Accepted Manuscript

Interest Rate Pass-through since the Euro Area Crisis

Sarah Holton, Costanza Rodriguez d'Acri

PII: S0378-4266(18)30180-8
DOI: https://doi.org/10.1016/j.jbankfin.2018.08.012
Reference: JBF 5406

To appear in: *Journal of Banking and Finance*

Received date: 26 January 2016
Revised date: 25 July 2018
Accepted date: 22 August 2018

Please cite this article as: Sarah Holton, Costanza Rodriguez d'Acri, Interest Rate Pass-through since the Euro Area Crisis, *Journal of Banking and Finance* (2018), doi: https://doi.org/10.1016/j.jbankfin.2018.08.012

Interest Rate Pass-through since the Euro Area Crisis

Sarah Holton *and Costanza Rodriguez d'Acri†

August 28, 2018

Abstract

The financial crisis has been characterised by fragmentation in the transmission of monetary policy, as reflected in the high dispersion in interest rates on bank loans to euro area firms. Heterogeneity in interest rate pricing also emerged within countries, suggesting that macroeconomic differences were not the only driver of dispersion. Using individual bank data for twelve euro area countries covering almost a decade since the start of the crisis, we identify the balance sheet characteristics that contributed to this fragmentation and document the share of the deviation in interest rates from policy rates that is accounted for by each characteristic. Interest rate pass-through heterogeneity is estimated using an error correction framework that accounts for macroeconomic variation and market structure, and includes standard bank characteristics, such as size, capital and liquidity, as well as variables that capture banks' funding access, risk and asset quality. Results show incomplete pass-through of changes in money market rates targeted by the central bank to firms' lending rates. Sovereign bond yields are shown to affect the cost of finance for firms, particularly in stressed countries and market concentration is associated with smaller reductions in lending rates. With regard to bank characteristics, asset impairment leads to a significant decrease in pass-though. Bank size, as a proxy for market power, and reliance on central bank funding affect pass-through for smaller loans, while capital is more significant for larger loans.

JEL Classification: E52, E58, G01, G20, E43, E44.
Keywords: Interest rate pass-through, Monetary policy transmission, Financial crises.

*E-mail: sarah.holton@ecb.europa.eu. Address: Directorate Monetary Policy, European Central Bank, Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany. Phone number: +49172 2395795

†E-mail: Costanza.Rodriguez@ecb.europa.eu Address: Directorate Macroprudential Policy and Financial Stability, European Central Bank, Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany. Phone number: +49691 3448474