China’s SMEs Amid the Pandemic
Facing cash flow problems and awaiting government aid

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8 May 2020
Executive Summary

The difficulty of financing micro, small and medium sized enterprises (MSMEs) is an age-old problem confronting the Chinese economy, and the economic tsunami caused by COVID-19 outbreak has added to the importance and urgency of this problem. Due to the pandemic outbreak, Chinese MSMEs’ first-quarter revenue was less than 50% of the same period last year. More than 80% of MSMEs are facing cash flow problems. Despite the introduction of a series of financial support policies, small and medium-sized banks are facing the dual challenges of rising ratios of non-performing loans and narrowing net interest margins when they extend credit to small and micro enterprises. The current predicament provides an opportunity for using big data, artificial intelligence and other technologies to solve the financing problems facing MSMEs.

China's GDP growth rate will hit a 40-year low in 2020. Under the coronavirus pandemic, more than 100 nations around the world have taken quarantine, social distancing, and lockdown measures, which have a huge impact on the global economy. The International Monetary Fund (IMF) projects the global economy to shrink by 3% this year. Considering the pre-pandemic economic growth slowdown and the impact of COVID-19, we expect China's GDP to grow at a rate of -1.5% to 3% for 2020, a 40-year low.

The pandemic has dealt a heavy blow to MSMEs. The first-quarter revenue of MSMEs was less than 50% of the same period last year, a decrease of about RMB6.7 trillion. More than 80% of MSMEs will run out of cash by June. MSMEs in education, accommodation and catering, cultural, sports and entertainment, and manufacturing are the worst affected.

MSMEs are crucial to China. MSMEs contribute 60% of GDP and provide 80% of urban employment. The central government has taken a series of policies to help MSMEs overcome the current hardships. Among them, the financial support and tax and fee reduction policies have reached a total of more than RMB6.03 trillion.

Small and medium-sized banks face challenges when extending credit to small and micro enterprises. More than 70% of small and micro enterprises get their loans from small and medium-sized banks. Whether the central government’s financial support policies can be fully implemented depends on the lending capacity of small and medium-sized banks. At present, rising non-performing loan ratios and narrowing net interest margins have restricted small and medium-sized banks from extending credit to small and micro enterprises. **However, this provides an opportunity for using big data, artificial intelligence and other technologies to manage the credit risk of MSMEs.**
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Foreword

Jun Zhang, Director of Fudan-Ping An Research Institute for Macroeconomy

The Fudan-Ping An Research Institute for Macroeconomy is an interdisciplinary platform for macroeconomics and finance, jointly established by Fudan University and Ping An Technology. The Institute has created a new model for sharing resources between first-class universities and first-class enterprises and complementing each other, and is committed to introducing the most cutting-edge technologies, such as artificial intelligence and big data, into research and applications in the macroeconomic field to build a world-leading think tank and research platform.

The Institute strives to address global economic policy frameworks, propose national macroeconomic strategies in China, and serve the needs of the real economy. It particularly focuses on the most studied, most discussed and most urgent macroeconomic issues in China. It provides forward-looking support and advice on the national and regional macroeconomy and administration policies as well as corporate macro-decision making, strategic planning and other topics.

This SME Financing Report Series, written by the Fudan-Ping An Research Institute for Macroeconomy, focuses on the problems faced by micro, small and medium enterprises (MSMEs) amid the COVID-19 pandemic, to give mid- to long-term recommendations based on our predictions of macroeconomic trends.

The importance of MSMEs in China’s economic development is undisputed. They not only generate a large amount of tax revenue, but also guarantee the vast majority of employment, contributing greatly to economic development and social stability. In August 2018, the first meeting of the State Council’s Leading Group for the Promotion of Small and Medium-sized Enterprises clearly presented the famous “Five Six Seven Eight Nine” argument – that micro, small and medium enterprises provide more than 50% of tax revenue, more than 60% of national GDP, more than 70% of technological innovation, more than 80% of urban employment, and account for more than 90% of all companies – for the first time, illustrating that MSMEs have been China’s cornerstone since the reform and opening up of the Chinese economy. However, due to the impact of COVID-19, China’s MSMEs suffered a double whammy of crimped demand and suspension of all production activities. Their income dropped precipitously. Many MSMEs faced a severe survival crisis. Although the government introduced relief policies in order to mitigate the impact on the economy, implementation of these polices ran into difficulties as government revenue declined at various levels and financial institutions are by nature risk-averse. The results were far below expectations. The survival crisis faced by MSMEs is one of the biggest challenges that China's macro policies must confront and work hard to solve. It is also imperative for Chinese MSMEs to figure out how to deal with the crisis and how to transform themselves for the future while dealing with the crisis.
I hope that this report will help the government and society give more attention to the need of MSMEs and work together to help them get over the current crisis and achieve transformation.

This report was conducted under my supervision. Ziyiing Fan, Xingjian Yi, Xican Xi, Yan Zhang, Hong Song, Mingdong Xu, Shiyan Li, Xu Hu, Stanley Tian and others participated in the writing of the report. In addition, Zhao Chen, Yuan Zhang, Changyuan Luo, Yongqin Wang, Dongbo Tang and Likun Wang provided valuable assistance for the report. I thank them and Yan Zhang, Lu Zhan, Shiyan Li, Chi Zhang from Fudan and Xu Hu and Stanley Tian from Ping An Technology for their contributions in organizing the writing of this report. I would also like to thank Mr. Peter Ma, Chairman of Ping An Group, Ms. Jessica Tan, Co-CEO of Ping An Group, Mr. Timothy Chan, Chief Investment Officer of Ping An Group, and Ms. Sohee Park, Chief Product Officer of Ping An Group, for their support of the Research Institute’s work.

May 7, 2020
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China’s Economic Outlook: 2020

According to Johns Hopkins University, as of May 6, 2020, COVID-19 has spread to more than 180 nations, with a total of more than 3.65 million infections and more than 256,000 deaths. The pandemic has a huge impact on the global economy, and the International Monetary Fund (IMF) in April predicted a 3% contraction for the global economy this year. Affected by the pandemic, China's economic growth in the first quarter of 2020 decreased by 6.8% year-on-year.

We predict China's GDP growth rate will reach a 40-year low in 2020, with an annual growth rate ranging from -1.5% to 3%. The pandemic’s negative impact on China's external demand will be greater than the 2008 financial crisis. In the long run, with the pandemic and deglobalization, global trade may give way to intraregional trade, multilateral trade to bilateral trade, and international trade to domestic trade. China's current and future macroeconomic performance will be dragged down mainly by global supply chain shocks and shrinking external demand. Until the global pandemic has been effectively controlled, expanding domestic demand in China will remain a top priority. However, consumption of durable goods is greatly affected by income expectations, and the effect of stimulating consumption will be limited this year. At present, China's economic recovery needs to focus on investment. To ensure its “Six Stabilities” – employment, finance, foreign trade, foreign investment, investment and expectations, and implement the “Six Guarantees” covering employment, livelihood, business survival, food and energy security, supply chains and the operations of local governments, China must improve its domestic socio-economic policies, optimize its economic regulation and control, and allocate its resources more efficiently.

![Figure 1: Major Economic Indices Dropped Markedly in Q1 2020](image)
MSMEs Face a Cash Flow Shortage Under the Pandemic

Evidence shows that revenue of MSMEs in the first quarter of this year was less than 50% of the same period last year. We estimate that the revenue of MSMEs in the first quarter decreased by about RMB6.7 trillion (about 6.76% of the annual GDP of 2019).1

![Figure 2: MSMEs' Q1 Revenue as a Percentage of the Same Period Last Year](image)

- MSMEs in education, accommodation and catering, culture, sports and entertainment and manufacturing have been worst affected by the pandemic. Turnover of MSMEs in the education industry was only 10.2% in February and 11.8% in March of the same periods in 2019. For MSMEs in the accommodation and catering industries, the turnover was only 12.8% in February and 23.5% in March of the same periods last year. Turnover of MSMEs in the cultural, sports and entertainment industry in February and March this year was less than 30% of the same period last year. For manufacturing MSMEs, turnover in February and March was less than 40% of the same period last year.2

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1. The economic recovery of micro, small and medium enterprises under the pandemic-analysis based on the operation data of millions of small, medium-sized and micro-enterprises, Institute of Fintech Research, Tsinghua University, etc., April 2020.

1. The decline of revenue in the education, accommodation and catering, cultural, sports and entertainment industries is mainly due to demand-side factors, including the falling demand caused by pandemic prevention and social distancing measures.

2. The decline in manufacturing revenue is mainly due to supply-side factors, including the inability of employees to get to their jobs and the inability to coordinate work resumption throughout the domestic and global supply chains.

3. More importantly, due to high operating costs, labor intensity, concentrated industry chains, and low digitization of business operations, MSMEs not only resumed production later than large enterprises, but also responded to the pandemic more passively.

- The direct consequence of the substantial revenue decrease is that most MSMEs are facing cash flow problems. According to a survey conducted by OneConnect in February, more than 80% of MSMEs reported that they would run out of cash by June.

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1. The economic recovery of micro, small and medium enterprises under the pandemic-analysis based on the operation data of millions of micro, small and medium enterprises”, Institute of Fintech Research, Tsinghua University, etc., April 2020

4. The China Cooking Association judges that the rate of dinner cancellation for the Chinese New Year’s Eve in 2020 reached around 94%. In a survey conducted in February, 57.6% of catering businesses said that local governments required restaurants to suspend both dine-in and take-out services; 26.6% of catering businesses stopped providing dine-in service. (Source: The Impact of the Novel Coronavirus Pandemic on China’s Catering Industry from 32,000 Questionnaires, Meituan Research Institute, February 2020.)

5. Among the enterprises that have resumed business, only 4 have a work resumption rate higher than 90%; only 25% of enterprises has a resumption rate higher than 50%; 75% of enterprises’ resumption rate is less than 50%. Among them, 31.7% had resumed production but saw few of their workers return, a sign that manufacturing companies’ work resumption rate is far below their production resumption rate. (Source: Reducing Burdens, Stabilizing Jobs, Expanding Employment; Manufacturers are “in the process of” Resuming Their Work and Production, China Labor Association Task Force on Migrant Worker Development (Work Resumption), March 2020.)

6. Various surveys have found that about 20% of SMEs are affected by shocks in the supply chain caused by the pandemic. (Source: Assessment Report on Impact of COVID-19 Pandemic on Chinese Enterprises, United Nations Development Programme in China, April 2020.)

7. Special Report on Micro, Small and Medium Enterprises’ War on the Pandemic, OneConnect, February 2020. The survey covered 3734 enterprises in Guangdong Province, of which 90.17% are micro, small and medium enterprises.
As the economic impact of COVID-19 has lasted a long time, it has severely disrupted almost every aspect of an enterprise from labor to cash flow, production and sales. Due to their small size and insufficient collateral, MSMEs’ funds are extremely tight. The enduring pandemic has caused the offline business to stagnate and business activities to plummet. MSMEs with tight cash flows are more severely affected by the pandemic and are more prone to closure. This will lead to an increase in unemployment, and people’s mid- to long-term consumption levels will decline as income dries up. In order to prevent the pandemic crisis from spreading from the supply side to the demand side, it is crucial to help MSMEs overcome difficulties and ensure that the majority of them survive.
Column I: The Rise of Online Education During the Pandemic

The COVID-19 pandemic has dealt a heavy blow to the economy and employment market in the short term, but it also provides opportunities for the new economy, represented by the digital industry. During the pandemic, classes were suspended across China but learning never stopped, and 265 million students turned to online courses. Online education became part of the formal education system. Through research and data analysis, we found that firstly, the public's attitude towards online education is positive and upbeat. Secondly, the online education industry is extremely popular and industry leaders saw users numbers increase dramatically. Thirdly, the pandemic has put a lot of stress on traditional online education. Offline education operations that have not resumed to their normal level will need policy support.

I. The general public is upbeat about online education

The pandemic quickly generated huge market demand, and the general public began to use and accept online education. At the end of January 2020, the Ministry of Education in China issued a notice delaying the start of the new semester, asked all training institutions to cancel offline classes, and encouraged them to use online platforms to keep teaching. With help from all sides, 265 million students turned to online education. Several platforms saw their daily active users surge above 10,000 during the pandemic. According to a report released by the China Internet Network Information Center (CNNIC), as of March 2020, China's online education users reached 423 million, more than doubling on the number of 200 million recorded at the end of 2018, far exceeding expectations. Online education’s utilization rate among all netizens also surged from 24.3% at the end of 2018 to 46.8%, indicating nearly half of all netizens have used online education.
We conducted an online survey to more than 20,000 primary and secondary school students and their parents. After sample adjustment and restriction, we obtained data samples that which are representative across region and urban-rural areas. Our analysis suggests that students and parents have positive attitudes to online education. Most students and parents can use online education equipment very well and believe that online education has good growth potential. Most students are able to manage independent learning while studying online. When it comes to challenges, the most common hardware problems that impact the effectiveness of online courses are internet speed and poor connectivity or network coverage.

This survey shows that, from the perspective of the demand side, students and parents have an optimistic attitude towards online courses and that online education has the potential for further promotion and development. However, supporting policies are also crucial. For example, the 14th Five-Year Plan" (2021-2025) – China’s top-level policy blueprint – could consider reinforcing the top-level design and planning of educational informatization and take measures to strengthen the information infrastructure in less developed regions to increase internet coverage and speed.

8 Online Survey: [https://www.wjx.cn/h/kqf4xcq5eeki44gtamzjq.aspx](https://www.wjx.cn/h/kqf4xcq5eeki44gtamzjq.aspx)
9 School of Economics, Fudan University; Song Hong Online Education Internet Survey, Fudan-Ping An Research Institution for Macroeconomy.
Figures 5-8: Students and Parents Online Education Survey Results

- **Online Course General Assessment**
  - Very promising, promotable: 43%
  - Promising but unpromotable: 30%
  - Neutral: 29%
  - Promising but currently unpromotable: 7%
  - Very much against promotion: 4%

- **Assessment of Teacher’s Performance**
  - Teacher used online features well, taught well: 43%
  - Teacher wasn’t used to teaching online and taught not so well: 14%
  - Teacher was quite used to teaching online and taught reasonably well: 30%
  - Teacher can’t teach online and taught badly: 4%

- **Students’ Activeness**
  - Very: 1%
  - Quite: 20%
  - Average: 37%
  - Not very active: 25%
  - Often truant: 9%

- **Hardware Issues**
  - Lack computer or mobile phone: 30%
  - Slow speed and bad signal: 19%
  - Poor video or audio quality: 16%
  - Other issues: 11%
  - Inconvenient electronic device: 14%
  - Incomplete function and unstable: 9%
  - No issue encountered: 1%

*Source: School of Economics, Fudan University*
II. Online Education-Related Industries and Enterprises Face New Opportunities

During the pandemic, online education platforms and enterprises’ market size continued to grow, with promising prospects for future development. Analysis of data from platforms such as "Qimai Data" suggests that since February this year, the number of online education-related app downloads and relevant application rankings have increased rapidly. For example, the ranking of the number of app downloads of the online education leading company "Tencent Classroom" has jumped suddenly since February. In the download ranking of all applications, it quickly leapt from its previous ranking of top 1,000 to the top 10.

III. Offline Education Institutions Face Challenges

Traditional offline education institutions in this pandemic are confronted with several challenges. As of mid-April, most offline education institutions were still unable to resume normal offline operations. They face refund demands and complaints from students and parents for previously subscribed offline courses. Confronted with almost zero revenue and unsustainable cash flow, a large number of small and medium-sized offline organizations have declared bankruptcy, and some organizations have moved online. According to a survey conducted by the China Association of Non-Government Education, offline education institutions not only bear the burden to pay rent and employees’ salaries, they will also find it hard to move online quickly.10

10 China Association of Non-Government Education: Training and Education Industry under the Pandemic (https://www.sohu.com/a/376315276_120567338)
MSMEs Are Key to China’s Macroeconomy

- The contribution of MSMEs to China’s macroeconomy can be summarized by the famous “Five Six Seven Eight Nine” statement: MSMEs provide 50% of the national tax revenue, generate more than 60% of GDP, account for more than 70% of the patents, create 80% of urban employment and take in 90% of the new workforce.\(^\text{11}\) Among MSMEs, the contribution of small and micro enterprises is particularly outstanding: small and micro enterprises account for more than 97% of all the enterprises and create 54% of all the jobs.\(^\text{12}\) It should be pointed out that the important contribution of MSMEs, especially small and micro enterprises, have been made while these enterprises face serious financing constraints and higher financing costs. Given the large shares of small and micro enterprises in the total number of firms and total employment, they only accounted for a disproportionate 32% of total corporate loan balances at the end of 2016. According to the monitoring data of the People's Bank of China, the financing costs of small and micro enterprises are on average 40% higher than those of large enterprises.\(^\text{13}\)

- Among the education, accommodation and catering, and cultural, sports and entertainment industries that suffered heavily under the pandemic in the first quarter, small and micro enterprises account for more than 60% of overall employment.

In 2017, small and micro enterprises accounted for 58% of China's tertiary industry employment, and the tertiary industry accounted for 55% of the employment of all small and micro enterprises. As shown in Figure 10, the top five industries with the highest proportion of employment provided by small and micro enterprises are: cultural, sports and entertainment (80%), education (78%), accommodation and catering (67%), wholesale and retail (66%), and scientific research and technical services (64%).

Compared with countries at a similar development level (measured by purchasing power parity-based GDP per capita), China’s service industry plays a comparatively smaller role in the economy. Its shares of total employment and GDP both fall behind by about 10 percentage points.\(^\text{14}\) As China's per capita income and its economic structure improve, it is reasonable to expect that China's economic development model will shift from investment and external demand driven to consumption and domestic demand driven in the next few decades, and that the service industry will become a major engine of economic growth. Since the proportion of MSMEs in the service industry is higher than in primary and secondary industries, MSMEs will play a major role in China’s future efforts to optimize its economic structure and economic potential.\(^\text{15}\)

- **In the manufacturing sector that suffered deeply from the pandemic, 70% of the workforce was employed by small and medium-sized enterprises with 400 workers or fewer.**


\(^\text{15}\) In addition, judging from regions, we find that micro and small enterprises in eastern China employed 82.19 million people in 2017, this accounted for 58% of the total people employed by micro and small enterprises in China. Taking up a bigger share in the employment, micro and small enterprises in the west and middle part of China made up for 58% and 57% respectively. Therefore, developing and protecting micro and small enterprises are crucial to the economic growth of all areas.
The sizes of manufacturing enterprises in China and the U.S. are compared in Figure 11: in the manufacturing sector, the share of jobs created by Chinese MSMEs is higher than that of their American counterparts. This fact implies that when setting macroeconomic policy, the Chinese government needs to give first consideration to its influence on the MSMEs, as they play a crucial role in total employment, including a huge number of migrant workers. These firms are vulnerable to external shocks since their cash flows and external financing abilities are not as strong as those of larger enterprises. Once MSMEs succumb to the pressure, a great number of migrant workers will lose their jobs, threatening economic and social stability.

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Policy Responses to COVID-19

- China’s policy priority shifted when responding to COVID-19, but MSMEs have always been the top-of-mind concern.

Figure 12-13: Global Confirmed COVID-19 Cases

After running a semantic analysis of more than 100 speeches delivered by the Chinese leadership and government work arrangements by using natural language processing (NLP), we found the work of the Chinese government can be split into the following three stages through which keywords about MSMEs frequently appear (such as micro and small enterprises, MSMEs, and individual businesses).

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17 The semantic analysis covers 101 articles from the Xinhua News Agency and government documents between Jan 20, 2020 and Apr 27, 2020, according to the website of the National Development and Reform Commission (NDRC) (https://www.ndrc.gov.cn/sydt/ztzl/fkyqfgwzxdzt/dzybs/index.html). The website summarizes the speeches and work arrangements about Covid-19 prevention and control made by the Chinese leadership, including related reports about the meetings of the Standing Committee of the State Council, the leading group of China’s COVID-19 pandemic response and the Standing Committee of the Political Bureau of the CPC Central Committee. Besides keywords related to MSMEs, other keywords frequently mentioned by Chinese leaders include “pandemic prevention and control”, “work resumption”, “foreign trade”, “foreign capital” and “employment”.

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1. **Ensuring supplies are not interrupted when battling with the disease (before Feb. 19):** The government focused on saving patients and preventing the spread of the virus, and at the same time, guaranteeing medical supplies and daily necessities. Key words in the policies: “medical supplies”, “daily necessities”, “goods and materials for disease prevention and control”.

2. **Advancing work resumption by places and risk levels (from Feb. 19 to March 17):** During this period, the spread of the virus was basically under control in China, so the government shifted to reopen businesses and factories at the supply end by gradually relaxing restrictions in pandemic prevention and control measures to allow the enterprises to resume work and help people back to work in accordance with local risk levels. Key words in the policies: “by places and risk levels”, “back to work”, “coordinated work resumption”, “point to point”.

3. **Coping with global recession (after March 18):** There were outbreaks in other parts of the world. The global economy entered a recession. The government took measures to withstand the negative impact caused at the demand side. Key words in the policies: “world economy”, “macro-economic policy”, “expand the domestic demand”.

- The Chinese government has announced a series of policies to help MSMEs cope with the shock of COVID-19. Those policies fall into the following four categories (see Appendix for the details of the 14 policy areas). For financial support and tax and fee cut policies, more than RMB6.03 trillion has been earmarked.\(^\text{18}\)

\[^{18}\text{http://www.gov.cn/xinwen/2020-04/15/content_5502554.htm}\]
1. **Financial support**: By raising central bank relending and rediscount quota, and directionally lowering the deposit reserve requirement ratio, the PBOC (People's Bank of China) is encouraging banks to offer loans to MSMEs with low interest rate.

2. **Tax and fees cut**: The government is helping MSMEs cut operating costs by reducing their facility payment, and cutting their social security contribution periodically.

3. **Encouraging employment**: The government is encouraging employers not to lay off workers or at least lay fewer workers off, and to recruit fresh graduates by returning unemployment insurance contribution and granting once-and-for-all subsidies to firms.

4. **Helping boost productivity**: The government is helping MSMEs succeed in digital transformation and improve their productivity through special campaigns of digital enablement, cloud computing, big data and artificial intelligence.
Column II: China’s Fiscal Outlook 2020

Policies that are made to help MSMEs require full support from the central and local treasury departments as well as implementation with all-out effort of various levels of governments. To gauge how big a difference those policies can make at the central and local levels, we must understand the fiscal revenue and expenditure of provinces and the state during COVID-19. In the first quarter of 2020, both fiscal revenue and expenditure declined in China. The decline of fiscal revenue was mainly caused by the drop in tax revenue related to production activities because enterprises and factories were temporarily closed. Fiscal expenditure fell because COVID-19 put a halt on many public projects. With the pandemic now under effective control, fiscal revenue and expenditure will likely start to increase steadily. However, a big gap between the revenue and expenditure in the public budget will remain for the state and provinces, and it will vary noticeably across the country.

Firstly, we expect that in 2020 the gap between fiscal revenue and expenditure in China will be between RMB6.42 trillion and RMB8.38 trillion.
We expect revenue in the general public budget of 2020 will decrease by 4% to 10% YoY, while expenditure will increase YoY. The major reason for the decline of revenue is the significant revenue drop in Q1, which has a decisive impact on the annual revenue. The ratio of the fiscal revenue of the first half of a year in China normally is over 50%. The fiscal revenue ratio of Q1 last year alone was 28%. However the public fiscal revenue of Q1 2020 was only RMB4.60 trillion, down by 14% YoY. It is highly possible that fiscal policies will be implemented to expand expenditure and grow revenue. Revenue-wise, with the spread of COVID-19 under control in China and production activities back to normal, we predict optimistically that the tax revenue from enterprise production activities in the rest of the three quarters will slightly higher than that of the same periods of 2019. Expenditure-wise, in the second half of the year after the National People’s Congress and the Chinese Political Consultative Conference (NPC and CPPCC) take place, the work on new public projects will restart gradually. As a result, the expenditure on gigantic public projects, including those for 5G networks and data centers in the New Infrastructure Construction Initiative, will boost the GDP growth rate that has obviously dropped in the first half of the year. The GDP growth rate of the whole year is expected to be kept between -1.5% and 3%.

Secondly, a better economic structure is an important element that stabilizes local fiscal revenue.

During the period of the outbreak, fiscal revenue and expenditure in each of the provinces has been closely related to local economic structures. The better the economic structure is, the smaller the margin of decline of fiscal revenue. Specifically, there are three types of provinces that deserve extra attention.

1. **Provinces with a strong manufacturing industry enjoy steady revenue.** Generally speaking, production in provinces with strong manufacturing industries do not come to a complete halt during the pandemic. Therefore, local fiscal revenue can stay stable as these provinces are able to resume work and production quickly. Even though there is a drop in fiscal revenue, the falling is acceptable. The growth rates of fiscal revenue of Jiangsu, Guangdong, Shanghai, Shandong and Zhejiang – the top five provinces in terms of manufacturing scales – were all higher than the national average in the first two months of this year, showing a great resilience. However, the growth rate of Q1 fiscal revenue in Hubei province, which ranks sixth in manufacturing strength, plummeted from 0% in 2019 to -47.58% in 2020, because the pandemic outbreak has caused a deadly blow to local production activities. If enterprises and factories in Hubei cannot reopen as soon as possible, the balance of fiscal revenue and expenditure will deteriorate badly, hindering local economic development. Accordingly, all the provinces should give top priority to the prevention and control of COVID-19, without which the local manufacturing industry, the key to stabilize state fiscal revenue, will take a big hit.

2. **The decline of fiscal revenue in provinces depending on mining industry is above national average.** Q1 fiscal revenues of three provinces with largest mining enterprises – Shanxi, Inner Mongolia and Shaanxi – fell more than 18 %, far more than the national average. Since the outbreak of COVID-19, the market has been generally bearish on China’s economy in 2020. Slumping market demand has
severely inhibited upstream mining production, resulting in rapid plummeting in local tax revenues. Timely resumption of work and production in industrial enterprises nationwide is key to relieving the financial pressure. If the pandemic is effectively controlled soon and China’s macroeconomic environment improves, the downward pressure on fiscal revenue in Shanxi, Inner Mongolia and Shaanxi will be alleviated.

Innovative business models and optimized and diversified economic structures can effectively enhance local financial resilience. Among China’s top nine provinces in the tertiary sector, only Zhejiang still had fiscal revenue growth from January to February 2020. As offline businesses have been particularly impacted by the pandemic, growth in Zhejiang has been supported by its rapid development of online economy. Information transmission software and information technology services have become its main sources of corporate income tax revenue growth. This indicates that innovative business models and optimized economic structure can effectively improve fiscal risk resistance and allow for the expansion of fiscal policies. As Zhejiang began to actively respond to favorable central fiscal policies such as the "Value-added Tax Policy for the Reinstatement of Individual Businesses" in late February, its value-added tax revenue growth rate fell from -7.6% YoY in January and February to -14.3% YoY in Q1. In addition, large tax incentives reversed the growth trend of fiscal revenue in Zhejiang, which fell to 5.1% in Q1. If the pandemic cannot be controlled in a timely and effective way, then even in Zhejiang province, which has the best fiscal performance, offline business may be irreversibly damaged in the long run.

To conclude, national and provincial fiscal revenues and expenditures are facing severe pressure, thus leaving little space for the implementation of fiscal policies, due to the rapid decline in tax revenue before and during the pandemic, as well as the pressure from tax incentives for economic recovery. Fiscal revenue has declined at both national and provincial levels. A growing gap between fiscal revenue and expenditure will be inevitable
in 2020, thus space for fiscal policies such as tax reduction and fee reduction is relatively limited. In response, it is necessary for monetary policies to provide necessary liquidity for MSMEs. Fiscal policy needs to be more focused on improving quality and efficiency, by cutting unnecessary expenditures and promoting budget performance management. On the other hand, it is also imperative to alleviate grassroots fiscal difficulties through debt issuance, for which we suggest a lift of the deficit rate to 4%, the issuance of RMB2 trillion of special Treasury debt and an increase in the issuance limit of special bonds to RMB4 trillion this year.
The Implementation of the MSME Financing Relief Policy

- Commercial banks still have plenty of room to lend money to small and micro enterprises using central bank’s low-cost funds. As of March 30, RMB500 billion out of the central bank’s RMB800 trillion relending fund had been used, of which RMB336.2 billion was converted into loans for MSMEs19. In late April, the central bank has specified usage of another RMB1 trillion fund for a relending and rediscount program, for which commercial banks can apply for loans to MSMEs.

- More than 70% of loans for MSMEs come from small and medium banks20. The full utilization of the central bank’s bailout funds depends on the lending ability of small and medium commercial banks. At present, rising non-performing loan (NPL) ratios and narrowing net interest margins are two major constraints for small and medium banks to lend to MSMEs.

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19 Liu Guoqiang, deputy governor of PBOC, answered reporters’ questions at the press conference of the State Council’s Joint Defense and Joint Control on April 3 (http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/4002107/index.html). As of March 31, RMB228.9 billion of the RMB300 billion special relending fund has been used, and over half of it was lent to MSMEs; RMB276.8 billion out of the RMB500 billion relending and rediscounting amount has been used, of which, RMB355.2 billion is agriculture-related loans, RMB155.6 billion is inclusive loans for small and macro businesses, and RMB66.1 billion is discounting business. Besides agriculture-related loan, both inclusive loans for small and macro businesses and discounting business are MSME loans, totaled RMB221.7 billion. Therefore, as of March 31, the total amount used for MSME loans from the relending and rediscounting fund is: 228.9/2 + 221.7 = RMB336.2 billion.

20 Medium and small banks refer to joint-stock commercial banks, urban commercial banks and rural commercial banks, and rural credit cooperatives, except for the five major state-owned banks. By the end of 2018, 70.55% of small and macro corporate loans balance of commercial banks come from medium and small banks. (Data source: WIND)
1. In terms of the NPL rate, under the pressure of macroeconomic decline and the impact of the outbreak, enterprises, especially MSMEs, are facing increasing operational difficulties, proposing challenges in bank credit risk management. **According to the data of Q1 2020, the ratio of NPL in the banking sector is 2.04%, 0.06 percentage points higher than that at the beginning of the year.** Owing to the delaying effect of the NPL confirmation, the real challenge of the quality of banking assets may not come until the second quarter.

- The strict assessment criteria of the NPL rate is one factor hindering MSMEs' access to credit. Due to the tolerance requirement for NPLs, small and medium banks are afraid to lend money to MSMEs, particularly MSMEs in manufacturing, accommodation and catering industries severely affected by the pandemic. Staff responsible for lending also tend to reduce the granting of loans to MSMEs in avoidance of accountability. It is time to consider measures such as raising the tolerance requirement for NPLs periodically and allowing more flexibility in the credit personnel assessment method.

![Figure 18: Non-performing loan rate Q4 2019](image)

Source: WIND

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21 Source: press conference on operation situation of banking and insurance industries of the State Council Information Office in Q1 2020 ([http://www.gov.cn/xinwen/2020-04/22/content_5505054.htm](http://www.gov.cn/xinwen/2020-04/22/content_5505054.htm))
2. At the same time, a rise in NPLs will bring additional pressure on banks to increase reserves and replenish capital, as capital constraints will also restrain banks from making small and medium-sized loans. Therefore, authorities should continue to broaden the scope for small and medium-sized banks to replenish capital, simplify the process and reduce costs.

3. In terms of net interest margin, if small and medium-sized banks issue low-interest loans to small and micro enterprises, net interest margin will narrow. **Currently, the net interest margin of relending loans for MSMEs from the central bank is 2.05%**, below the average of commercial banks.

![Figure 19: Net Interest Margin in Different Banks in Q4 2019](image)

Source: WIND

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22 Data source: Liu Guoqiang, deputy governor of PBOC, answered reporters’ questions at the press conference of the State Council’s Joint Defense and Joint Control on April 3 (http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/4002107/index.html). State Council requests that the interest rate on loans to small and micro enterprises not exceed 4.55%, and the central bank cuts interest rate on small relending loans to 2.5%, as a result, net interest margin on inclusive loans to small and micro enterprises using the RMB500 billion relending fund of the central bank is 2.05%. At the same time, in the practice of the RMB500 billion relending scheme, a lot of local finance department provide subsidies. Therefore, commercial banks have an actual net interest margin higher than 2.05%.
• **Helping small and medium-sized banks to manage the loan credit risk of MSMEs is the key to solve the financing problem of MSMEs.** SME loan risk not only lies in pre-loan risk identification and adverse selection, but also in the post-loan fund's supervision and risk management. In order to prevent policy arbitrage of MSMEs from using accessed loan funds for real estate or capital markets, increasing their credit risk, we suggest that banks strengthen the constraint on the use of loan funds in contract clauses, and utilize technologies including big data and AI to effectively regulate the use of loan funds.

• **The Chinese government could strengthen the coordination between fiscal policy and monetary policy and improve the efficiency of financial resources utilization.** To improve the lending capacity of small and medium banks to MSMEs, and make good use of the RMB1 trillion relending and rediscounting policy, it is suggested that: (1) the Ministry of Finance provide appropriate guarantee to MSMEs for loans, making reference to the U.S. and other relief policies; (2) the Ministry of Finance helps local departments to issue suitable interest subsidy policies; (3) banks and local tax offices share information on businesses for greater efficiency. In addition, given tight budgets, local governments should grasp the benefits of digitalization, reducing unnecessary expenditure, improving budget management, and finally enhancing the efficacy of fiscal policies.
Column III: U.S. Fintech Companies Help Distribute PPP Loans

- By the end of March 2020, the U.S. government passed a relief program of USD350 billion for small and micro enterprises (Paycheck Protection Program in the CARES Act, or PPP), helping them pay employees and other necessary expenses. An extra USD310 billion was added on April 23.

- The first batch of funds were released on April 16, but many small and micro enterprises are not covered. Some big companies took advantage of regulatory loopholes to get the money, such as burger franchiser Shake Shack with USD$10 million, the Los Angeles Lakers basketball team, USD4.60 million, and the U.S. largest used car dealer AutoNation, USD77 million. Now, those big companies have said they will return the money.

- U.S. Treasury Secretary Steven Mnuchin agreed fintech companies could participate in the PPP. It is likely because:

  1. **Large customer networks**: Fintech companies have a large user network, so they can help the relief money to reach small and micro corporates that are ignored by large banks. For example, U.S. payment firm PayPal serves over 10 million small and micro businesses, and fintech company Intuit’s financial software QuickBooks has 6 million users.

  2. **Quick processing**: Fintech enterprises have daily operation data of small and micro enterprises, so they are able to quickly prepare the materials needed for applying the funds. As PPP loans are given on a first-come, first-served basis, acting fast is critical to access the aid. Fintech companies Square and Intuit provide users with HR management software, so they can provide materials for application for small and micro enterprises quickly.

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3. **Big data and AI-facilitated risk management**: Fintech enterprises have daily operation data of small and micro enterprises, so with the help of AI algorithms, they can identify small and micro businesses with low credit risk. For example, restaurant owner Billy Joe Wilson in the U.S. state of Texas obtained $150,000 loan via mobile app in 2018. Fintech company Square read the data returned from credit card reader, learned about the sale of Mr. Wilson's restaurant and found out that Mr. Wilson's business had low credit risk, so they granted the loan of $150,000 to Mr. Wilson via mobile app.29

- According the U.S. Federal Deposit Insurance Corporation, from 2015 to 2019, outstanding loans granted to small and micro businesses from U.S. large banks fell by one-fifth, while outstanding loans granted by PayPal increased ten-fold to about USD2.4 billion.30

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Conclusion

The economic downturn, together with the COVID-19 pandemic, place a number of MSMEs at the edge of survival. Since the outbreak of the pandemic, while monetary and financial conditions remain generally loose, decision-makers in China focused on the financing problems of small and medium-sized enterprises, and quickly launched a series of targeted measures. The financial system's abundant supply of low-cost funds for MSMEs is unprecedented. At the same time, there remains a question whether the trillions of central bank bailout funds can reach the MSMEs, which will ultimately determine the effectiveness of policies and the size of economic loss. Judging from the policy implementation in the last three months, small and medium-sized banks are not capable of providing micro business loans, which is restricting the transmission of monetary credit policy. We should accelerate the use of fintech in combination with recovery policies, and integrate monetary, financial regulation, fiscal and industrial policy resources to help MSMEs access these favorable policies during the pandemic. In particular, local governments are at the forefront of providing services MSMEs. They need to take into account local conditions, make use of the latest financial technologies, improve the connectivity between central government policies and MSMEs, and explore the formation of a sustainable financial service system for MSMEs.
## Appendix: Summary of Policies to Support MSMEs In Response to COVID-19

<table>
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<tr>
<th>Policy area</th>
<th>Segmented policy items</th>
<th>Release date</th>
<th>Responsible department</th>
<th>Main contents</th>
<th>Policy basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial support</td>
<td>Central bank loans</td>
<td>Feb. 7, 2020</td>
<td>Ministry of Finance, People's Bank of China, National Development and Reform Commission, Ministry of Industry and Information Technology, National Audit Office</td>
<td>The central bank will provide RMB300 billion special re-lending funds to guide Banks to extend loans to key enterprises so as to ensure the supply of important medical supplies and daily necessities during the pandemic. The lending rate shall not exceed the one-year LPR minus 100 bp in the previous month, and the loan term is one year. The central government will subsidize enterprises to pay 50% of the actual interest, ensuring that their actual financing costs do not exceed 1.6% and that the subsidy period does not exceed one year.</td>
<td>&quot;Emergency Notice of the Ministry of Finance, Development and Reform Commission, Ministry of Industry and Information Technology, People's Bank of China, Audit Office, Guan Qian, Winning Pandemic Prevention and Control, Strengthening Pandemic Prevention and Control, Key Guarantees for Enterprise Financial Support&quot; (Cai Jin (2020) No. 5), &quot;Guan Qian Notice on Issues Related to Issues of Special Re-loans to Support the Prevention and Control of Pneumonia Pandemic Infected by Novel Coronavirus (Yinfan (2020) No. 28), &quot;How to Apply for Central Government Discount Funds-Caijin (2020) Circular No. 5</td>
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<td></td>
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<td>Feb. 25, 2020</td>
<td>PBOC</td>
<td>Deploy RMB500bn capital for relending and rediscount, some of which are used to support the recovery of micro and small business. At the same time, the interest rate for re-lending to agriculture and small businesses was reduced by 0.25 percentage points to 2.5%.</td>
<td>February 25, 2020 Executive Meeting of the State Council</td>
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<td>Delayed repaying principle and interests</td>
<td></td>
<td>March 1, 2020</td>
<td>CBIRC, PBOC, Development and Reform Commission, Ministry of Industry and Information Technology, Ministry of Finance</td>
<td>Allow extended debt-service loans for MSMEs (including micro business owners and sole proprietorship) to be extended to June 30, 2020 at the maximum.</td>
<td>Notice of the China Banking Regulatory Commission, Development and Reform Commission of the People's Bank of China, Ministry of Industry and Information Technology, Ministry of Finance, Guan Qian, Temporary Extension of Principal and Interest Repayment for Loans to Small, Medium, and Micro Enterprises (supervised and monitored by bancassurance (2020) No. 6)</td>
</tr>
<tr>
<td>Financial Guarantee</td>
<td>March 27, 2020</td>
<td>Ministry of Finance</td>
<td>Play the role of government financing guarantee to increase credit for small and micro enterprises, the main contents are:</td>
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<td>- By 2020, the state financing guarantee fund will invest in 10 prefecture-level and city-level government financing guarantee institutions that have achieved remarkable results in supporting small farmers, and an additional RMB400 billion will be invested in the re-guarantee business.</td>
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<td>- The national financing guarantee fund shall waive the reinsurance premium for the guarantee business of a single cooperative institutions with a value of RMB1 million or less, and shall halve the reinsurance premium for the guarantee business of a single family with a value of more than RMB1 million for the whole year in 2020</td>
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<td>- We require local government financing guarantee and re-guarantee institutions at all levels to halve the charge of financing guarantee and re-premium for small and micro businesses by 2020, and strive to reduce the comprehensive financing guarantee rate for small and micro businesses to 1% below.</td>
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</table>

"Notice on Giving Full Play to the Role of Governmental Financing Guarantees for Increasing Credit for Small and Micro Enterprises and agriculture, rural areas and farmers" "Subjects" (Finance (2020) No. 19) Guiding Opinions on Supporting the Development of Small and Micro Enterprises and agriculture, rural areas and farmers" "General Office of the State Council (2019) No. 6"
<table>
<thead>
<tr>
<th>Date</th>
<th>Authority</th>
<th>Event Description</th>
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<tbody>
<tr>
<td>Jan. 1, 2020</td>
<td>PBOC</td>
<td>On January 1, 2020, the deposit reserve ratio of financial institutions was lowered by 0.5 percentage points, releasing RMB800 billion worth of long-term funds. “People’s Bank of China decided to reduce the deposit reserve ratio of financial institutions on January 6, 2020”</td>
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<td>March 13, 2020</td>
<td>PBOC</td>
<td>From March 16, 2020, targeted RRR cut of 0.5 to 1 percentage point for banks that meet financial inclusive appraisal standards. In addition, offering an additional 1 percentage point targeted RRR cut for qualified joint-stock commercial banks. “People’s Bank of China decided to lower the targeted RRR on March 16, 2020, and release RMB550 billion of long-term funds”</td>
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<tr>
<td>April 3, 2020</td>
<td>PBOC</td>
<td>On April 15th and May 15th, small and medium-sized banks were subject to targeted RRR cuts, with a reduction of 0.5 percentage points each time, releasing RMB400 billion worth of long-term funds. “PBOC decides to cut RRR for small- and medium-sized banks in April 2020, and cut the interest rate on excess deposit reserves of financial institutions at the central bank.”</td>
</tr>
<tr>
<td>Feb. 25, 2020</td>
<td>Policy bank</td>
<td>Policy bank will increase the special credit quota of RMB350 bn, and provide prime lending rate to private companies and medium-sized micro business.</td>
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<tr>
<td>March 31, 2020</td>
<td>CSRC, CBIRC, PBOC</td>
<td>Promote micro business to achieve RMB800bn for the whole year.</td>
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<td>Date</td>
<td>Authority</td>
<td>Measures</td>
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<td>April 7, 2020</td>
<td>Ministry of Finance</td>
<td>Extend some expired tax benefits policies to the end of 2012. Including: exempt VAT for financial institutions that issue RMB 1mn and below loans to small and micro enterprises, individual businesses, and rural households.</td>
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<tr>
<td>April 21, 2020</td>
<td>China Banking and Insurance Regulatory Commission</td>
<td>Increase the weight of inclusive finance to over 10 % in the indicator for the comprehensive performance appraisal of sub-branches of banking financial institutions. Reduce the regulatory requirements on small and medium-sized banks by 20 percentage points.</td>
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<tr>
<td>Feb. 23, 2020</td>
<td>National Development and Reform Commission</td>
<td>For natural gas users, the low price strategy will be implemented in advance until June 30, 2020.</td>
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<tr>
<td>Feb. 20, 2020</td>
<td>Ministry of Human Resources and Social Security, Ministry of Finance, State Administration of Taxation</td>
<td>Starting from February 2020, exempt the payment of the three social insurance units for micro business in stages, which shall not exceed 5 months.</td>
</tr>
<tr>
<td>Feb. 21, 2020</td>
<td>State Medical Insurance Bureau, Ministry of Finance, General Administration of Taxation</td>
<td>Starting from February 2020, employees’ medical insurance will be levied half on a periodic basis, and the period of reduction shall not exceed 5 months.</td>
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<tr>
<td>Feb. 29, 2020</td>
<td>State Administration of Taxation (SAT)</td>
<td>From March 1 to May 31, 2020, small-scale taxpayers in Hubei provinces are allowed to a 3% levy rate for the taxable sales income and are exempted from VAT; the 3% pre-rated VAT prepaid tax for projects, prepayment of VAT is suspended. Except for Hubei Province, small-scale taxpayers in other provinces, autonomous regions and municipalities are suitable to a 3% collection rate of taxable sales revenue, and VAT is collected less than 1%; 3% pre-collection rate is applied for advance payment items, reduce 1% of the prepaid VAT.</td>
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<tr>
<td>Support enterprises’ employment</td>
<td>One-time employment allowance during the Spring Festival</td>
<td>Feb. 5, 2020</td>
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<td>Promote the issuance of unemployment insurance</td>
<td>March 18, 2020</td>
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<td>Allowance for recruiting new graduates</td>
<td>March 19, 2020</td>
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<td></td>
<td>Boost productivity</td>
<td>March 19, 2020</td>
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<td></td>
<td>National Development and Reform Commission, Central Internet Information Office</td>
<td>April 7, 2020</td>
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</table>
| Ministry of Industry and Information Technology, Ministry of Finance | Feb. 19, 2020 | Jointly held by the Ministry of Industry and Information Technology and the Ministry of Finance  
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