Journal of Banking & Finance 40 (2014) 28–41

Contents lists available at ScienceDirect

Journal of Banking & Finance

journal homepage: www.elsevier.com/locate/jbf

The global financial crisis and integration in European retail banking

Aarti Rughoo [a,*], Nicholas Sarantis [b]

[a] Hertfordshire Business School, University of Hertfordshire, UK
[b] Cass Business School, City University, UK

ARTICLE INFO

Article history:
Received 25 October 2012
Accepted 8 November 2013
Available online 25 November 2013

JEL classification:
F36
G21
C33

Keywords:
Integration
European retail banking
Savings
Lending rates
Household sector
Global financial crisis
Phillip and Sul convergence method

ABSTRACT

The aim of this paper is twofold. Firstly, to investigate the integration process within the European Union retail banking sector by analysing deposit and lending rates to the household sector during the period 2003–2011. Secondly, to assess the impact of the 2008 global financial crisis on the banking integration process, an area that is yet unexplored. An important contribution of the paper is the application of the recently developed Phillips and Sul (2007a) panel convergence methodology which has not hitherto been employed in this area. This method analyses the degree as well as the speed of convergence, identifies the presence of club formation, and measures the behaviour of each country's transition path relative to the panel average. The empirical results point to the presence of convergence in all deposit and lending rates to the household sector up to 2007. In sharp contrast, the null of convergence is rejected in all deposit and credit markets after the onset of the 2008 financial crisis. These results show that the global crisis has had a detrimental effect on the banking integration process. We find some convergence in a few sub-clusters of countries but the rate of convergence is typically slow and several countries are identified as diverging altogether. In addition, we find that the credit market, in general, is far more heterogeneous than the savings market.

© 2013 Elsevier B.V. All rights reserved.

1. Introduction

As part of the wider aim for a Single Market for financial services which was launched in 1992, a Single Market for EU banking was viewed as pivotal by the European Commission. The aim was to facilitate the establishment of pan-European providers of financial products, generate greater consumer choice, and boost efficiency and competition, amongst others. At the time, major regulatory and institutional reforms were launched and these have been revised and reformulated over the years to keep up with an ever-changing and dynamic market. The wholesale banking sector has been widely investigated in the literature while the retail sector to a much lesser extent. The first aim of this paper is to investigate how successful the Single Market initiatives have been in creating an integrated European retail banking sector. Financial integration is understood to lead to long-run equilibrium and in this paper we assess the degree and speed of convergence towards retail banking integration. Given the importance of the household sector as a component of retail banking, it is believed that a thorough analysis of deposit, consumer credit and mortgage rates with varying maturities can paint a true picture of the integration process in European retail banking.

Moreover, given the severity of the 2007/8 global financial crisis and the ensuing Euro sovereign debt crisis, it is essential that we analyse the impact of the recent crises on European banking sector integration. Indeed as argued by Dabrowski (2010), the global financial crisis has sprung new challenges for the Single European Market initiative and its institutional structure. Quoting the heavy exposure of European banks to toxic assets and the subsequent chaotic policy responses at EU level, Dabrowski (2010) further argues that the crisis has uncovered several systemic weaknesses amongst European banks. This view has also been reported by Fonteyne et al. (2010) who argue that the financial crisis has revealed gaps in the current EU cross border arrangements on crisis management, resolution and burden-sharing within the EU. The debate now is whether the new arrangements can fully address the shortcomings that have come to light. In addition, as the authors point out, the crisis has also shown the weaknesses of linking financial stability to fiscal responsibility. Not only has the strain on national budgets been severe since the crisis but it has also prevented better cross-border coordination. This has distorted the workings of an efficient Single Market. Furthermore, as stated by Arghyrou and Kontonikas (2012), since 2009, the global financial crisis turned into a sovereign debt crisis in the euro area whereby global bank-

* Corresponding author. Address: Hertfordshire Business School, University of Hertfordshire, Hatfield AL10 9AB, UK. Tel.: +44 1707284000.
E-mail address: a.rughoo@herts.ac.uk (A. Rughoo).

0378-4266/$ - see front matter © 2013 Elsevier B.V. All rights reserved.
http://dx.doi.org/10.1016/j.jbankfin.2013.11.017

ing risks have been transformed into sovereign risk due to a lack of bank liquidity and an increase in fiscal liabilities as well as due to the impact on government debt after bank bailouts. This is reflected in the credit ratings of the EU countries where a clear demarcation is noted with Greece, Italy, Ireland, Portugal and Spain being rated lower compared to the rest of the EU15 countries. Furthermore, as argued by Black et al. (2013), in 2011, with the escalation of the Greek crisis and the fear of contagion spreading to Spain and Italy in particular, concerns about systemic risk in European banks were mounting. In their empirical measurement of systemic risks amongst European banks, Black et al. (2013) find that the banks' systemic risks were largely due to default risks and reached a peak in 2011. Furthermore, variability in the systemic importance of banks was present with Italian and Spanish banks showing higher concerns compared to the UK banks. Consequently, in light of the challenges faced by the Single Market due to heightened credit risks, refinancing risks and sovereign risks in the banking sector stemming from the global crisis, the second aim of this paper is to assess the impact of the global financial crisis on the integration of the European retail banking sector. We do so by firstly subdividing the sample period into 2 sub-periods; 2003–2007 and 2008–2011. Secondly, we further divide our sample for the second sub-period into two groups of countries; one comprising the countries with a lower credit rating[1] (Greece, Ireland, Italy, Portugal and Spain) and the second group consisting of the remaining ten EU countries. In addition, given that the UK and Sweden conduct independent monetary policy, we further test for convergence exclusively for the group of euro area countries plus Denmark.[2]

An overview of the literature, starting from the 1990s to the present, shows a mixed picture with regards to investigations on the process of European retail banking integration. Some of the earlier studies (Kleimeier and Sander, 2000, 2003; Schuler and Heinemann, 2002), typically conduct bivariate cointegration analysis on interest rate spreads for different household lending and deposit rates. Other studies (Murinde et al., 2000; Adam et al., 2002 and Vajanne, 2007) draw from the growth literature based on beta and sigma panel convergence tests to assess the degree and speed of convergence in the retail household sector. The remaining studies (Affinito and Farabullini, 2006; Sørensen and Lichtenberger, 2007; Sørensen and Gutiérrez, 2006), apply some different techniques such as the tests of coefficient equality and hierarchical cluster analysis to euro area retail banking sector.

Overall, for the 1990s period, the evidence in the literature so far paints a picture of a fragmented retail banking market. Regarding the more recent period, progress in the retail banking integration process is observed. This lends support to the argument that the launch of the euro, as well as the initiatives stemming from the Single Market and more recently, the Financial Services Action Plan, has been effective. Nonetheless, in most of the recent studies, the persistence of cross-country heterogeneity is also clearly evident. Limited institutional convergence in European banking and the importance of national characteristics, among other factors, are considered to be responsible for these results.

In the case of several of these studies, a number of short-comings have been identified. Firstly, some of the earlier studies (see Schuler and Heinemann, 2002; Kleimeier and Sander, 2003) apply time series cointegration analysis to small samples which, as widely argued in the literature, result in a loss of power of the test. The same observation is noted for the study by Affinito and Farabullini (2006) who apply unit root tests and tests of equality on country coefficients on a sample covering 2 years only. Second, the sample periods covered in most of the studies stop in the early 2000s except for the one by Vajanne (2007) who considers a sample up to 2006. The empirical model used by Sørensen and Lichtenberger, 2007 also considers data up to 2006 but it must be noted that their analysis is predominantly an investigation of the determinants of mortgage rate dispersion rather than a direct assessment of the degree of integration within retail banking. Third, none of the studies on retail banking integration uses an actual test of convergence except for the application of beta and sigma convergence tests drawn from the growth literature.[3] However, even with the beta and sigma convergence methodology, limitations have been identified. For instance, as argued by Quah (1996), beta convergence is uninformative on the behaviour of the dispersion of the entire cross-section. He further argues that sigma convergence does not factor in the convergent or divergent behaviour of individual countries in the sample but is only concerned with how the whole cross-section behaves. Hence these convergence tests do not enable the analysis of the behaviour of each individual country series over time. Also, as argued by Islam (2003), β- and σ-convergence are more relevant within the context of growth literature and he has uncovered problems that arise when empirical analysis of convergence are conducted using these methodologies.

We make three major contributions to the literature. First, we present a detailed analysis of the convergence process in the European retail banking market for the period 2003 to December 2011, thus updating the current literature. Second, we investigate for the first time the impact of the global financial crisis on European banking integration. Third, we apply the recently developed powerful panel convergence methodology by Phillips and Sul (2007a),[4] which has not been previously employed in this area.[5] This test of convergence, termed as the *logt test*, is ideally suited for this paper for the following reasons. Firstly, this methodology provides an empirical modelling of long run equilibria within a heterogeneous panel, outside of the co-integration setup. Secondly, this methodology can provide an estimate of the speed of convergence and can also cluster panels into club convergence groups. This test would thus not only be able to reveal whether any convergence is present within the European banking sector of the EU15 countries but the clustering algorithm will, in turn, detect whether any specific group of countries are converging or diverging. Thirdly, the test does not necessitate any specific assumptions regarding the stationarity of the variables and allows for cases where individual series may be transitionally divergent. This information is obtained through the computation of each country's relative transition parameter and the depiction of its transition path which portrays the country's behaviour relative to the panel cross-section average over time. This is very significant as it can potentially uncover situations where individual countries may be diverging even if as a whole group, convergence is detected.

The rest of the paper is organised as follows: Section 2 outlines the Phillips and Sul (2007a) convergence methodology. Section 3 describes the datasets used. Section 4 presents the empirical results, while Section 5 concludes.

2. Empirical methodology

In this paper we take the view that integration in retail banking is a process whereby segmented markets become unified and open and where there is a tendency for prices of financial assets to con-

[1] GR, IE, IT, PT and ES have a rating lower than AA based on S&P, Fitch and Moody's ratings. The remaining 10 EU countries have a rating above AA.

[2] Denmark maintains a fixed exchange rate with the euro.

[3] Developed by Barro and Sala-i-Martin (1991) and Barro and Sala-i-Martin (1992) in the growth literature. β convergence measures the speed of convergence while σ convergence measures the degree of convergence. These convergence tests have been used by Adam et al. (2002) and Vajanne (2007).

[4] See an application in Phillips and Sul (2007b, 2009).

[5] Except by the same authors who have conducted a similar analysis on the non-financial corporations sector.

Download English Version:

https://daneshyari.com/en/article/5089041

Download Persian Version:

https://daneshyari.com/article/5089041

Daneshyari.com