

Box B: Financial Tightening Measures in China

In 2003 and early 2004, economic growth in China accelerated to the point where the Chinese authorities were concerned that the economy was overheating. Consequently they adopted measures aimed at slowing growth to a more sustainable pace. Given the underdeveloped nature of the Chinese financial system, the policy approach adopted has differed from that used in most OECD economies, where short-term interest rates are the predominant financial macro-stabilisation tool. Efforts have focused largely on administrative and liquidity controls, which aim to slow investment through influencing the provision of credit.

In late 2003 the authorities undertook a number of measures aimed at reducing the liquidity in the economy, including increased issuance of central bank bills and increases in reserve ratios for banks. These have been supplemented more recently by a number of administrative measures. The authorities have sought to restrain bank lending in particular sectors of the economy including property, steel, cement, and aluminium, where they feel that the pace of growth is unsustainable.

- In February 2004, the China Banking Regulatory Commission (CBRC) required banks to limit their exposure to the property sector to a maximum of 30 per cent of outstanding loans.
- In April 2004, the State Council increased capital funding requirements by requiring larger cash deposits, and ordered that no new applications for steel, aluminium or cement projects be approved for the remainder of the year.
- In May 2004 the People's Bank of China (PBOC), CBRC, and State Development Reform Commission (SDRC) issued a joint statement directing banks to limit lending to industries that may be subject to over-investment. The CBRC has also directed banks to cease funding fixed-asset investment projects that have not obtained government approval.

- On a number of occasions over the past year, the PBOC has sought to influence the lending behaviour of commercial banks via 'window guidance' whereby it meets directly with banks to seek co-operation in achieving its policy goals.

To date interest rates have only had a limited role, with the key base lending rate (the one-year working capital rate) and the deposit rate unchanged since February 2002, at 5.31 per cent and 0.72 per cent respectively. There have, however, been minor adjustments to several other interest rates, with the PBOC increasing the ceiling on bank lending rates to 1.7 times the base lending rate (9.03 per cent) in January 2004, allowing banks to charge higher rates to borrowers. The previous ceiling had been 1.3 times the base lending rate for small enterprises, and 1.1 times the base lending rate for medium to large enterprises. In March the PBOC increased the interest rate ceiling on loans to commercial banks and for rediscounting trade bills.

Thus far, the measures look to have had some effect. Growth in bank lending has slowed from 24 per cent in the year to August 2003, to 16 per cent in the year to June 2004, while M2 growth has slowed from 22 per cent to 16 per cent over the same period (Graph B1). ↗

Graph B1

