Central bank instruments to deal with the crisis – from the perspective of the People's Bank of China

People's Bank of China

I. Monetary policy instruments to support interbank lending in local currency

With the adoption of an appropriately accommodative monetary policy, the People's Bank of China (PBC) has closely monitored and actively responded to the changing internal and external economic and financial situations and has employed a mix of monetary policy instruments including interest rates, reserve requirement ratios, open market operations (OMOs), central bank lending and rediscount operations to stabilise the financial market, boost domestic demand and promote economic growth.

First, the leveraging role of the interest rate was brought into full play. Since September 2008, the PBC has reduced the benchmark deposit and lending rates of financial institutions on five occasions, with the one-year benchmark deposit rate and lending rate being shaved accumulatively by 189 and 216 basis points, respectively. Cutting the benchmark interest rate effectively stimulated credit demand and resulted in a rapid rebound of money and credit, contributing to a more buoyant domestic demand and stronger market confidence. At end-November 2009, the year-on-year growth of M2 and M1 had reached 29.7% and 34.6%, respectively, suggesting steadily enhanced liquidity. New renminbi (RMB) loans totalled 9.21 trillion yuan and credit growth registered 33.8%, which greatly satisfied the corporate and individual needs for funds. Growth of RMB deposits reached 28.3%, indicating adequate funds and strong payment capability in the corporate sector.

Second, the reserve requirement ratio was used appropriately. In 2008, the PBC cut the RMB reserve requirement ratio of financial institutions four times in a row from 25 September to 25 December. Specifically, the reserve requirement ratio of large financial institutions was cut by 2 percentage points accumulatively, whereas that of small financial institutions was cut by 4 percentage points accumulatively. By the end of 2008, according to trend calculations, a total of 800 billion yuan of liquidity had been released. The liquidity in the banking system remained ample.

Third, open market operations were carried out flexibly with a steadily optimised toolkit to stabilise market expectations. In light of the liquidity demands during different periods, the PBC effectively handled the pace and intensity of OMOs and appropriately enhanced the flexibility of interest rates on the OMO market so as to guide market expectations and ensure abundant liquidity in the interbank market. Since July 2008, the PBC has gradually decreased the amount and frequency of central bank bill issuance and has used both central bank bills and short-term repos to further enhance the resilience of the banking system to short-term liquidity shocks. In coordination with movements of the benchmark deposit and lending interest rates and the reserve requirement ratio, the interest rates on the OMO market fell steadily, significantly driving down interest rates on money and bond markets and contributing to the sound and smooth conduct of interbank lending. From late June 2009, with the improving economic situation, OMO rates were moderately increased and the role of the market interest rate in adjusting the demand and supply of funds was further strengthened.

Fourth, the innovation of monetary policy instruments was strengthened with the introduction of the Term Auction Facility (TAF). At end-October 2008, the PBC launched the TAF, ie the issuance of short-term pledged loans with a maturity of no more than three months, to qualified domestic financial institutions (including foreign-funded banks incorporated in China) through bids. Qualified domestic financial institutions could submit an application to the PBC for TAF financing and provide eligible collateral such as government securities, central bank bills, financial bonds issued by policy banks, foreign exchange in cash, credit assets and equities, etc. The introduction of TAF not only alleviated the liquidity problems of some foreign-funded banks in a timely fashion but also stabilised financial market confidence.

Fifth, the PBC provided rediscount operations and central bank lending to financial institutions facing liquidity difficulties. Central bank lending and rediscount operations were conducted according to relevant procedures and regulations. Commercial drafts accepted by the central bank for rediscount operations are limited to bank acceptance drafts. The central bank must grant loans to financial institutions against eligible collateral, which was expanded to include equities held by financial institutions and eligible collateral provided by their parent banks.

II. Measures to support foreign currency refinancing of banks and corporations

Banks and corporations in many economies have faced an insufficient supply of foreign exchange refinancing since the outbreak of the global financial crisis. However, this has not been the case for China for the following reasons. First, the stable RMB exchange rate, proactive fiscal policy and appropriately accommodative monetary policy, together with the RMB 4 trillion yuan stimulus package, have contributed to stable market confidence and a well-functioning foreign exchange debt market. Second, China's foreign exchange debt is at a moderate level and of a reasonable structure. Both the external debt/foreign exchange reserve ratio and the short-term external debt/foreign exchange reserve ratio have been kept below international safety standards, with the share of external debt of financial institutions not exceeding one fifth of their foreign exchange assets and short-term foreign currency loans of corporations less than one 24th of annual exports. Third, in contrast to the liquidity stress in the international US dollar market, local foreign exchange liquidity was abundant with low financing costs because financial institutions retained their foreign exchange domestically to hedge risks in the international market when the crisis gradually intensified. Therefore, with both the interbank foreign exchange market and the foreign exchange debt market functioning effectively, the central bank, besides paying close attention to market movement, has not taken additional measures.

At the same time, as a responsible stakeholder in international society, China has done its best to actively participate in the international crisis bailout by providing funding resources and commitments. The PBC has signed six bilateral swap agreements in local currencies totalling 650 billion yuan with central banks in Korea, Malaysia, Belarus, Indonesia and Argentina as well as the Hong Kong Monetary Authority. As an important measure to bolster liquidity, these agreements have helped to strengthen economic and financial stability, lift market confidence and boost trade, investment and economic growth in the region.