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PRESS RELEASE

Determinants of Belgian bank lending interest rates

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The article analyses the factors which influence the setting of lending rates by Belgian banks. The latter are an important link in the process of transmission of monetary policy impulses, bank lending being a major source of finance for the private sector in Belgium as in the rest of the euro area.

The first part of the article describes the main determinants of bank lending rates and also briefly examines the impact of the capital requirements. The second part analyses the transmission of monetary policy impulses to risk-free market rates, then from those to the lending rates of Belgian credit institutions. Finally, the third part draws the first lessons from the new harmonised survey of bank interest rates for the period June 2003-May 2004.

The only rates over which the central bank has tight control are very short-term interest rates on the money market. Changes in those rates influence the longer term market rates. The transmission of changes in the overnight rates to market rates diminishes and becomes slower and more uncertain as the duration increases.

In its turn, the risk-free yield curve constitutes a basis for setting lending rates, since it influences the cost of the banks' resources and may also be regarded as the opportunity cost of lending. However, lending rates are influenced by a range of other factors, such as the other costs and risks incurred by the banks, as well as the level of competition on the lending market and the type of relationship with customers.

The transmission of market rates to lending rates, examined on the basis of the results of the old bank rate survey, presents a mixed picture: Belgian credit institutions appear to adjust the rates offered on corporate loans more quickly and completely than the rates on loans to households, the transmission being particularly weak in the case of consumer credit.

In addition, the data from the old survey reveal a widening of the spreads between the majority of the lending rates and the market rates for similar durations during the period 2001-2003. One of the reasons for this increase in the margins could be alignment with the terms applied in neighbouring countries, as a result of cross-border mergers of credit institutions. Be that as it may, the new harmonised survey of bank rates indicates that the lending rates charged by Belgian banks are currently close to the average for the euro area, with occasional exceptions: they are lower for short and medium-term corporate loans but considerably higher for overdrafts.

The results of the new survey also show that the average lending rates are graduated according to the amount, duration and risk of the loan. The dispersion in rates seems to be due mainly to risk dispersion, and is particularly marked in the case of overdrafts and consumer credit. Certain characteristics of the banks also influence their lending rates. For example, the most highly capitalised banks tend to apply higher rates, probably to cover riskier loans. Conversely, the most liquid banks tend to set lower rates. Finally, lending rates are not a positive function of the banks' size or their market share: factors such as the big banks' access to cheaper funding and the reduction in the risk due to the size of the loan portfolio (law of large numbers) or a clientele comprising larger firms are more significant than the possible use of market power.