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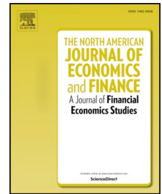

Interest rate convergence across maturities: Evidence from bank data in an emerging market economy☆

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ABSTRACT

Against a background of financial liberalisation reforms, we assess the extent of market integration and competition in Colombian retail deposits and loans markets. We employ a dataset comprising bank-level interest rate data for different financial products across a range of banks. We utilise and further develop the Phillips and Sul convergence club approach by estimating the drivers of club formation. We find integration of the deposits market, but not loans where portfolio riskiness and loan maturity explain why there is not a fully integrated market. Also, the degree of loan market convergence responds asymmetrically to changes in monetary policy.

1. Introduction

Financial liberalisation reforms have been made by many emerging economies since the 1990s, where a key component has been the drive towards increased competition in retail banking. It is of interest to consider whether or not the new banking regimes that have emerged are characterised by integrated domestic markets for retail deposits and loans. Indeed, measuring the extent of integration or convergence across interest rates set by banks can provide valuable insights into how fragmented retail markets might still be despite significant changes in regulations. A further consideration is that the extent of convergence across maturities has implications for our understanding of the term structure of interest rates as based on expectations theory or liquidity preference considerations.

This paper investigates the extent of interest rate convergence in the retail banking sector of an emerging market economy, namely Colombia, which embarked upon a financial liberalisation process in the early 1990s. Prior to these reforms, Colombia, like many other developing countries, was characterised by "financial repression", a term used to describe an economy with a banking sector that is subjected to important restrictions in the form of high reserve requirements and liquidity ratios, interest rate ceilings, and subsidised credit to specific sectors of the economy, among others. Uribe and Vargas (2003) note that the reforms aimed at creating an independent central bank; redefining of the structure of the financial sector; relaxing the requirements for entry and exit

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