Monetary Policy Rule under Financial Deregulation in China

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Abstract

This paper examines the monetary policy rule in practice for China during the period from 1998Q1 to 2014Q2 by applying the Taylor rule and by estimating policy reaction functions. The analysis would be significant since during that period the monetary-policy instruments and targets have been more market-oriented in accordance with the progress in financial deregulation.

The findings can be summarized as follows. First, the recent policy rule since 2003 has become synchronizing with the Taylor rule. Second, the response of policy-target interest rate to inflation, though identified in policy reaction functions, has been weak enough to accommodate changes in inflation, probably because the excess-reserve operation as another policy-target has worked together to respond to inflation. Third, the response to output gap has been robust in the backward-looking specification. Fourth, the response to exchange rate has been insignificant probably due to imperfect capital mobility and an increase in exchange rate flexibility.