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The role of banks in the monetary policy transmission in the new EU member states☆

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ABSTRACT

This paper aims to enrich the knowledge on the monetary policy transmission mechanism in the new European Union member states with empirical evidence on the impact of monetary policy on bank lending. This work is based on individual bank balance sheet data and covers a sample of commercial banks from 10 Central and Eastern European countries over the period 1998–2006. We follow the approach suggested by Kashyap and Stein (1995) and control for cross-section heterogeneities among banks. The results indicate the existence of asymmetric adjustment of loan quantities with respect to specific bank characteristics. Our findings indicate the existence of a functioning bank-lending channel through small banks. This applies in the short-run to several, but not all, of the analysed banks.

1. Introduction

A correct assessment of the monetary transmission mechanism is crucial for understanding and forecasting the effects of the monetary conditions on the real economy.

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The analysis of the differences in monetary transmission mechanisms is very important in Central and Eastern European countries (CEECs) both in the context of their forthcoming full euro-area participation (e.g. Slovenia and Slovak Republic—members of the euro area since 2007 and 2009, respectively) and in that of the existing gap in the development of their financial sectors, relative to the euro area. The banking sectors of these countries have undergone massive transformations over the last two decades marked by numerous bank failures and the accumulation of huge amounts of non-performing loans (in the early phase of economic transition). They have witnessed, at the same time, the privatisation of a large number of state-owned banks which contributed to an increased efficiency in their banking sectors (Bonin and Wachtel, 2002; Weill, 2003). Nevertheless, these countries continue to be characterised by a bank-based financial system with no viable alternatives to bank loans as sources of financing ("transition countries are over banked, but under serviced") (Hainz, 2004). Therefore, the analysis of the bank-lending channels is more than pertinent.

Moreover, the enlargement of the monetary union is thought to have increased the heterogeneity in financial structures in the euro area, and the monetary policy decisions of the European Central Bank (ECB) are likely to have had a different impact across countries.[1]

We focus on two questions: (1) what is the role of banks (i.e. bank loans) in the monetary transmission mechanism in the new EU countries, and (2) are there differences in this respect? The large majority of studies in this area focus on interest and exchange rate channels and little attention is paid to the bank-lending channel. The explanation is that the financial innovation of the recent past calls into question the importance of the bank-lending channel due to the diminished role played by the banks in the credit markets. This aspect is pertinent to the developed economies, but it does not apply to our sample of countries whose financial systems continue to be mainly bank-based where borrowers do not have viable alternatives to bank loans as sources of financing.[2]

In this paper we use a panel of individual bank-level data sets. We expect to get more precise estimates by using cross-sectional information from the data sets, thus allowing for better inference on differences across banks. To our knowledge, a similar analysis for this sample of countries does not yet exist. This paper complements similar analyses (Wróbel and Pawlowska, 2002; Juks, 2004; Pruteanu, 2004; Havrylchyk and Jurzyk, 2005; Horváth et al., 2006) to provide a complete picture of the role of banks in the monetary policy transmission mechanism in the new EU countries.

Our central aim is to identify the reaction of loan supply to monetary policy actions. In particular, we investigate the existence of asymmetries in the behaviour of banks in the aftermath of a monetary policy change. The analysis follows an approach similar to Kashyap and Stein (1995). According to their methodology, smaller/poorly capitalised/low liquidity banks react strongly to monetary policy changes, i.e. their lending activity is more sensitive compared to the larger banks.

We use disaggregated bank-level data on Central and Eastern Europe commercial banks over the period 1998–2006. A preliminary analysis on the whole sample of banks does not yield robust results. The period of analysis is relatively short and there might be a problem with the heterogeneity of our sample of commercial banks. To overcome these difficulties, the banks were separated into three groups according to their intermediation (loans to deposits) ratio. The analysis is then performed for each group, in order to identify the potential differences in banks' behaviour, inside each group, following a monetary policy tightening move. The results indicate some evidence for the existence, in the short-run of a bank-lending channel for banks with a moderate loans to deposits (L/D) ratio. Nevertheless, this conclusion cannot be generalized for the entire sample of banks.

This paper makes several contributions to the empirical literature. First of all, the analysis covers ten countries from Central and Eastern Europe, whereas most previous research consists of country-level studies. Secondly, we control for cross-section heterogeneities and thus the results are consistent with those from previous studies. In the short-run, for banks with a moderate L/D ratio, the size affects

[1] There are considerable differences in the monetary policy transmission mechanisms among the European Monetary Union (EMU) countries (mainly in intensity but also in timing), primarily explained by the existing differences in their financial structure (Ehrmann, 1998; Cecchetti, 1999).

[2] In countries with underdeveloped equity markets and weaker shareholder protection, as is the case of the Eastern European countries, companies rely to a large extent on debt (specifically on bank credit) to fund investment (Giannetti and Ongena, 2009).