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Monetary policy and bank lending: Evidence from German banking groups ☆

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Abstract

This paper analyses the impact of monetary shocks on bank lending in Germany. We follow a cross-sectoral approach by looking at six different banking groups. In general, smaller banks hold a larger buffer of liquid assets which they can use to offset monetary shocks. In addition, the response of bank lending after a monetary contraction is very different across banking sectors. Lending by the credit co-operatives, which are on average the smallest banks, declines most, whereas big banks are able to shield their loans portfolio against monetary shocks. Overall, our results provide support for the existence of a bank lending channel.
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1. Introduction

The purpose of this paper is to provide empirical evidence on the role of banks in the monetary transmission process. The implications of the German institutional setting for the impact of monetary policy on bank lending are a priori ambiguous. On the one hand, the mere fact that banks play an important role suggests that the scope for an effective bank lending channel is potentially large. On the other hand, banks

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may try to shield their loans portfolio from monetary disturbances which may weaken, rather than strengthen, the impact of monetary policy. The latter may be particularly relevant for Germany, given the importance of long-run relationships between banks and clients in this country.

In this paper, we look whether evidence can be found for a 'bank lending channel' of monetary policy, by considering the response of bank lending to monetary shocks. It is well known that this kind of research is complicated by a serious identification problem: is the fall in bank lending after a monetary tightening induced by supply or by demand? Several recent studies based on US data have addressed this problem by analysing disaggregated data, either for borrowers (e.g. Gertler and Gilchrist, 1993a, 1994; Gilchrist and Zakrajšek, 1998) or for lenders (e.g. Kashyap and Stein, 1995, 2000). We follow the latter approach, by considering different banking groups, as defined in the Bundesbank's *Banking Statistics*. In this way, we capture one key element of the bank lending channel, namely that some types of banks (particularly the smaller ones) face more information problems and find it more difficult to neutralise monetary shocks than other types of banks (typically large ones).

Is it still sensible to look at Germany separately after the start of EMU? After all, monetary policy is first and foremost based on euro-wide aggregated data now. However, credit markets are still likely to exhibit specific national characteristics (see e.g. De Bondt, 2000). Hence, as cross-national differences in monetary transmission may complicate the implementation of a common monetary policy, it is still useful to consider individual EMU economies.

The organisation of this paper is as follows. Section 2 discusses recent literature on monetary transmission and bank lending. Section 3 gives an overview of the German banking system and discusses key characteristics of banking groups. In Section 4, we present our empirical results. We look at cross-sectoral differences in balance sheet structure and present dynamic simulations of the response of bank lending to monetary shocks. Section 5 concludes.

2. The bank lending channel

In recent years, a vast literature has developed on the effectiveness of monetary policy and the channels through which this policy works. This renewed interest in monetary transmission must be seen within the context of a revival of theories that stress the impact of the financial system on aggregate economic activity. This literature, known as the 'credit view', takes as a point of departure the assumption that financial markets are characterised by imperfections and that bank assets (loans, securities) are imperfect substitutes (see Bernanke and Gertler, 1995; Kakes, 2000). One of the implications is that monetary policy may affect the economy through a 'bank lending channel'. According to this mechanism, banks respond to a monetary contraction by reducing the supply of loans which, eventually, affects inflation and real activity.

The existence of a lending channel implies that the Modigliani–Miller propositions do not hold for both borrowers and banks. Obviously, a lending channel be-

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