
Foreign-exchange forward transactions increased. In the first half of 2021, the forward market saw a cumulative trading volume of USD 466.5 billion, up 111 percent year on year. In terms of market distribution, in the client market purchases and sales of forwards in foreign exchange totaled USD 414.3 billion, of which purchases and sales of forwards were USD 243.7 billion and USD 170.6 billion, up 143 percent, 113 percent, and 205 percent, respectively (see Chart 4-9). Short-term 6-month transactions accounted for 73 percent, up 4 percentage points year on year. The inter-bank forward market saw a cumulative trading volume of USD 52.3 billion, up 2 percent year on year.

Swap trading rose slightly. In the first half of 2021, cumulative foreign-exchange and currency-swap transactions totaled USD 9.4 trillion, up 26 percent year on year. In terms of market distribution, cumulative foreign-exchange and currency-swap transactions in the client market reached USD 69.1 billion, down 44 percent. Spot purchases/forward sales and spot sales/forward purchases reached USD 52.2 billion and USD 16.8 billion, respectively, down 42 percent and 48 percent, respectively. The inter-bank foreign exchange and currency-swap markets, which play an important role in local and foreign-currency liquidity management by banks, saw cumulative transactions of USD 9.3 trillion, up 27 percent. Swaps remain an important tool for banks to manage liquidity in both domestic and foreign currencies.

Options transactions increased. In the first half of 2021, the trading volume of options totaled USD 601.2 billion, up 67 percent year on year. In terms of market distribution, the client market saw a total trading volume of USD 176.3 billion, up 32 percent. The inter-bank market saw a total trading volume of USD 424.8 billion, up 87 percent.

The foreign-exchange hedging rate of enterprises increased. Domestic enterprises actively use foreign-exchange derivatives to avoid exchange losses. In the first half of 2021, the hedging rate of enterprises increased by 7.5 percentage points to 22.8 percent compared with the first half of 2020.

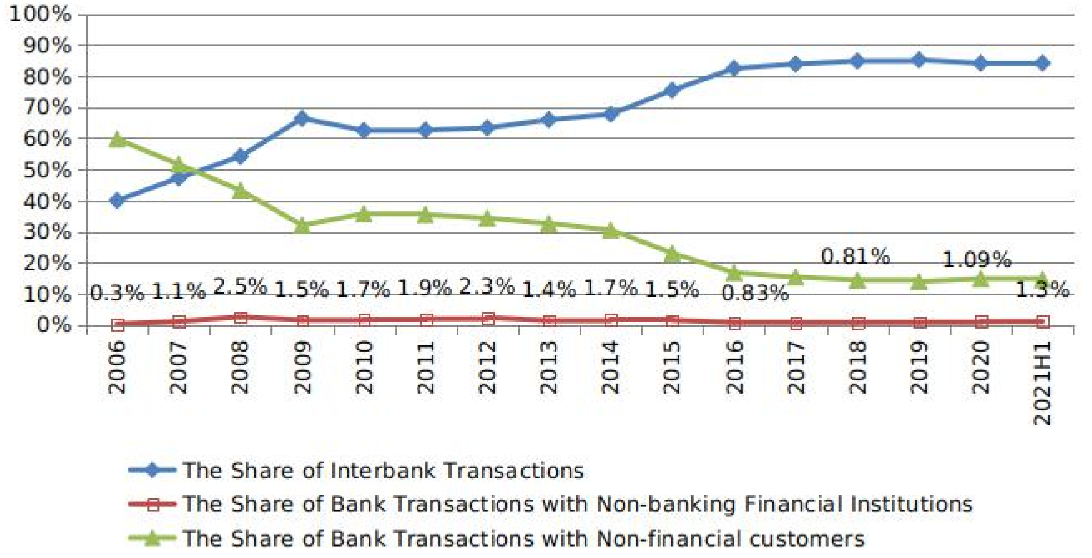
Chart 4-9 Forward Settlement and Sale of Foreign Exchange by Banks to Customers



Source: State Administration of Foreign Exchange.

The structure of foreign-exchange market participants remained stable. Proprietary transactions by banks continued to dominate (see Chart 4-10). The share of inter-bank trading in the overall foreign-exchange market was 85 percent, roughly the same as that in 2020. The market share of non-financial clients and non-bank financial institutions dropped slightly from 14.8 percent to 14.6 percent. The market share of transactions by non-bank financial institutions edged up to 1.3 percent, from 1.1 percent in 2020. The participation of non-bank financial institutions in China's foreign-exchange market remained limited.

Chart 4-10 The Structure of Participants in China's Foreign-Exchange Market



Sources: SAFE, CFETS.

Table 4-1 Transactions in the RMB/Foreign-Exchange Market, half of 2021

Product	Trading Volume (100 million USD)
Spot	**69483**
Client Market	**19945**
Interbank Foreign Exchange Market	**49538**
Forward	**4665**
Client Market	**4143**
Less than 3 months (including 3 months)	2095
3 months to 1 year (including 1 year)	1773
More than 1 year	275
Interbank Foreign Exchange Market	**523**
Less than 3 months (including 3 months)	367
3 months to 1 year (including 1 year)	120
More than 1 year	36
Foreign Exchange and Currency Swaps	**93893**
Client Market	**691**
Interbank Foreign Exchange Market	**93202**
Less than 3 months (including 3 months)	84196
3 months to 1 year (including 1 year)	8838
More than 1 year	168
Options	**6012**
Client Market	**1763**
Foreign Exchange Call Options/RMB Put Options	757

Foreign Exchange Put Options/RMB Call Options	1006
Less than 3 months (including 3 months)	896
3 months to 1 year (including 1 year)	720
More than 1 year	148
Interbank Foreign Exchange Market	**4248**
Less than 3 months (including 3 months)	3107
3 months to 1 year (including 1 year)	1135
More than 1 year	6
Total	**174053**
Client Market	**26542**
Interbank Foreign Exchange Market	**147511**
Including: Spots	69483
Forwards	4665
Foreign Exchange and Currency Swaps	93893
Options	6012

Note: The trading volumes here are all unilateral transactions and the data employ rounded-off numbers.

Sources: SAFE, CFETS.

Box 4

Maintaining a Neutral Exchange-Rate Risk and Helping Enterprises Stabilize Their Financial Performance

In the market environment of two-way exchange-rate fluctuations, exchange-rate risk management has a very important impact on the financial performance of enterprises, especially enterprises with a high proportion of international business.

I. It is increasingly important to establish the concept of exchange-rate risk neutrality

Establishing a neutral exchange-rate risk concept is helpful for enterprises to achieve their main business objectives. Exchange-rate risk neutrality refers to enterprises that incorporate exchange-rate fluctuations into their daily financial decisions, focus on their main business, and minimize the negative impact of exchange- rate fluctuations on their main business and corporate finance, so as to attain their main business objectives, such as budget achievement, improving the predictability of operations, and managing investment risks. Enterprises should aim to "maintain value" rather than to "increase value," carry out reasonable and prudent hedging, and avoid deviating from the main business and turning from real to virtual. Speculative arbitrage away from exchange-rate risk neutrality only adds to the risks.

Enterprise exchange rate-risk management awareness gradually increased. In recent years, the trading scale of foreign-exchange derivatives has increased significantly, and the hedging level of domestic enterprises has gradually improved. In the first half of 2021, enterprises used forwards, options, and other foreign-exchange derivatives to manage the exchange-rate risk of nearly 600 billion USD, up 94 percent year on year. The hedging ratio was 22.8 percent, up 7.5 percentage points from the same period of the last year, indicating that enterprises have become more mindful of avoiding risks in the exchange rate and improving their risk-neutral management philosophy. However, the non-neutral behavior of enterprise exchange-rate risk management still exists. Some enterprises do not hedge the exchange-rate risk exposure or the hedging ratio is low. Some enterprises use foreign-exchange derivatives to seek profits or to engage in arbitrage, deviating from their main business.

II. Development of the foreign-exchange market effectively supports various hedging demands of enterprises

First, financial institutions can provide abundant foreign-exchange derivatives. At present, banks have a complete range of exchange-rate hedging products. Forwards, foreign-exchange swaps, currency swaps, options, and various combinations of products basically meet the daily needs of enterprises.

Second, all relevant services are generally covered. At present, there are 115 banks in China that can provide foreign-exchange derivative services, including large, medium, and small banks, Chinese and foreign banks, and market services that can cover all regions of the country.

Third, the cost of enterprise hedging is not high. Banks generally do not charge hedging fees, and the margin ratio is adjusted with the product term and market conditions. Enterprises can use the credit line to replace the margin, and some high-quality enterprises can apply for a margin reduction.

III. Enterprises should constantly improve their ability to manage exchange-

rate risks

First, identify potential exchange-rate risks. Enterprises should adapt to the normal two-way fluctuations in the RMB exchange rate, identify and analyze the exchange-rate risk factors existing in daily operations, and fully evaluate the risk exposure of enterprises.

Second, formulate scientific and effective hedging strategies. Enterprises can formulate hedging strategies according to their own risk exposure as well as their production and operations conditions. In terms of the hedging ratio, a simple "fixed hedging" strategy can be set at the initial stage and "dynamic hedging" can be selected after a certain experience, that is, a certain hedging ratio range can be set. Product selection follows the principle of simple application and selects forwards, swaps, options, and other foreign-exchange derivatives that are suitable for the enterprises' risk tolerance and consistent with their hedging needs.

Third, choose flexible and applicable trading methods. Enterprises can either choose "static hedging," that is, the import and export businesses of enterprises adopt an order system, the order stipulates the amount of delivery at each time point and the quotation, after the order is cleared, the use of derivatives is locked for each period. "Rolling hedging" can also be used, that is, there is a long term and relatively fixed amount of enterprise foreign-exchange exposure, such as long-term foreign-currency debt, according to the liquidity of swap products of different maturities and the changing trends in the interest-rate difference among currencies, choice of the appropriate locking period, and maintenance of rolling locking. "Layered rolling" can also be selected, that is, the sales of an enterprise directly face overseas retail terminals or users and future sales data are difficult to predict, so different proportions can be allocated for different periods. The period with a higher predictive accuracy can increase the hedging proportion accordingly.

Fourth, establish and perfect a scientific assessment mechanism. Follow the scientific evaluation standard of combining the principle of "period" and "present," that is, add up the profits and losses of risk exposures and the profits and losses of derivative instruments, and evaluate the results after summing up. It is not possible to compare the forward lock-up exchange rate with the spot exchange rate on the maturity date to evaluate whether hedging is a "loss" or a "gain."

V. Outlook for the Balance of Payments

In the second half of 2021, the fundamentals for the recovery of China's economic stability and long-term improvement have not changed, the overall situation of comprehensively deepening reform and opening-up has not changed, and the pattern of enhancing the flexibility of the RMB exchange rate and maintaining basic stability has not changed. These will continue to serve as a solid foundation for China's basic balance of payments.

The current account will adapt to domestic economic development, and the surplus is expected to remain within a reasonable range. First, trade in goods will maintain a surplus at a certain scale. In terms of exports, the current economic recovery of the major developed economies will support the growth of China's foreign demand. At the same time, China's sustained and stable production and supply capacity will also maintain the growth of exports. However, the easing of the pandemic situation in the major developed countries will lead to a decline in China's exports of pandemic prevention materials and its "housing economy." Factoring in the high base effect in the second half of last year, overall export growth may stabilize. On the import side, China will maintain a certain growth of imports due to the gradual recovery of domestic demand and the high international commodity prices. Second, the services trade deficit will continue to operate at a low level, and it will take some time to return to its pre-epidemic level. With the acceleration of vaccinations in the developed economies, the demand for cross-border study abroad and travel that determine the status of the services trade is expected to restart, but this will be a gradual process and the process of the services trade returning to normal will be slower than that of goods trade. In the medium and long term, China's economic structure has been continuously optimized, the transformation and upgrading of the manufacturing industry has been steadily promoted, and the foundation for current account operations within a reasonable and balanced range will be more solid.

Box 5

Transformation and Upgrading of China's Manufacturing Industry Helps to Maintain a Reasonable Equilibrium in the Current Account

The development of the manufacturing industry is closely related to the evolution of trends in trade in goods and the current account. The production capacity and level of the manufacturing industry have an impact on both export competitiveness and import demand for goods. From the experiences of the major industrial countries, when a country's manufacturing industry starts to develop rapidly and the demand for capacity output is large, a rapid increase in the surplus of trade in goods and the current account will be promoted. When the manufacturing industry enters a stage of transformation and upgrading, medium and high-end industries will enter a cultivation period, and growth of the surplus of trade in goods will stabilize.

After the transformation and upgrading of the manufacturing industry, product competitiveness will gradually be enhanced and the import and export structure will be optimized, thus being conducive to the sustainable development of trade in goods and a reasonable equilibrium in the current account at a higher level.

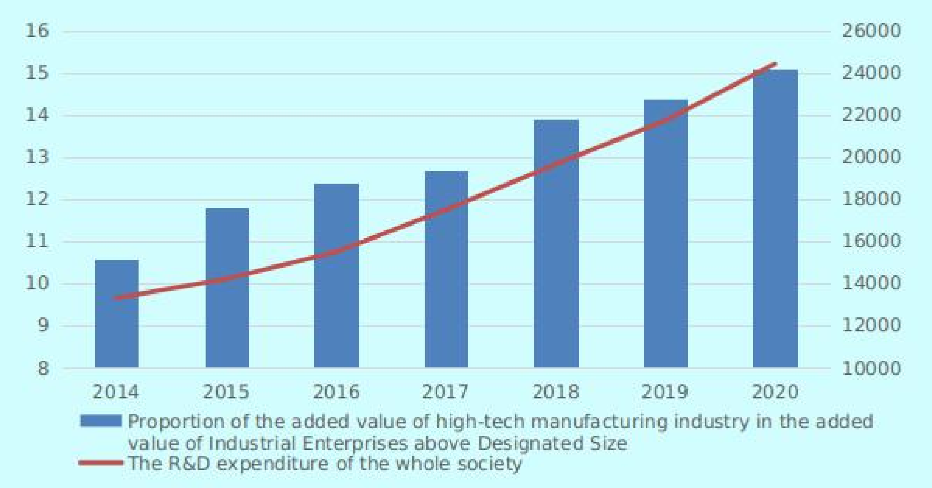
In recent years, China's current account has gradually tended to be balanced, and the ratio of the current account surplus to GDP has continued to be within 2 percent, reflecting the joint influence of adjustments in the domestic economic structure, the transformation and upgrading of manufacturing, and other factors. In the future, the transformation and upgrading of the domestic manufacturing industry will be an important factor determining trends in China's trade in goods and current account. The State Administration of Foreign Exchange recently selected more than 2,000 typical enterprises in 11 provinces and cities[11] to conduct a survey on the transformation and upgrading of China's manufacturing industry. The results show that, at present, manufacturing enterprises still focus on domestic production and operations and, at the same time, they steadily promote technological progress and product innovation. It is expected that in the future manufacturing enterprises will gradually realize transformation and upgrading.

The foundation of China's manufacturing industry has solidified and its competitiveness has continuously been improved, as it gradually moves forward to a stage of high-quality development. At present, China is showing further characteristics of industrial upgrading and structural optimization. In 2020, the added value of China's high-tech manufacturing industry accounted for 15.1 percent of the added value of Industrial Enterprises Above a Designated Size, 3.3 percentage points higher than that in 2015 at the end of the 12th Five-year Plan. Overall R&D expenditures increased by 72 percent compared with those in 2015. At the end of 2020, the number of valid patents was 2.2 times that at the end of 2015. The survey

[11] The survey involves 11 regions, including Guangdong, Jiangsu, Zhejiang, Fujian, Shandong, Beijing, Chongqing, Hebei, Jilin, Hunan, and Shaanxi, covering 27 industries, such as textiles and garments, petrochemicals, chemical manufacturing, pharmaceutical manufacturing, automobile manufacturing, electric appliance manufacturing, computer and communications manufacturing, and basically all manufacturing industries.

shows that branding and technological and intelligent production have become the main goals of the transformation. Enterprises are striving to promote product quality and brand influence, improve productivity, and reduce labor costs through technology research and development and by enhancing their ability for comprehensive management, etc. For example, the survey in Shaanxi shows that the focus of the transformation and upgrading of automobile manufacturing enterprises is the upgrading of product technology (80 percent of the enterprises selected this item), innovation in sales and marketing models (70 percent), cost reductions (70 percent), and product differentiation (50 percent). Investments by Jiangsu manufacturing enterprises in scientific research have been increasing and the number of patent applications has grown significantly compared with 2015. More than 70 percent of the surveyed enterprises in Shandong selected the strengthening of R&D and independent innovation to maintain their leading edge in the international and domestic markets.

Chart C5-1 China's Manufacturing Industry is Developing in toward a High-Quality Stage



Source: NBS.

Manufacturing enterprises still focus on domestic production, reflecting China's systematic advantages in the macro environment, basic resources, and supporting system. According to the survey, the proportion of enterprises that plan to or that have already implemented overseas business activities is not high, and the ratio of enterprises that have already planned overseas business in the developed coastal areas is higher than that in Central China. With respect to those enterprises that have already launched overseas arrangements, their overseas capacities account for only a small share of their total capacities, half of which are less than 10 percent. It is expected that this figure will not be higher than 30 percent even after the further expansion of their arrangements in the future. A large number of enterprises put equal emphasis on "capacity transfer" and "domestic investment." There are good prospects for domestic economic development: high overall labor quality and production efficiency, complete industrial categories, upstream and downstream supporting facilities, and a convenient infrastructure are important factors for most enterprises to adhere to domestic production.

At present, most of the overseas transfers of enterprises are limited to non-core links, such as processing and sales, while the production and operations of foreign capital in China remains stable. In order to reduce production costs and get close to the market, some enterprises invest in and set up factories overseas, mainly focusing on some medium and low-end manufacturing industries. According to the survey in Chongqing, in terms of enterprises that have invested abroad, 52 percent and 44 percent of enterprises have moved product assembly or terminal sales, respectively, to other countries. Industrial transfers by more than 70 percent of enterprises in Zhejiang and Guangdong focus on terminal sales, product assembly, and parts processing, which are relatively independent and simple production processes rather than whole processes in the industrial chain. At the same time, the scale of divestments in foreign-invested enterprises in the manufacturing industry is generally limited. The major divestments after 2015 were mainly due to the elimination of products in the technological iterative upgrading or the loss of competitiveness in the Chinese market. On the whole, the willingness of multinational manufacturing corporations to invest and start business in China is still stable.

At present, the transformation and upgrading of China's manufacturing industry continues to advance, the production and operations of enterprises are mainly in the domestic market, and the status of China's manufacturing industry is gradually improving in the global industrial chain and value chain. In the future, China will accelerate the construction of a new development pattern, actively promote the coordinated development of domestic and foreign demand, imports, and exports, the introduction of foreign investments and outward investments, and promote the upgrading of the industrial foundation and the modernization of the industrial chain in accordance with the arrangements of the 14th Five-year Plan, which will further enhance the international competitiveness of China's products, improve the quality, efficiency, and stable development of trade in goods, and help to consolidate the foundation for an equilibrium in China's current account.

Cross-border capital flows are expected to continue to perform in a two-way flow pattern with an overall equilibrium. First, the positive situation with respect to pandemic prevention and control and the robustness of economic fundamentals in China are still prominent globally, which helps to consolidate the confidence of the market and investors in RMB assets. For example, the international sovereign credit default swap price, which can reflect the market's view of the economy (5-year CDS, the lower the value, the lower the default risk) shows that at present China's value is 30-40 basis points, standing at a historically low level and indicating that the market is optimistic about China's economic growth prospects. **Second,** the two-way opening of China's financial markets will help to broaden channels for the balanced flow of cross-border capital. China has continued to promote the two-way opening of financial markets and investment liberalization and facilitation measures, which create a good policy environment for two-way and balanced cross-border capital flows. At the same time, China is accelerating the construction of a new development pattern, with the domestic cycle as the main body and the domestic and international dual cycles promoting one other, which will promote a high level of opening to the world and further improve the quality of cross-border two-way investments. **Third,** the foreign-exchange market adjustment mechanism has matured and RMB exchange-rate flexibility has been enhanced. Since 2020, the exchange rate of the RMB against the USD has been adjusted to the environmental changes in a timely manner, effectively releasing pressures for a rise or a depreciation and without forming sustained and strong unilateral expectations, which helps to play the role of an automatic stabilizer in regulating the balance of payments. On this basis, it is expected that all kinds of investments in China and abroad will develop stably, and overall cross-border capital flows will operate within a reasonable and equilibrium range.

The novel corona virus pneumonia pandemic will continue to evolve in the second half of 2021, and the world economy will continue to recover unevenly. There are still many uncertainties in international economic and financial operations. Guided by Xi's Thought on Socialism with Chinese Characteristics for a New Era and in accordance with the decisions and arrangements of the Party Central Committee and the State Council, the foreign-exchange management departments will base themselves on the new development stage, implement the new development concept, build a new development pattern, better coordinate development and security, and constantly reform and improve the foreign-exchange management mechanism and system suitable for the new system with a higher level and open economy, maintain the stable operation of the foreign-exchange market, and preserve a basic equilibrium in international balance of payments.

We will continue to promote reform and opening-up in the field of foreign exchange, actively serve the development of the real economy, and effectively consolidate the internal foundation for the international balance of payments. First, we will steadily and orderly promote the high-level opening of capital accounts, improve the management of funds for the domestic issuance of stocks and bonds by overseas institutions, and support private equity investment funds to carry out cross-border and industrial investments, expand the pilot programs of Qualified Domestic Limited Partners (QDLP) and Qualified Overseas Limited Partners (QFLP); promote the reform of foreign debt registration and management, facilitate cross-border financing for innovative enterprises, and carry out a pilot project for integrated domestic and foreign capital with pooled funds for the operations of multinational companies. Second, expand the scope of the pilot for trade payments and receipts facilitation and optimize financial services in new trade formats, such as new offshore international trade, cross-border e-commerce, and market procurement trade. Third, build an open and diversified foreign-exchange market with sound functions, support financial institutions to launch more foreign-exchange derivatives that meet market needs, further enrich foreign-exchange market products and participants at home and abroad, and constantly improve the infrastructure system in the foreign-exchange market. Fourth, support a regional opening-up and innovation and special regional construction, and study and carry out a high-level opening-up pilot on cross-border trade and investment. Fifth, we should deepen the reform of "delegating management and services," continue to streamline administrative licensing items, standardize administrative licensing items, and promote more “online operations foreign-exchange businesses, and improve the level of the "Internet plus government services." Sixth, on the basis of ensuring the safety, liquidity, preservation, and appreciation of foreign-exchange reserves, we will make sustainable investments a long-term goal, further strengthen the operation and management of foreign-exchange reserves, and promote construction of a professional investment capacity, a capacity for the management of scientific and technological operations, and a market-oriented institutional governance capacity.

We will continue to improve the market-oriented regulation mechanism and the management of cross-border capital flows and steadily respond to external challenges in the operation of the balance of payments. We will continue to maintain the flexibility of the RMB exchange rate and promote the role played by the exchange rate as an "automatic stabilizer" for macroeconomic regulation and the balance of payments. We will continuously improve the transparency of the foreign-exchange market, strengthen the interpretation of regulations and data, and strive to stabilize market expectations. We will urge banks to further improve the level of their foreign-exchange business, better serve enterprises to manage exchange-rate risks, and further guide enterprises to establish the concept of neutrality in exchange rate risks. We will improve the management of cross-border capital flows with strengthening macro prudence as the core, improve the micro supervision of the foreign-exchange market with changing the mode of supervision as the core, and explore the establishment of an authenticity audit management mechanism focusing on prior due diligence, in-process monitoring, post inspections, substantive audits, and due diligence exemption. We will severely crack down on illegal activities in the foreign-exchange field, such as underground banks and cross-border gambling, and we will maintain order in the foreign-exchange market and national economic and financial security.