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Chengsi Zhang, Yuchen Sun



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# Confidence in Monetary Policy: Evidence from China

Chengsi Zhang<sup>1\*</sup>, Yuchen Sun

China Financial Policy Research Center, School of Finance, Renmin University of China

zhangchengsi@gmail.com

zhangcs@ruc.edu.cn

\*Correspondence: School of Finance, Renmin University of China, 59 Beijing Zhong Guan Cun Street, Beijing, China, 100872. Fax.:+86-10-82509261

## Abstract:

Is confidence an important channel through which monetary policy affects the Chinese real economy? To answer this question, this paper uses a counterfactual structural vector autoregression method and examines the impulse responses of entrepreneurs' confidence to a monetary supply shock for China. The empirical results show that an easing monetary policy can inspire confidence and stimulate economic growth. However, the effectiveness of a positive policy will be undermined if the channel of confidence is removed. Further analysis reveals that the state of confidence matters for credit and pricing decisions. These findings are robust to different measures of monetary policy in China.

**Keywords:** Confidence; Monetary Policy; Counterfactual Analysis; SVAR

**JEL Classifications:** D81; E52; E58

## 1. Introduction

During the recent global financial crisis, the role of confidence in economics has been widely discussed and intensively examined. Although there is a widespread belief that confidence is a crucial factor in the transmission of policy shocks to economic activities, there is little evidence and agreement on whether and how confidence could have an impact on the real economy. As Fuster *et al.* (2010) recently noted, "If a sample of macroeconomists were forced to write down a formal model of animal spirits, most wouldn't know where to start and the rest would produce models that had little in common."

To date, there are two major views on the role of confidence in macroeconomics, namely

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<sup>1</sup> Chengsi Zhang is Professor of Finance at School of Finance and China Financial Policy Research Center, Renmin University of China. This research is supported by the Fundamental Research Funds for the Central Universities (Grant No. 15XNI001).

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