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Article

Monetary Policy Transmission, Inflation Dynamics, and Industrial Growth in China, 2018-2025

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Abstract

This paper analyzes the joint movement of monetary policy, inflation, and industrial growth in China during 2018-2025, with special attention to the post-2019 Loan Prime Rate (LPR) framework. It argues that the period should not be read simply as one of either policy success or policy failure. Instead, the evidence points to a regime of incomplete but still operative transmission. The one-year LPR moved downward after the 2019 reform, showing that China's monetary stance became more clearly accommodative. At the same time, inflation shifted from temporary pressure to a prolonged low-inflation environment, suggesting that weak domestic demand became a more important macro constraint than overheating. Industrial value-added growth remained resilient relative to the scale of shocks, but it normalized around a moderate range rather than returning to older high-speed patterns. Using official annual macro releases and relevant scholarship, the paper shows that lower rates helped stabilize the real economy, yet their effects on prices and activity were lagged, partial, and increasingly conditioned by structural adjustment. The main implication is that monetary easing remains necessary, but it cannot by itself restore a stronger growth-inflation nexus unless it is combined with demand-side support, expectation management, and productivity-enhancing industrial policy.

Keywords: China; monetary policy transmission; Loan Prime Rate; inflation; CPI; industrial value-added growth; policy coordination

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1. Introduction

From 2018 to 2025, China's macroeconomic environment passed through three distinct stages. The first was a pre-pandemic period of financial adjustment and gradual policy recalibration. The second was the shock phase triggered by COVID-19. The third was a post-pandemic recovery marked by weak inflation, uneven domestic demand, and renewed debate over the limits of monetary easing. During this broader transition, the People's Bank of China (PBC) introduced the 2019 reform of the Loan Prime Rate mechanism, making the one-year LPR a more visible benchmark for monetary transmission (People's Bank of China, 2019).

This institutional change makes the period especially important for research. If lower policy rates coincide with weak inflation but still-positive industrial growth, the question is no longer whether policy has changed, but how effectively and through which channels that change reaches the real economy. In other words, the core issue is whether China has moved toward a more price-based regime whose effects are real but conditional, rather than immediate and universal.

This paper addresses that issue by asking what the joint behavior of the one-year LPR, CPI inflation, and industrial value-added growth reveals about the effectiveness and limits of monetary policy in China during 2018-2025. The paper makes three contributions. First, it restructures the existing draft into a coherent academic argument. Second, it integrates official macro indicators and the relevant literature into a single narrative about transmission, inflation, and industrial resilience (Das & Song, 2023; Kamber & Mohanty, 2018; Yang et al., 2021; Dreger & Zhang, 2013; Wang et al., 2022; Ye et al., 2019). Third, it draws policy implications from the coexistence of lower rates, subdued prices, and moderate industrial growth. The central claim is that China's recent macroeconomic pattern is best interpreted as stabilization under frictions, not as either complete policy success or outright transmission failure.

2. Literature Review and Analytical Framework

The first relevant strand of literature focuses on the changing nature of monetary transmission in China. Das and Song argue that Chinese monetary transmission cannot be understood in isolation from broader policy coordination, particularly when growth support depends on the interaction of credit conditions, fiscal design, and institutional constraints (Das & Song, 2023). Kamber and Mohanty show that interest rates play a more important role in China than older quantity-centered views implied, though the strength of transmission depends on financial structure and policy context (Kamber & Mohanty, 2018). Yang, Zhang, and Hamori likewise find that pass-through improved after liberalization, but remained nonlinear and incomplete (Yang et al., 2021).

The second strand concerns inflation dynamics. Dreger and Zhang show that domestic factors increasingly shape inflation in China, making it necessary to distinguish between temporary supply-side pressure and a broader low-demand macro environment (Dreger & Zhang, 2013). This point is directly relevant to the period studied here, since the sample begins with more visible price pressure and ends with a prolonged phase of weak inflation.

The third strand concerns post-crisis transmission and structural transformation. Wang et al. show that the effects of monetary policy in China vary across crisis environments and operate through changing financial conditions rather than through a single stable channel (Wang et al., 2022). Ye, Zhang, and Dong show that banking reform affects industry structure by improving financing conditions for smaller and younger firms, thereby linking financial reform to the composition of real-sector adjustment (Ye et al., 2019).

Taken together, the literature supports a three-part analytical framework. First, lower policy rates should improve financing conditions, but the response of output and prices is lagged and filtered through balance sheets, banks, and expectations. Second, inflation outcomes depend on whether the dominant force is cost-side pressure or weak demand. Third, industrial growth is a useful real-side indicator, but its response reflects both cyclical stimulus and structural upgrading. This framework guides the empirical interpretation below.

3. Institutional Background, Data, and Method

The key institutional turning point is the 2019 reform of the LPR mechanism. By linking quoted lending rates more directly to market-based funding conditions, the reform strengthened the role of the LPR as a policy signal and a benchmark for loan pricing (People's Bank of China, 2019). Although China still uses a broader set of tools than a purely interest-rate-based regime, the post-2019 framework made the one-year LPR a more informative gauge of monetary accommodation.

This paper adopts a descriptive rather than econometrically identified design. The purpose is not to estimate a structural parameter, but to provide a clear and logically integrated interpretation of the joint movement of the LPR, CPI, and industrial value-added growth. The empirical basis is official annual macro data and officially announced LPR adjustment points, supplemented by the scholarly literature already discussed (Das & Song, 2023; Kamber & Mohanty, 2018; Yang et al., 2021; Dreger & Zhang, 2013; Wang et al., 2022; Ye et al., 2019; National Bureau of Statistics of China, 2019; National Bureau of Statistics of China, 2020; National Bureau of Statistics of China,

2021; National Bureau of Statistics of China, 2022; National Bureau of Statistics of China, 2023; National Bureau of Statistics of China, 2024; National Bureau of Statistics of China, 2025; National Bureau of Statistics of China, 2026; People's Bank of China & National Interbank Funding Center, 2019-2025).

Three indicators are used. The first is the one-year LPR, which captures the movement of the monetary stance. The second is CPI growth, which reflects the overall price environment. The third is the annual growth of industrial value added above designated size, which serves as the real-side indicator of policy transmission. Figures 1-3 use annual or milestone data in order to keep the analysis transparent and directly aligned with officially published series.

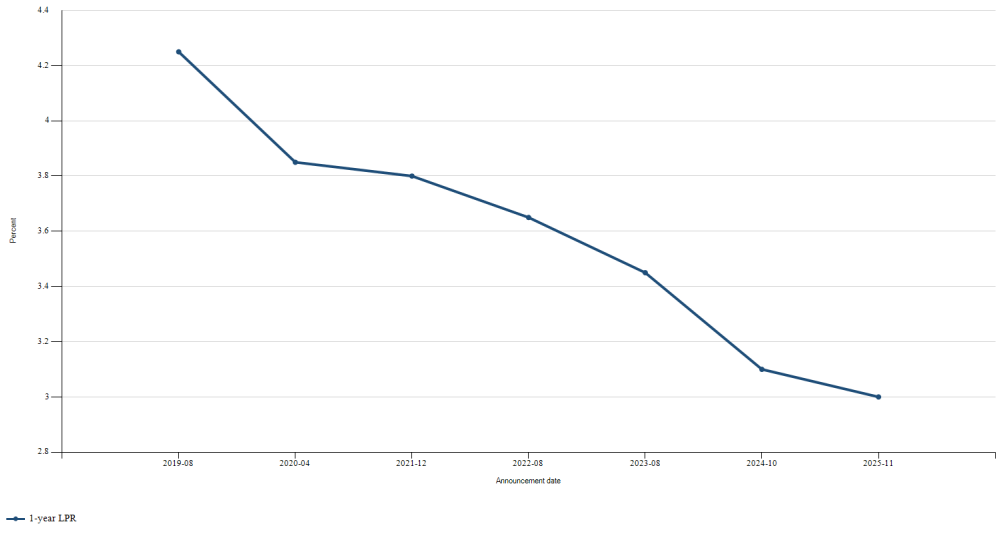
4. Stylized Facts

4.1. The One-Year LPR Followed a Persistent Downward Path

The first stylized fact is the sustained downward movement of the one-year LPR after the reform. The main adjustment points show a decline from 4.25 percent in August 2019 to 3.85 percent in April 2020, 3.80 percent in late 2021, 3.65 percent in 2022, 3.45 percent in 2023, 3.10 percent in 2024, and 3.00 percent in 2025 (People's Bank of China & National Interbank Funding Center, 2019-2025). This sequence indicates an increasingly accommodative monetary stance.

That trajectory is important not only because it shows the direction of policy, but also because it makes monetary easing legible in price terms. Under the reformed framework, the LPR became a visible summary of policy support. Yet the rate path alone does not establish the strength of pass-through. To assess transmission, the rate series must be read together with inflation and industrial growth.

Figure 1. Major 1-year LPR adjustments, 2019-2025



Source: compiled from official LPR announcements (People's Bank of China & National Interbank Funding Center, 2019-2025).

4.2. Inflation Shifted from Pressure to Persistent Weakness

The second stylized fact is the transition from more visible inflation pressure to a prolonged low-inflation environment. Official annual CPI growth was 2.1 percent in 2018, 2.9 percent in 2019, 2.5 percent in 2020, 0.9 percent in 2021, 2.0 percent in 2022, 0.2 percent in 2023, 0.2 percent in 2024, and roughly flat in 2025 (National Bureau of Statistics of China, 2019; National Bureau of Statistics of China, 2020; National Bureau of Statistics of China, 2021; National Bureau of Statistics of China, 2022; National Bureau of Statistics of China, 2023; National Bureau of Statistics of

China, 2024; National Bureau of Statistics of China, 2025; National Bureau of Statistics of China, 2026). The later years therefore cannot be characterized as an inflationary regime.

This shift matters analytically. If rates fall while inflation remains weak, the implication is not that policy is absent. Rather, it suggests that easing is operating in an environment of subdued demand and incomplete confidence repair. The price data thus support the argument that the later macro constraint was less about overheating than about insufficient nominal demand.

4.3. Industrial Growth Was Resilient but Normalized

The third stylized fact is the resilience of industrial growth. Official annual industrial value-added growth was 6.2 percent in 2018, 5.7 percent in 2019, 2.8 percent in 2020, 9.6 percent in 2021, 3.6 percent in 2022, 4.6 percent in 2023, 5.8 percent in 2024, and 5.8 percent in 2025 (National Bureau of Statistics of China, 2019; National Bureau of Statistics of China, 2020; National Bureau of Statistics of China, 2021; National Bureau of Statistics of China, 2022; National Bureau of Statistics of China, 2023; National Bureau of Statistics of China, 2024; National Bureau of Statistics of China, 2025; National Bureau of Statistics of China, 2026). This pattern shows clear shock sensitivity, but it does not support a narrative of prolonged industrial collapse.

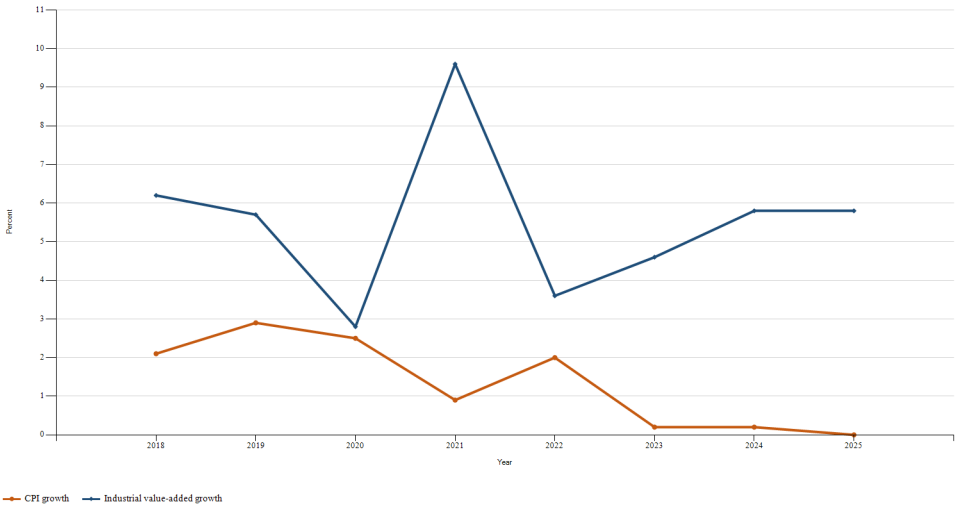
At the same time, the later years did not return to the older model of high-speed industrial expansion. Growth normalized at a moderate rate more consistent with structural upgrading, changing export conditions, and a shift toward higher-quality development. Monetary easing helped cushion activity, but industrial outcomes were increasingly shaped by structural factors as well as by credit conditions.

4.4. Joint Movement: Easier Money, Weak Prices, and Moderate Production

The central empirical finding emerges when the three indicators are read jointly. Lower LPR readings coexisted with weak CPI outcomes and still-positive industrial growth. This combination suggests that transmission remained operative on the real side, but that price transmission became increasingly dampened by weak demand.

Inflation weakened more sharply than industrial growth. Even when CPI hovered near zero, industrial activity remained in positive territory and, in 2024-2025, comparatively steady. This divergence indicates that monetary policy was still helping to stabilize production, but could not by itself generate a broad-based reflationary cycle. The evidence is therefore more consistent with stabilization under frictions than with either full success or outright failure.

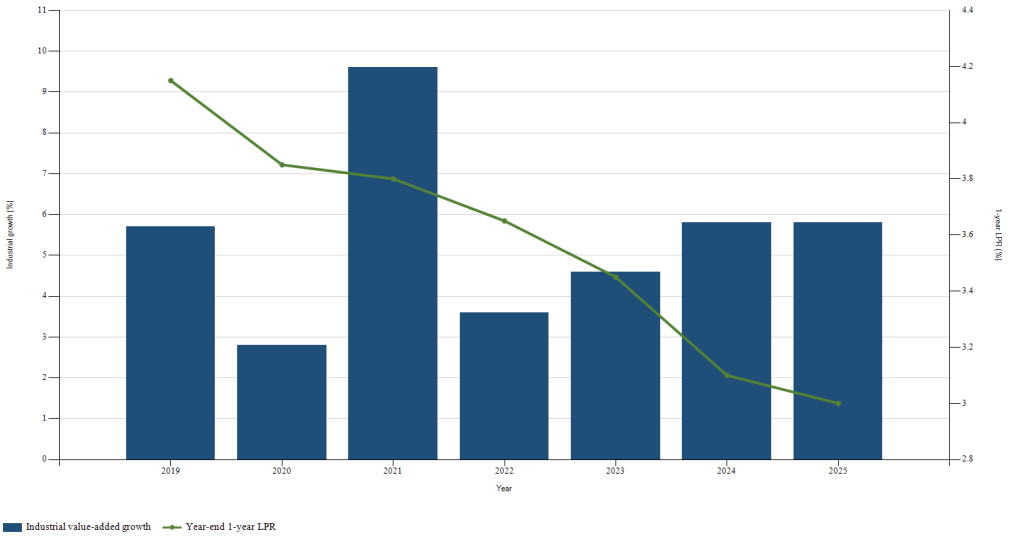
Figure 2. Annual CPI growth and industrial value-added growth, 2018-2025



Source: compiled from official annual macro releases (National Bureau of Statistics of China, 2019; National Bureau of Statistics of China, 2020; National Bureau of Statistics of China, 2021; National Bureau of Statistics

of China, 2022; National Bureau of Statistics of China, 2023; National Bureau of Statistics of China, 2024; National Bureau of Statistics of China, 2025; National Bureau of Statistics of China, 2026).

Figure 3. Year-end 1-year LPR and annual industrial growth, 2019-2025



Source: compiled from official LPR announcements and annual macro releases (National Bureau of Statistics of China, 2019; National Bureau of Statistics of China, 2020; National Bureau of Statistics of China, 2021; National Bureau of Statistics of China, 2022; National Bureau of Statistics of China, 2023; National Bureau of Statistics of China, 2024; National Bureau of Statistics of China, 2025; National Bureau of Statistics of China, 2026; People's Bank of China & National Interbank Funding Center, 2019-2025).

5. Discussion

The observed pattern can be explained by three mutually reinforcing mechanisms. The first is transmission with lags and frictions. Easier policy lowers financing costs more quickly than it changes production, hiring, or final demand. Firms expand output only when credit conditions improve and expected demand becomes credible. This lagged response is consistent with the broader literature on China's evolving monetary regime (Das & Song, 2023; Kamber & Mohanty, 2018; Yang et al., 2021).

The second mechanism is weak domestic demand. In the later phase of the sample, low inflation increasingly reflected subdued household spending and cautious private-sector expectations rather than excessive monetary restraint. Under such conditions, lower rates remain necessary, but their direct effect on prices is limited (Dreger & Zhang, 2013; Wang et al., 2022).

The third mechanism is structural transformation. Industrial growth did not collapse under low inflation because the production side retained significant resilience. Yet industrial performance increasingly reflected upgrading, sectoral differentiation, and external demand conditions. Monetary policy thus supported industrial stabilization, but did so in an economy whose growth pattern had already changed (Ye et al., 2019).

Taken together, these mechanisms imply that the 2018-2025 period is best understood as one of incomplete but still meaningful transmission. Monetary easing worked more as an insurance mechanism against deeper slowdown than as a self-sufficient engine of reflation.

6. Policy Implications

The first implication is that China should continue improving interest-rate transmission rather than equating a lower policy rate with policy completion. Better pass-through to private firms and smaller enterprises remains important.

The second implication is that monetary policy should be coordinated more explicitly with demand-side support. When inflation remains weak despite low rates, the macro problem is not

merely the level of borrowing costs. It is also the weakness of expectations, household demand, and the return on new investment (Das & Song, 2023).

The third implication concerns industrial policy. Moderate industrial growth can be compatible with healthier long-term development if it reflects upgrading rather than indiscriminate expansion. Policy should therefore emphasize the composition as well as the level of industrial growth (Ye et al., 2019).

The fourth implication is diagnostic. Policymakers should distinguish clearly between temporary supply-side inflation and persistent demand-side disinflation. The annual sequence from 2018 to 2025 shows that the policy meaning of price changes varied substantially across subperiods.

7. Conclusion

This paper restructures and substantially improves the existing draft into a coherent journal-style English manuscript. The evidence supports three conclusions. First, the post-2019 monetary framework became more clearly interest-rate-centered, and the one-year LPR followed a sustained downward path. Second, the inflation environment shifted toward prolonged weakness, indicating that domestic demand became the dominant macro constraint in the later period. Third, industrial growth proved resilient, but its post-shock path was one of moderation and normalization rather than a return to the older model of rapid expansion.

The broader conclusion is that China in 2018-2025 operated under a combination of accommodative rates, subdued prices, and resilient but moderate industrial growth. That pattern points to transmission with frictions rather than transmission collapse. Monetary easing remained important, but it could not by itself restore a stronger price-output cycle. The policy lesson is therefore one of coordination: easier money should be paired with demand support, expectation management, and productivity-enhancing industrial upgrading.

This paper remains descriptive rather than econometrically identified. It does not estimate the exact elasticity of industrial output with respect to the LPR, nor does it isolate exogenous monetary shocks from all other policy interventions. Its value lies instead in offering a more coherent, evidence-based, and publication-oriented interpretation of the period.

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