

ASIA Treasury Markets Summit

Recent macroeconomic developments in China: Inflation and monetary policy response

Hans Genberg

Executive Director (Research)



HONG KONG MONETARY AUTHORITY
香港金融管理局

Organisers



HONG KONG MONETARY AUTHORITY
香港金融管理局

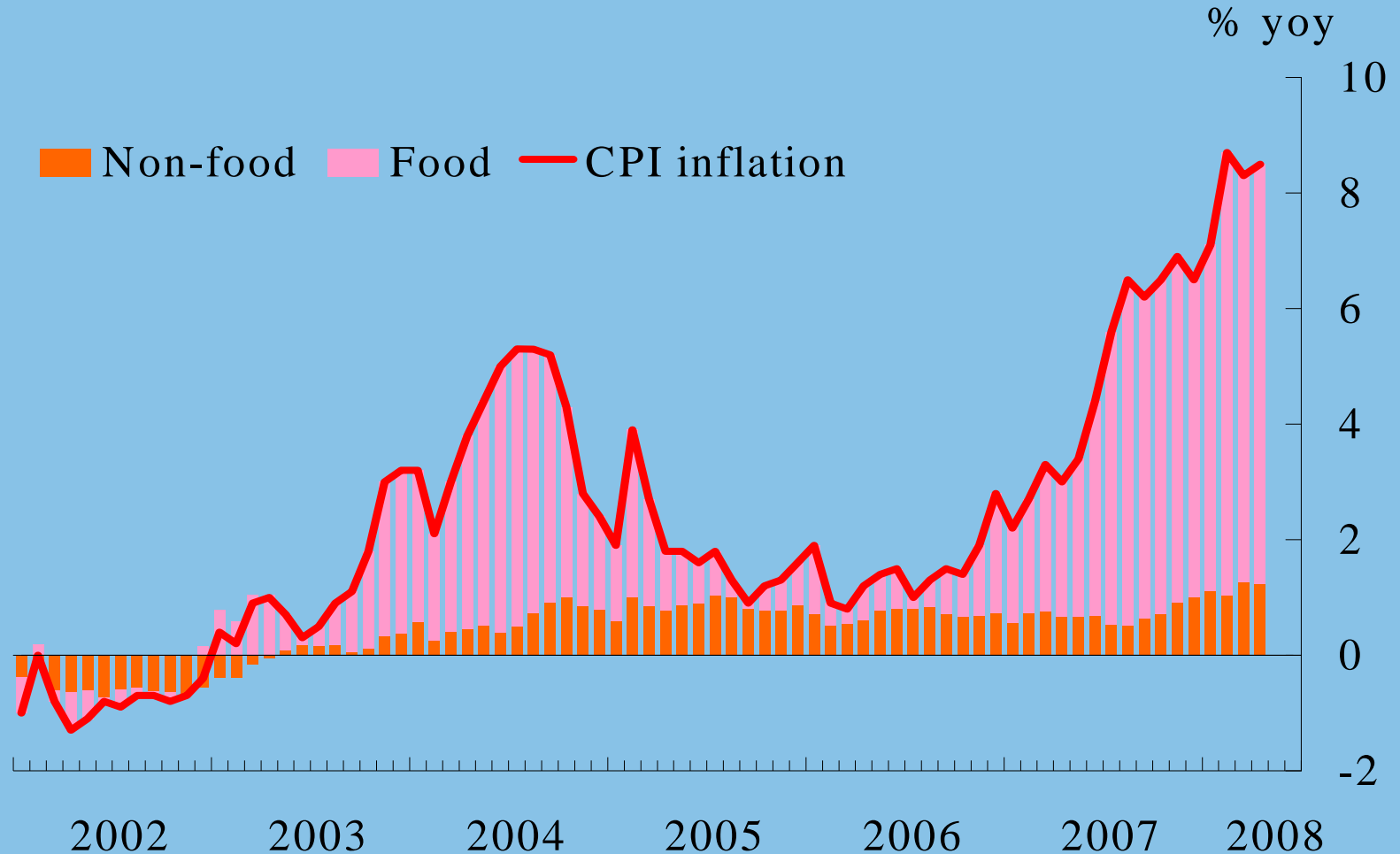


財資市場公會
Treasury Markets Association

Two interrelated issues

- The nature of the current surge in inflation. Is it really only a food problem?
- Currency appreciation, capital inflows and monetary conditions. Have the authorities lost control?
- The answers: ‘Increasingly not’ and ‘No”

Headline CPI inflation is surging, but...



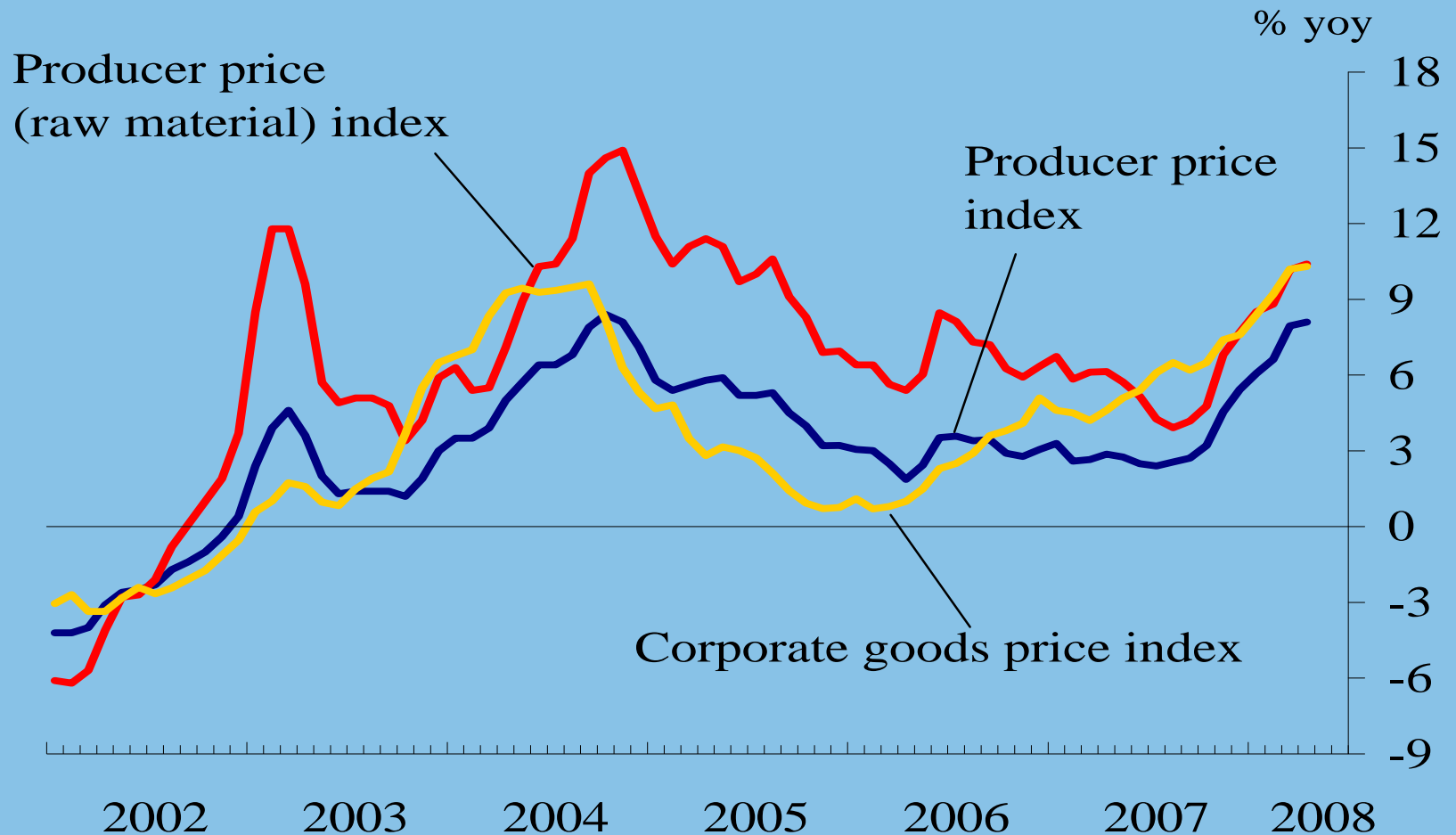
Contribution of food to inflation rates in May 2008 (y-o-y)

	CPI Inflation	Food	Weight of Food	Contribution of food
China	7.7	19.9	0.33	6.6
Indonesia	10.4	16.5	0.35	5.7
Philippines	9.6	13.7	0.50	6.9
Thailand	7.6	11.8	0.36	4.2
Hong Kong	5.4	11.1	0.27	3.0
Taiwan	3.7	9.3	0.26	2.4
Singapore	7.5	8.5	0.23	2.0
Malaysia	3.0	5.7	0.30	1.7
Korea	4.9	4.5	0.27	1.2
Japan	0.8	1.9	0.31	0.6
EU	4.0	7.2	0.19	1.4
US	4.2	5.1	0.14	0.7

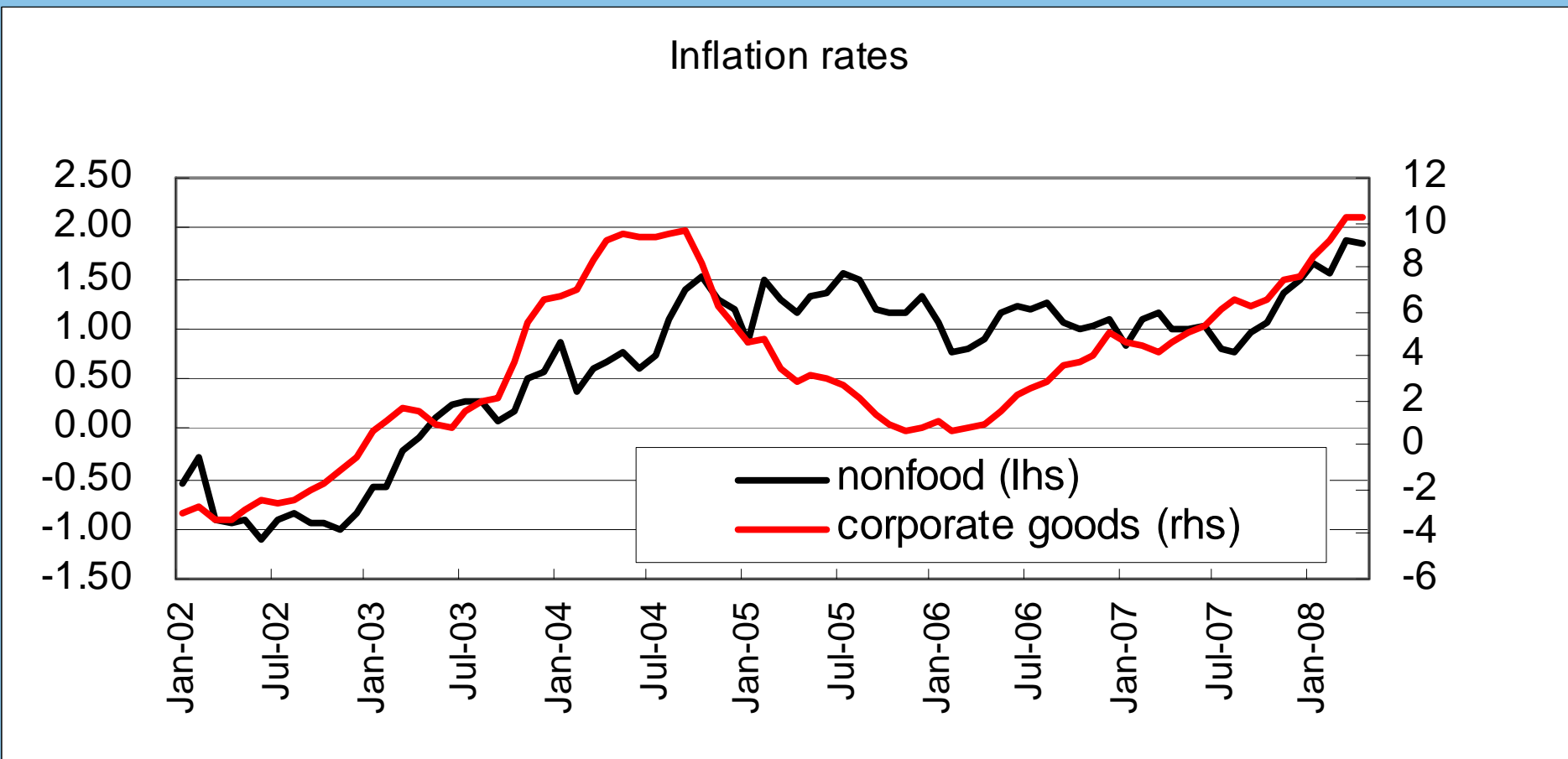
Will Headline Inflation converge to 'core' or the other way around?

- Persistence of food (and energy) inflation
 - Will the price of food relative to other goods and services keep going up? If not, headline will converge to 'core'.
- Will headline inflation feed into increase in wage inflation?
 - Expectations of inflation

Ominous developments in producer prices



Does corporate/producer price inflation lead to CPI inflation?



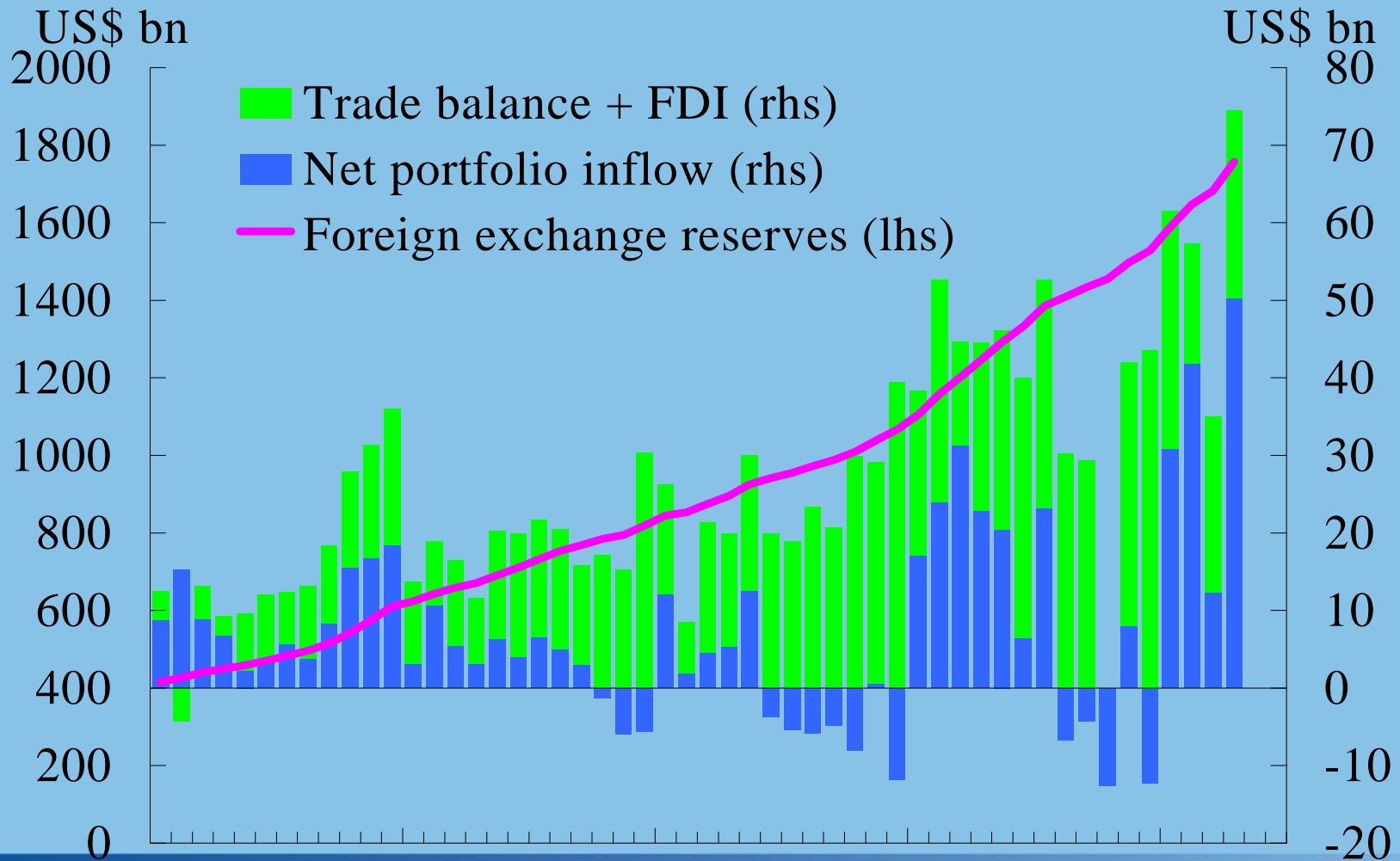
What to do?

- Standard answer: Prevent (temporary) food and energy price inflation from feeding through to core items.
- But how? My second topic
 - Currency appreciation, capital inflows and monetary conditions. Have the authorities lost control?

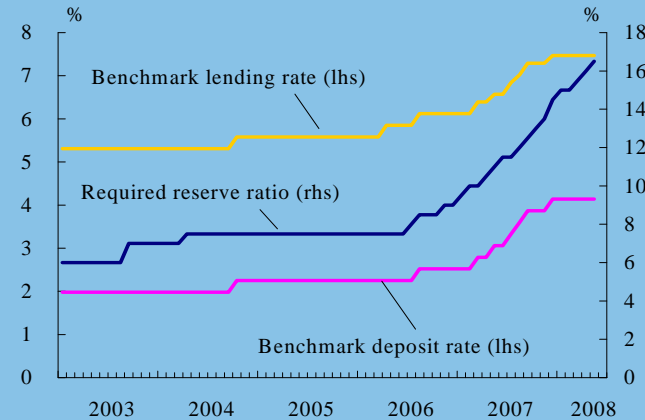
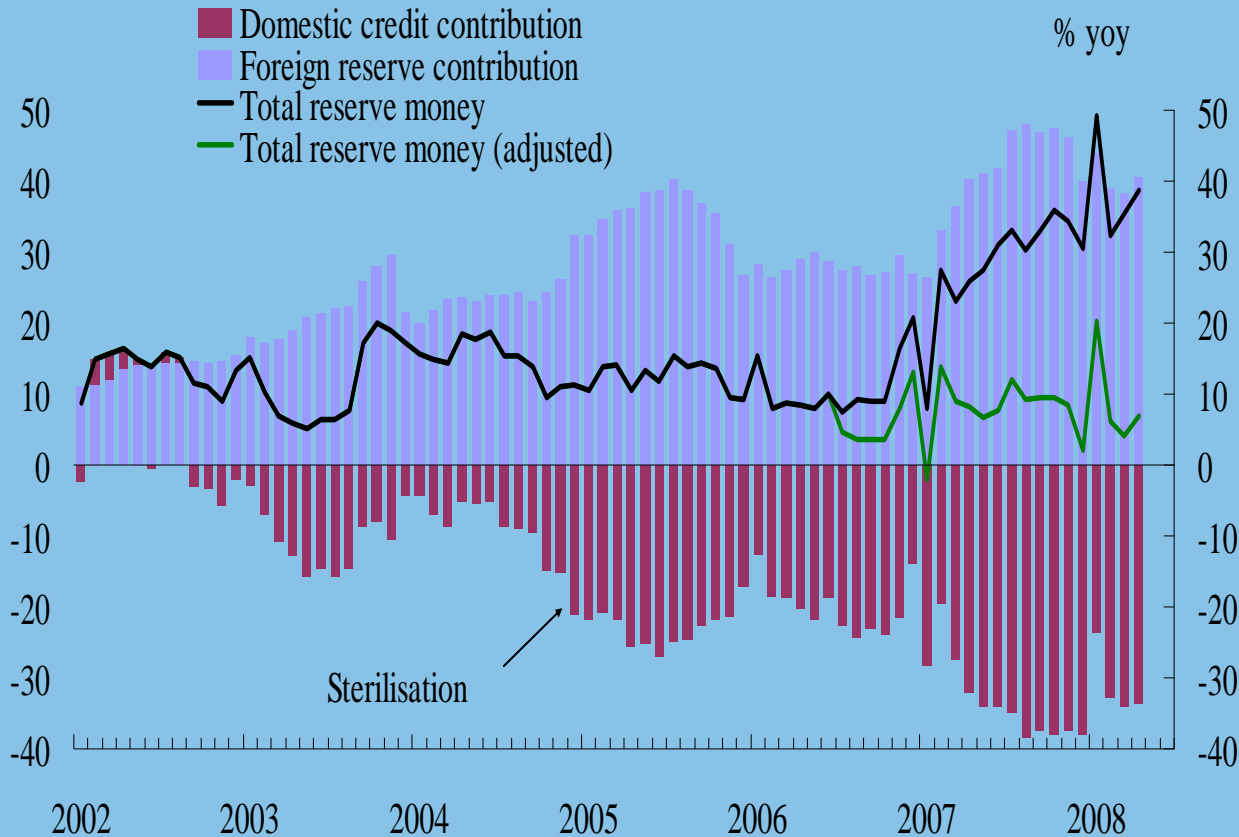
Have the authorities lost control over monetary conditions?

- Why the question?
 - Too slow appreciation of the RMB -> build-up of international reserves -> sterilization is losing its effectiveness -> money and credit aggregates are growing too rapidly -> inflation
- The answer: While theoretically appealing, the argument is factually incorrect.

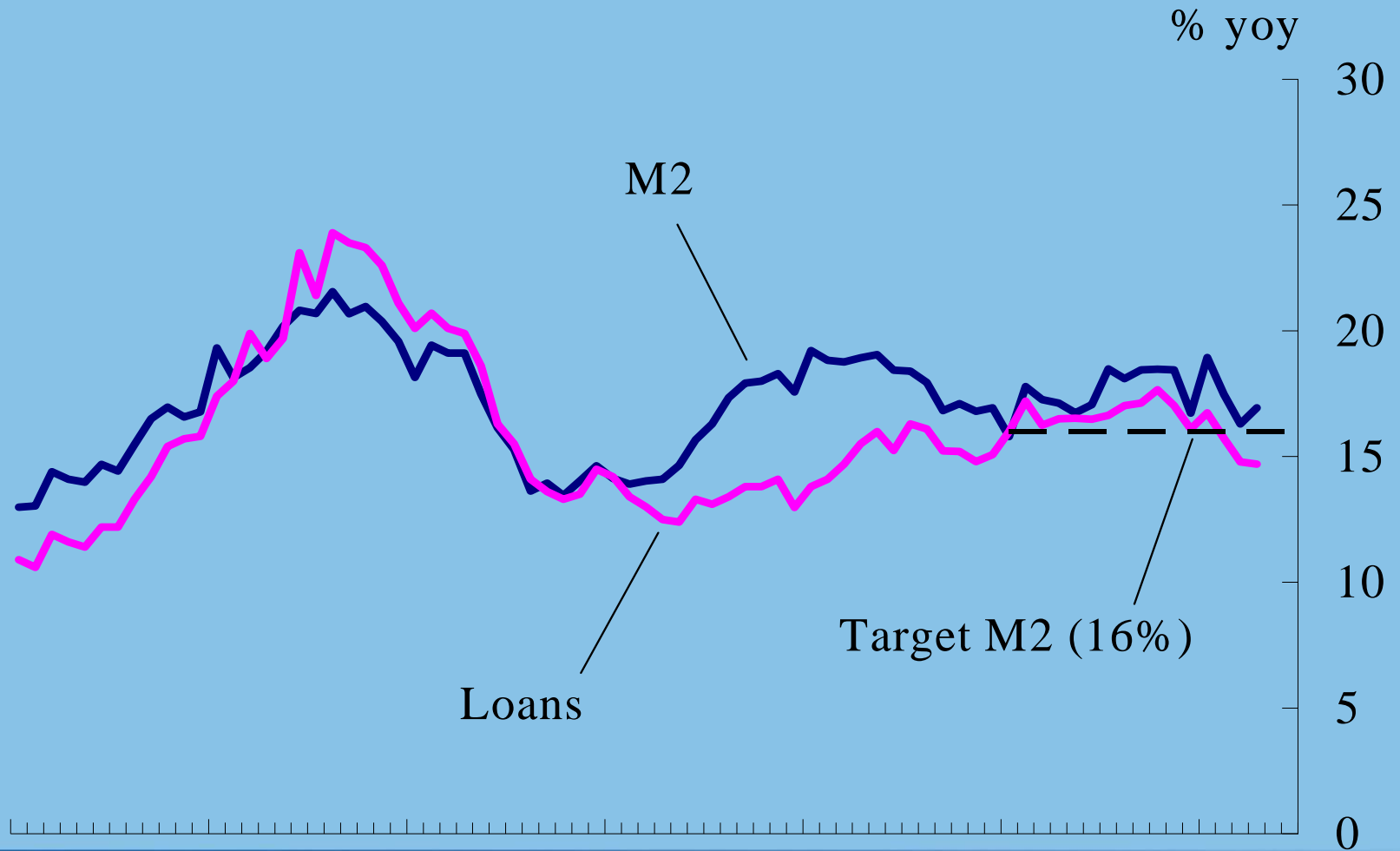
Reserve accumulation



Contribution to reserve money growth



Growth in M2 and financial institution loans



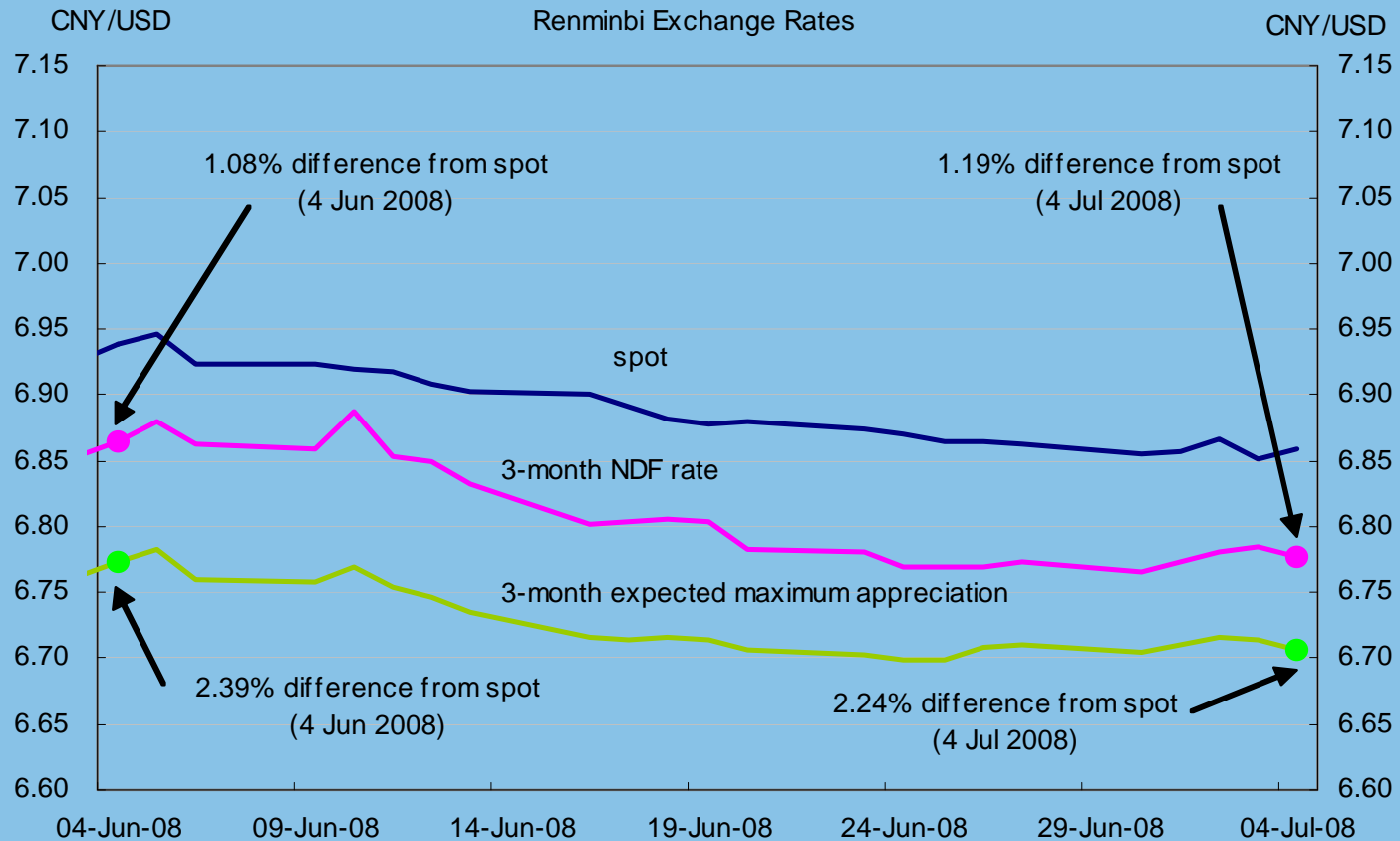
Tightening monetary conditions further: instruments and trade-offs

- Raising interest rates
 - Attracting additional capital inflows
- Selling PBoC bills
 - Making them attractive may become costly for the PBoC balance sheet
- Raising reserve requirements
 - Increasingly costly for the banking system, i.e. shifts the costs from the PBoC to the banks

Tightening monetary conditions further: instruments and trade-offs

- A faster rate of appreciation of the RMB
 - Attracts further capital inflows
 - Pass-through to consumer prices is not very large
- A surprise ‘maxi’-appreciation
 - Direct pass-through effect is limited
 - Will it succeed in reducing ‘speculative’ capital inflows?
 - What are the financial stability consequences?
- Conclusion: There is no ‘silver bullet’ solution. A difficult situation for the PBoC.

A final word on the RMB: What do the markets believe?



Sources: Bloomberg, JP Morgan and HKMA staff estimates (Working Paper 03/2008)

Thank You