

Is the Chinese growth miracle built to last? by Eswar Prasad

Ila Patnaik

NIPFP, December 4, 2007

The Chinese monetary policy regime



中国人民银行
THE PEOPLE'S BANK OF CHINA



中文版

Nov.20

1 0 0 7 2

About PBC

Management Team

Former Governors

News

Speeches

Monetary Policy

Survey & Stat.

Rules&Regulations

Financial Stability

Links

[Home](#)»[Monetary Policy](#)»[Objective of the Monetary Policy](#)

Objective of the Monetary Policy

The objective of the monetary policy is to maintain the stability of the value of the currency and thereby promote economic growth.

[\[Back\]](#)

Chinese currency regime

- Build up of reserves.
- Sterilisation.
- Loss of an interest rate instrument.
- Financial repression of banks. Impedes banking reform.
- Cheap capital has encouraged capital intensive investment that cannot absorb adequate labour.
- Sharp rise in asset prices.

Sterilisation in China

- Large savings by households and firms in bank deposits.
- Difficulties of giving bank credit to private companies.
- Capital adequacy norms support investment in government bonds.
- Banks hold excess reserves with PBC.

Advocates

- Flexible exchange rates.
- Inflation targeting but not as an explicit objective of PBC.
- Slow movement on capital account liberalisation.

Comparing with India

| Period | Currency Purchase (Rs. crore) | Sterilisation (Rs. crore) | Ratio (Percent) |
|-----------------|----------------------------------|------------------------------|--------------------|
| 2000-01 | 11,501 | 19,324 | 168 |
| 2001-02 | 33,949 | 30,334 | 89 |
| 2002-03 | 75,617 | 53,401 | 71 |
| 2003-04 | 139,586 | 41,598 | 30 |
| 2004-05 | 91,204 | 64,584 | 71 |
| 2005-06 | 35,065 | -35,149 | -100 |
| 2006-07 | 119,180 | 33,912 | 28 |
| Jun-06 - Jul-07 | 157,267 | 49,015 | 31 |

Currency volatility in India and China

| Year | Annualised currency volatility | |
|------|--------------------------------|-------|
| | India | China |
| 2002 | 1.079 | 0.137 |
| 2003 | 2.147 | 0.055 |
| 2004 | 5.257 | 0.016 |
| 2005 | 3.343 | 2.042 |
| 2006 | 3.518 | 0.749 |
| 2007 | 5.369 | 1.189 |

Pace of the Indian reserves accumulation varies

| Period | Reserves growth (Percent per month) |
|----------------------|--|
| Mar 1997 to Aug 1998 | 0.203 |
| Sep 1998 to Jun 2000 | 1.355 |
| Jul 2000 to Feb 2002 | 1.947 |
| Mar 2002 to Feb 2004 | 3.146 |
| Mar 2004 to Nov 2005 | 1.325 |
| Dec 2006 to Jul 2007 | 2.453 |

Steady increase in pace of Chinese reserves accumulation

| Period | Reserves growth (Percent per month) |
|----------------------|--|
| Mar 1997 to May 2001 | 0.59 |
| Jun 2001 to Oct 2002 | 1.37 |
| Nov 2002 to Oct 2004 | 2.51 |
| Nov 2004 to Dec 2006 | 2.67 |

Reserves as a percentage of GDP

| Country | 1997 | April 2007 |
|---------|------|------------|
| China | 14.7 | 45.0 |
| India | 5.9 | 21.3 |

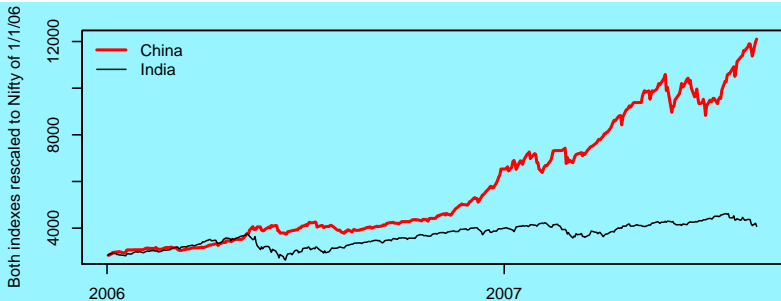
Interest rate differentials with US

| Country | 1997 | July 2007 |
|---------|------|-----------|
| China | 1.6 | -3.1 |
| India | 1.5 | 2.5 |

Real interest rates

| Country | 1997 | July 2007 |
|---------|------|-----------|
| China | 6.7 | -1.4 |
| India | 2.9 | 3.2 |

Stock market rise



Recent developments in China

- The October '07 CPI value in China is 6.5 percent.
- They have begun putting in price controls.
- Growth of household bank deposit down to 3.7 percent.

Recent difficulties

Stampede at China supermarket kills three

By Jamil Anderlini in Beijing

Published: November 12 2007 02:00 | Last updated: November 12 2007 02:00

Three people were killed and 31 injured at the weekend in a stampede for low-priced cooking oil in the western Chinese city of Chongqing.

The incident is a reflection of the current surging inflation, which has in the past been a harbinger of social upheaval in the country.

A 20 per cent discount on five-litre bottles of rapeseed oil at Carrefour had people lining up from 4am on Saturday. A stampede ensued four hours later when the doors were opened to the shopping mall where the French hypermarket is located.

"The government is investigating to determine the cause of the accident," Carrefour said yesterday.

Wholesale vegetable oil prices in China have jumped more than 40 per cent in the past year and increases accelerated in October, with weekly price rises of about 3 per cent at supermarkets in Beijing.

Prices of other foodstuffs such as milk, pork and eggs are also rocketing, contributing to annual headline inflation of more than 6 per cent - the highest level for more than a decade.

China has a history of relatively benign price increases spiralling quickly into double-digit inflation.

A freeze on loans



ASIA-PACIFIC
CHINA

[FT Home](#) > [World](#) > [Asia-Pacific](#) > [China](#)

CHINA - ECONOMY & TRADE

China loan freeze to tackle inflation

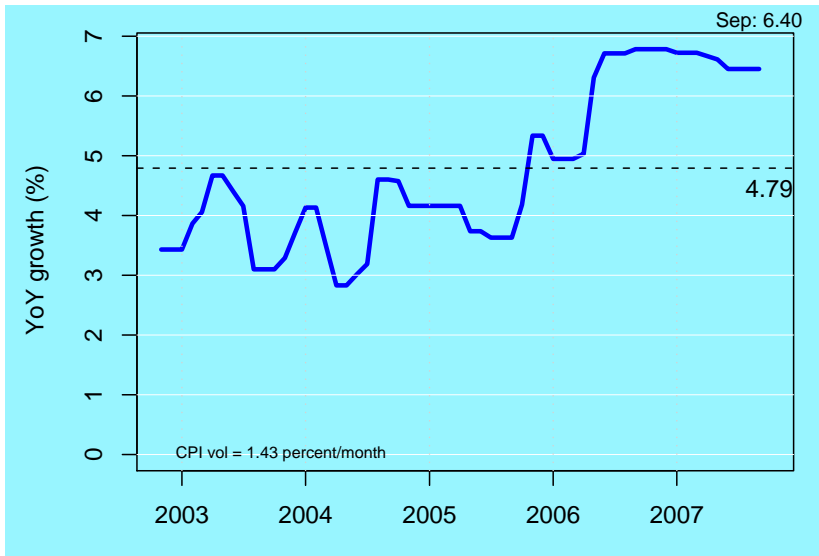
By Jamil Anderlini in Beijing and Kevin Brown in Hong Kong
Published: November 13 2007 05:44 | Last updated: November 13 2007 06:37

Companies investing in Chinese real estate or heavily polluting industries, including some foreign companies, have been told by bankers that they cannot access credit before the end of the year because of a government order to freeze lending.

China has for some time tried to rein in the rapid increases in bank lending that have contributed to rising consumer and asset price inflation. But a renewed effort is affecting foreign banks and companies for the first time as the central bank and regulatory officials step up their "window guidance" to try to cool the overheating economy.

Only projects that were in tune with the "spirit of the 17th Communist party congress", such as renewable energy projects, should still be given access to credit.

Inflation in India (CPI-IW, y-o-y smoothed)



Conclusion: How can India increase the extent of sterilised intervention, in order to emulate China?

For this we need to:

- Redirect more savings towards banks.
- Make banks buy MSS bonds.

Thank you.