Rate of inflation 'still low'

Central bank signal comes amid division over interest rate hikes

Central bank governor Zhou Xiaochuan said yesterday China's inflation rate remains "relatively low", amid ongoing debate among officials and economists on when policymakers should raise interest rates to rein in rising inflation and asset prices.

The inflation rate still needs to be "closely watched", Zhou told reporters in Sydney after a meeting with other central bankers.

China's consumer price index (CPI), a major measure of inflation, rose by 1.9 percent in December from 0.6 percent in November, due to the country's ample liquidity. The country initiated its economic stimulus plan to keep economic growth stable in late 2008. Chinese banks extended 9.6 trillion yuan ($1.4 trillion) in new yuan loans in 2009, almost double that of 2008, while the lending in January is forecast to reach 1.3 trillion yuan.

The rapidly rising inflation, together with surging house prices, has led to expectations of imminent interest rate hikes. The stock market has also been declining in recent trading days as investors expected more tightening policies following the country's move to raise the reserve requirement ratio of commercial banks and tighten real estate deals.

But Dai Xianglong, chairman of the influential National Social Security Fund, said in a speech in India on Monday that China was unlikely to raise interest rates in the first half of 2010 as the economic recovery was still not on solid ground.

Dai, a former central bank governor, said that despite possible policy adjustments to combat inflation and asset bubbles, money and lending supply will remain relatively loose over the course of the year.

"Interest rate hikes are not the most appropriate tool if policymakers want to control inflation," said Zuo Xiaolei, chief economist of China Galaxy Securities.

China's recent inflation rise, in essence, stems from increasing liquidity in the financial system. The best way to curb inflation is to raise banks' reserve requirement rate or conduct open market operations, she said.

China announced the raising of banks' reserve requirement ratio, or the proportion of money commercial banks must keep in reserve, on Jan 12. It has also resorted to a number of open market operations to mop up liquidity as banks rushed to lend to pre-empt a possible tightening of policy.

China may continue to raise the requirement ratio this year, possibly increasing it three or four times to 18 percent from the current 16 percent, said Qu Hongbin, chief China economist of HSBC.

Qu said an interest rate hike could come in April because inflation could be very serious if interest rates are not raised. China is scheduled to release its first-quarter economic data in mid-April.

Economists also forecast that China's CPI could be mild in January, because of the relatively high base of last January. China's traditional Spring Festival fell in January last year.

But it can rise up to 3 percent in February as consumption can still pick up during the Chinese New Year period, which starts on Feb 14, analysts said. Inflation could stabilize later, Nomura Securities reported.

"If that happens, the possibility of interest rate hikes would decrease," said Zhang Lan, head of research at Shanghai-based Changjiang Securities.

Source: China Daily