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The Effectiveness of Monetary Policy Transmission Channels: An Empirical Investigation of SAARC Countries

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ABSTRACT

This paper empirically investigates the transmission mechanism of monetary policy in south Asian association of regional cooperation (SAARC) countries for the period of 2005Q1-2020Q4. For this purpose, structural vector auto regression approach (SVAR) is used. We considered four pertinent channels through which monetary policy transmits its impact to the real economy (GDP and Inflation) namely interest rate channel, credit channel, exchange rate channel and asset price channel. The objective of this paper is to identify the relative importance of each channel in SAARC countries. Based on the empirical estimates obtained by employing Structural Vector Auto regression (SVAR), we find the effectiveness of monetary policy to influence the aggregate output of the economy in SAARC countries i.e., GDP and prices. The study also finds that the exchange rate channel is the most important channel in Pakistan and Sri Lanka whereas interest rate channel and the credit channel are the dominant source of fluctuation in India and Bangladesh, respectively. The identification of transmission channels of MP is very important to set an effective MP with an efficient set of policy instruments by the central banks in SAARC countries. The study also provides the important policy implication for the central banks of respective countries to set an effective monetary policy.

Keywords: Monetary policy; Credit channel; Interest rate channel; Exchange rate channel; Asset price channel; Monetary Transmission mechanism

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