Applied Economics ›
Volume 45, 2013 - Issue 11

Original Articles

Impact of bank competition on the interest rate pass-through in the euro area

Michiel van Leuvensteijn, Christoffer Kok Sørensen, Jacob A. Bikker & Adrian A.R.J.M. van Rixtel

Pages 1359-1380 | Published online: 12 Dec 2011

Cite this article https://doi.org/10.1080/00036846.2011.617697

Abstra

This arti rates
applied l ovel
measure tronger
competi terest rates
for n that
stronge pass-through
of marke nted by our
Error Co ome losses
from inc r findings
with resp cations, as
they sug g sector are
likely to e.

Keywords: monetary transmission competition bank lending and funding interest rate spreads error-correction model

JEL Classification:: C23 D4 E50 G21 L10

Notes

[1] Except Kok Sørensen and Werner (2006), who used a nearly identical data set. This is the first time the data set has been published in a journal article.

[2] For other euro area countries we have insufficient data to estimate the Boone indicator.

[3] Enterprises comprise the entire population of nonfinancial corporations.

[4] Of course, competition is not the only factor determining the level of bank interest rates. Factors such as credit and interest rate risk, banks' degree of risk aversion, operating costs and efficiency are also likely to impact on bank margins. See, for example, Maudos and Fernández de Guevara (2004).

[5] See, for example, Neuwark and Sharpe (1992) and Master and Saunders (1995) for empirica US banks.

[6] In addi justment costs, ba in a situation nged and to limit the ay also choose t smoothing bank mes banks give e to recoup the cost ass through for outst

[7] Sander lso model the seve s approach aims to o pass on changes

[8] The few existing empirical studies based on the Boone indicator have all used a log-linear relationship. See, for example, Bikker and van Leuvensteijn (2008).

[9] For other arguments against the HHI, see Section I.

[10] See also van Leuvensteijn et al. (2011) who use a similar approach.

[11] GMM is used to correct for endogeneity between market shares and marginal costs using different moment conditions.

[12] Most likely, the favourable result for Germany hinges in part on the special structure of its banking system, being built on three pillars, i.e. commercial banks, publicly-owned savings banks and cooperative banks (see Hackethal, 2004).

[13] In order to avoid spurious results, see Granger and Newbold (1974).

[14] An ECM is a dynamical system in which the deviation of the current state from its long-run relationship will be fed into its short-run dynamics. This provides a coherent framework for the analysis of interest rate dynamics.

[15] See, for example, Mojon (2001), De Bondt (2002, 2005), Sander and Kleimeier (2004), and Kok Sørensen and Werner (2006).

[16] Viz., fo ort and
long-ter d current-
account

[17] As the nnual
estimate tes $-BI_{i,t}$ as
follows. tive year
and ther nonth
movi

[18] Note t st rates
(that is, and bank
rates (ex

[19] Unit ro er time. For
a survey description
and app 2006).

[20] In the panel versions of the tests the alternative hypothesis assumes a root which is less than one, but is identical across the countries. Hence, the group mean versions allow for stronger heterogeneity. As a result, we focus on the test's group mean version.

[21] For some bank products in some countries, it is not possible (due to insufficient data availability) to extend interest rates series all the way back to 1994. Therefore, unbalanced samples were used for some bank products.

[22] The two series have been linked in January 2003 with a parallel level shift of the series prior to this date. The level shift was based on the average monthly difference between the NRIR and MIR series for the period from January 2003 to September 2003 for which observations for both definitions were available. In contrast to Kok Sørensen and Werner (2006), we use new business weights (applying monthly averages observed in the January 2003–June 2004 period to smoothen out undue volatility) to aggregate the MIR categories to the NRIR. We believe this captures the differences across countries more precisely in terms of initial rate-fixation periods and also corresponds better to the new business rate nature of the NRIR statistics.

[23] The market rates have been chosen to best match bank interest rates on the basis of information from the Methodological Notes for the NRIR statistics and from the volume weights of the MIR statistics.

[24] Sprea es and are sometim and the corresp

[25] p-valu rmal distribut (1999).

[26] For ex nders (199 ffernan (1997), nd: Bredin et al. (2

[27] Estima ompetition does not th the results o

[28] A re-estimation of Equation 6 with the distance to default for, respectively, mortgage, consumer loans and loans to firms using ECB data suggests no substantial change in the parameter of the Boone indicator. This lack of change appears for each of the four types of loans. Unfortunately, the level of default tends to decrease the lending rates instead of increasing it (as one would expect). Apparently, this indicates an underpricing of default risk in the period 1999–2002, see for instance Pavlov and Wachter (2006). Inclusion of Gross Domestic Product (GDP) to capture the business cycle did not change this result. Hence, inclusion of risk does not improve (nor significantly changes) our relationship between competition and the interest rate pass through.

[29] We use Newey–West's kernel-based HAC variance estimations to correct for heteroscedasticity and autocorrelation, with the bandwidth set on two periods.

[30] See also Mojon (2001), De Bondt (2005) and Kok Sørensen and Werner (2006).

[31] Re-estimation with a risk measure, did not affect the estimation results of the ECM, see also footnote 28.

[32] As mentioned in Section V, the estimated long-run relationship between, on the one hand, interest rates on consumer loans and current account deposits and, on the other hand, th statistically significa

[33] The nu es and residuals s in favour of separate

[34] The re rmulated in terms of

[35] See