Bank Lending Channel in Turkey: Evidence from Islamic and Conventional Banks

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Abstract

We examine the degree of sensitivity to interest rate changes among creditors and depositors in Islamic and conventional banks. We estimate bank lending channel proposed by Bernanke and Blinder (1992). We find that bank lending channel works for banks in Turkey on aggregate terms. An interest rate increase lead depositors to withdraw their money and in turn decrease the volume of lending in respective banks. Impulse responses for conventional and Islamic banks reveal that Islamic bank depositors' sensitivity to interest rate changes is larger than conventional bank depositors. As a response to a one standard deviation interest rate increase, Islamic bank deposits withdrawal exceeds 5% at the end of six quarters. This figure is merely 2% percent in conventional banks. From lending side, we find similar results implying that tighter monetary policy leads to similar contraction in credits.

1 Introduction

Bank lending channel simply contends that central banks can control banking sector's ability to lend by adjusting the reserve supply via open market operations. On a contractionary policy, central banks sell over open market operations to drain bank reserves. Shortly after, the level of deposits decline and banks reduce lending, once banks can not generate alternative sources of funding to compensate for this withdrawal instantly. This spill-over chain is well established yet how this mechanism works for different bank types

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is not clearly presented in the literature. In this study, we empirically compare bank lending channel in Islamic and conventional banks. Since bank lending channel incorporates the behaviour of customers (depositors) and creditors in a single mechanism, we will be able to understand different motives of Islamic and conventional banks and Islamic and conventional bank depositors.

It is well known that Islamic banks contribute to financial inclusion by including religiously motivated bank customers into the system. These banks are therefore unique finance houses for customers whose financial preferences are driven by religious beliefs. Prior research finds an association between religiosity and risk aversion no matter what the religion the individual is attached to. For example, Miller and Hoffmann (1995) report a negative correlation between religiosity and attitudes towards risk at individual level. Similarly, Hilary and Hui (2009) find that firms located in US counties with high levels of religiosity tend to exhibit lower risk exposure as measured by the variances in returns on assets or in equity returns. In a similar vein, Abedifar et al. (2013) argue that Islamic bank depositors are more sensitive to bank performance and demonstrate greater withdrawal risk than those at conventional banks. Once it is considered that monetary policy alters the opportunity cost of depositing money and thus risk perception among Islamic bank depositors, it could be argued that bank lending channel works different (none, less or more) for conventional and Islamic banks.

Since the outbreak of the global financial crisis, Islamic banking has emerged as a hope for maintaining a stable banking system. In parallel to the accelerating visibility of Islamic banking sector, increasing academic attention has resulted in a wide range of research foci. A number of studies focussed on the efficiency differences between Islamic and conventional banks (e.g. Samad, 1999; Abdul-Majid et al., 2010; Srairi, 2010). As a response to the arguments that Islamic banking is principally and practically differs from conventional banking, several papers identified the similarities and differences between conventional
banking and Islamic banking (e.g. Iqbal, 2001; Beck et al., 2013; Elnahass et al., 2013). In pursuit for a stable alternative to conventional banking system, there is now a growing literature studying the resilience of Islamic banks during the 2008 global financial crisis (Ciha´k and Hesse, 2010; Hasan and Dridi, 2011; Abedifar et al., 2013; Rajhi and Hassairi, 2013).

This study contributes to the strand of literature which tries to reveal the behavioural differences between Islamic and conventional finance (Abdelsalam et al., 2014; BinMahfouz and Hassan, 2012). We mainly investigate whether or not depositors and creditors differently respond to policy rate changes in conventional and Islamic banks. This paper contributes to the literature in several ways. First, Turkey presents an interesting case study as it has a dual banking system. This dual structure allows us to handle a comparative analysis. This paper directly measures creditors’ and depositors’ response to policy rate shocks in a dual banking system. Whilst the influence of interest rate changes is frequently discussed in conventional banks, the differences between Islamic banks and conventional banks is rarely examined within this context. Second, Islamic banking constantly gets higher stakes in global finance however the stance of Islamic banking in current complex financial web is little known. In this study, we provide evidence on the association between monetary policy and Islamic banking which deserves further evidence. As a final contribution, we examine depositors’ and creditors’ responses to interest rate changes using a panel vector auto–regression (panel− VAR) framework, which controls for bank level heterogeneity and is rarely addressed in bank lending channel studies.

In this paper, we disentangle the degree of sensitivity of creditors and depositors to policy rate changes in Islamic and conventional banks. We specifically find that bank lending channel works for banks in Turkey. As a response to interest rate increase, depositors are better–off to withdraw their money and search for more lucrative investment. This decline in turn decrease the volume of lending in respective banks. Impulse responses for conventional and Islamic banks reveal that Islamic bank depositors’ sensitivity to interest
rate changes is larger than conventional bank depositors. As a response to one standard deviation interest rate increase, Islamic bank deposits withdrawal exceeds 5% at the end of six quarters. This is only 2% in conventional banks. From lending side, we find similar results indicating that the drainage in deposits directly affect banks’ lending propensity.

The rest of this paper proceeds as follows. Section 2 reviews the previous literature and discusses the motivation behind the study. Section 3 introduces the data and methodology. Section 4 discusses the main findings, offers some robustness checks related with empirical analyses and discusses the findings. We conclude in Section 5.

2 Brief Literature and Motivation

This study examines depositors’ and creditors’ responses to policy rate changes through bank lending channel proposed by Bernanke and Blinder (1992). In their seminal work, Bernanke and Blinder (1992) argue that reserves in the banking system drains steadily followed by an increase in policy rate. A deposit shock generated from policy rate changes impacts bank lending. Since it would be costly and timely to complement the withdrawn deposits through other sources, banks tune their lending according to new level of deposits.

The impact of monetary policy changes on Islamic banks and depositors is blurred. The transmission can be ineffective among Islamic banks since Islamic banking operations ideally should not be linked to interest rate credentials. A priori proposition would suggest that Islamic banks and their depositors are insensitive to policy rate changes since these banks have different business models. The main pillar of Islamic banking is the prohibition of Riba (interest). Islamic banks operate just like equity–based companies where depositors can only have shareholder rights (Khan and Mirakhor, 1989). In this business model, banks share their earnings with their depositors according to a pre–agreed rate of profits. From this perspective, ideal mode of Islamic financing is based on the paradigm of profit–and–loss sharing (PLS) which reflects a symmetrical risk–return distribution between counterparties.
(El-Hawary et al., 2007). The PLS paradigm hence implies that conventional monetary policy tools are not operational on Islamic banks.

Whilst the principles of Islamic banking strictly prohibits interest, the claim that monetary policy transmission is effective on Islamic banks is plausible on several grounds. Just contrary to the propositions of PLS paradigm, it is widely believed that current Islamic banking practices relies primarily on non–PLS model. Accordingly, Islamic banks tend to follow their conventional counterparts in creating their assets (Dar and Presley, 1999; Chong and Liu, 2009; Charap and Cevik, 2011). These assets include a guaranteed profit margin which is very akin to conventional bank operations. Leaving aside the extant discussion whether or not this mode of financing is permissible in Islamic finance, we argue that depositors and creditors in Islamic banks may respond to policy rate changes due to the prevalence of non– PLS products in Islamic banking. Moreover, the argument that Islamic bank depositors are expected not to leave their banks as a response to interest rate changes is hard to defend. Islamic bank depositors may reconsider their investment in their banks since interest rate changes potentially offer alternative Shariah–compliant investment opportunities, e.g. the real estate investments (see e.g. Erdem et al., 2013b,a, for the dynamics of housing market in Turkey). Ideally, Islamic bank depositors keep their savings in Shariah–compliant finance houses to abstain from interest returns, however the withdrawal of deposits as a response to monetary shock do not necessarily show a deviation from Islamic principles, but a rational recalculation of utility. Therefore, we argue that monetary transmission can be effective on Islamic banks as well, putting a remark that this is not necessarily the direct result of detachment from Islamic commitment.

We know little on the impact of monetary policy on Islamic banks and their depositors. Assuming that interest rate shocks affect both Islamic and conventional banks, Islamic banks

\footnote{Demiralp and Demiralp (2014) argues that period of adjustment following a monetary policy action in Islamic banking constitutes a conundrum for Islamic bank depositors either to follow their religious beliefs or seek optimal return.}
may not be as successful as conventional banks to restore the deposit level after a positive interest rate shock. Conventional banks may effectively use deposit interest rates to attract displaced deposits, yet Islamic banks are slower in adjusting their rates of return. This time delay arising from operational difference of Islamic banks may hinder these banks to recollect enough deposits. At this stage, we can at least argue that bank lending channel works different for Islamic than conventional banks, assuming bank lending channel works for Islamic banks as well. We therefore hypothesize that Islamic banks respond harsher than conventional banks to interest rate shocks.

The relationship between monetary policy and rates in Islamic banks and conventional banks is investigated in a number of countries whose banking system is composed of Islamic and conventional banks. Among these countries, Takayasu (2013) studies Malaysian banking sector and finds that Islamic deposit returns and conventional interest rates co-move in Malaysia. The author interprets this finding as the existence of significant commons in Islamic and conventional banks. Likewise, Ergec and Arslan (2013) examine Turkish banking system and find that the impact of interest rate shocks on deposits are similar in conventional banks and Islamic banks. Charap and Cevik (2011) compare Turkish and Malaysian dual banking system and find similar results. In addition to few evidence on the relation between monetary policy and Islamic banking, hitherto analysis did not uncover the degree of responses to policy rate changes. This lack of evidence motivated us to examine the degree of sensitivity of creditors and depositors as a response to policy rate shocks in Islamic banks. In this study, we fill a significant gap in Islamic banking and try to find out the degree of sensitivity in bank lending channel and the reasons behind potential differences in Islamic and conventional banks.

3 Data and Methodology

We investigate whether deposits and credits in Islamic banks react differently than conventional banks to interest rate changes. We estimate a panel–VAR model with monthly
data for Turkey. We then obtain impulse response functions (IRFs) to measure the response of deposits and credits in conventional and Islamic\(^5\) banks to a change in policy rates.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Definition</th>
<th>Obs</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Min</th>
<th>Max</th>
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<td></td>
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<tr>
<td>credits</td>
<td>Total loans</td>
<td>975</td>
<td>14.81</td>
<td>2.44</td>
<td>6.11</td>
<td>18.52</td>
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<td>fx</td>
<td>US Dollar / Turkish lira exchange rate</td>
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<td>1.49</td>
<td>0.19</td>
<td>1.17</td>
<td>1.86</td>
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<td>aggr</td>
<td>Total deposits</td>
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<td>13.39</td>
<td>2.71</td>
<td>6.10</td>
<td>17.47</td>
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<tr>
<td>cpi</td>
<td>Quarterly change in consumer price index</td>
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<td>3.16</td>
<td>2.28</td>
<td>-0.58</td>
<td>10.76</td>
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<td>ir</td>
<td>Policy rate</td>
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<td>11.45</td>
<td>5.81</td>
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<td>aggr</td>
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<tr>
<td>credits</td>
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<td>14.38</td>
<td>0.55</td>
<td>13.05</td>
<td>15.33</td>
</tr>
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</table>

Note: The deposit and credit amounts are in thousand Turkish Liras and are log-transformed. The policy rate is the quarterly average of overnight money market rate. Foreign exchange rate is the quarterly average of CBT's effective rate.

We use the following variables in the listed Choleski order: policy rate (\(ir\)), US Dollar / Turkish lira exchange rate (\(fx\)), consumer price index (\(cpi\)), aggregate deposit level (\(aggr\)), and total loan amount (\(credits\)) for the period of 2004:3 – 2012:12. All the variables in this study is from the Central Bank of Turkey. We log-transform the money variables, credit and deposit data (\(aggr\) and \(credits\)), and use the others on their levels. We use overnight money market rate of the Central Bank of Turkey as policy rate, (\(ir\)). We compute the average overnight rates per quarter during the sample period and use the differences between consecutive quarters to proxy for interest rate changes (see Table 1 that presents the summary statistics for the variables used in our analysis.)

The deposits data used in our analysis is under deposit insurance. The reason for selecting deposits under insurance is that uninsured deposit holders may represent different

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\(^5\) Islamic banks in Turkey are named as participation banks in Turkey.
behaviour than insured deposit holders with respect to monetary shocks (Demirguc-Kunt and Kane, 2002; Karas et al., 2013). On a theoretical model, Andries and Billon (2010) show that deposits under insurance exhibit a more stable pattern with respect to a monetary policy impulse. In case of increasing bank risk and corresponding monetary policy interventions, for instance, uninsured deposit holders’ response to monetary shocks is augmented with the response to bank risk of failure. Deposit insurance therefore eliminates these possibilities and enable us to concentrate on the relationship between monetary policy, credit provision and deposits.

We use panel–VAR methodology which extends the traditional VAR approach to a panel setting to control for bank level heterogeneity. As in traditional VAR approach, the variables in the system are treated as endogenous. We specify our model of order \( s \) is as follows:

\[
Z_{i,t} = \Gamma_0 + f_i + \Gamma_1 Z_{i,t-1} + \Gamma_2 Z_{i,t-2} + \ldots + \Gamma_s Z_{i,t-s} + \varepsilon_{i,t}.
\]

(1)

In this specification the variables \( \text{ir}, \text{fx}, \text{cpi}, \text{aggr} \) and \( \text{credits} \) are the components of a vector \( Z \) in the VAR system for bank \( i \) and time \( t \). We estimate a one–lag panel–VAR to investigate the depositors’ and creditors’ response to interest rate changes since the time dimension of the panel is relatively short. In all estimations, we control for bank level heterogeneity by incorporating \( f_i \) as proposed by Holtz-Eakin et al. (1988). We exploit “Helmert procedure” that uses forward mean–differencing. In this procedure, the fixed effects \( (f_i) \) are eliminated by the transformation in deviations from forward means.

Let \( \bar{z}_m^k = \frac{s=m+1}{T_t-m} \) denotes the means obtained from the future values of a variable \( z_i^k \), a variable in the \( p \)-variable vector \( Z_i = (z_i^1, z_i^2, \ldots, z_i^k, \ldots, z_i^p)' \), at \( t = m \). \( T_t \) denotes the last period of data available for a given bank series. Let \( \bar{\varepsilon}_{i,m}^k \) denotes the same transformation.
for $\varepsilon_{im}^{k}$, where $\varepsilon_i = (\varepsilon_1^i, \varepsilon_2^i, ..., \varepsilon_k^i, ..., \varepsilon_p^i)^0$. Hence we get following variables after Helmert transformation:

$$Z_{imk} = \hat{\delta}_{it}(Z_{imk} - Z_{imk})$$

(2)

and

$$\tilde{z}_{im}^{k} = \hat{\delta}_{it}(\tilde{z}_{im}^{k} - \tilde{z}_{im}^{k})$$

(3)

where $\hat{\delta}_{it} = \sqrt{\frac{T_{i-m}}{T_{i-m+1}}}$. The final transformed model is thus given by:

$$Z_{it} = \Gamma_0 + f_i + \Gamma_1 Z_{it-1} + \Gamma_2 Z_{it-2} + ... + \Gamma_s Z_{it-s} + \varepsilon_{it}.$$  

(4)

This transformation satisfies the orthogonality assumption between transformed variables and lagged regressors. Therefore, we can use lagged dependent variables as instruments and estimate the coefficients by system GMM (Love and Zicchino, 2006).

To analyse the potential effects of policy rate shocks, $ir$, on deposits and credits ($aggr$ and $credits$), we generate impulse response functions for each variable to show how each variable responds to individual shocks of other variables in the system. In this approach, the response of a variable to the shock of transmitted from another variable is estimated where shocks to other variables in the system are held constant. To do so, it is necessary to decompose the residuals so that they are orthogonal. This can be accomplished by ordering the variables, namely Choleski ordering, to allocate any correlation between two variables to the variable that comes ahead of it in the ordering. Choleski ordering suggests that variables that enter into the VAR system earlier affect the following variables contemporaneously and with a lag, while later variables affect the variables that entered earlier with a lag (Hamilton, 1994).
4 Results

4.1 Main Findings

We first conduct a unit–root test on all the variables used in the analysis. To this end, we test whether the selected variables are stationary or not. We use Fishers test statistics for panel unit root (see e.g. Maddala and Wu, 1999), since this test does not require a balanced panel unlike the Im–Paseran–Shin test proposed by Im et al. (2003). According to our test results, the null hypothesis of unit roots is rejected at their level at 1% significance level. Hence, we conclude that they are stationary ⁶.

Figure 1: Relationship between Deposits and Policy Rates: Conventional versus Islamic Banks

⁶ We do not report the results for unit root test, which are available upon request.
Figure 2: Relationship between Credits and Policy Rates: Conventional versus Islamic Banks

Figure 1 and 2 fit a simple regression line to have an idea whether the expected outcome of interest rate shocks is observable on credits and deposits data. These two figures simply suggest that deposits and credits are negatively associated with policy rates regardless of the bank type. Since we are interested in the degree of sensitivity of these responses, the slopes in Islamic banks are steeper mimicking that Islamic banks and their depositors respond larger to policy rate shocks.
Figure 3: Impulse Responses of Deposits to Policy Rate Shocks: Conventional versus Islamic Banks

Figure 4: Impulse Responses of Credits to Policy Rate Shocks: Conventional versus Islamic Banks
Since the impulse response functions are constructed from panel–VAR models’ estimated coefficients, the standard errors of estimated coefficients need to be calculated. Monte Carlo simulations is used for generating confidence intervals for the impulse response functions. This is conducted by taking random draws of the models’ coefficients, using the estimated coefficients and their variance-covariance matrix. We take 500 draws. The 5th and 95th percentiles of the results are used to interpret on the confidence intervals of the impulse responses. If the confidence intervals do not contain the zero line, we interpret the results are significant, i.e. rejecting the hypothesis that impulse responses are zero.

We report how credits and deposits respond to policy rate, foreign exchange and inflation shocks. We first display conventional and Islamic bank depositors’ responses to policy rate changes in Figure 3. Overall results suggest that depositors in Islamic and conventional banks respond to interest policy rate changes negatively, as expected. When we are interested in the degree of sensitivity, we observe that Islamic bank depositors more strongly respond to policy rate changes. Deposits’ response to one standard deviation shock in policy rates is larger than in conventional banks. A one standard deviation interest rate shock is associated with a 5% withdrawal after four quarters in Islamic banks, whereas in conventional banks the withdrawal reaches to 2% at the end of six quarters. The zero line, indicating no response of a particular variable to a specific shock, is obviously not fully covered by the confidence bands only in the IRFs of Islamic banks. Such a result is commonly interpreted as the evidence of a significant response of the variable.

Figure 4 demonstrates the credits’ response to interest rate shocks. As found in deposits, credits’ response to interest rate shocks is larger in Islamic banks. Whilst the negative response to a positive interest rate shock exceeds 5% after four quarters in Islamic banks, credits in conventional banks still do not catch up this level at the end of six quarters. All these results suggest that both conventional and Islamic banks were not able to complement

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7 All impulse response functions are provided in Figure 9 and 10 in the Appendix.
deposit withdrawals with alternative sources of funds. These findings confirm the findings in Carpenter and Demiralp (2009) and Demiralp (2008) who argue that banks in emerging countries may not be capable of finding alternative sources to replace deposits as banks in advanced countries which can find funding sources with alternative borrowing instruments like bond issuances.

Figure 5: Impulse Responses of Deposits to Inflation Shocks: Conventional versus Islamic Banks
Figure 6: Impulse Responses of Credits to Inflation Shocks: Conventional versus Islamic Banks

Figures 5 and 6 plot the responses of credits and deposits in Islamic and conventional banks to inflation shocks. Both credits and deposits in Islamic banks respond negatively to inflation shocks. Credits and deposits in conventional banks also respond similarly, but the response of deposits is positive in initial quarters but turns out to be negative in the upcoming quarters. The responses are larger in Islamic banks similar to those responses to policy rate shocks. The intuition is obvious, depositors demand higher interest against higher inflation and thus shrinking net return.

Figure 7: Impulse Responses of Deposits to Foreign Exchange Shocks: Conventional versus Islamic Banks
The responses to foreign exchange shocks is depicted in Figures 7 and 8. These figures also in line with previous IRFs suggesting a negative relationship between foreign exchange valuations and deposits and credits. This is especially important that foreign exchange rises eventually leads to decline in deposits and credits. Possible reason is that both depositors and banks themselves divert their funds to foreign exchange investments as a response to positive net valuations in foreign exchange.

4.2 Robustness Checks

In this section we present two robustness checks. Bernanke and Blinder (1992) propose monetary policy is transmitted through several stages. There is a spill-over from exchange rate to the inflation rate contemporaneously and that effects the general economy. This assumption is valid for an import-dependent emerging economy since foreign exchange fluctuations affects inflation with lags. Due to the possibility that the spill-over path differs
from the one introduced in Bernanke and Blinder (1992), we check the sensitivity of our results with respect to the re–ordering of the variables in the Cholesky decomposition as the first robustness check. We therefore alter the inside of the Cholesky ordering and re–estimate the Panel–VAR (see e.g. Grossmann et al., 2014; Lof and Malinen, 2014; Kim and Lee, 2008, for similar sensitivity analysis). The main results remain unchanged. Since we run various ordering the results are not reported here to save space but available upon request from the authors.

During the inspection of the banks observation, it is noticeable that heterogeneity in conventional bank sample is significant. For instance, several conventional banks operate for over hundred years in the country and have extensive branch coverage. On the other hand, some of conventional banks operate around thirty years and their branch coverage is still emerging. The bank coverage and years of operations also reflect the size of these banks. The characteristics of banks, e.g. size, age, branch coverage, can directly impact the behaviour of depositors and bank lending. Although we consider cross sectional heterogeneity by employing panel–VAR, we study with a restricted sample of conventional banks as the second robustness check. In doing so, we eliminate those banks who has the least bank coverage and less depositor base. As a benchmark we focus on the average asset size of the banks during the sample period. We arbitrarily select those banks whose average asset size is larger than 10 billion Turkish Lira. In doing so, we restrict the number of conventional banks to fifteen banks. The estimation results and impulse responses do not change by restricting the sample. We even obtain significant results which have been insignificant in the whole sample (see Figure 11 in the Appendix). These two robustness checks finally suggest that Islamic banks and their depositors’ responses to policy changes are significantly larger than conventional banks.
4.3 Discussion

The traditional conceptualization of the relationship among monetary policy, deposits and credits circle suggest that central banks are able to control the level of deposits in the banking system that in turn impact the lending behaviour of the banks (see e.g. Bernanke and Blinder, 1988; Kashyap and Stein, 1995). According to this view, following a tight monetary policy action, loan supply is reduced since the central bank drains reserved deposits from the system through open market sales. Another interpretation is also possible such that agents rebalance their portfolio as a response to the policy rate changes that contemporaneously change the yields on assets other than deposits (see e.g. Kishan and Opiela, 2000; Ehrmann et al., 2001). Either way, a policy tightening seems to affect the deposits of both conventional and Islamic banks.

Our results show that Islamic banks are in fact more sensitive to monetary policy shocks. There are possible explanations for this result. This finding seems to confirm the possible existence of displaced commercial risk between Islamic and conventional banks, such that Islamic bank depositors transfer their funds to conventional banks upon a monetary policy shock. This possible fund transfer, given the small share of Islamic banks in Turkish banking system, does not seem to increase the deposit volumes of conventional banks in a significant way. However, we can safely argue that the withdrawal from Islamic banks partly compensate the drainage in conventional banks.

Our results confirm the argument that religious attachments tend to exhibit lower resistance to the variances in the returns on assets (Abedifar et al., 2013). There is significant possibility that the fear of losing lucrative return may largely motivate Islamic bank depositors to withdraw their money and invest in alternative assets.

We also consider the operational principles of Islamic banking in Turkey behind larger sensitivity of Islamic bank depositors. Only a handful of Islamic banks are operating in Turkey, which might give them a strong market power in the negotiation of pro-rata shares
of asset returns. Islamic banks distribute a pre-defined return collected on the assets portfolio which is not open to negotiation between the banks and depositors. Negotiation is however possible in conventional banks, depositors holding bigger amounts have higher power to negotiate on the fixed interest returns. Strong market power driven by Islamic banking principles enables Islamic banks to impose pro-rata shares which may not be satisfactory to depositors. Once depositors are not satisfied with the proposed returns, then Islamic bank depositors withdraw their money (Admati and Pfleiderer, 2009; Edmans and Manso, 2011). The level of dissatisfaction is proportionate to the level of policy rate hikes and thus the opportunity cost.

As a final element, Islamic banks are slower in adjusting their rates of return, which makes them more vulnerable to policy shocks. During periods of declining interest rates, this strategy yields competitive returns which lead to an expansion of the deposit base. On the other hand, since it widens the wedge between the rates of return offered by Islamic and conventional banks, increasing interest rates may result in sharp reductions in the deposit base of Islamic banks.

5 Concluding Remarks

This paper examined if and to what extent bank lending channel works differently for Islamic banks in Turkey. The current debate on Islamic banking focuses on to what extent Islamic banking differentiates from conventional banking. In this paper, we contribute to this debate and specifically find that Islamic banks and depositors respond to policy rate changes significantly and even larger than conventional banks.

While it is plausible to expect that Islamic banks depositors should not respond to policy rate changes, we present the reasons why they can respond to policy rate changes with possible explanations. We particularly point risk perception attitude of Islamic bank depositors and operational differences in Islamic banks as the potential reasons.
Although the stake of Islamic banking is relatively small in Turkish banking, the findings in this study should be supported by the evidence from other dual banking systems. If the results are confirmed by the other country experiences, the direct policy implication would suggest that policymakers should put due interest on the more sensitivity of Islamic bank depositors to policy rate changes. The dominance of Islamic banking in dual banking system would imply more volatile credit market subject to policy rate changes.

References


cited By (since 1996)73.


Figure 9: Impulse Responses for Conventional Banks
Figure 10: Impulse Responses for Islamic Banks
Figure 11: Impulse Responses for Restricted Conventional Banks