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Is monetary policy forward-looking in China?

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Abstract: This paper investigates the empirical success of the forward-looking rule in explaining Chinese monetary policy during the period from 2001 to 2016 when survey expectations are used in conjunction with alternative monetary policy rules (money supply rule v.s. interest rate rule). The paper also contributes to the literature by addressing the important problems of serial correlation and structural breaks in the underlying policy reaction function. Contrary to existing results indicating the strong role for expectations in Chinese monetary policy, we find expectations only play a significant role after year 2008, before which there is little role for expectations. This finding is robust to whether the expectations series used relates to individual consumers or professional forecasters. We also find that the Chinese central bank promotes economic growth in a pro-cyclical way whereas it holds a countercyclical policy for inflation.

Keywords: inflation expectations, monetary policy reaction function, survey data

JEL Classifications: E58; E31

1. Introduction

Central bank monetary policy operations have been considered as a matter of practice, while the macroeconomic modelling of the monetary policy reaction function is regarded

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