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

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## Abstract

This article analyses the impact of loan market competition on the interest rates applied by euro area banks to loans during the period 1994–2004, using a novel measure of competition called the Boone indicator. We find evidence that stronger competition implies significantly lower spreads between bank and market interest rates for most loan market products, in line with expectations. This result implies that stronger competition causes both lower bank interest rates and a stronger pass-through of market rate changes into bank rates. Evidence of the latter is also presented by our Error Correction Model (ECM) for bank rates. Further, banks compensate income losses from increased loan market competition by offering lower deposit rates. Our findings with respect to the loan market rates have important monetary policy implications, as they suggest that measures to promote competition in the European banking sector are likely to render the monetary policy transmission mechanism more effective.

Keywords: [monetary transmission](#) [competition](#) [bank lending and funding](#) [interest rate spreads](#) [error-correction model](#)

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