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Interest Rate Pass-Through in the Euro Area during the Financial Crisis: a Multivariate Regime-Switching Approach

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Abstract

In this paper we use a Markov-switching vector autoregressive model to analyse the interest rate pass-through between interbank and retail bank rates in the Euro area. Empirical results, based on monthly data for the period 2003-2011, show that during periods of financial distress bank lending rates to both households and non-financial corporations show a reduction of their degree of pass-through from the money market rate. Significant sectoral heterogeneities characterise the transmission mechanism of monetary policy impulses, with rates on loans to non-financial firms being more affected by changes in the interbank rate than loans to households, both in times of high volatility and in normal market conditions.

Key Words: *Interest rate pass-through, financial crisis, interbank interest rate; loans interest rate; Regime-switching vector autoregressive models; Euro area.*

JEL Classification: *C32, E43, E58, G01, G21.*

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