Active Policy Rule versus Ineffective Monetary Policy: TVP-VAR Analysis of Chinese Monetary Policy from1994 to 2012

PhD student from Hitotsubashi University Cicely Liu

This paper aims to provide an analysis on the effectiveness of the monetary policy in China during the past two decades by using the time-varying parameter structural vector Autoregression (TVP-VAR) with stochastic volatility. The TVP-VAR model, combined with stochastic volatility, enables us to capture structural changes in underlying structure of the Chinese economy in a flexible and robust manner. The Markov chain Monte Carlo method is employed for the estimation of the TVP-VAR models with stochastic volatility. Both the policy rule and effectiveness of the monetary policy are explored from three perspectives: inflation, output and real effective exchange rate in this paper. We come to a conclusion that money supply policy is an active monetary policy rule but it is not effective. One of the reasons may be the exchange rate regime changes. This paper is the first attempt to use TVP-VAR model to analyze Chinese monetary policy.

Keywords: Chinese monetary policy, exchange rate regime, TVP-VAR with stochastic volatility, MCMC

JEL codes: E52