## Why Did Bank Lending Rates Diverge from Policy Rates After the Financial Crisis?

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**Abstract**

After the global finance crisis short-term policy rates were cut to near-zero levels, yet, bank lending rates did not fall as much as the decline in policy rates would have suggested. The crisis represents a structural break in the relationship between policy rates and lending rates, which have diverged. This poses a puzzle for monetary policymakers. Using a new weighted average cost of liabilities to measure banks' funding costs we model interest rate pass-through with dynamic panel data methods and show a stable relationship can be recovered. It suggests central banks should focus on the cost of bank liabilities more broadly to understand lending rates.