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Interest rate pass-through in Europe and the US: Monetary policy after the financial crisis

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Abstract

We examine the interest rate transmission mechanism for the Eurozone and the USA and discuss this issue in the light of the recent financial market tensions. For an efficient monetary policy, any change in the central bank policy rate is meant to be transmitted to retail interest rates, ultimately influencing consumer and business lending rates and therefore aggregate domestic demand and output. The disaggregated GETS methodology is employed, which allows us to reveal the relative importance of the central bank and money market rates as policy vehicle variables in the two banking systems. Our empirical results for the two banking systems are rather mixed as far as it concerns the pass-through transmission and completeness. We also refer to the lessons learned prior to and after the collapse of the monetary and financial system on both sides of the Atlantic. We believe that this study has interesting policy insights and provides certain policy suggestions, which might be useful for the regulatory authorities in their attempt to monitor and reinforce monetary policy effectiveness.

JEL classification

E52; E43; C22

Keywords

Interest rate pass-through; Disaggregated general-to-specific model