Financial Accelerators and Business Cycle Transformation in China: Evidence from an Estimated DSGE Model

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Abstract

We quantify the role of the housing financial accelerator (FA) in China's business cycles using an estimated DSGE model. Comparing specifications with (FA) and without (NoFA) the mechanism on quarterly data 1999-2019 using Bayesian methods, we find the FA mechanism is crucial. It not only reverses the transmission of housing shocks to consumption and improves model fit, but fundamentally acts as a cycle transformer, its presence shifts the primary drivers of macroeconomic fluctuations from aggregate technology shocks to sector specific shocks .Housing preference shocks overwhelmingly drive house price volatility and exhibit distinct high and low volatility regimes, with high volatility concentrated in 2005-2012.

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