

## **From Policy Rate to Bank Lending Rates: The Chilean Banking Industry**

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This paper studies the transmission of the monetary policy in terms of the interest rate pass-through in the case of Chile. Specifically, we are interested in the response of commercial banks lending rate to a money market interest rate movement. International evidence suggests that there is some sluggishness of adjustment of lending interest rates to changes on the policy rate. In general this stickiness is related to lack of competition in the banking sector, capital flow restrictions and volatility of the policy rate.

One of the first comprehensive empirical studies on bank interest rate pass-through for monetary policy is Cottarelli and Kourelis [1994]. They found important differences between countries. The estimated impact effects varied between 0.06 and 0.83, and the long run effects ranged from 0.59 to 1.48 with an average of 0.97. Our estimates for the Chilean case are an impact of 0.81 and a long run pass-through of 0.97 for nominal interest rates.

Previous studies suggest that sluggishness of adjustment is associated to market conditions and regulation of the banking sector. In this paper, by using data at the bank level, we explore other factors that may influence the degree of delay in market interest rate response to changes in the policy rate. The aim is to identify which characteristics may explain the differences in the average rates charged by each bank and their responsiveness to movements in the policy rate. The main variables considered were the size of the bank, type of customers and the loan risk level, which are related to demand elasticity and cost of adjustment for banks. A theoretical model presented in the paper motivates the choice of these factors and dynamic panel data estimation supports the implications of the model. Stylized facts and estimation results suggest that banks with smaller portion of past-due loans and higher percentage of household adjust faster to policy rate movements.