THE ROLE OF CREDIT POLICIES IN CHINA'S MONETARY POLICY: A BRIEF ASSESSMENT

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EAI Background Brief No. 1703

Date of Publication: 30 March 2023

Executive Summary

1. The People's Bank of China (PBOC) has increasingly been using structural tools in its conduct of monetary policy to pursue different policy goals, from buffering the economy from negative shocks to facilitating the economy's transition to more sustainable growth.

2. Since 2014, the PBOC has introduced over 10 separate target tools known collectively as "structural monetary policies". These are unconventional monetary policy tools that channel financial support to specific economic sectors, the traditional role of the government.

3. Examples of such structural policy tools (结构性货币政策工具) include credit facilities for small and medium-sized enterprises and farmers, funds for the construction of affordable housing and favourable adjustments on reserve requirements if commercial banks lend to certain targeted sectors.

4. The use of structural tools or credit policies has been criticised for the efficacy of targeting. The administrative intervention in bank credit allocation and influence of the central bank in the business decisions of commercial banks interfere with the market which should be allowed to play a decisive role in capital allocation without excessive government interference.

5. The excessive use of structural monetary policy instruments can have the unintended consequence of hindering the overall effectiveness of non-targeted policy tools (open market operations [OMO] or OMOs to influence interest rates) and may affect the overall objectives of monetary policy.

6. Even with the restrictions on the use of funds provided via structural tools in place, it could have an impact on base money and aggregate money supply since there is essentially no difference between the funds injected by the central bank into the

market and other non-structural tools such as OMOs. Monitoring banks on the use of credit as promised when they obtain special loans from the PBOC is a problem.

7. A recent International Monetary Fund study reveals that credit policies may also adversely affect medium-term productivity, apart from distorting credit allocation. Other researchers have cautioned that the excessive use of (quantity-based) credit policies may also affect monetary and fiscal discipline.

8. While structural monetary policy tools can complement non-targeted policy instruments in delivering liquidity to selected sectors of the economy, they can be ineffective when liquidity shortage is not the problem but more an issue of a lack of credit demand because of a weak economic climate and economic uncertainty.

9. The PBOC would have to mitigate financial risk, balance credit growth and support the real economy in a property downturn. Higher US interest rates and exchange rate pressures on the renminbi have added to monetary policy woes. As the US Federal Reserve continues its rate hike cycle and the USD strengthens further, China is facing greater RMB depreciation and capital outflow pressures.