

A Study on the Impact of China's Monetary Policy on Economic Development

*Yuxiu Tan**

School of Business, Soochow University, Suzhou, Jiangsu Province, 215021, China

Abstract. At present, China's national economy is in a stable recovery phase and is undergoing structural transformation and upgrading. At this historic key point, monetary policy, as a vital macroeconomic regulatory instrument, exerts an immensely significant role in promoting national economic development. Amidst China's pursuit of high-quality economic development and the ongoing refinement of its market system, the effect and influence of the implementation of monetary policy is increasingly being paid attention to. This paper will start from the relevant concepts of monetary policy, and by sorting out the tools, roles, economic principles, and relationship with economic development of monetary policy, its objective is to elucidate the pathways and impacts of monetary policy on pivotal economic indicators, such as economic growth, commercial credit, employment, etc. It puts forward policy recommendations such as improving monetary policy tools, strengthening the coordination between monetary policy and fiscal policy, and improving the transparency of monetary policy, with a view to providing theoretical basis and practical reference for China's macroeconomic regulation.

1 Introduction

Economic development is a cyclical process that goes through boom, recession and recovery. In recent years, affected by the epidemic, the influence of the real estate bubble burst, the challenges of economic structural transformation, and the complexity and volatility of the international situation., China's national economy has suffered a certain degree of impact. Therefore, according to the existing economic situation, the use of reasonable financial instruments to regulate the macroeconomy and improve the national economy and people's livelihood has become an important issue for the government. Monetary policy as a crucial instrument of macroeconomic regulation and control, the formulation of scientific monetary policy is of great significance to stabilize the national economy.

The impact of monetary policy on economic development has long been one of the most important topics of economics research. Currently, the research of domestic scholars focuses on the impact of the association between monetary policy and some other fields, for instance, some scholars analyze the impact of monetary policy on employment in depth through model construction [1]; some focus on the field of finance, pointing out that commercial credit is an important financing tool for enterprises in the market activities, and that the monetary

* Corresponding author : 2210409012@stu.suda.edu.cn

policy has an important impact on business credit [2]. In addition, domestic scholars are generally concerned about the effectiveness of the monetary policy transmission mechanism, for example, someone analyzes the mechanism of monetary policy through the deposit reserve policy, open market operations and interest rate policy, and then explores the future trend of monetary policy [3]. While foreign scholars focus on the innovative development of monetary policy, for example, many researchers explored the impact of innovative monetary policy tools on the liquidity creation capacity of listed commercial banks, and concluded that borrowing tools have a positive impact on the enhancement of the ability of commercial banks to generate liquidity [4].

This paper will synthesize the research of scholars at home and abroad, focus on the analysis of the influence of the government's monetary policy on economic development, and provide theoretical support and policy recommendations for the optimization of China's monetary policy.

2 Relevant concepts and theoretical foundations

2.1 Overview of monetary policy

Monetary policy, also known as financial policy, is a policy measure of macro-regulation and control of economic activities by means of regulating money supply and interest rate in order to realize macroeconomic objectives with the central bank as the main body. Its core lies in the intervention of the money market, affecting the economic subject's consumption, investment and other behaviours, and then achieve the purpose of stabilizing prices, promoting economic growth, balancing the balance of payments and so on. For instance, in the event of an overheated economy, the central bank may increase interest rate and decrease the money supply in order to restrain investment and consumption.

Common monetary policy tools are reserve requirement ratio, interest rate, open market operations, rediscount policy, etc. Expansionary monetary policy or tight monetary policy can be adopted according to the economic situation.

2.2 The role of monetary policy

Monetary policy serves as a crucial tool in macroeconomic regulation and control, with its impact primarily manifested through the comprehensive adjustment and guidance of macroeconomic activities. Through measures such as controlling the money supply, adjusting interest rates, and managing the scale of credit, the central bank has the ability to effectively influence aggregate demand levels via monetary policy, thereby achieving key macroeconomic goals, including price stability, economic growth, full employment, and balance of payments equilibrium.

Monetary policy exerts a significant influence on the interest rate level by modulating the supply and demand dynamics within the money market. This, in turn, impacts investment and consumption behaviours, thereby either stimulating or restraining economic growth. Regarding price stability, monetary policy manages inflationary or deflationary expectations by controlling the rate of money supply expansion, thereby maintaining the relative stability of the price level and providing fundamental assurance for the healthy functioning of the economy. Additionally, monetary policy regulates exchange rates and interest rate levels, which subsequently affects international capital flows and the trade balance, ultimately achieving a balance of payments. When it comes to financial stability, monetary policy prevents the buildup of systemic financial risks and ensures the sound operation of the financial system by regulating financial market liquidity. Overall, monetary policy is of

paramount importance in macroeconomic regulation and control. Its effectiveness and precision are crucial for achieving macroeconomic objectives, fostering sustainable economic development, and maintaining social and economic stability.

2.3 Relevant theoretical foundations

Economists from the Classical school argue that money is neutral, which means that the changes in money supply only have an impact on nominal economic variables, such as the price level and inflation rate, but do not affect real economic variables like real output and real wages. Now, it is generally accepted by people that the money is non-neutral in the short run and neutral in the distant future.

On the basis of such a theory, the government implements monetary policy to regulate the money supply in the market, thereby achieving the goal of macroeconomic control. For instance, the central bank reduces the supply of money in the trading market by raising the benchmark interest rate, which will increase the cost of financing for enterprises and the cost of borrowing for consumers, reduces market demand, and has a dampening influence on economic development in the short run, while at the same time reducing inflation.

3 Monetary policy and economic development

3.1 The impact of monetary policy on commercial credit

When the central bank adopts a tight monetary policy, small private enterprises will be at a financing disadvantage whether they seek bank credit financing or commercial credit financing, which will lead to a rise in internal financing for small private enterprises. Therefore, we can conclude that the implementation of tight monetary policy by China's central bank has increased the difficulty of obtaining bank credit financing and commercial credit financing, and at the same time, the bank credit financing of state-owned enterprises has a squeezing effect on small private enterprises, which will lead to a rise in their commercial credit financing [5,6].

In addition, the implementation of monetary policy by China's central bank will have an impact on the investment behaviour of enterprises, and changes in corporate investment strategy will affect the supply and demand for their commercial credit. Once a company begins to invest, the invested capital often becomes a sunk cost, which leads to a trade-off between current and future investments. When the central bank implements an expansionary monetary policy, the firm's expectation of return on investment rises, so the firm prefers to invest in the present and will increase its capital expenditures, while when the central bank implements a tight monetary policy, the firm's expectation of return on investment falls, so the firm prefers to invest in the future and will decrease its capital expenditures. From this, we can conclude that in the case of the central bank's expansionary monetary policy, enterprises will increase commercial credit financing, so as to expand investment and increase leverage in order to obtain higher investment returns; while in the case of the central bank's implementation of tight monetary policy, the enterprise's demand for investment is reduced, and will correspondingly reduce commercial credit financing [6].

3.2 The impact of monetary policy on the capital market

To foster the development of the capital market, central banks are able to inject liquidity into the economy by increasing the money supply and lowering market interest rates through expansionary monetary policy. This approach can help to enhance market confidence, reduce

financing costs and increase liquidity. According to the wealth effect, the assets that people hold can be divided into two main categories: financial assets, which include stocks, bonds, and real estate, and monetary assets, which consist of cash and deposits. The central bank increases the amount of money in the market through policies such as open market operations and reducing the deposit-reverse ratio, which is conducive to promoting the price of financial assets such as stocks; when the price of financial assets rises, consumer confidence in consumption increases with it, which indirectly affects consumption and thus promotes the development of the capital market [9,12]. At the same time, the central bank by reducing interest rate and thus increasing the price of bonds and other financial assets, can likewise increase consumer confidence, thus promoting the prosperity of the capital market, and promote economic growth.

3.3 The impact of monetary policy on the macroeconomy

Controlling inflation has always been a major function of monetary policy. The central bank can regulate the money supply and credit conditions through monetary policy to ease inflationary pressure and ensure price stability. Specifically, when inflationary expectations rise, central banks usually adopt tightening monetary policy measures, such as increasing borrowing costs by raising the benchmark interest rate to reduce the amount of money circulating in the market, thereby reducing the purchasing power of consumers and enterprises and curbing excessive demand growth. At the same time, the Central Bank can roll back liquidity in the market by reducing the amount of funds injected in open market operations to curb the further spread of inflation. These measures can control the excessive growth of money in the short term and prevent the price level from continuing to climb [8]. In addition, the currency exchange rate is also an important factor affecting the macroeconomy. The central bank is able to influence the foreign exchange reserves through the exchange rate policy, or directly purchase and sell the national currency in the exchange rate, so as to achieve the exchange rate target and thus stabilize the national economy.

3.4 Impact of monetary policy on employment

The impact of monetary policy on employment is a complex transmission process. In this process, from the point of view of interest rate policy, the central bank makes the downstream interest rate system such as company loan interest rate, personal loan interest rate, financial market interest rate, etc. change by reducing the interest rate [5]. Enterprises can obtain funds for investment at a lower cost. It is conducive to expanding the scale of enterprises and increasing production, which in turn increases the demand for enterprise employment, and promotes enterprises to increase recruitment, create employment opportunities and jobs, thereby promoting employment; the lower borrowing costs of individual investors are conducive to promoting consumption, which makes the enterprise's income increase, thereby further promoting the expansion of enterprise production.

4 Recommendations for monetary policy development

4.1 Combination of monetary policy and financial regulation

Implementing monetary policy is a lengthy process. If not properly regulated, its effectiveness and efficiency can be significantly undermined. Therefore, it is essential for us to enhance financial supervision and conduct real-time monitoring of the entire process of monetary policy implementation. For instance, the government and relevant institutions need

to gradually improve the relevant regulatory regulations, so as to promote the implementation of monetary policy; in addition, the government should also combine its own situation, hire professional technicians, scientific formulation and supervision of monetary policy, according to the current stage of the financial market to develop a good and reasonable management mechanism, through a variety of management and means to reduce the impact of the enterprise due to the financial market risk[13].

4.2 Innovative monetary policy tools

For a long time, the central bank's main tools for implementing monetary policy are limited to open market operations, interest rate policy, reserve requirement ratio and so on. Although these policies are effective, with the development of the economic situation and the rapid changes in the domestic and international situation, it is necessary to innovate monetary policy tools to cope with the complex and changing new situation.

For example, structural monetary policy tools such as securities, fund and insurance company swap facilities and stock buybacks, increased holdings of refinancing, etc. The central bank has supported refinancing through innovative structural monetary policy tools, injected vitality into the financial market and the consumer market, facilitated the sound development of the capital market, and successfully coped with the complex domestic and international situation in the context of the Fed interest rate-cutting era.

4.3 Strengthening expectation management and integrating cross-cycle and counter-cycle adjustment

Managing expectations is an important means of promoting the formation of rational expectations in the market and avoiding the impact of irrational expectations on the economy and finance. In the transmission of monetary policy, market expectations and the realization of the ultimate goal of monetary policy are complementary and inseparable. Strengthening expectation management is of great significance in building a more open and transparent monetary policy framework and forming a self-reinforcing, virtuous cycle of monetary policy operations. In the aftermath of the 2008 global financial crisis, the Federal Reserve and other major central banks in many countries initiated the use of forward-looking guidance as an instrument to amplify the effectiveness of monetary policy transmission by providing clear and anticipatory policy signals. China's central bank has also been improving its expectation management, forming a diversified and three-dimensional monetary policy communication system, articulating the monetary policy stance and releasing policy signals on a month-by-month basis through daily open market operation announcements, monthly medium-term lending facility (MLF) operations, quarterly press conferences and monetary policy implementation reports. These initiatives have effectively enhanced the efficiency of communication with the public, laid the foundation for dealing with complex and volatile market fluctuations, and helped smooth the monetary policy transmission mechanism and enhance the effectiveness of monetary policy regulation [7].

It is recommended that the central bank further strengthen the guidance of market expectations, take into account the short-term economic situation and long-term development and reform needs, and focus on the organic combination of cross-cycle and counter-cyclical regulation. Through the scientific use of structural monetary policy tools, and with fiscal and other policy synergies, focusing on supporting scientific and technological innovation, green development, boosting consumption and other key areas, to promote high-quality economic development.

5 Conclusion

This study investigates the multifaceted role of monetary policy in influencing economic development in China. It examines how monetary policy drives economic growth, stabilizes prices, regulates employment, and balances the balance of payments, as well as its practical implications. By analyzing the transmission mechanisms of monetary policy and conducting empirical research, this paper arrives at several significant conclusions.

Monetary policy is a key instrument for macroeconomic regulation and control, and its effectiveness is closely related to economic stability and growth. In this study, the theoretical underpinnings of monetary policy are reviewed and integrated with the specific context of China's economic development. The impact of monetary policy on economic growth, financial market development, and employment is analyzed through the transmission mechanisms of the interest rate channel, credit channel, and money supply channel.

The research findings indicate that China's monetary policy has a substantial impact on economic development. Specifically, expansionary monetary policies can stimulate investment and consumption by reducing interest rates and increasing the money supply. These measures, in turn, promote economic expansion, corporate investment, consumer spending, and ultimately lead to higher employment rates.

Despite the valuable insights provided by this study, several limitations remain. First, due to data constraints, the study is unable to fully account for the behaviors of all microeconomic agents that may influence the transmission of monetary policy. Second, the study primarily focuses on short- and medium-term policy effects, with relatively insufficient analysis of long-term impacts. Additionally, the synergistic effects between monetary policy and other macroeconomic policies, such as fiscal and industrial policies, are not sufficiently explored in this paper. Future research should aim to address these gaps and expand the scope of analysis in this area.

In summary, China's monetary policy has a profound impact on economic development, and its effective implementation is essential for achieving macroeconomic goals. Future research should continue to focus on the innovation and optimization of monetary policy to better adapt to the evolving requirements and challenges of economic development.

References

1. AJ. Wan, XD. Li, X. Wang, Employment effects of monetary policy - from traditional monetary policy to "job-guaranteed" monetary policy. *Fin. Dev.* **02**, 61-76(2023)
2. T. Ye The impact of monetary policy on commercial credit. *Coop. Econ. Technol.* **21**, 45-47 (2023).
3. WQ. Zhou, Analysis of the Role Mechanism and Trend of Monetary Policy of China's Central Bank. *Mod. Mark. (Lower Decade)*, **03**, 21-23(2023)
4. XD. Zhang, JW. Li, The impact of monetary policy instrument innovation on commercial banks' liquidity creation. *Fin. Res. Lett.* **73**, 106622-106622(2025)
5. YQ. Qi, Analysis and reflection on the transmission channels and effects of monetary policy in China. *Macroeco. Res.* **07**, 4-20(2023)
6. YP. Ling, Analysis of the impact of regional monetary policy synergy on regional economic integration. *China. Eco. Trade. J.* **18**, 82-84(2024)
7. J. Lv, The current risk challenges facing China's monetary policy and response suggestions. *Eng. Eco.* **05**, 42-50(2022)
8. D. Tan, The impact of monetary policy on macroeconomic stability in emerging markets. *Sci. Tec. Eco. Market*, **08**, 66-68(2024)

9. F. Li, CG. Li, Economic policy uncertainty, monetary policy rules and macroeconomic stability. *J. Xinjiang. Univ. Fin. Eco.* **01**, 35- 48(2022)
10. XM. Zhu, The relationship between central bank monetary policy and economic development. *China. Inter. Fin. Eco (in Chinese and English)*, **21**,87-89(2016)
11. B. Fen, Y. Xu, Improvement of monetary policy: financial crisis rethinking. *J. Hubei Ins. Sci. Tec.* **06**, 32-35(2017)
12. XL. Dai, Research on the relationship between monetary policy, stock market and real economy. *China. Bus. J.* **09**, 110-113(2023)
13. WR. Din, The impact of China's monetary policy choices on the financial market. *Coop. Eco. Tec.* **17**, 50-52(2023)