FINANCIAL SITUATION AND MONETARY POLICY: ASSESSMENT AND SUGGESTIONS

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I. Economic Situation in 2009 and 2010: General Assessment

Since the close of 2008, China’s economy has undergone separate stages: a halt in its decline, stabilisation and return to growth. With the implementation of a package of economic stimulus policies and their respective impacts, the domestic economy has exhibited a relatively remarkable recovery trend. In the third quarter of 2009, GDP grew by 8.9 percent, and forecasts suggest that annual GDP may grow by 8.3 percent.

In our opinion, it is very probable that the GDP growth rate will exceed 8 percent in 2010. This opinion is based on two key points: First, domestically, consumption demand has maintained a stable upward trend, investment demand has maintained a certain intensity, and the contribution of exports to economic growth will turn positive in 2010 after a period of negative performance in 2009. Overall, domestic factors will guarantee that the national economy in 2010 will maintain an upward track over that for 2009. Second, internationally, the global economy has stabilised. A recovery to pre-crisis levels will be difficult, but there has nonetheless been a return to a track of positive growth. Our research shows that the influence rate of net exports on China’s economic growth is approximately 65 percent. Based on this kind of connection, the stabilisation of the global economy will have a positive impact on China’s economic growth.

Based on the aforementioned assessment, we believe that the economic and macro control initiatives for 2010 should prioritise restructuring and the deepening of reform, with no particular attention paid to “maintaining economic growth”.
II. Currency Credit Data and Monetary Policy Operations in 2009 Must Be Correctly Assessed

China witnessed record-high currency and credit growth in 2009. This generated extensive doubt, rooted in the assessment of currency and credit data and monetary policy operation trends in 2009. A careful analysis of these data is therefore required.

This involves a review of issues on three levels:

First, what does the growth in currency supply and credit in 2009 actually mean?

Second, what is the force driving this high monetary and credit supply growth? Specifically, did the central bank’s monetary policy or other economic factors result in the high level of growth of the currency and credit supply?

Third, if the central bank’s monetary policy operations were not the major reason underpinning the high level of growth of the monetary and credit supply, what monetary policy should be selected for the next year?

A. Assessment of Currency and Credit Expansion in 2009

China’s money supply structure is relatively unique, i.e. deposits account for a sizeable percentage of monetary aggregates. For instance, a wide range of deposits accounted for 93.8 percent of M2 as of the end of September 2009; and a wide range of deposits accounted for 81.5 percent of M1. This is to say that the variation in deposits determines the variation in China’s money supply to a major extent. Because of this connection, the relationship between deposits and loans becomes a key factor for understanding China’s money and credit growth trends.

With regard to the relationship between deposits and loans, deposits may have led to loans or similarly, loans may have led to deposits. The economic operation implications of both, however, are quite the inverse. If the increase in deposits is mostly attributable to increases in primary deposits (incurred by the growth of the national economy), the money supply is basically neutral; in contrast, if the increase in deposits is attributable to an increase of loans (incurred by deposit/loan operations in the banking system), the money supply is expansive. It is our assessment that China’s current situation is dominated by the former, namely that the money supply is basically neutral.