

The adjustment of China's monetary policy stance in the face of global volatility

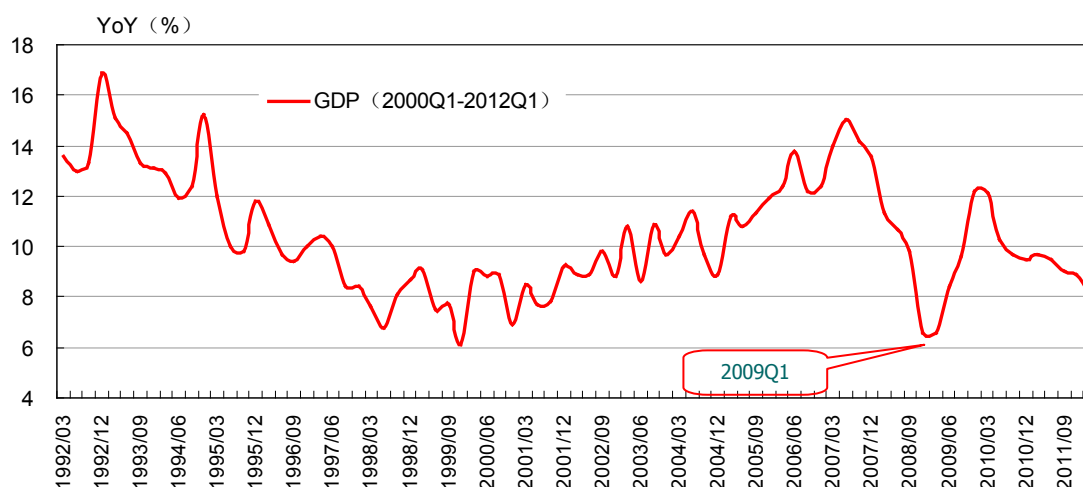
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Since 2007, the US subprime crisis, the global financial crisis and the European sovereign debt crisis have stoked volatility in global markets with varying degrees of impact on the world's economies. To ensure the sustainable and steady development of the nation's economy and maintain a stable price level, the People's Bank of China (PBC) has adjusted its monetary policy stance three times to good effect.

The first adjustment: responding to the crisis

Due to the global financial crisis, China's GDP growth rate fell to 6.1% in the first quarter of 2009. Meanwhile, the consumer price index (CPI) dropped continuously, sagging to -1.8% in July 2009.

Chart 1
China GDP growth rate



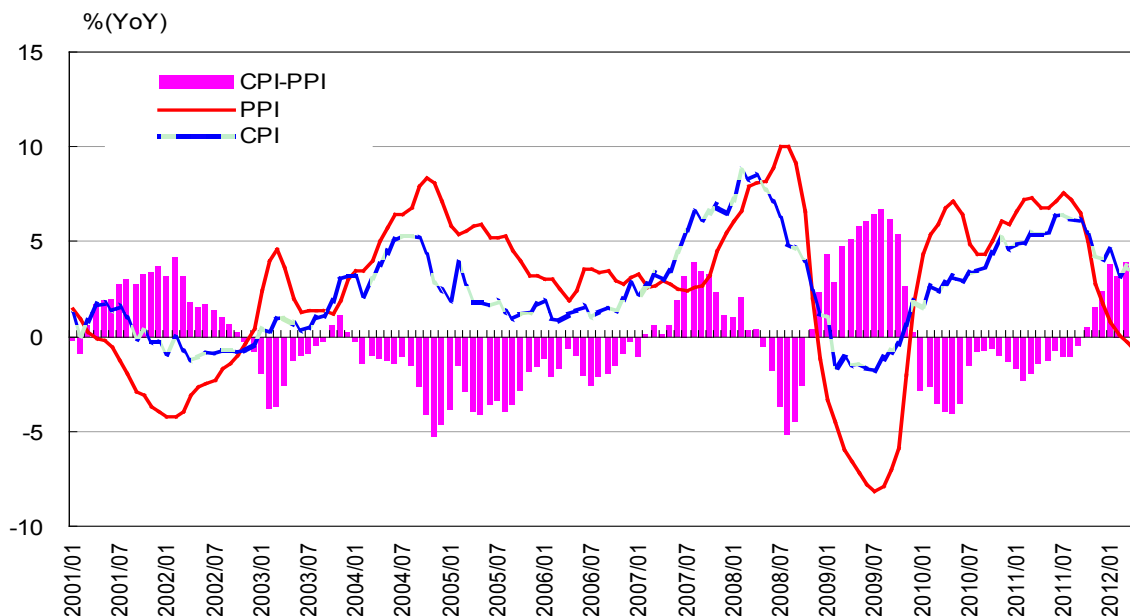
Source: PBC.

In response, the PBC adopted a moderately loose monetary policy stance and launched a series of measures to ensure economic growth and financial market stability. In the second half of 2008, the PBC strengthened its support for economic development, lowering the benchmark deposit and loan rates on five occasions and reducing the reserve requirement

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ratio (RRR) four times. In 2009, China reported GDP growth of 8.7% and was the first country to recover from the crisis.

Chart 2
China's CPI and PPI movements



Source: PBC.

Table 1
Adjustments of RMB benchmark one-year deposit and loan interest rates
(Q3 2008–Q4 2008)

	Deposit rate (After adjustment)	Adjustment	Loan rate (After adjustment)	Adjustment
2008-12-23	2.25	0.27	5.31	0.27
2008-11-27	2.52	1.08	5.58	1.08
2008-10-30	3.60	0.27	6.66	0.27
2008-10-9	3.87	0.27	6.93	0.27
2008-9-16	4.14		7.20	0.27

Source: PBC.

Table 2
RRR adjustments (Q3 2008–Q4 2008)

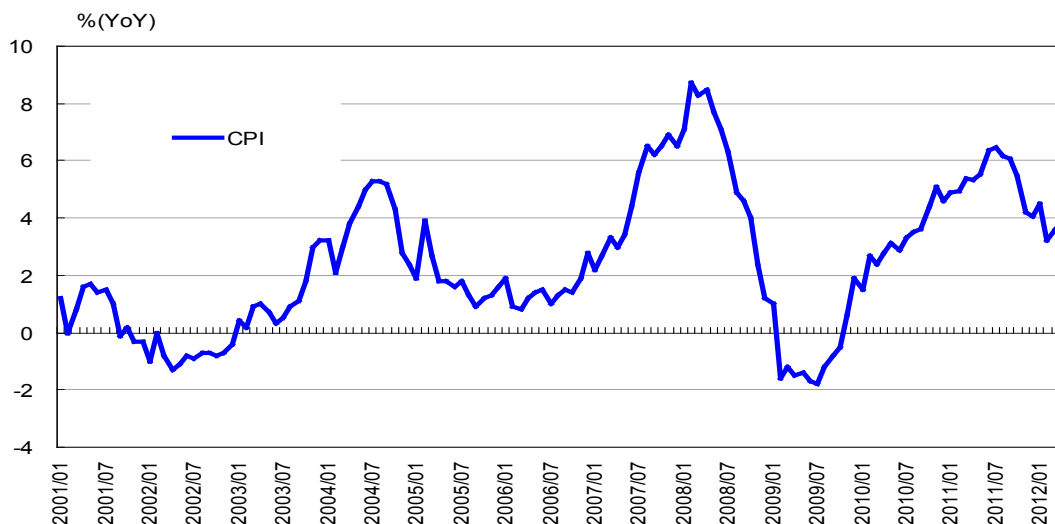
	RRR for large depository financial institutions (After adjustment)	Adjustment	RRR for other financial institutions (After adjustment)	Adjustment
2008-12-25	15.5	0.5	13.5	0.5
2008-12-5	16.0	1.0	14.0	2.0
2008-10-15	17.0	0.5	16.0	0.5
2008-9-25	17.5		16.5	1.0

Source: PBC.

The second adjustment: to combat inflation

As the world economy recovered, inflation in different countries began to rise from the second half of 2010. Due to soaring global commodity prices and a continuous rise in domestic labour costs and resource prices, China's inflation pressure increased in the second half of 2011. In July 2011, China's CPI growth reached 6.5%.

Chart 3
China's CPI movements



Source: PBC.

In the face of upward inflationary pressure, the PBC took immediate action: it shifted its monetary policy stance from *moderately loose* to *prudent* at the end of 2010 and changed its

monetary policy goal from fighting against the crisis to combating inflation. From 2010 to the third quarter of 2011, the PBC lifted its benchmark deposit and loan rates on five occasions and increased the reserve requirement ratio 12 times to 21.5%. By the end of December 2011, the rising trend of China's price level had been contained with CPI inflation dropping to 4.1%. Meanwhile, China's economy continued to grow rapidly and registered GDP growth of 9.2% in 2011.

Table 3

Adjustments of RMB benchmark one-year deposit and loan interest rates (2010–11)

	Deposit rate (After adjustment)	Adjustment	Loan rate (After adjustment)	Adjustment
2011-7-7	3.50	0.25	6.56	0.25
2011-4-6	3.25	0.25	6.31	0.25
2011-2-9	3.00	0.25	6.06	0.25
2010-12-26	2.75	0.25	5.81	0.25
2010-10-20	2.50	0.25	5.56	0.25

Source: PBC.

Table 4

RRR adjustments (2010–11)

	RRR for large depository financial institutions (After adjustment)	Adjustment	RRR for other financial institutions (After adjustment)	Adjustment
2011-6-20	21.5	0.5	19.5	0.5
2011-5-18	21.0	0.5	19.0	0.5
2011-4-21	20.5	0.5	18.5	0.5
2011-3-25	20.0	0.5	18.0	0.5
2011-2-24	19.5	0.5	17.5	0.5
2011-1-20	19.0	0.5	17.0	0.5
2010-12-20	18.5	0.5	16.5	0.5
2010-11-29	18.0	0.5	16.0	0.5
2010-11-16	17.5	0.5	15.5	0.5
2010-5-10	17.0	0.5	15.0	0.5
2010-2-25	16.5	0.5	14.5	0.5
2010-1-18	16.0	0.5	14.0	0.5

Source: PBC.

The third adjustment: to stabilise economic growth

As the European sovereign debt crisis continues to worsen, China's economy has also changed. Economic growth has slowed and the inflation rate has dropped. In particular, the downside risks to economic growth have increased.

Since early 2012, inflation has fallen rapidly in China. The CPI reading posted 3.4% and 3% in April and May respectively.

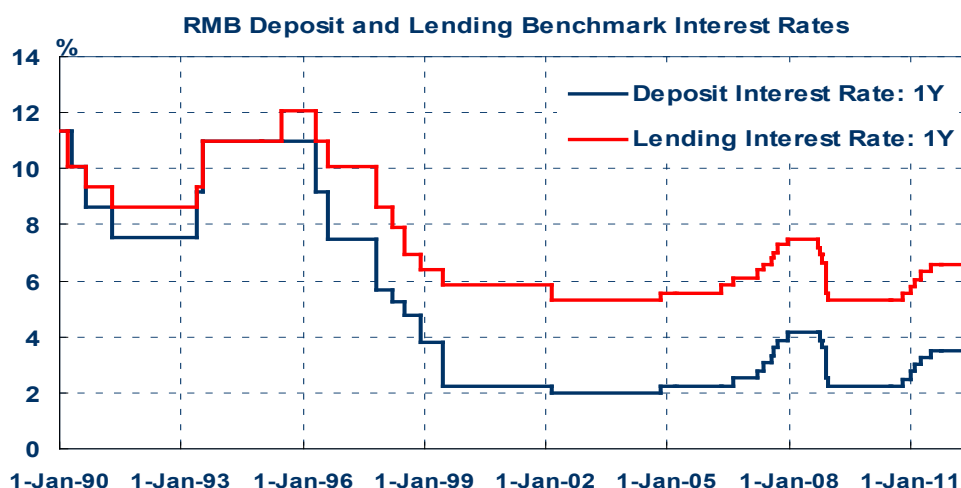
Faced with these new challenges, the Chinese government decided to stick to the principle of seeking progress amidst stability, appropriately balancing the relationship between maintaining steady and rapid economic development, restructuring the economy and managing inflation expectations. The priority was now to stabilise economic growth. Accordingly, the PBC has gradually changed its monetary policy stance, lowering its reserve requirement ratio on three occasions in December 2011, February and May 2012. After these adjustments, the reserve requirement ratio had come down 1.5 percentage points to 20%. Meanwhile, the PBC reduced its benchmark deposit and loan rates in June 2012. In addition, the PBC has also used a mix of monetary policy instruments to appropriately increase market liquidity. These monetary policy measures have been effective: in the first quarter of 2011, China's GDP grew by 8.1% year on year while, in May 2012, China's CPI inflation dropped to 3%.

Table 5

Adjustments of RRR and RMB benchmark one-year deposit and loan interest rates (Q4 2011–Q2 2012)

	RRR for large depository financial institutions (After adjustment)	Adjustment	RRR for other financial institutions (After adjustment)	Adjustment
2012-5-18	20.0	0.5	18.0	0.5
2012-2-24	20.5	0.5	18.5	0.5
2011-12-5	21.0	0.5	19.0	0.5
	Deposit rate (After adjustment)	Adjustment	Loan rate (After adjustment)	Adjustment
2012-6-8	3.25	0.25	6.31	0.25

Source: PBC.



Monetary policy stance for the next period

In future, the PBC will further improve its macro adjustment mechanism and make China's monetary policy more forward-looking, more anticipatory, better targeted and more flexible. Above all, the PBC will appropriately strike a balance between maintaining rapid economic growth, restructuring the economy and managing inflation expectations, so as to achieve sound and rapid economic growth with stable price inflation. Meanwhile, the PBC will improve credit allocation, increase support to economic restructuring, and guide financial institutions and financial market in better serving the real economy. In addition, the PBC will steadily push forward reforms to liberalise interest rates, allowing markets to play a larger role in the formation and movement of RMB interest rates. Finally, the PBC will further promote reforms of the exchange rate regime in a gradual and coordinated manner, with a view to enhancing exchange rate flexibility, and to keeping the RMB exchange rate basically stable at an appropriate and balanced level.