The Response of Corporate Financing and Investment to Expansionary Monetary Policy: Evidence from China

Graduate School of Economics, Waseda University
Cai Yue (Graduate Student)

This article studies the role of heterogeneity in firms' productivity in determining the response of corporate financing and investment to monetary policy shocks. We combine monetary policy shocks, measured using the exogeneous M2 growth rates, with firm-level outcomes from yearly CSMAR (China Stock Market & Accounting Research Database) data over the 2003-2013 period. Using regression of total bank debt on the interaction between the monetary policy shock and the firm-level total factor productivity (TFP) as well as various firm level outcomes, we find the coefficient of interaction is negative and significant. One firm lies at the 90th percentile of the TFP distribution exhibits a 1.09 times larger elasticity of total bank debt with respect to monetary policy shock than another firm lies at the 10th percentile of the TFP distribution. Estimation of a linear investment equations shows that the coefficient of the interaction between monetary policy shock and TFP is positive and significant. On the investment dimension, firm lies at the 90th percentile of the TFP distribution reacts an additional 7.8% more than the firm lies at the 10th percentile of the TFP distribution.

Our research reveals the need for policy makers to carefully consider the distribution effect of monetary policy in the developing countries. Policies based on the traditional credit channel of monetary policy may not achieve the goals: constrained firms with high productivity will increase borrowing and investment in response to expansionary monetary policy. The expansionary policy is, in this cases, even harmful to the economy because it causes misallocation of credit across firms.