

Reformist PBoC governor signs off after 15 years at helm

Interest rate deregulation among highlights of Zhou's modernisations



Zhou Xiaochuan: Not a powerful, independent figure like his peers at the US Federal Reserve or European Central Bank © Reuters Tom Mitchell in Beijing and Gabriel Wildau in Shanghai MARCH 9, 2018

China's longest-serving central bank governor quietly exited the global stage on Friday, offering assurances that Beijing was getting to grips with high debt levels and predicting a gradual relaxation of capital controls imposed in late 2016.

In a final official briefing before his successor is confirmed on March 19, Zhou Xiaochuan avoided a repeat of the warnings he issued last year about a looming "[Minsky moment](#)" — or sharp correction in asset prices — and about profligate state-owned enterprises and local governments.

Despite setbacks to his reformist agenda over the past two years, in his 15 years as central bank governor Mr Zhou slowly but steadily pushed through a series of landmark reforms, often in the face of stiff resistance. When he was appointed head of the People's Bank of China in December 2002, China was the world's sixth-largest economy and fourth-largest exporter. It is now ranked second and first, respectively.

"The reforms that Governor Zhou has managed to shepherd through, even in the face of difficult economic and political constraints, add up to a significant legacy," says Eswar Prasad, a former head of the IMF's China division who now teaches at Cornell. "He has accomplished this through a combination of forceful and persistent advocacy, persuasion of the top leadership and willingness to challenge entrenched powers."

Mr Zhou presided over the deregulation of China's domestic interest rates, a reform that economists regarded as crucial to allowing market forces rather than government bureaucrats to determine which borrowers can obtain financing. After years of incremental moves, in 2015 the PBoC eliminated the [hard ceiling](#) on bank deposit rates, ostensibly forcing lenders to compete for customer funds by offering higher rates.

The resulting rise in deposit rates was in turn supposed to force banks to allocate more loans to borrowers whose more profitable, if riskier, businesses enabled them to pay higher interest on loans, thereby channelling increased funding to more efficient parts of the economy.

But despite the deregulation, the PBoC continues to use "[window guidance](#)" — the industry term for informal instructions delivered orally — to keep banks from raising deposit rates too aggressively. Local government officials also continue to maintain considerable influence over lending decisions by banks in their regions, distorting capital allocation, while non-state companies struggle to obtain financing.

In organisational terms Mr Zhou was not a powerful, independent figure like his peers at the US Federal Reserve or European Central Bank, but rather just another minister advising Premier Li Keqiang's State Council. Above the State Council loomed the Chinese Communist party's Politburo Standing Committee and [Xi Jinping](#), the president, to whom Mr Zhou ultimately reported.

Under this system rival bureaucracies such as the commerce ministry can lobby the State Council and party leaders to adjust monetary policy in ways opposed by the PBoC. In a series of recent valedictory interviews with Chinese media outlets, Mr Zhou hinted at the frustrating limits of his power, hinting at resistance to further liberalisation of China's exchange rate system.

"If a few ministries have different views over the timeframe or conditions [for liberalisation], then the likely outcome is to wait, to rely on others, and to request others to move first, which in turn leads to irresponsibility and deadlock," he said in October.

One of the lowest moments in Mr Zhou's otherwise distinguished career came after China's central bank inadvertently shocked global markets in August 2015, when it announced technical changes to the renminbi's "daily fix" against the dollar. The renminbi is not allowed to rise or fall more than 2 per cent against the fix in a single trading session.

The changes effectively gave the market a greater say in determining the dollar price of the renminbi, paving the way for it to be recognised by the International Monetary Fund as an official reserve currency.

But the PBoC distracted attention from this welcome reform by simultaneously announcing a "one-off" 1.9 per cent devaluation of the renminbi against the dollar, which spooked global markets about the prospect of a "currency war" between the world's two largest economies. The devaluation

marked the start of six months of silence from senior Chinese leaders, including Mr Zhou, during a period of extreme [market turbulence](#) and capital flight.

“It was a major, major communication error that China has only recently recovered from,” says one person who advises Mr Zhou.

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