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The multi-regime bank lending channel and the effectiveness of the Polish monetary policy transmission during transition

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In this paper, we examine the consequences of interactions between the bank lending channel and the traditional interest rate and exchange rate channels on the effectiveness of monetary policy transmission in Poland since 1994. Using a dynamic small open-economy model, we show that the bank lending channel may either amplify or attenuate the impact of monetary policy shocks. The direction of change in the spread between a loan rate and a policy rate is a useful indicator of different regimes. Empirically, we find evidence of an attenuation regime from 1996 to 1998 and of a neutral effect of the bank lending channel, on average, after that time. *Journal of Comparative Economics* **33** (1) (2005) 1–24. Banque de France, Paris, France; CREFED–CERPEM, Paris Dauphine University, Place du Maréchal de Lattre de Tassigny, 75775 Paris cedex 16, France.

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1. Introduction

Monetary policy actions transmitted through various interrelated transmission channels have a significant impact on real economic activity, at least in the short run, and on inflation. After more than a decade since the beginning of transition, Polish capital markets are still relatively thin compared to international standards and the Polish financial system is dominated by banks. Given these stylized facts, we investigate the role played by the banking sector in the transmission of monetary policy in Poland from 1994 until the beginning of 2002. More specifically, we study the consequences of interactions between the bank lending channel and the traditional interest rate, or money, and exchange rate channels. The difficulties encountered by the authorities in seeking to control credit aggregates indicates that the Polish banking sector plays a key role in the effectiveness of monetary policy actions during the 1990s (Polański, 1998).

The main conclusion of the seminal model of the bank lending channel by Bernanke and Blinder (1988) is that this transmission channel amplifies monetary policy actions when compared to the traditional interest rate channel. As Bernanke (1993), Kashyap et al. (1993) and Bernanke and Gertler (1995) emphasize, the model predicts that variations in both the spread between loan and bond interest rates and the credit supply summarize the amplifying nature of the bank lending channel. The interest rate spread increases (decreases) and the supply of credit decreases (increases) if monetary policy is restrictive (expansionary). Following Dale and Haldane (1993, 1998) and using the model of Bernanke and Blinder (1988), Kierzenkowski (2003) shows that the bank lending channel may either amplify or attenuate the effects of the traditional interest rate channel because the result of systematic amplification of monetary policy impulses is dependent on several specific assumptions made by Bernanke and Blinder (1988).[1] This author also establishes that, after a monetary policy shock, the direction of change in the spread between loan and bond interest rates tends to be a good indicator of attenuation and amplification regimes. Following a monetary tightening (expansion), the interest rate spread increases (decreases) in the event of amplification effects and decreases (increases) if monetary policy shocks are attenuated.

However, these testable implications are not valid for Poland because the National Bank of Poland (hereafter, NBP) controls the interest rate while the model of Bernanke and Blinder (1988) assumes a base money targeting. In this paper, the impact of an interest rate control within a Bernanke–Blinder framework is examined. We consider a dynamic small open-economy model with sluggish price adjustment, imperfect nominal wage indexation, and capital mobility under two different exchange rate systems, namely, a fixed one with sterilized intervention and a floating one. Within this framework, a multi-regime bank lending channel evolves. Our main objective in Section 2 is to derive the theoretical conditions that are necessary so that the direction of change in the interest rate spread between a loan rate and the central bank's intervention rate is an indicator of the different regimes. In Section 3, we investigate empirically the impact of the bank lending channel on the potency of monetary policy transmission to the corporate sector during the Polish

[1] The existence of these additional assumptions is indicated in the cited version and details are provided in the (NBER, No. 2534) working paper version.