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China: Monitoring of Monetary Easing

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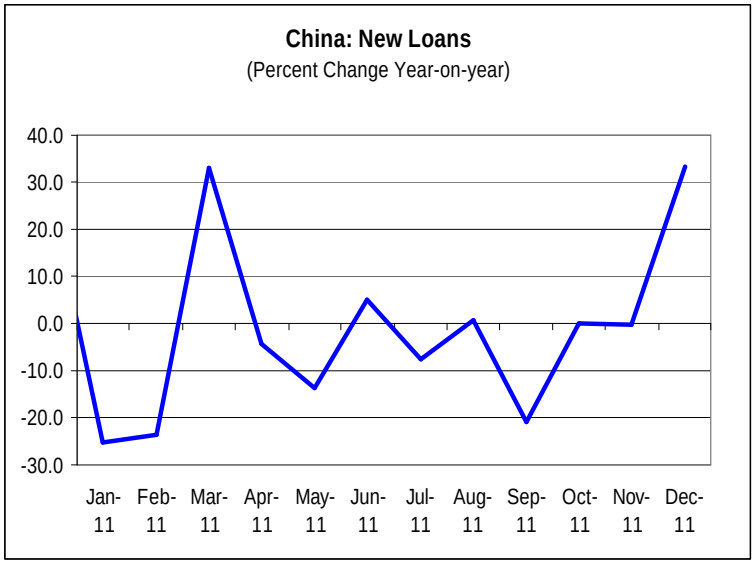
China's December lending data suggest that monetary policy may have entered a decisively easier phase. New loans, for example, rose 33% year-on-year, after dropping 8% year-on-year during the first 11 months of the year. On a monthly basis, loans jumped 12.4%.

This increase is probably part of a trend; further relaxation of credit is likely in the months ahead. In fact, it is quite likely that the PBOC, which reduced bank reserve requirements in December, will do so again in the near term, and perhaps repeatedly during 2012.

Conditions in the economy seem to support the central bank's easing bias. Inflation, for example, dropped to 4.1% year-on-year last month, within the PBOC's comfort zone and far from the 6.5% post-global recession peak. It should also be pointed out that the inflation trend is still, at least for the moment, downward, and that policymakers have in recent days given increasingly clearer signals that the balance of risk has, in their eyes, moved in the direction of recession.



Not that the economy is in or near-recession. Activity has certainly slowed, and it may still be (gently) slowing. But by all indications real GDP is still possibly in the 8.5%-to-9.5% range that would be quite acceptable to policymakers—a *soft-landing* range.

Nonetheless, Chinese producers face significant headwinds from abroad, and the authorities seem now convinced that it is time to remove the macroeconomic constraints that they put in place to slow growth from double-digits. As exports continue to decelerate, and given that they are substantially exposed to Europe's troubles, China's policy turns towards stimulating domestic demand, particularly consumption. As part of this effort, in addition to the monetary policy loosening already underway, there will probably be a series of measures designed to increase consumer's purchasing power, including targeted tax breaks and subsidies on the lower end of the income distribution. As for exchange rate policy, the odds of a more stable renmimbi are growing, with only minimal changes (1%-to-3 or 4%) during the next year or so, as exporters face a weakening European demand and the Chinese trade surplus shrinks into irrelevance.