



Article

# Who responds more to monetary policy, conventional banks or participation banks?

Fatih Macit

Department of Economics, Suleyman Sah University, Istanbul, Turkey

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ABSTRACT

In this paper I investigate whether there is a systematic difference between conventional banks and participation banks in terms of their response to monetary policy shocks. For this purpose I look at the quarterly loan growth of commercial banks and participation banks in Turkish banking sector and see whether the lending channel of monetary policy differs depending on bank type. At the same time, I control for some bank specific variables, namely the log of real assets, the ratio of liquid assets to total assets and the ratio of equity to total assets. I find that participation banks show larger reaction to monetary policy. In terms of bank specific variables, banks with higher liquidity ratio tend to have higher loan growth, whereas banks with larger asset size have smaller loan growth.

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## ¿Cuáles responden mejor, los bancos convencionales o los bancos participativos?

RESUMEN

En este trabajo se investiga si hay diferencias sistemáticas entre los bancos convencionales y los bancos participativos en cuanto a su respuesta a las sacudidas en política monetaria. Para tal efecto, se ha observado el crecimiento trimestral de los préstamos de los bancos comerciales y participativos del sector bancario turco para ver si el flujo crediticio de la política monetaria difiere según el tipo de banco. Al mismo tiempo, se ha controlado por algunas variables específicas de cada banco, como el registro de activos reales, la proporción de activos líquidos respecto al total de activos y la proporción de acciones sobre el total de los activos. Se ha encontrado que los bancos participativos muestran reacciones más amplias a la política monetaria. En cuanto a las variables bancarias específicas, los bancos con tasas de liquidez mayores tienden a presentar mayor crecimiento crediticio, mientras que los bancos con activos de mayor tamaño tienen crecimientos crediticios menores.

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## 1. Introduction

The lending channel of monetary policy has been a topic of research for many economists and policymakers. The general wisdom is that when the central bank adopts a monetary policy tightening by raising the interest rates, this leads to a rise in the

funding costs of banks and therefore a reduction in loan growth. The studies reveal that lending channel of monetary policy works for many economies but the reaction of banks to changes in monetary policy is not uniform and depends on various factors. In this regard bank fundamentals have a significant impact on the lending channel of monetary policy. Peek and Rosengren (1995) found that bank capitalization, measured by the ratio of capital to total assets, affects the reaction of banks to monetary policy. Kishan and Opiela (2000) investigated lending channel of monetary policy for U.S. banks from 1980 to 1995 and they found that small banks and undercapitalized

E-mail address: fmacit@ssu.edu.tr (F. Macit).

banks were more affected by monetary policy. In another paper Kishan and Opiela (2006) analyze the lending channel of monetary policy for low-capital and high-capital banks during expansionary and contractionary monetary policy periods. They found that banks that are well-capitalized are less affected from contractionary monetary policy. Kashyap and Stein (2000) also analyzed the monetary transmission mechanism for U.S. banks and found that the lending channel of monetary policy has larger impact on banks with lower ratios of cash and securities to assets. Stein (1998) also found that banks that have lower ratio of liquid assets to total assets tend to show larger reaction to contractionary monetary policy.

The studies also reveal that bank ownership and the level of competition in the market also affect the lending channel of monetary policy. Macit (2012) studied the Turkish banking sector from 2006 to 2010 and investigated whether the ownership structure of banks affects their response to monetary policy. He finds that public banks show the smallest reaction to monetary policy, whereas foreign banks are the most responsive banks.<sup>1</sup> Bhaumik et al. (2011) analyzed the implications of bank ownership for lending channel of monetary policy for Indian banking sector. They found that bank ownership has significant impact on the reactions of banks to monetary policy. Olivero et al. (2011) investigated the impact of the level of competition in banking sector on the lending channel of monetary policy by looking at the data for commercial banks in 10 Asian and 10 Latin American countries from

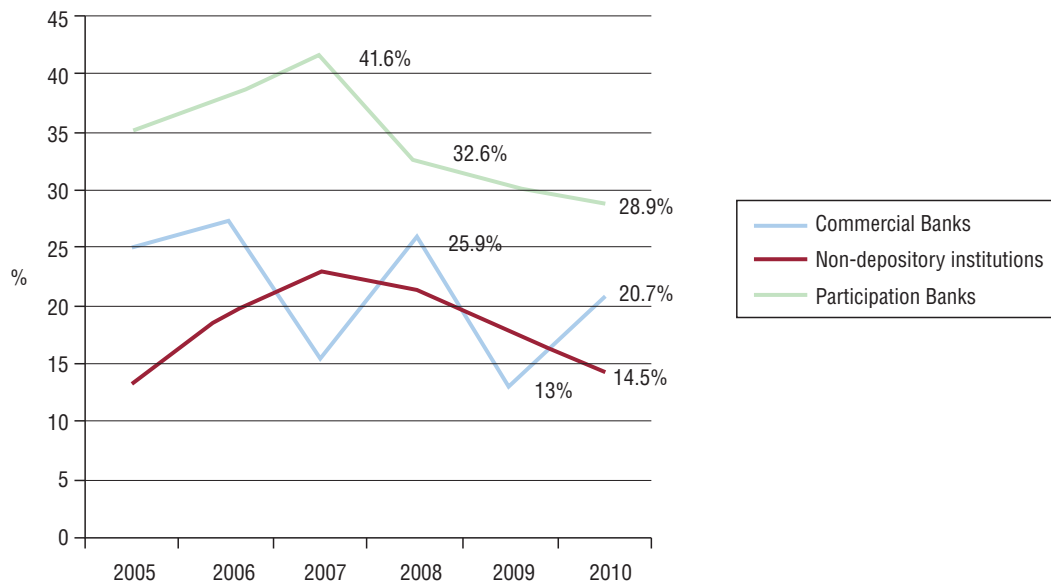
1996 to 2006. They found that the lending channel of monetary policy is weakened as the level of competition increases.

The contribution of this paper to existing literature is that it investigates the lending channel of monetary policy for the Turkish banking sector and analyzes whether banks' reactions to monetary policy change depending on their type. In particular, I probed whether there is a systematic difference in the response of commercial banks and participation banks to changes in monetary policy. In the Turkish banking sector there are three types of banks, namely commercial banks, participation banks, and investment and development banks.<sup>2</sup> Table 1 shows the number of banks and total asset size for each type by the end of the third quarter of 2011. In the Turkish banking sector, commercial banks significantly dominate the sector and they hold about 92.5% of the total assets in the Turkish banking sector. Participation banks operate according to Islamic rules in their lending and deposit collection activities, and they own about 4.4% of total assets in the sector. As opposed to commercial banks, they do not promise a fixed interest payment to their depositors. Instead, the funds that are collected from depositors are utilized in trade and industry, and the profit that is obtained from the lending pool is shared by the depositors. The name "participation banks" also stems from the fact that the depositors participate in profit or loss that results from the activities of the bank. As can be seen in Figure 1 and Figure 2, even though these banks occupy a small place in the sector, their rapid growth rate implies an important future potential for them.

In order to investigate whether there is a difference in the reactions of commercial banks and participation banks to changes in monetary policy, I looked at the quarterly loan growth of these banks to see how it is affected from a change in monetary policy instrument. At the same time, I verified for some bank specific variables, namely the log of real assets, the ratio of equity to total assets, and the ratio of liquid assets to total assets. I found that participation banks were more responsive compared to commercial banks in terms of lending channel of monetary policy. The results

**Table 1**  
Number of banks and total asset size (million TL)

Bank types	# Banks	Total asset size	% Share
Commercial Banks	30	1,121,032	92.5%
Participation Banks	4	53,550	4.4%
Investment and Development Banks	13	37,898	3.1%
Total	47	12,12,480	100.0%



**Figure 1.** The growth rate of assets for different bank types.

1. Aydin and Igan (2010), Catik and Karacuka (2011), and Alper et al. (2012) are some other examples who study the lending channel of monetary policy for Turkish banking sector.

2. I do not take into account investment and development banks when looking at whether the lending channel of monetary policy changes depending on bank type. The reason is that, as opposed to commercial banks and participation banks, these banks are not entitled to collect deposits and this might create a significant difference.

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