

DANMARKS NATIONALBANK

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BANKING AND MORTGAGE LENDING, INTERESTS, OCTOBER 2018

Banks' business models determine their interest margin

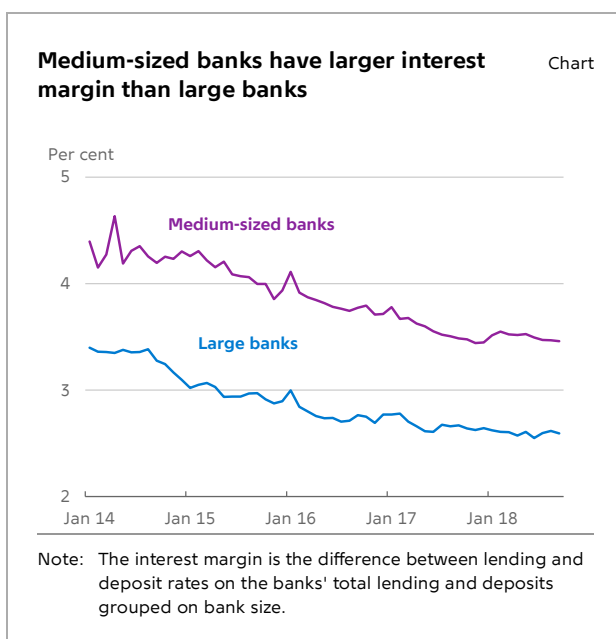
In October 2018, the difference between large and medium-sized banks' lending and deposit rates, their interest margins, was around 1 percentage point. The medium-sized banks' interest margin was close to 3.5 per cent whereas the interest margin of large banks was around 2.6 per cent. As the deposit rates are similar in the two groups, the difference in the interest margin is due to differences in the lending rates.

Lending rates depend on the banks' business models which affect a range of economic factors, such as the risk profiles of the loans and the size of other

income than interest income, e.g. income from fees. Other factors, like the level of competition and banks' cost structure, may also have an effect.

An important factor in the determination of banks' aggregated lending rates and hence the interest margin is the composition of the bank lending. Borrowers with risky profiles tend to pay higher interest rates than borrowers with less risky profiles. This affects the interest margin in the two groups of banks as medium-sized banks lend relatively more to private and business borrowers where the losses typically are larger. Large banks tend to lend more to the financial and public sector which has smaller losses. At the same time, large banks lend relatively more to large and well-established businesses, which are usually safe borrowers and borrow on a larger scale. Finally, medium-sized banks have larger losses than large banks, even within the same sector.

Another factor in determining the interest margins is that fees make up a larger share of the total interest and fee income in the large banks than in medium-sized banks. Since 2009, fees have become a more important part of both large and medium-sized banks' income. The low interest rate environment has squeezed income from the interest margin as banks have reduced their lending rates more than their deposit rates, as they have refrained from charging negative rates on deposits from privates.



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