

Discussion of K.Chen, J.Ren and T.Zha's
"Nexus of Monetary Policy and Shadow Banking
in China"

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Questions:

How does monetary policy shock transmit to credit supply in China?

Answer:

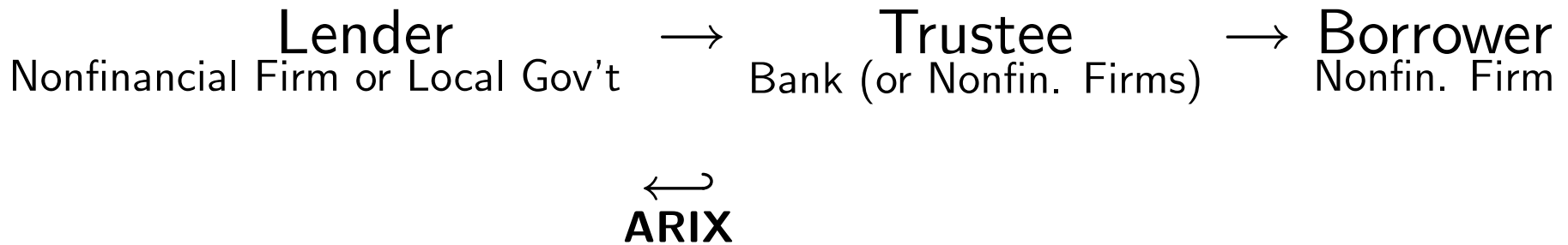
Unexpected drop in M2 growth rates leads to a contraction of bank credit and an expansion of shadow bank credit

Approach:

VAR of aggregate variables and panel VAR of bank level data

Shadow Bank Data

Entrusted loans (off B/S of bank):



Banks buy the beneficiary rights of entrusted loans directly or indirectly: Account-Receiveable Investment, excluding central gov't securities (on B/S of bank)

Share of shadow bank loans is 11% in 2008 \rightarrow 20% in 2013

About a half of them is entrusted loans

Share of nonbank, state bank, and nonstate bank $\simeq \frac{1}{4} : \frac{1}{4} : \frac{1}{2}$

Typical transmission of Monetary Tightening

Central Bank: CB	
Loan to PD ↑ ↘	CB Bill ↑
Gov't Bond ↓	Reserve ↘

Primary Dealer: PD	
Gov't Bond & CB Bill ↑	CB Loan ↑ ↘
Deposit at Bank ↘	

State Bank	
Reserve ↘	CB Loan
ARIX	Deposit ↘
Bank Loan ↘	Equity

Nonstate Bank	
Reserve ↘	CB Loan
ARIX ↗	Deposit ↘
Bank Loan ↘	Equity

Comments

Impressive work, especially construction of shadow bank data

Policy Implications

Monetary tightening is partly offset by expansion of shadow bank credit

Monetary tightening may make financial system more unstable

As long as interest rates on bank loans and deposit are suppressed low,

(a) A broader bank credit targeting may lead to credit expansion by nonfinancial firms, e.g. Aribaba

(b) Those who decide where to allocate funds are influential

Needs gradual financial liberalization

(a) Stop low interest rate policy on loans and deposits

(b) Those who used to decide fund allocation will lose their influence

(c) Need market discipline of local government's business, including default

(d) Need liberalization of foreign financial transactions eventually