CHINA NEWS

China's Central Bank Prevails in Policy Battles Over Economic Future

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The headquarters of the People's Bank of China in Beijing. *Reuters*

BEIJING—China's central bank is turning into a policy heavyweight in a battle among the country's top economic authorities over how to fuel growth without piling on excessive debt.

The government has sought to portray a united front on its "mini-stimulus" measures, or small adjustments to monetary policy to bolster growth.

Behind the scenes, however, China's biggest economic agencies—the People's Bank of China, the Ministry of Finance, the state planning commission and other financial regulators—have fought over whether more should be done to bolster growth, such as cutting interest rates for the first time in two years, according to officials familiar with the government's deliberations.

More

China's gross domestic product growth has fallen below its target of 7.5% for the year, deepening concerns about the

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strength of the world's No. 2 economy.

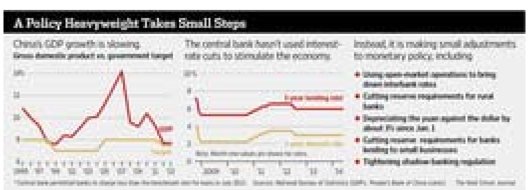
In the latest battle, the country's top banking regulator on Friday said it would ease rules to make it easier for banks to lend only to small companies. That followed a decision a week earlier by the State Council, the government's top decision-making body, to target more bank funding for small businesses and farms.

The central bank fended off calls to cut interest rates, at least for now, the people familiar with the situation said, by arguing that a rush of new credit could add to already ballooning debt and funnel money to the real-estate sector, which is struggling with a housing glut that is dragging down growth and threatening to trigger loan defaults.

"Theoretically, conditions are ripe for a rate cut as inflation is not a concern right now," a central bank official said. "But it wouldn't be as effective as we would want it to be" because it could worsen other problems in the economy.

How China negotiates the slowdown matters to the Chinese leadership's goal of restructuring the economy so that it is powered by domestic consumption and service industries. Reliance on investment in infrastructure, construction and smokestack industries produced unmatched growth for more than three decades, but, economists say, is reaching its limits, as evidenced by rising debt and the polluted skies over Beijing.

"There's not a case yet for significant stimulus," said the International Monetary Fund's deputy managing director, David Lipton. "But even if that materializes, we'd still be against a broad use of accommodative monetary policy," he said.



A too-sharp drop in growth, which has historically led to unemployment and unrest, could prompt Chinese leaders to reach for more-aggressive stimulus measures, setting back restructuring.

Residential real estate, an economic engine in the past, is suffering its worst slide in years because of excess supply that is hitting other industries including construction, steel and aluminum.

The central bank has long been more cautious about economic stimulus than the other agencies. It has frequently lost battles to the Ministry of Commerce and the state planning agency, which is called the National Development and Reform Commission, which count big, influential state companies among their constituents.

In China, the central bank isn't independent; it is one voice among many in the topmost panels of decision-making.

In the previous administration, Premier Wen Jiabao often ignored advice by central bank chief Zhou Xiaochuan, according to officials involved in the decisions, particularly when the central bank lobbied to limit stimulus spending in response to the global financial crisis of 2008 and 2009 out of concern about rising inflation and bad debts.

Over the past two years, Mr. Zhou has accumulated more power, Chinese and Western officials say. He was one of the few policy makers who kept his post after passing the mandatory retirement age of 65, and the current Communist Party chief, Chinese President Xi Jinping, appointed him to a new panel to oversee economic reform.

"There is certainly a role reversal from the time when the PBOC was taking orders from other arms of government to one where the PBOC sets the tone of the macroeconomic policy and reform agendas," says Eswar Prasad, a China scholar at Cornell University.

Mr. Zhou's allies are rising, too. Yi Gang, the central bank's vice governor, who is in charge of managing China's nearly $4 trillion foreign-exchange reserves, was named deputy chief of the economic policy group that advises the Politburo Standing Committee, China's seven-member ruling body, according to Chinese and Western officials familiar with Mr. Yi's assignment. Another Zhou partisan, Fang Xinghai is in charge of putting together a financial-reform blueprint for the economic policy group, called the Office of the Central Leading Group on Financial and Economic Affairs.

Among its other victories, the PBOC has won approval for the creation of privately owned banks and the widening of the band in which the tightly controlled Chinese yuan can trade daily—a step toward full convertibility. It is also in the last stages of getting approval of bank deposit insurance, which has been batted around for 20 years and has been opposed by large state-owned banks.

In the days before the State Council's mini-stimulus announcement late last month, Chinese Vice Premier Ma Kai, who is responsible for the financial sector, called a meeting of the major economic agencies to discuss how to make credit more accessible and less expensive for businesses around the country, according to a government official with knowledge of the matter. The meeting took place shortly after Premier Li Keqiang's visit to Inner Mongolia, during which companies across energy, textiles and other industries complained about the difficulty in getting financing.

During the discussions, officials from China's top banking regulator and the state planning agency pushed for an interest-rate cut, saying the easing measures taken by the central bank so far weren't enough to help prop up the economy, the official said. The central bank, which in mid-April approved a cut in the funds rural banks had to keep in reserve at the central bank, was now pushing for a similar cut at other banks, but only if the funds were targeted to small and medium-size businesses. Such enterprises, Chinese officials have said, have been shortchanged by the big state banks and are considered important to creating jobs and restructuring the economy.

The opponents at the session argued that cutting the reserve requirements would be ineffective because many banks were already approaching government-imposed lending limits and wouldn't be able to lend more, Chinese officials said. J.P. Morgan economist Haibin Zhu says that changes in the reserve requirement would only have "very modest" effect.

PBOC officials carried the day, the official said, by citing concerns about boosting credit growth. Two other officials said that Mr. Ma was among those convinced by the arguments.

China has experienced a credit boom in the past five years similar in pace to the economies of the U.S., Europe, Japan and South Korea before they crash-landed. The PBOC officials argued that a broad rate cut would inevitably mean credit would flow to the very sectors China has been trying to rein in, such as property, steel and other industries beset by overcapacity, according to the official familiar with the meeting.

Press officials at the State Council, Finance Ministry and the NDRC referred questions to the central bank.

The PBOC and the China Banking Regulatory Commission press officials didn't respond to requests to comment.

In the end, the State Council agreed to limited measures, including reducing business fees, and tightening regulation on so-called shadow-banking institutions, such as trust companies, leasing companies and other informal lenders, as a way to reduce borrowing costs for business. It also approved the reserve-requirement reduction aimed at smaller businesses.

Details continue to be thrashed out. Central bank officials were scheduled to brief reporters on supporting small businesses and the agricultural sector Thursday. But the news conference was canceled, an official from the State Council, which was organizing the event, said Wednesday, without providing a reason.

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