From Quantity- to Interest Rate-Based Framework: Multiple Monetary Policy Instruments and Their Effects in China

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Summary

We construct the structural VAR model that explicitly considers interactions among various monetary policy instruments and other monetary variables including intermediate targets in China. Using this model, this study analyzes the effects of various monetary policy instruments in China, such as reserve requirement ratio, benchmark lending and deposit rates, and short-term interest rate. Empirical results suggest the effects of the changes in benchmark lending rate and short-term interest rate on loan, M2, and output are larger than those of the changes in reserve requirement ratio. Non-policy shocks exert substantial effects on intermediate targets such as loan and M2 under quantity-based policy framework. These results may imply that monetary policy is more effective under a newly introduced interest-rate based policy framework than the old quantity-based policy framework. The effects of short-term interest rate shocks are larger in the most recent period, which shows the recent push by PBoC to move from quantity-based policy framework to interest rate-based policy

framework has progressed significantly. In addition, short-term interest rate has the strongest effects on asset prices, such as stock and housing prices, among various policy instruments, which may imply that the interest rate-based framework of PBoC is likely more effective in achieving the financial stability objective adopted by PBoC in recent years.