Chinas Financial System and Economy A Review

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China's financial system has been integral to its spectacular economic growth over the past 40 years. We review the recent literature on China's financial system and its connections to the Chinese economy based on the categories of Aggregate Financing to the Real Economy (AFRE), a broad measure of the nation's yearly flow of liquidity accounting for unique features of China's financial system. While early work on China's financial system emphasizes the state-owned enterprise (SOE) reform, the recent literature explores other more market-based financing channels—including shadow banking—that grew rapidly after 2010 and have become important components of AFRE. These new financing channels are not only intertwined with each other, but more importantly often ultimately tied back to the dominant banking sector in China. Understanding the mechanisms behind these channels and their intrinsic connections is crucial to alleviate capital allocation distortion and mitigate potential systemic financial risk in China.