Comments on ”Chinese Monetary Policy and the Dollar Peg”

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23.7.2010

What does the paper do?

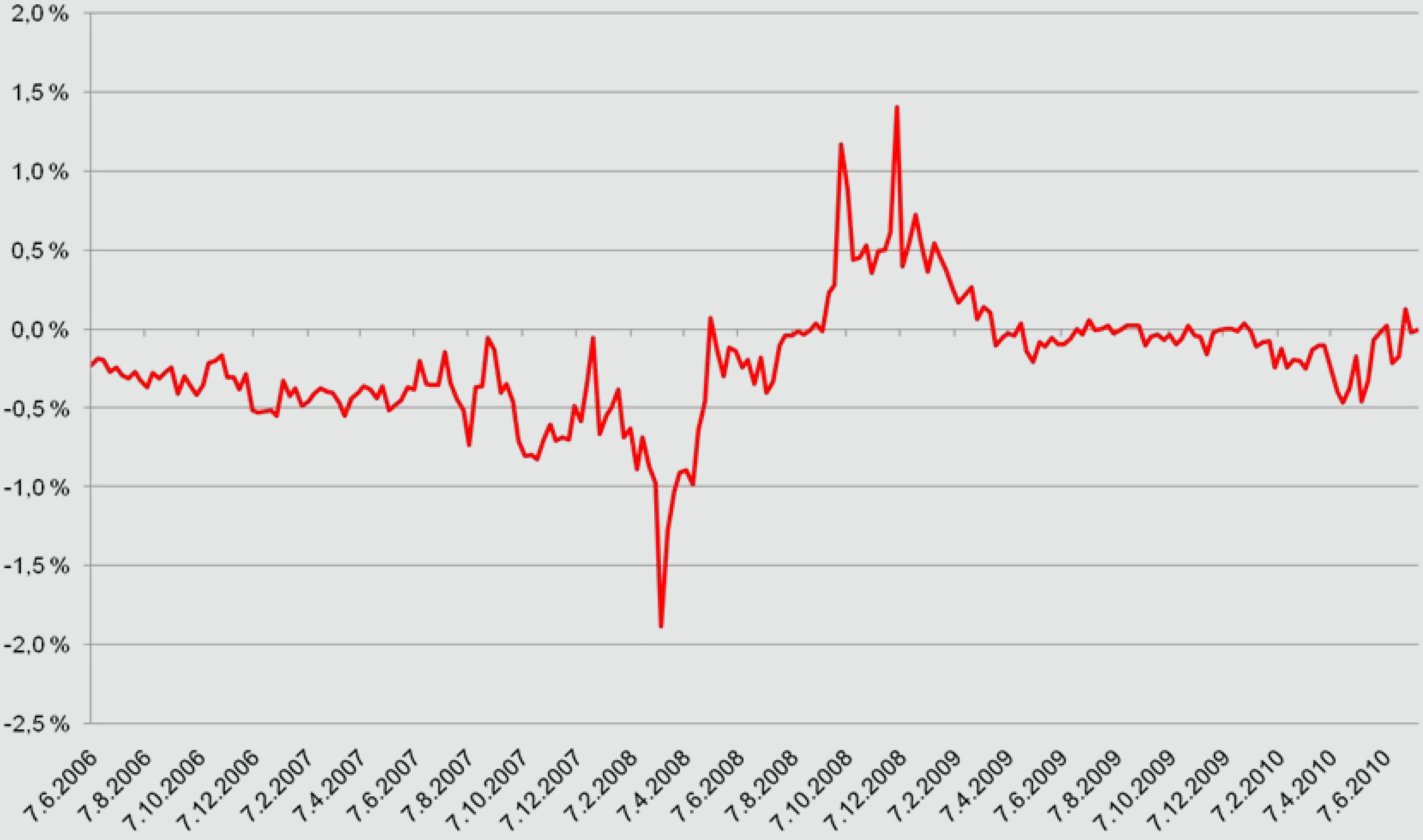
1. Check whether the US and Chinese interest rates are cointegrated; there is *some* evidence for this
2. Check what kind of factors affect the conduct of Chinese monetary policy; monetary policy appears to rely on quantity-based measures and is mainly concerned with sterilizing changes in the foreign currency reserves

Interesting results, which are more or less in line with the earlier findings in the literature, but I have some suggestions as to how to make the paper stronger.

What happened to the ”dollar” we were promised in the title?

- Exchange rate doesn’t feature explicitly in estimations
- Nor is there any differentiation as to the periods of fix and crawling peg in the estimations
- Now the authors test $r_t = r_t^*$, but if we believe expectations about exchange rate changes matter, this is misspecified (and if exchange rate expectations do not matter, their *omission* should at least be discussed), especially since the sample includes two years of crawling peg (test for similarity between three different regimes?)
- Uncovered interest rate parity might shed more light on the developments and on the transmission; China might have had a peso problem in reverse...

Forward premium/discount from 1-month RMB NDFs



Money demand estimations interesting I

- Separating money demand and supply interesting
- Further confirmation that the PBoC uses many different policy tools
- However, interpretation of the results is somewhat hampered by the fact that many variables have been differenced twice; perhaps robustness check with once-differenced variables (which would be consistent with the economic theory) would benefit the paper
- Impulse responses?
- Would the results change with one-lag differencing instead of 12-lag?

Money demand estimations interesting II

- Many surprising/counter-intuitive findings: rediscount rate *destabilizes* money supply, reserves increase when money demand goes up, inflation destabilizes money demand, required reserve ratio goes down when output goes up; are there any plausible reasons for these?
- Given the three long-run relationships and the associated 7×3 alpha matrix, we have a LOT of relationships between variables, some statistically significant and some not; perhaps a table would tell at least as much as 500 words?

Some concluding thoughts

- Why does the PBoC not use the interest rate tool more actively? More discussion on this could be enlightening; note that many other emerging market countries also rely more on other policy instruments (especially exchange rate)
- Why is the current regime suboptimal?
- Countries have more room to operate if there is pressure for the exchange rate to *appreciate*, as long as they are willing to shoulder the costs associated with sterilization