

Abstract

This thesis comprises of four essays on issues related to money and credit, with either direct or indirect implications for monetary policy.

The point of departure in *Essay I* is that the long-term interest rates are largely driven by inflation expectations that, in turn, potentially depend on both fiscal policy and monetary policy. The literature on institutions and policy credibility proposes that the average rate of inflation (and inflation expectations) is related to the institutional policy setup. Using a panel of annual data for 16 OECD countries, and vector error correction models (VECM) for Belgium and the U.S., we find that more expansionary monetary and/or fiscal policy is associated with a more positively sloped yield curve (measured as the spread between long-term rates and short-term rates). One interpretation of the results is that the current fiscal policy stance directly affects the credibility of future monetary policy. The weaker effects from fiscal policy found in the later part of the sample—despite generally worsening government finances—do not appear to be closely linked to strengthening of central bank independence per se.

Using Sweden *Essay II* examines the extent of possible monetary policy transmission through the credit market as suggested by the so-called lending channel of monetary policy. Causality tests propose significant forecasting power of credit and money velocity for output, but the results also show that a rise in credit signals a future decline in output. The impulse response functions generated by interest rate shocks in a vector auto regression (VAR) model are broadly consistent with priors about the transmission effects of monetary policy, and they confirm a tendency in U.S. data for bank loans to initially increase following a contractionary shock before they start decreasing. These results caution against interpreting the transmission effect as working in the narrow way suggested by the lending channel, but point to the potential significance of broader credit market effects.

Essay III tests the hypothesis that variations in banks' credit supply contribute to fluctuations in aggregate fixed business in Sweden. In VECM's it is found that credit to small and medium sized firms cointegrate with investments, and that causality runs in both directions. This stands in contrast to the results for large firms where neither cointegration nor causality was detected. The findings are interpreted to reflect that credit constraints working through lending to smaller firms contribute to fluctuations in investments. As smaller firms are likely to be more bank dependent, shocks that influence banks' willingness to lend affect those more than others. Aspects of the monetary policy experience during the economic slump and credit market stress in the early 1990's is discussed in light of these results.

Essay IV investigates how changes in the money stock were transmitted to output, prices and interest rates in Sweden during 1969-92. The results suggest that deviations from long-run equilibrium between supply and demand for money affect the rate of change of money as well as output and inflation. The key conclusion is that it appears to have been money supply shocks in Sweden during the estimation period, associated with a monetary transmission mechanism that largely resembles the predictions of the buffer-stock theory of money. In effect, it is misleading to think of the money stock as having been adjusted purely to demand factors. Yet, it does not follow that the central bank actually controlled money supply.

Key words: *monetary policy, term structure, lending channel, credit constraints, money demand, buffer stock theory, cointegration, VECM, VAR, pooled data.*

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