Homework #3 – News Review

Title: China’s Central Bank Raises Interest Rates on Mortgages
Author: Keith Bradsher
Source: The New York Times, March 17, 2005

This article discusses the interest rate hike conducted by the central bank in China on mortgages from 5.31% to 5.51%. The move is in an effort to grasp control over an economy that is growing at an “unsustainable rate”. Real estate prices in China have been soaring, faster than those in the US, at a rate of 10.8% in the fourth quarter of 2004. Chinese leaders have pledged to constrain the Chinese growth rate to 8% in 2005, as opposed to the 9.5% in 2004, and the adjustment of the interest rate is part of the plan to cool down the property market. If the economy does continue to grow at this rate throughout the year, oil, energy, and other commodities in huge demand in China will experience large price increases around the globe. In a further effort, the central bank in China has convinced banks to hold loans to 15% to slow investment spending.

It’s a common belief that economists are constantly seeking to stimulate the economy, however, in China’s case, the booming economy may becoming out of control. Economists most likely believe that the economy is above potential GDP, and thus have reverted to raising the interest rates on mortgages. This will in effect reduce consumption of property, investment in property, and foreign investment (March 18, “III. Short Run Effects of Money”). The aggregate demand curve will shift downward, moving the economy back to potential without inflation. The move to restrict loans will reduce the amount of money reintroduced into the economy by banks. This will also reduce aggregate demand and set the price level back to potential (March 21, “A. An increase in
the Quantity of Money at full employment”). The article also notes that there is large speculation on the inflation of the Chinese yuan. This may be the cause behind the huge investments in the economy. If people hold on to their money, it will lose value, however if they invest in assets, namely property, they will make money over time (March 18, “I.A. Influences on Money Holding”).

Word Count: 343