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Intermediate targets for Chinese monetary policy: comments on Zhang X.

BOFIT workshop on Chinese monetary and exchange rate policies

The issue

- ◆ Previous intermediate targets have become ineffective.
 - Large discrepancies between loan growth and its target.
 - Financial system develops continuously.
- ◆ What should come next?
 - Quantity theory of money: inflation a monetary phenomenon
 - Promising candidates based on past correlations with CPI and GDP:
 - the dynamic reserve requirement ratio (RRR),
 - amended M2,
 - M3 and/or the total finance aggregate.

About intermediate targets

- ◆ Serve as the operational targets.
- ◆ Important properties from the mopo perspective:
 - Observable & controllable to a large degree by central bank
 - Link with the final targets of future inflation, output
- ◆ Special challenges in China
 - Deregulation affects observability & controllability
 - Structural change blurs the link with the final targets
- ◆ The stakes are especially high
 - How to contain the inflationary pressures
 - How to avoid a post-deregulation financial meltdown
- ◆ Very welcome that the PBOC elaborates on its views.

My take on the new approach

- ◆ Quantitative financial intermediate targets understandable:
 - Regulation enhances control
 - Financial markets still under-developed.
- ◆ The suggested changes are a temporary ‘patch’ to the old system until liberalization
 - Quantitative financial targets have not been very successful in liberalized financial systems (euro area 2. pillar).

Issues of interest

- ◆ How to quantify the intermediate target?
 - Considerable scope for growth in financial intermediation!
- ◆ The role of transparency in enhancing effectiveness?
 - Regulated systems opaque
- ◆ Extent of coordination with exchange rate target?
 - Regulation still brings some, but not unlimited, possibilities to pursue multiple goals.
 - Arbitrage may in part explain the ineffectiveness of the old intermediate targets.
- ◆ Quantitative financial targets & deregulation?
 - Possibilities to control deregulation boom by quantitative financial targets.
 - The risk that arbitrage makes quantitative targets non-implementable.