Does the bank credit channel of monetary policy matter in the Philippines?

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Abstract

This paper addresses the bank credit channel of monetary policy in the Philippines by adding and re-specified a dynamic, structural, economy-wide macro econometric model. The main question is whether the credit channel matters in transmitting impulses to the real economy in the Philippines. The evidence on the bank credit channel is obtained by estimating changes in bank credit that take into account not only the monetary policy indicators, but specific banking indicators to monetary policy actions, such as bank capital. Simulation results suggest that bank credit channel matters in Philippine monetary transmission mechanism. The total demand impact of changes in bank credit is the sum of various effects in the money supply, Treasury bill and lending rates, personal consumption and investment, all of which have significant impact on aggregate demand. However, the impact of a monetary policy tightening on output appears to be relatively moderate and quite long. Meanwhile, the impact on the price level appears to be stronger and shorter compared to the impact on output. In addition, bank capital is found to have significant effects on bank credit, implying that it could potentially be a key determinant of monetary policy transmission. The preliminary results also indicate a feedback loop from real output to bank credit through the financial accelerator and wealth effects.

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