“Why so negative? The effect of monetary policy on bank credit supply across the euro area” by Diana Bonfim, Bank of Portugal

Abstract:
This paper studies the transmission of monetary-policy rates to banks’ credit supply to firms. A simple model of an “augmented” bank capital channel characterizes the transmission in positive as well as in negative territory. The model allows for risk taking and a different pass-through of the policy rate to banks’ cost of funding because of a zero lower bound (ZLB) on retail deposit rates but not on wholesale debt. We examine the European Central Bank’s negative interest rate policy in 2014, and use the unique combination of two confidential credit registers to exploit variation in the pass-through to deposit rates across the euro area. In the periphery (Portugal) the pass-through is intact because deposit rates are far away from the ZLB, while in the core (Germany) the pass-through is impaired because of the ZLB on deposit rates. We find that in Portugal the negative interest rate policy acts like a standard rate cut, and expands credit supply especially for low-equity banks. In contrast, in Germany the policy leads to risk taking by high-deposit banks. We use the convex combination of our estimates to characterize the transmission of the 2014 rate cuts across the entire euro area.