Journal of Monetary Economics

August 23 2018

Reserve requirements and optimal Chinese stabilization policy

Summary

"China's central bank frequently adjusts reserve requirements for macroeconomic stabilization. We evaluate the effectiveness of such policy in a two-sector DSGE model. A heavy-industry sector—proxied as state-owned enterprises (SOEs)—is financed through government-guaranteed bank loans subject to reserve requirements, while more productive private firms rely on unregulated off-balance sheet financing. Increasing reserve requirements reallocates resources towards private firms, raising both aggregate productivity and SOE bankruptcies. Optimal reserve requirement adjustments complement money supply adjustments in improving macroeconomic stability and welfare. However, gains are greater under sector-specific shocks, which call for resource reallocation, than under aggregate shocks."

Recommended Citation:

Chang, Chun, Zheng Liu, Mark M. Spiegel, and Jingyi Zhang. "Reserve Requirements and Optimal Chinese Stabilization Policy." *Journal of Monetary Economics* 103 (May 2019): 33–51. https://doi.org/10.1016/j.jmoneco.2018.08.005.