Monetary Policy and Bank Lending in China — Evidence from Loan-Level Data

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October 2013

Summary

Bank credit remains the most important channel of financial intermediation in China, even as money and capital markets have developed rapidly. Under a "dual-track" interest rate system, benchmark interest rates in the banking system are regulated and set by the central bank but money and bond market rates are market-determined. Reflecting the evolving structure of the financial system, the monetary policy framework has increasingly focused on guiding market rates toward desired levels, although quantity-based policy instruments remain important.

In this paper we investigate how monetary policy in a mixed system like that of China affects bank lending using a newly constructed loan-level dataset. We develop a stylized model to illustrate the mechanisms through which bank lending is affected by market-determined interest rates under the dual-track interest rates system. The empirical findings are consistent with theoretical predictions: loan rate is affected not only by the regulated benchmark deposit rate, but also by market-determined interest rates. On the other hand, loan size does not appear to be sensitive to either the regulated rate or the market rate; instead, it seems to be affected by an implicit quota imposed on aggregate bank lending as a policy instrument of window guidance.

These findings suggest that the monetary policy framework in China is still in a state of transition. Traditional policy instruments such as the benchmark deposit rate and loan quota still play important roles in influencing bank lending. However, market-determined interest rates have already started to play a significant role in influencing banks' pricing decisions, although loan size does not appear sensitive to movements in market interest rates. Sensitivity of loan size to market interest rates is expected to increase and the importance of quantity-based policy instruments is expected to diminish, as the PBC moves and maintains its benchmark bank rate or policy rate closer to equilibrium levels. Overall, with further progress in commercialization of state banks and interest rate liberalization, the role of market interest rates in determining banks' lending behavior is expected to become even larger.