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How do banks adjust to changing input prices? A dynamic analysis of U.S. commercial banks before and after the crisis

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Abstract

The 2000 – 2013 period was characterized by substantial regulatory, monetary and technological change, especially after the onset of the global financial crisis. This study assesses the total impact of these policy shifts and technological changes on U.S. commercial banks' short-run and long-run substitution elasticities. An endogenous-break test divides the sample into a pre-crisis period and a (post-) crisis period. During the former period, banks' inputs tend to be inelastic substitutes. After the onset of the crisis, particularly the long-run substitutability of most input factors decreases to even lower levels due to changes in both cost technology and economic conditions. At the same time, banks' response to input price changes becomes more sluggish. Hence, especially after the onset of the crisis, banks have little flexibility regarding input factor usage and are thus sensitive to input price changes from a cost perspective.

JEL codes: G21, D24, C30

Keywords: financial crisis, substitution elasticities, dynamic demand systems, U.S. commercial banks

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