BANK HETEROGENEITY AND INTEREST RATE SETTING: WHAT LESSONS HAVE WE LEARNED AFTER LEHMAN?

by Leonardo Gambacorta (Bank for International Settlements) and
Paolo Emilio Mistrulli (Banca d'Italia)

A wide strand of literature has investigated the role of relationship lending in shielding borrowers from idiosyncratic shocks. Much less is known about how the nature of lending relationships and bank-specific characteristics affects the functioning of the credit market in an economy wide crisis, when banks might find it difficult to perform the role of shock absorbers. In this paper, we investigate how bank-specific characteristics (such as size, liquidity, capitalization, funding structure) and the bank-firm relationship have influenced bank interest rate setting after Lehman's collapse. Differently from the existing literature, which has paid attention mostly to the amount of credit lent during the crisis, we focus on the cost of credit. To this aim we use detailed information at the bank-firm level from the Italian Credit Register merged with Supervisory reports.

The results suggest that close lending relationships allowed firms to be more insulated from the financial crisis. They also indicate that the ability of banks to shield their borrowers from shocks crucially depends on their capital and liquidity conditions. These findings support the Basel III focus on bank's core capital and on funding liquidity risk.