EFFECTIVENESS OF THE BANK LENDING CHANNEL FOR MONETARY POLICY TRANSMISSION IN PAKISTAN

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ABSTRACT

Purpose

Transmission of monetary policy is a process whereby the central bank's decisions pertaining to monetary policies are converted into the objectives eventually desired for changes in real output and inflation (price stability). The literature identifies five channels in the monetary policy transmission mechanism. The money channel also known as interest rate channel, the credit channel, the asset prices channel, the exchange rate channel, and the expectations channel. A country's structure of the financial system and the stage of its economic development impact the way these channels function. Unraveling the role and responsibility of commercial banks in the transmission mechanism is expected to provide valuable insights for determining the effects of monetary policy on the economy. Commercial banks are a vital part of the credit channel. The channel of credit is subdivided into balance sheet channel and the bank lending channel (BLC). Studies undertaken by World Bank and IMF indicate that the developed economies exhibit existence of an effective and strong transmission mechanism as compared to the developing economies. There is mixed evidence on the effectiveness of the transmission mechanism in Pakistan. The research papers have emphasized more elaborate and in-depth coverage by future researchers to unfold the characteristics of the transmission mechanism in Pakistan.

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