Monetary policy and the banking sector in Turkey

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\textbf{A R T I C L E   I N F O} & \textbf{A B S T R A C T} \\
Article history: & We find that monetary policy influenced Turkish bank lending between 1991 and 2007 through the money and bank lending channels. While capital and GDP growth have positive and significant long-run effects on bank loan growth, inflation, bank size and efficiency are not significant determinants. The latter is despite our finding that all Turkish banks’ efficiency improved over the period. Domestic banks are unexpectedly found to be more efficient than foreign banks. With no evident dynamics or fixed-effects in loan growth we prefer the pooled-OLS estimator. We caution against assuming fixed-effects and dynamics are present as this may adversely affect inference. \\
Received 21 September 2012 & © 2013 Elsevier B.V. All rights reserved. \\
Accepted 6 August 2013 & \\
Available online 26 September 2013 & \\
\end{tabular}

\begin{tabular}{ll}
\textit{JEL} classification: & \\
C23 & \\
C26 & \\
E52 & \\
\textbf{Keywords:} & \\
Bank lending channel & \\
Efficiency & \\
Panel data & \\
Turkey & \\
\end{tabular}

1. Introduction

In last two decades, the Turkish economy has faced several financial crises that were caused mainly by poor macroeconomic conditions combined with a fragile banking system. Although the

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1 The views expressed in this paper are those of the authors and do not represent the views of BRSA.
Turkish government initiated in the early 1990s structural, legal and institutional reforms banks’
balance sheets continue to be affected by the high percentage of non-performing loans (NPLs) for a
detailed discussion see, for example, Alp and Elekdag (2011), Bakir and Öniş (2010), Ozkan-Gunay
and Tektas (2006) among others. The banking sector has been the backbone of the Turkish economy
and the government realised that a sound and efficient banking sector requires an adequate macro-
and micro-economic environment in which to operate, that will be consistent with, and help pro-
mote, the widening financial activities of commercial banks. Several research studies have recently
been published on the performance and efficiency of the Turkish banking system, see, for exam-
Demir et al. (2005, 2007). Nevertheless, we identify a gap in current research on the Turkish bank-
ing system and monetary policy. In recent years there have been a large number of studies that
try to explore the impact of monetary policy shocks on banks’ behaviour through the bank lend-
ing channel (BLC). See, for example, Kashyap and Stein (2000), Ehrmann et al. (2003), Gambacorta
(2005), Balázs and MacDonald (2009), Matousek and Sarantis (2009), Brissimis and Delis (2009),
Gambacorta and Marques-Ibanez (2011), Kishan and Opiela (2012), Brämer et al. (2013), among
others.

This study contributes to this ongoing research by providing a detailed overview of the development
of the Turkish banking system in the last twenty years. In particular, we analyse bank performance over
the period 1991–2007. Such a long observed period allows us to capture the effects of the restructuring
and consolidation process of the financial markets and to identify actual or potential problems in the
Turkish banking system and individual banks. Such information is valuable in the process of further
banking consolidation and restructuring. In addition, it contributes to the current discussion about
the competitiveness and efficiency of the Turkish banking sector in the context of the EU enlarge-
ment process. If there is significant inefficiency among banks there may be room for structural changes,
increased competition, mergers and acquisitions.

The paper contributes to policy makers and bank management by analysing the impact of the liberalisa-
tion and restructuring process of the banking sector in Turkey. Further, it provides policy recom-
endations for Turkey where significant challenges in banking consolidation remain.

Throughout the study we show the following: Firstly, based upon inference from our favoured
pooled-OLS specification, that monetary policy has a direct impact upon bank loans in Turkey through
the money lending channel. Secondly, we provide evidence that the BLC in Turkey depends on bank
characteristics (liquidity and capital) which is consistent with recent empirical studies for transition
economies, for example, Balázs and MacDonald (2009) and Matousek and Sarantis (2009). Thirdly,
banks’ liberalisation and restructuring processes in the early 1990s and 2001 had the expected effect
on the Turkish banking system in terms of improved performance (increased efficiency). This result
contrasts with the findings published by Ozkan-Gunay and Tektas (2008), Demir et al. (2007), among
others. Fourthly, we assess the hypothesis that foreign banks should be more efficient than domes-
tic banks (Isik and Hassan (2002), Mercan and Yolalan (2000)). This hypothesis is in line with the
results from transition economies see, for example, De Haas and Van Lelyveld (2006). Our find-
ings are not consistent with this hypothesis, indicating that domestic banks are, on average, more
efficient than foreign banks. Fifthly, we show that bank efficiency is not an important determin-
ant in the BLC or of the growth of bank loans more generally in Turkey. Finally, we find that
while there are dynamics in the levels of the data they are not evident in their first differences
and so we do not favour inference from the Arellano and Bond (1991) estimator. We further find
an absence of significant fixed-effects which suggests that our first difference specification likely
removes any fixed-effects that are present in the levels of the data. Hence, we favour inference
from the pooled-OLS estimator. We note that previous research on the BLC using panel data that
assumes the presence of dynamics and fixed-effects in the first differenced data may not, there-
fore, be using the most appropriate estimators for inference. We suggest that future research in
this area gives full consideration to the most appropriate estimator to be used in any particular
application.

The paper is structured as follows: Section 2 reviews current studies on the BLC and bank efficiency.
Section 3 outlines the estimation methodology and measuring cost efficiency in the banking industry.
Section 4 discusses the results while Section 5 concludes.
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