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

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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 cou interest rates. Fa ersion, operatin e, for example

[5] See, fo 1995) for empirica US banks.

[6] In ad justment costs in a situation nged and to limit the ay also choose t smoothing bank loa mes banks give cus to recoup the costs ass through for outstanding borrowers.

[7] Sander and Kleimeier (2002, 2004) differ from other studies in that they also model the severity of the interest rate shock (rather than merely its direction). This approach aims to take into account menu cost arguments implying that banks tend to pass on changes in market rates of a minimum size only.

[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 framewo

[15] See, f meier (2004), a

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

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

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

rates (expressed by $\theta\, MR_{i,t}$).

[19] Unit root tests analyse whether a time series variable is nonstationary over time. For a survey of panel unit root tests, see Banerjee (1999). For a more detailed description and application to a similar set of data, see also Kok Sørensen and Werner (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 countrie rresponds better to

[23] The m the basis of informat the volume weights

[24] Sprea es and are sometim and the corre

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

[26] For ex nders (1995); ffernan (1997), nd: Bredin et al. (2001).

[27] Estimations in first differences of bank consumer loan rates reveal that competition does not have a significant effect on changes in the lending rates, in line with the results of Table 12.

[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 f

[32] As me on the one hand, in n the other hand, th statistically significa

[33] The nu es and residual s in favour of sepa

[34] The re rmulated in terms of

[35] See al