Reserve Requirement and Optimal Chinese Stabilization Policy: Discussion

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ABFER

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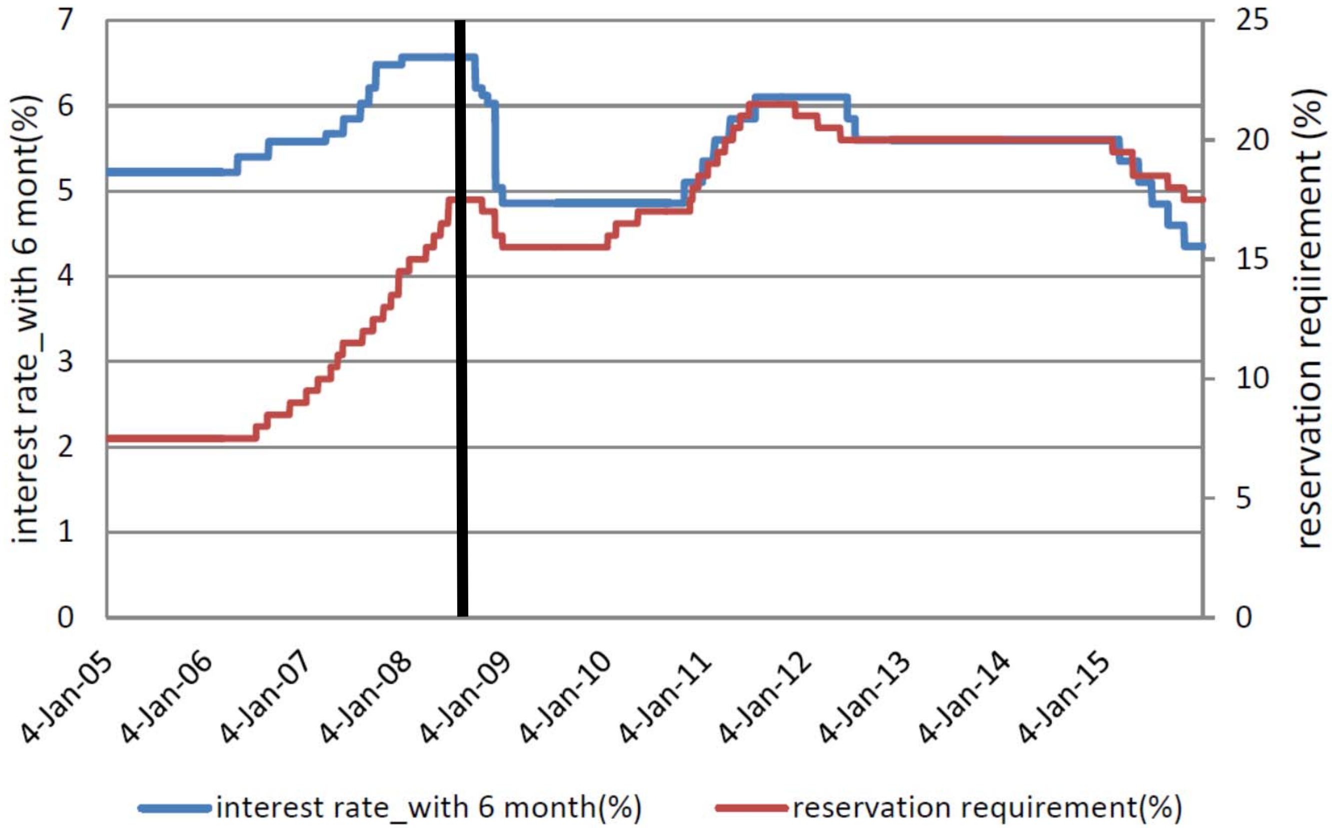
This Paper

- Welfare implications of monetary policy in a distorted economy like China
  - New insight, nice empirical evidence and solid quantitative exercise

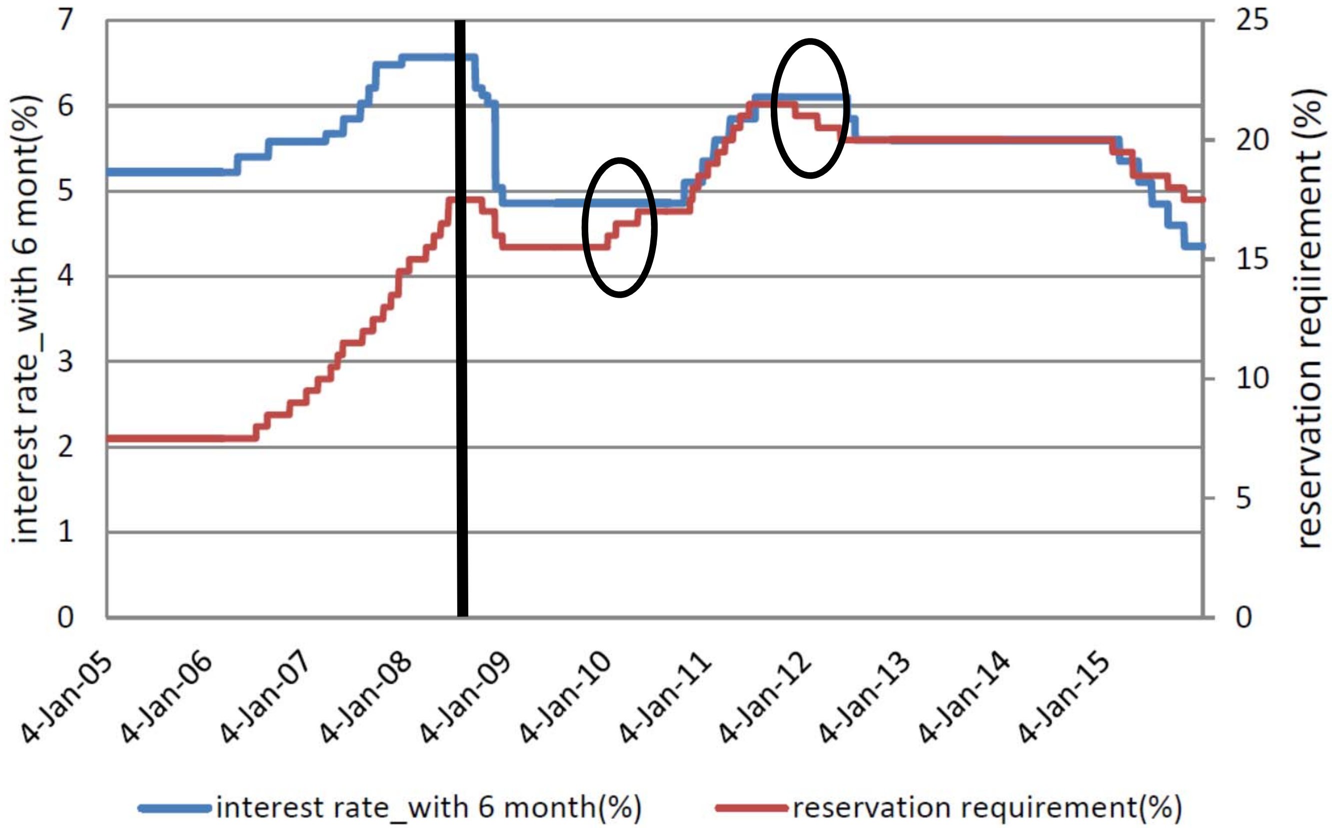
- Two distortions: $R_s \neq R_p$ and $(R_s - 1)(1 - \tau) = R - 1$
  - From government guarantee for SOEs, which is hard to correct by R policy due to the perfect R transmission for SOEs holding RRR fixed
  - From off-balance-sheet loans for private firms ("reduced-form") and RRR, a wedge that can be used to correct the first distortion

- Mechanisms:
  - RRR $\uparrow \rightarrow R_s/R \uparrow \rightarrow$ Private sector $\uparrow$ + Bailout $\uparrow$
  - Much richer policy implications in DSGE framework

Interest Rate vs. RRR

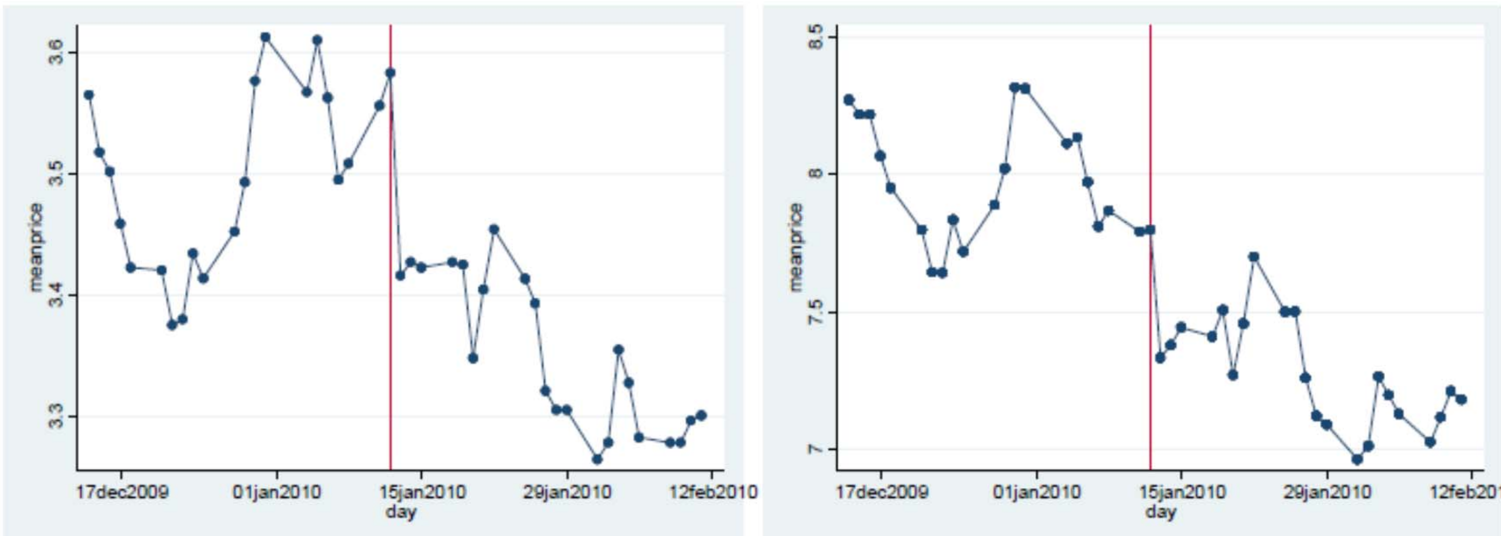


Interest Rate vs. RRR



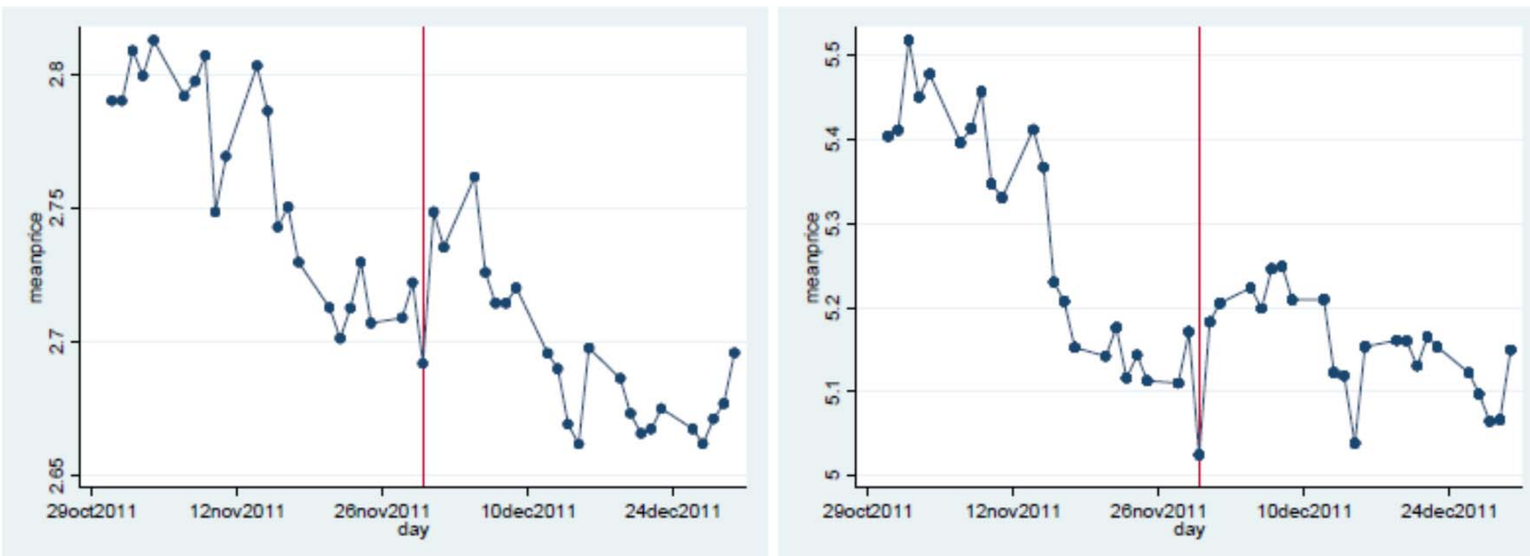
Stock Market Responses (RRR↑ R unchanged)

2010-01-12 15.5 16↑



Stock Market Responses (RRR↓ R unchanged)

2011-11-30 21.5 21↓



So, Why Is RRR Adjustment Needed?

- Distorted interest rate
  - Weak R transmission mechanism
  - Asymmetric financial frictions

- Quantity vs. price rules
  - Low R elasticity of money supply
  - The legacy of planned economy (e.g., loan quota)

- Caveat: Unintended consequences …

Quantitatively Small Welfare Gain?

- Start with the case in which the price rule doesn’t work very well for China (weak R transmission / low R elasticity of money supply / other shocks)

- Find bigger welfare gains by conducting optimal RRR policy