

Household Indebtedness and the Consumption Channel of Monetary Policy: Evidence from China

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Summary

Empirical evaluations of monetary policy have traditionally focused on the responses of macroeconomic aggregates. Instead, this paper uses detailed Chinese household survey data to uncover substantial heterogeneity in the effects of monetary policy upon consumption at the household level. This allows our study to answer numerous questions that cannot be addressed with aggregated data. One exemplary question is the importance of different transmission channels. Another question is what possible different reaction patterns depend on.

The specific focus of this paper is the impact of household indebtedness on the consumption channel of monetary policy. Employing Chinese household-level survey data and a panel

smooth transition regression model we shed light on the effects of household indebtedness. Equipped with these data and a flexible nonlinear modelling approach, we are able to estimate the dynamic responses to monetary policy at a high level of disaggregation.

We find that the balance sheets of households, approximated by their indebtedness, affect the consumption response to monetary policy shocks. It is shown that this effect is nonlinear as there is a much larger counteraction of consumption in response to monetary policy shocks when household indebtedness increases from a low level rather than from a high level. Furthermore, the weakened monetary policy transmission from indebtedness is stronger in urban households than in rural households. This can be explained by the investment good characteristic of houses in China.

Taken together, the micro-level data yield a number of new insights that may guide policy makers and future theoretical modelling work alike. Understanding how monetary policy shocks and policies affect different types of households has the potential to improve our modelling of aggregate dynamics compared with the restrictive approach of imposing that aggregate household behaviour can be adequately represented by a single, representative household.