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# Lessons and implications for the present of Chinese anti-crisis measures in 2015

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***Abstract:*** *So far this year, unlike other fragile emerging market economies, China has adhered to the fundamentals of developing its domestic economy and pursued an independent and accommodative monetary policy, diverging from the Fed's interest rate hike policy and gradually increasing its spillover impact on the domestic economy, which bears similarities to the context of the turnaround in the domestic economic situation in 2015. Against this background, it is of practical significance to study the causes of and responses to the turnaround in the economic situation in 2015, and to draw valuable lessons. The article will firstly analyse the reasons for the turnaround in the economic situation in 2015, secondly sort out the measures taken to cope with the turnaround in 2015 and their effects, and finally put forward suggestions to deal with the current economic situation.*

***Keywords:*** *anti-crisis, monetary policy, capital flows, exchange rate, China*

## 1. Introduction

Since this year, the spillover effects of the divergence of monetary policies between China and the United States have gradually increased, and the Chinese economy has faced numerous difficulties and dangers, especially since August 2022, when the violent domestic stock market shocks coexisted with the increased risk of RMB exchange rate depreciation, once again triggering strong market concerns. Against this backdrop, it is relevant to examine the causes of the stock and foreign exchange market shocks in 2015 as well as the anti-crisis measures formulated and implemented by the Chinese government and their effects.

The SSE broke through 2,100 on 24 July 2014, breaking years of hovering around 2,000, soaring all the way up and finally surging to 5,178 at the end of June 2015, before starting to plummet to around 2,950 on 25 August that year. Obviously, since October 2022, although the SSE has fallen below 3,000 again, the plunge has been significantly smaller than in 2015. In addition, on 11 August 2015, the RMB exchange rate underwent market-based reforms and the RMB fell by 2% against the US dollar on that day, with the overall RMB showing a sustained depreciation trend for over a year thereafter, depreciating to 6.97 at the end of 2016.

## 2. Reasons for stock and currency market shocks in 2015

### *2.1. Downward pressure on the domestic economy continued to increase.*

The PPI has continued to grow negatively since August 2014, with the decline becoming progressively larger and mismatched with the CPI in reverse, and the economy is at risk of deflation and decline, which is related to the surplus of industrial manufactured goods under the suppression of investment and real estate, as well as the decline in exports. In addition, the GDP assessment model of local governments, which is based purely on increasing production capacity to maintain a high GDP growth pattern, has further exacerbated overcapacity. On the other hand PMI growth continued to fall in the second half of 2014 and was even below 50% for a prolonged period from the second half of 2015 to the first quarter of 2016 (Figure 1).

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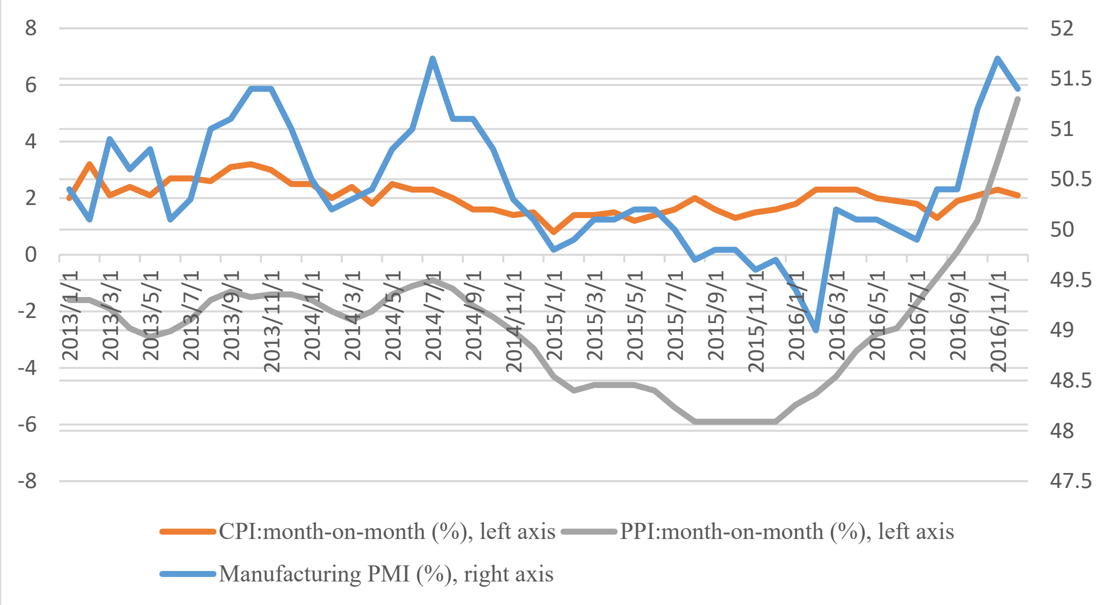


*Source: Chinese National Statistical Office*

*Figure 1: Key economic indicators for China.*

***2.2. The spillover effects of the Fed's tightening monetary policy on China's capital markets.***

In mid-2013 the Fed began to release signals of its exit from quantitative easing to guide market expectations of tightening monetary policy. In January 2014 the Fed formally launched its tapering of its asset purchase programme, at which point its spillover effect on China was relatively small compared to other emerging economies. However, as the Fed moved from gradually scaling down its asset purchases to ending them in October 2014, from the mooting phase of interest rate hikes to the formal 25 basis point hike at the end of 2015, and then to the announcement of the official launch of tapering at the Fed's September 2017 rate meeting, the US dollar index oscillated higher.

***2.3. The policy bull market has led to a stock market explosion that is divorced from economic fundamentals.***

In the second half of 2014, for the purpose of direct financing to revitalise the real sector, incremental over-the-counter funds were allowed to enter the stock market through trusts with leveraged allotments, however, the policy bull market did not wait for the real economy to improve. In the second half of 2015, with no improvement in various economic indicators and the real economic environment, hot money withdrew from the Chinese stock market at high levels, triggering market panic.

***2.4. The end of the nearly 10-year RMB appreciation cycle saw domestic entities increase their foreign exchange asset allocation and accelerate the repayment of USD debt.***

The RMB exchange rate has generally shown an appreciation trend since the exchange rate reform on 21 July 2005. Against the backdrop of continued downward pressure on China's domestic economy, the gradual withdrawal of quantitative easing by the Federal Reserve and preparations for interest rate hikes, and the appreciation of the US dollar, expectations of RMB exchange rate appreciation changed from March 2014 onwards, with the spot RMB/US dollar exchange rate in the Chinese interbank foreign exchange market turning more consistently weak relative to the RMB/US dollar mid-rate (Figure 2). From the second quarter of the same year, China's financial account of a non-reserve nature turned from a surplus to a deficit, and from the third quarter onwards, foreign exchange continued to be in short supply in the bank settlement market, with foreign reserve assets turning from an increase to a decrease.

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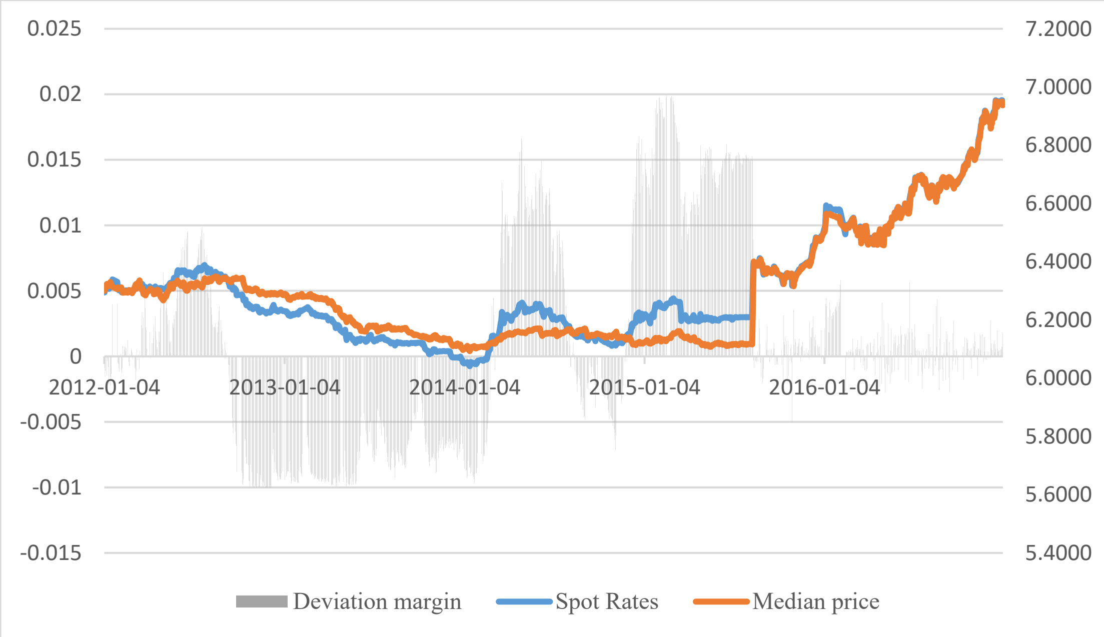
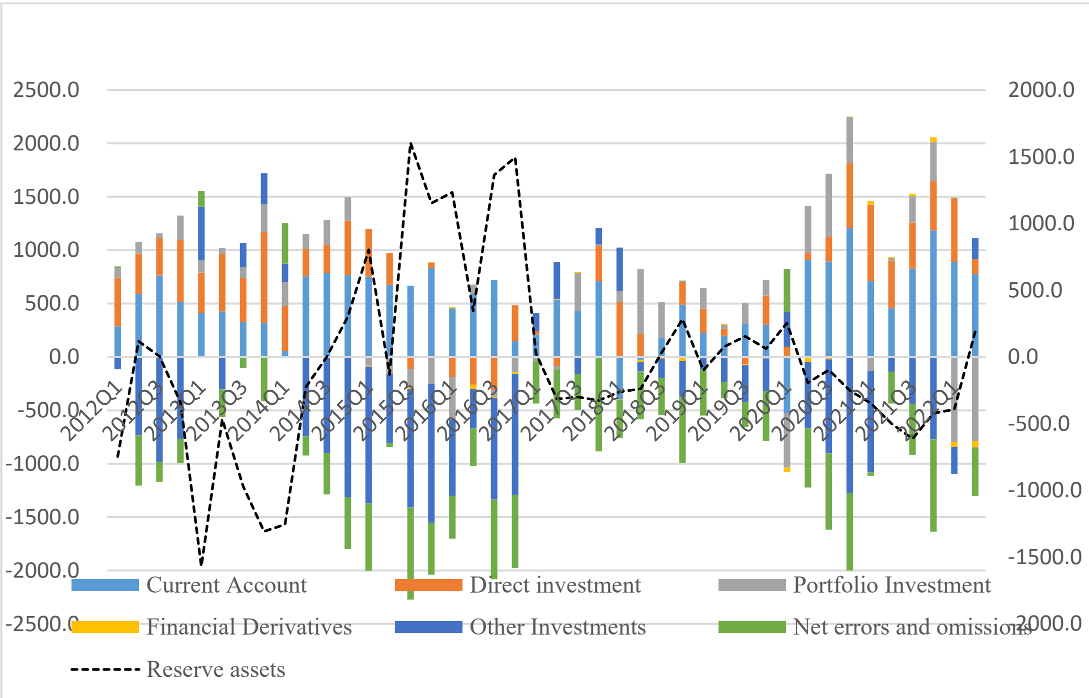



*Source: China Foreign Exchange Trade Centre; Wind*

*Figure 2: Renminbi exchange rate movements.*




*Source: Chinese National Statistical Office*

*Figure 3: China's Balance of Payments (US$ billion).*

From 2015 to 2016, the capital account (including net errors and omissions) continued to experience outflows totalling US$1.29 trillion and a total reduction in foreign exchange holdings of US$5.13 trillion. The persistent capital outflows faced by China at that time were partly due to domestic institutions and individuals increasing their foreign exchange assets or their allocation of assets abroad, i.e. "hiding foreign exchange with the people"; and partly due to domestic enterprises accelerating the repayment of US dollar debt borrowed earlier, the unwinding of carry trades, and the partial reduction of RMB assets held by foreign entities, i.e. "debt repayment" [1]. In the second half of 2014, the capital account deficit was larger than the current account surplus, and reserve assets under the balance of payments caliber decreased by USD 30.1 billion, and then by USD 342.939 and USD 443.665 billion in 2015 and 2016 respectively (Figure 3). Foreign currency foreign reserves of the

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People's Bank of China decreased by USD 150.195, 5126.56 and 3198.45 billion in the same period. foreign currency foreign debt decreased by USD 136 billion in 2015 compared to 2014, and increased by USD 173.5 billion in 2016 compared to 2015, indicating that the element of "hiding foreign exchange in the people" was greater than that of "debt repayment".

## 3. Anti-crisis measures

In 2015, the policy restrictions on the real estate sector were gradually relaxed and, led by the leading real estate economy, the supply-side structural reform of "removing production capacity, removing inventory, removing leverage, reducing costs, replenishing short boards and optimising inventory" was carried out in multiple industries and fields in 2016. The economic fundamentals basically returned to stability in 2017.

The monetary policy adopted by the People's Bank of China was mainly focused on "stabilizing growth", and liquidity supply was supplemented by successive cuts in interest rates. The benchmark lending and deposit rates were cut once in November 2014 and five times in 2015, resulting in a cumulative reduction of 1.5% in the benchmark one-year deposit and lending rate and 1.5% in the one-year deposit rate; the statutory reserve requirement ratio was cut by 3% four times in 2015 and once in 2016, with the reserve requirement ratio for large financial institutions reduced to 17% and for small and medium-sized institutions - 15%. The reduction could only release part of the previously frozen liquidity in the banking system and could not affect the total amount of the central bank's balance sheet. Therefore, the central bank adopted targeted and fine-tuned measures such as short-term liquidity adjustment tools (SLOs), medium-term lending facilities (MLFs), standing lending facilities (SLFs) and collateralised supplementary loans (PSLs) to partially offset the impact of the contraction in the central bank's balance sheet brought about by the decline in foreign exchange holdings.

In terms of exchange rate policy, on 11 August 2015, the People's Bank of China announced the improvement of the RMB exchange rate mid-price formation mechanism (hereinafter referred to as the "8-11" exchange rate reform), forming the RMB mid-price quotation model of "closing price + change in a basket of currencies". The model.

The necessity of the "8-11" exchange rate reform: 1) From early July 2014 to the end of July 2015, against the backdrop of a US$341.9 billion decline in the central bank's foreign exchange reserves, a slowdown in domestic economic growth and divergent monetary policies in China and the US, the US dollar index rose by 21.8% and the RMB appreciated by 0.57% against the US dollar. US dollar exchange rate mid-rate instead appreciated by 0.57%, and the RMB accumulated some depreciation pressure; 2) Figure 2 shows that the RMB spot exchange rate began to depreciate from December 2014, and the contradiction between it and the relatively stable mid-rate became increasingly obvious: in the first half of 2015, the average deviation of the RMB/US dollar mid-rate from the market rate reached 1.5%, up 0.5 percentage points.

On the day of the "8-11" exchange rate reform and in the two trading days afterwards, the spot RMB/USD exchange rate in the interbank market depreciated by 3.05% and the mid-price depreciated by 4.66%, and depreciation expectations were released in the short term. The sharp change in the level of the RMB exchange rate after the exchange rate reform stimulated depreciation expectations, which, together with various factors such as the economic downturn and the Fed's interest rate hike, caused a boom in private purchases of foreign exchange and retention of foreign exchange earnings as well as a sell-off of RMB assets and a concentrated acceleration in the repayment of foreign debt. By the end of 2016, the RMB/USD market exchange rate and mid-price had fallen by a further cumulative 8.72% and 8.43% respectively from 14 August after the exchange rate reform.

It can be argued that the objectives of an accommodative monetary policy during the domestic economic downturn were consistent with the exchange rate devaluation policy. However, China's accommodative monetary policy drifted away from the Fed's tightening monetary policy, with China cutting interest rates four times and lowering quotas twice from November 2014 to June 2015, and the convergence of domestic and external interest rate differentials, further accelerating capital outflows and RMB devaluation.

The PBOC intervened directly in the foreign exchange market to prevent excessive depreciation of the RMB - buying RMB and selling foreign exchange reserves to slow down the depreciation of the RMB, which somewhat hedged the effect of the accommodative monetary policy. From August 2015 to the end of 2016, the People's Bank of China sold an average of US$37.7 billion of foreign exchange

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reserves per month to meet market demand for foreign exchange, up from a monthly average of US$26.3 billion between July 2014 and July 2015.

In addition, the People's Bank of China and the State Administration of Foreign Exchange have strengthened capital flow management through macro-prudential management measures and foreign exchange controls. In particular, the following measures have been taken.

Measures to expand inflows and increase foreign exchange supply

(1) Adjustment of the integrated bank position management system for foreign exchange settlement and expansion of the lower limit of bank position for foreign exchange settlement; on 30 December 2014, the State Administration of Foreign Exchange (SAFE) resumed the management of positive and negative interval limits for bank positions, requiring the average position of each working day of the week to be kept within the approved limits; on 29 April 2016, the lower limit of integrated bank position for foreign exchange settlement and sales was further expanded. The positive and negative range management can enhance the initiative and flexibility of bank position management, reduce the cost of funds and effectively prevent the risk of foreign exchange depreciation.

(2) The State Administration of Foreign Exchange promulgated the Notice on Further Promoting Trade and Investment Facilitation and Improving Authenticity Audit (Huifa [2016] No. 7), whereby from the end of April 2016, the foreign exchange income from trade of enterprises in category A will not be entered into the export income pending verification account for the time being and can be directly entered into the current account or settled; unified foreign debt settlement management policy for Chinese and foreign-funded enterprises, whereby foreign debt borrowed by Chinese non-financial enterprises The funds can be settled and used in accordance with the foreign debt management regulations for foreign-invested enterprises.

(3) Expanding the scope of macro-prudential management of full-calibre cross-border financing. On 25 January 2016, the People's Bank of China expanded the pilot full-caliber macro-prudential management of cross-border financing with integrated domestic and foreign currencies for 27 banking financial institutions and enterprises registered in the four free trade zones in Shanghai, Guangdong, Tianjin and Fujian, linking the scale of borrowing by market players to their capital strength and debt servicing capacity; in May 2016, it was extended to financial institutions and enterprises nationwide (except government financing platforms and real estate enterprises), and the prudential management framework was extended to the whole country. In May 2016, the pilot scheme was extended to financial institutions and enterprises nationwide (except government financing platforms and real estate enterprises), and the prudential management framework was extended to the whole country, under which both domestic market players with Chinese and foreign capital backgrounds can borrow foreign debt.

Enhanced audit and regulation of foreign exchange expenditure type measures

(1) Strengthen the management of foreign exchange expenditure under current account. According to Huifa [2016] No. 7 clear trade in goods offshore resale documents to be reviewed on a case-by-case basis for authenticity, trade in goods foreign exchange management classification level of B enterprises to suspend the offshore resale foreign exchange income and expenditure business, regulate the trade in goods risk alert letter system.

(2) Strengthening macro-prudential management of banking business. The People's Bank of China adopted macro-prudential management measures on banks' forward foreign exchange sales and RMB purchase and sale business in late August and mid-September 2015 respectively, requiring financial institutions to deposit interest-free foreign exchange risk reserves at 20% of their forward foreign exchange sales (including options and swaps) contracted amounts [2].

(3) Adopting a management framework that combines macro-prudential management and foreign exchange controls on cross-border capital flows.From 25 January 2016, the People's Bank of China implemented a normal reserve requirement ratio for offshore RMB deposits placed by offshore participating banks with domestic banks such as domestic correspondent banks. Calculated at around $1.3 trillion in offshore RMB deposits at the time, this policy would result in over $200 billion of offshore RMB being locked up, which would reduce offshore RMB currency creation and cause a further tightening of offshore RMB liquidity [3]. But soaring and maintaining high offshore RMB interest rates will result in cross-border arbitrage will become even more frenzied, so the State Administration of Foreign Exchange (SAFE) is both scrutinizing cross-border funds under trade more strictly and narrowing the channels for cross-border outflows under capital, such as suspending new

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funds from RMB qualified domestic institutional investors (RQDII) to go offshore, suspending cross-border financing to overseas participating banks, suspending individual foreign banks' cross-border RMB purchase and sale business, and the implementation of integrated macro-prudential management of domestic and foreign currency for RMB offshore lending business of domestic enterprises [4], etc.

The foreign exchange management measures to ease the pressure of RMB depreciation during this period were to "expand inflows" and "control outflows". Figure 3 shows that the effect of the policy of expanding inflows was better than that of controlling outflows, with foreign exchange earnings under the current account being US$194.9 billion higher from the third quarter of 2014 to the end of 2016 than from 2012 to the second quarter of 2014; portfolio investment and direct investment turned from positive to negative, and capital outflows under other investment and net error were significantly more than in the previous period. exchange rate expectations.

## 4. Insights and recommendations

### *4.1. Optimising industrial structure, supporting technology innovation and improving the quality of economic development*

Faced with the high indebtedness of Chinese residents and enterprises, it is no longer optimal to use the real estate sector to boost the economy. Moreover, the high cost of housing squeezes consumption demand in other areas, which is not conducive to the formation of a general domestic cycle. With the US technology blockade on high-tech areas such as chips, more fiscal incentives and state administrative power should be used to support the development of innovation-driven industries. As the global epidemic continues to recur and China's economy is under pressure from contracting domestic foreign demand and supply shocks not seen for many years, it should support business development, especially the development of small and medium-sized enterprises, in terms of financing and tax cuts to fundamentally strengthen the foundation of economic development and prevent a recession.

### *4.2. Enriching the supply of financial products and improving the capital market system*

China has now formed a multi-layered equity financing market consisting of the main board of the SSE and the Keitai market, the small and medium-sized board and the GEM market in Shenzhen and the New Third Board market on the BSE. Suggestions to continue to promote the development of an open, transparent and healthy multi-layered stock market: 1) further strengthen the protection of investors and improve the class action mechanism for small and medium-sized investors against listed companies; 2) encourage the trading of stock index futures development. A sound shorting mechanism allows investors to profit from shorting stocks or indices and helps to avoid the formation of excessive bubbles in the stock market; 3) introduce a registration system instead of an approval system in all stock market boards; 4) further open the stock market to the outside world while strengthening the regulation of foreign investors, who may be an amplifier of volatility rather than a stabilizer of the Chinese stock market.

### *4.3. Focusing on the spillover effects of the Fed's tightening monetary policy on China*

The external factor for the stock and currency shocks in 2015 and 2022 is the Fed's interest rate hike. The Fed's interest rate hike is ultimately a monetary tightening policy that allows global capital to flow back to the U.S. Given the U.S. dollar's current unassailable status as an international currency, the Fed's rate hike has undoubtedly tightened liquidity in global financial markets, especially in emerging market countries, with specific manifestations of reduced capital inflows or large-scale capital outflows, indirectly affecting liquidity, asset prices, and financing costs in emerging market countries.

### *4.4. Using monetary policy tools and exchange rate control tools to complement macro-prudential foreign exchange management*

Since the 2015 exchange rate reform, the increased marketization of the RMB exchange rate, the increased flexibility of the exchange rate, the two-way fluctuation of the RMB exchange rate becoming the norm. The increased adaptability and tolerance of market players to the fluctuation of the RMB exchange rate, and China's capital flow management framework of macro-prudential foreign exchange management and foreign exchange control in extreme cases complementing each other, are the reasons

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for the current state of renewed divergence between the monetary policies of the US and China, which insist on ensuring domestic economic.

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