Pushing on a String: State-Owned Enterprises and Monetary Policy Transmission in China

Hongyi Chen
Hong Kong Institute for Monetary Research

Ran Li
Bank for International Settlements

and

Peter Tillmann
University of Giessen

April 2018

Summary

It is often argued that monetary policy is unable to "push on a string". By using this metaphor, market participants and central bank observers describe the notion that tighter monetary policy can pull the economy into a recession when financing constraints are binding. Easier monetary conditions, however, can only relax financial constraints but cannot push the economy into an expansion. The available empirical evidence for the US supports this notion. As a result, tightening shocks should have larger effect on the real economy than easing shocks.

We study whether a "pushing on a string" phenomenon can be found for China. The case of China is particularly interesting because it offers a specific: the large role of state-owned enterprises (SOEs), which have better access to external financing. Our main hypothesis is that the presence of SOEs gives rise to an asymmetric adjustment to monetary policy shocks. Suppose SOEs are indeed characterised by (i) government interference into their operations

and (ii) preferential access to finances. A policy tightening should have stronger effects on private firms and smaller effects on SOEs, since the latter is not equally exposed to an inward shift in credit supply as a consequence of the policy move. Now think of a policy easing: the state-owned sector might expand more than the private sector because authorities could interfere into the management of SOEs in order to use SOEs as a vehicle to support expansionary policies. As a result, SOE activity should expand more strongly than economic activity of private firms.

We use an identified monetary policy shock from the literature and a battery of VAR models, local projections and a large firm-level data set. Overall, we find that easing shocks have stronger effects on SOEs than tightening shocks. This translates into an asymmetric response of Chinese GDP and other measures of real activity. Thus, in contrast to other advanced economies, monetary policy is able to "push on a string" and is more effective when it provides additional stimulus compared to a situation where policy tightens.