

# **Monetary Policy Uncertainty in China**

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## **Summary**

In this paper, we study the measurement and the consequences of monetary policy uncertainty in China.

We make three contributions. First, we provide a new index of monetary policy uncertainty, which we derive from the reporting about the PBOC monetary policy in international newspapers. We follow the literature on newspaper-based uncertainty measures and count the number of articles that contain references to the PBOC and, at the same time, reflect uncertainty about its policy. We rely on articles exclusively in leading international newspapers and not newspapers from mainland China. Deviations between our index and the existing index from the literature, which is based on mainland newspapers, reflect an offshore-onshore differential in the perception of China's monetary policy uncertainty.

Second, we estimate an empirical model of Chinese monetary policy uncertainty with a small set of variables in order to identify the surprise component of monetary policy uncertainty. We show that an increase in monetary policy uncertainty prompts the private sector in mainland China to curtail investment. Real economic activity falls significantly following an increase in uncertainty. Hence, monetary policy uncertainty has sizable business cycle effects. Furthermore, we study the spillover effects of monetary policy uncertainty to other economies in Asia. We find that shocks to China's monetary policy uncertainty cause a strong fall in equity prices and a drop in real GDP growth in Asia. Hence, the consequences of monetary policy uncertainty are not limited to mainland China but spread throughout the region.

Finally, we revisit the spread between our index and the index from the literature. We show that a widening of the spread predicts an increase in uncertainty reflected in mainland newspapers' reporting, not the reporting in international newspapers. Hence, an increase in reporting about MPU in leading international newspapers, relative to the reporting in mainland newspapers contains valuable information. We also show that an increase in the offshore-onshore spread in reporting about uncertainty prompts a strong decline in stock prices in Asia. From that, we conclude that investors pay particular attention to international newspapers when evaluating Chinese monetary policy.

Our index of monetary policy uncertainty is essentially forward-looking. It is not based on the past monetary policy decisions such as the variation of past policy rates. Instead, it is based on the international newspaper's reporting about the future monetary policy of the PBOC. Given its forward-looking nature, it is not surprising that it affects investment and asset prices the most since they are in general the most forward-looking variables.