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Monetary policy, cash holding and corporate investment: Evidence from China

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Abstract

This paper uses 13,766 firm-year observations between 2003 and 2013 from China to investigate the effects of monetary policy on corporate investment and the mitigating effects of cash holding. We find that tightening monetary policy reduces corporate investment while cash holdings mitigate such adverse effects. The cash mitigating role is especially significant for financially constrained firms, non-state-owned enterprises (non-SOEs) and those firms located in a less developed financial market. Cash holding also improves investment efficiency when monetary policy is tightening and tightening monetary policy enhances the ‘cash-cash flow’ sensitivity. Our empirical evidence calls for a critical evaluation on the monetary policies implemented in China which are less effective for state-owned enterprises. It also calls for a necessity for local government to further develop regional financial markets to protect vulnerable businesses, such as non-SOEs and financially constrained firms, from external shocks in order to maintain their sustainable growth and competitive advantages.

Key words: monetary policy; cash holding; corporate investment; financial constraints

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