China’s monetary policy and imf

Economics, Money

China's contemporary monetary policy and regulation Monetary Policy Committee Policies (interest rate, ERR, foreign reserves... Risks IMPs Involvement Recent monetary reform Ill. Conclusion A. Future of China's economy International Monetary Fund is an organization that consists of 188 countries, in which countries work together to promote global monetary cooperation, secure financial stability, and sustainable economic growth around the globe. MIFF serves as an International bank, loaningmoneyto member countries due to economic difficulties; and as an adjudicator, reconciling economic conflicts between countries.

It's a pool of central bank reserves and national currencies that allows member countries to borrow. China Joined MIFF in 1945, and has twice used MIFF credits, in 1981 and in 1986. China holds annual consultations with MIFF on economic development and policy Issues. In recent number of years, China has been accused of currency manipulation and excessive foreign reserves to underpin economic China to make policy reforms. In this paper, I will begin with China's monetary system, 1994 monetary crisis, and then discuss China's current monetary policies, reforms, and Miff's regulation on China.

China regulates its monetary system through POOCH (People's Bank of China) by adjusting interest rate, performing open market operation, and manipulating Reserve Requirement Ratio. How Chinese government uses these policy tools is interdependent of how Chinese currency Yuan's is arranged in foreign exchange mechanism. Central banks depreciate currency by cutting interest rate and increasing in foreign reserve to stimulate

economic growth. In other words, Chinese regulators used more non-market financial policy to administrate credit expansion.

Through effective tight state control policies, China had passed a long way from where it was to the second largest economy in the world. It went wrought 1994 Monetary Crisis, 1997 East Asian Crisis, and Global Financial Crisis in 2008. These crises not only gave lessons to the Chinese regulating body and MIFF, but also indicate a warning sign of the underlying risk of using too much state control on interest rate and exchange rate. 1994 was a significant year in China's economic history. China faced an unprecedented annual inflation rate of 24% in 1994.

It was largely caused by the over investment in early 1990 as government loosen credit to enterprises. Especially after Denominations visit to Southern China in 1992, in which e strongly advocated for economic growth, investment increased " 43% from previous year"(3). The overstatement not only doubled the price of construction materials such as steel and lumber, but also increased price of grains significantly. The sudden rapid rise in price had a devastated effect on resident's living conditions.

To fight with the inflation, the Chinese government implemented a series of actions, which include " tightening credit/loans, strict regulation of local/regional capital fund raising, tightening fixed asset investment scale, re-examining various newly established financial institutions, and controlling capital and cash holding of all financial organizations"(3). The main goal of these policies is to lower the economic growth rate and decrease the overall fixed asset investment. After one year of adjusting and implementing

policies, the inflation rate reduced to 9. % in December 1995. Just like the cause of China's Financial 1994 Crisis, the Asian Crisis of 1997 was the aftermath of a sudden surge in capital inflows tofinanceproductive investments, which made a country's economy vulnerable. The Asian Crisis started with the lapse of Thai Baht in July 1997, when Thai government was forced to float the baht due to lack of foreign currency to support its fixed exchange rate. Then the Crisis began to spread across to many East Asian countries, including South Korea, Philippines, Indonesia, and Singapore.

All of the countries had acquired a burden of foreign debt. In Korea, the foreign debt-to-GAP ratio rose from 13% to as high as 40%. Furthermore, the crisis was " deepened by the Miff's initial misdiagnosis" when MIFF imposed " budgetary tightening" policy to stabilize currency in Thailand, South Korea, and Indonesia (1). Although China was less affected by the crisis, it influenced its the monetary policies. Just as other Asian countries, China started built up official reserves so that it don't have to borrow from MIFF.

Both crisis had a significant impact on China today's monetary policy, which is Ojibwa, advocates for " dovish bias, a tendency to prefer accommodative monetary policy, supporting the use of policy tools to stimulate growth while placing less emphasis on the risks of inflation"(4). This policy belief led to manipulation in exchange rate when China was experiencing a rapid economic growth and currency appreciation. ARM appreciated from about 8. 828 Yuan in 2005 per dollar to 6. 09 in 2013, approximately 34% appreciation on a nominal basis against dollar and by 42% on a real basis (5).

It was because of China's rapid economic development in the past decades. China has become one of the world's largest exporters and created massive trade surplus and strong demand for ARM. The sudden appreciation led to inflation and consequently lower purchasing power of residents in China. The situation forced government to interfere with the exchange rate in order to maintain financial stability ND protect citizen's welfare. POOCH cut the interest rate to increase the demand for credit, reduced ERR, and increase foreign reserve to fight against appreciation.

China's large purchases of foreign reserves reduced their yields and push capital to emerging market, which successfully decelerated the speed of appreciation of ARM. However, how would these policies affect China's economy in a long run? MIFF pointed out that China's tight State control over banking system is creating risk to its economic growth in the future. China' undervalued currency not only has negatively affected U. S and Global trade, but also has brought risk to its own economy.

According to the New York Times, there's a growing list of countries, from the United States to the European Union to Brazil, have complained that China has been cheapening its currency. U. S criticized that China is trying to " gain unfair trade advantages over trading partners"(5). International Monetary Fund also claimed that ARM is significantly undervalued, and wrote a report to urge China to ease State controls on banking in 2011. The report examined on China's financial policy, in which encourages high savings, high levels of equity, and high risk of capital misapplication and asset bubbles, especially in real estate.

In MIFF words, the consequence of these distortions is " rising over time, posing increasing macro-financial risks". MIFF warned China: " tight government management of the nation's banking and financial system was creating a steady build-up in vulnerabilities that could eventually damp economic growth "(2) Excessive bank lending and increasing local government debt as a long-term policy would put China's economy at risk. However, China did not implement immediate change in monetary policy after Miff's warning.

Instead, Chinese official argues that their exchange rate is not meant to earn unfair trade advantage, but to foster economic stability and social welfare to citizens. The government continues to regulate extensively on interest rates, estate price and exchange rate. Not until recently, China finally implements major monetary reforms in reply to Miff's constant warnings. In order to maintain the economic growth, Chinese government must reform its banking system and adopt a flexible exchange rate. The POOCH has taken step to loosing the government's intervention on interest rate, letting racket to set the price instead.

Just as recorded in the article " The Interest Rate As A Monetary Policy Instrument in China", mainland lenders are allowed to charge rates on loans below the official benchmark-lending rate, effective from 20 July 2013. The scrapped (6). Furthermore, the cap on credit union lending rates was also abolished. These reforms indicate that Bank is not favoring state-owned entities, and indeed stimulates real economy. China is putting effort to liberalize interest rates, open financial market, and promote greater foreign

investment. I believethat a tightened state control monetary policy is not efficient and sufficient in a long run.

Although it has brought finance stability, China has to let the capital flow freely in order to maintain economic growth in the future. China should move away from non-market financial policies and step toward a more market-based currency to rebalanced China's economy. After decades of exponential expansion, China's expansion is entering a period of slower growth. In the first half of 2013, China's export growth rate was significant lower and GAP has also fallen. Zinnia claimed that the Yuan was nearing equilibrium against the dollar in June 2013.

In conclusion, China should depend less on exports and fixed investment to stimulate real economic growth. Ultimately, China should exert less power and subsidies state enterprises, but open up the market and foster global competition. It benefits Chinese Economy in a long-term by " re-directing resources away from inefficient (and often subsidized) sectors of the economy to those that are more efficient and competitive" (5). The reform would not only increase the efficiency of Chinese mommies firms, but also bring lower prices for consumers in China and improving standards of living after all.