Opening remarks

Zhou Xiaochuan[1]

Ladies and gentlemen, good morning. It's our great pleasure to co-host this research conference with the BIS here in Beijing to discuss the very important issue of globalisation and inflation in Asia and the Pacific. On behalf of the People's Bank of China, I would like to extend a warm welcome to all participants from the BIS, the IMF, the central banks of the Asia-Pacific region and academics.

Globalisation and inflation is a very broad topic. In my welcoming remarks, I would like to reflect on one small part of it, related to globalisation and fighting the crisis. My theme is "monetary policy; learning from each other". And I would focus on the unconventional monetary policy measures, in particular the forward guidance, a topic frequently visited in recent discussions of the central bank community.

Because of globalisation, monetary policy in one country has an impact on others. We face considerable challenges in areas such as inflation targeting, the use of unconventional measures and the formulation of macroprudential countercyclical policies. We are also working to expand our toolkits, and one new device is the use of forward guidance by some advanced economies. In this respect, one question is whether Asia-Pacific economies too should consider the use of forward guidance.

In answering this question, we need to look at the issue carefully and understand the implication of these measures: for China, and for the People's Bank of China more specifically, and perhaps also for our colleagues in other Asia-Pacific economies. In my opinion, there are a lot of challenges and plenty of room for debate.

First of all, do central banks have more information than the market? If we assume that central banks have superior information that is unavailable to market participants, then they really do have an advantage when guiding market participants. But in most contemporary economies, it is far from clear whether central banks have an obvious information advantage. I think that, at least in some economies, financial markets have as good information as central banks can get.

Second, do central bankers have a better analytical framework, or mathematical models, than the market does, ones which can provide better analysis and prediction of future trends? I think this is also questionable. Central banks certainly try to hire the best people, the best economists and the best econometricians, to use the best mathematical models and to produce the best forecasts. However, everyone else in the marketplace is trying to do exactly the same thing. So there is no obvious way that central banks can have a better analytical framework than the marketplace. Especially in emerging markets and developing economies, central banks sometimes find themselves less able to attract the best people for the job due to certain institutional constrains. So, on the analytical side, central banks do not necessarily have any advantage over the market participants.

Third, in forward guidance, we tend to use a single variable in communicating with the public about the formulation of monetary policy. An example is to say that

[1] Governor, People's Bank of China.

"once the unemployment rate is lower than 6.5%, we can then adjust our policy accordingly". By saying this, we seem to indicate that one variable is central to a change in monetary policy. But this is an oversimplification of economic phenomena. Admittedly, for many years when inflation targeting was the popular framework, inflation was the single variable that central banks tended to focus on. But economic systems are complicated, and I think that's partly why the United States has emphasised that they have more than one target: not just inflation but also unemployment.

However, even two variables may not be enough. We need to look at many other indicators. As monetary policy is itself a function of many variables, to simplify and focus on one variable understates the challenges and uncertainties we face – even if such a simplification might be useful for communication purposes. Moreover, even the assumption that other indicators are stable has not proved workable recently, for there are uncertainties that complicate the reality and some variables that may change unexpectedly. So it's questionable whether this simplification is a good thing.

A fourth issue is that the monetary function is a continuous function, not a discrete one. But in recent practices of forward guidance, for the convenience of communication, it is simplified into a single threshold for a single variable to change monetary policy. This is also an oversimplification.

A thing to mention is that, with these challenges, we need to be very cautious: in what conditions, under what assumptions, will forward guidance work well? For example, when we reach the zero lower bound during a crisis, there is no room for further use of conventional monetary policy. In such circumstances, central banks will try to find alternative tools and come up with something else, such as forward guidance, the aim of which is to use a commitment about future monetary policy changes to guide market expectations. But this strategy is very specific to the crisis period, when conventional monetary policy tools no longer work and central banks have to find alternative solutions. That said, the unconventional measures, although they have produced some favourable outcomes, are not for every country in every situation.

The fifth question is related to communication. Central banks have been placing increasing emphasis on communication with both the general public and politicians. But it is challenging for central banks to do a good job. Some journalists have even remarked that central banks have become too talkative. Communication can be controversial, especially when we use too many conditional terms, such as when we say "if this happens, then the monetary authority is going to do that". Such communications may contain little valuable information for market participants.

So, we are in a very interesting and challenging period as a result of the crisis. We may have to do many creative and unconventional things. Meanwhile, we need to study these issues further. Looking at the Asia-Pacific region, with the exception of Japan, which is in its own very unique situation, most countries are not at the zero lower bound. We are not in a position where conventional monetary policy tools no longer work, so we probably do not need to follow the examples elsewhere or immediately adopt some of the new methodologies being employed. Many countries are still facing traditional challenges related to inflation and capital flows, which are closely connected with globalisation.

I hope this will be helpful to your discussions at this conference, which I'm sure will be a very successful one. Thank you very much.