

Synchronisation and Staggering of Deposit Account Interest Rate Changes

June 2007

Synchronisation
and Staggering
of Deposit
Account
Interest Rate
Changes

CCP Policy Briefings

BACKGROUND

- As systems of monetary policy have increasingly focused on controlling money supply through interest rate targets, understanding how banks set their market interest rates has developed a critical policy importance.
- Past international assessments of deposit interest rate change have indicated infrequent and sluggish interest movement is common. This has been attributed to, amongst other factors, the competitiveness of retail financial services markets; reasons of interest rate asymmetry; and the structure of the banking industry.
- This study addresses whether interest rate rigidity exists and how this rigidity occurs by assessing if interest rates change in a staggered or synchronised fashion. Staggered price setting is a central explanation of the presence and duration of time lags in the transmission of monetary shocks to the real economy, whereas synchronised price policies may accelerate the adjustment process.

METHODOLOGY

- Interest rates change both between banks and within banks. A “between banks” interest rate change is recorded when a bank changes any of its deposit products in a particular month. A “within bank” interest rate change is recorded when a bank changes one, all, or an intermediate proportion of its deposit products’ interest rates.
- Interest rates are assumed to change in either a staggered or synchronised manner.
- Staggered interest rate change assumes that interest rate movements are initiated at regular intervals with a consistent and predictable time lag after an external shock. Under these circumstances regular cyclicity should be displayed.
- Synchronised interest rate change assumes interest rate movements are initiated in response to other bank interest rate changed.
- Three characteristics of interest rate change are quantified to indicate whether staggered or synchronised interest rate change prevails:
 - The proportion of interest rate changes in a single time period is calculated;
 - The incidence of consecutive interest rate changes is assessed;
 - The characteristics of cyclical interest rate change are measured.
- The study considers monthly interest rate observations from the UK market for deposit accounts over the sample period November 1988 to December 2006 - data issued by Moneyfacts plc. In total, 1618 deposit accounts which have operated for at least 24 months and issued by 52 institutions are included in the study.
- This database of 77,379 observations recorded over 218 monthly intervals represents the effective population of all deposit accounts issued in the UK between 1988 and 2006.
- Of these accounts, 49.5% are instant access accounts, and the remainder are time deposits.
- There is a high degree of entry and exit in the market, amongst both financial products and financial institutions.

June 2007

 Synchronisation
 and Staggering
 of Deposit
 Account
 Interest Rate
 Changes

CCP Policy Briefings

KEY FINDINGS

Proportions of Interest Rate Change

- “Between banks” interest rate change: distribution indicates that staggering is present. The values observed for retail banks and converted building societies are greater than those observed for other bank groups, implying a marginally higher degree of synchronisation for retail banks and building societies.
- “Within banks” interest rate change: around 90% of observations occur when none or all of bank’s deposits change interest rates, and only a limited number of observations are recorded in the intermediate classes. This apparent polarisation is representative of synchronised interest rate setting.

Frequency, Duration and Cyclicity of Interest Rate Changes

- Shorter runs of consecutive interest rate changes are more frequently observed. The frequency distribution of consecutive interest rate change varies between different types of banks, with converted building societies particularly displaying a larger number of consecutive interest rate changes.
- A generally lower level of consecutive interest rate changes is observed for the “within banks” case relative to the “between banks” case. However, little difference in the number of consecutive interest rate changes is observed for different types of bank.
- Findings are consistent with a relatively low level of consecutive interest rate change, and would indicate that interest rate change cyclicity and, by implication, staggering, is present.

POLICY ISSUES

- Due to the staggering of interest rate changes monetary shocks may be propagated over longer periods of time than may have been previously acknowledged. Such a finding would suggest that the transmission of change from the base rate to the interest rates of retail deposit products used by the general public may be far slower than has been previously assumed.
- The existence of rigid deposit rates and relatively more responsive loan rates would enable relative interest rates spreads to develop in response to interest rate targeting by monetary authorities.

THE CCP

The ESRC Centre for Competition Policy (CCP), at the University of East Anglia, undertakes competition policy research, incorporating economic, legal, management and political science perspectives, that has real-world policy relevance without compromising academic rigour.

FOR MORE INFORMATION

The full working paper (CCP Working Paper 07-14) and more information about CCP and its research is available from our website: www.ccp.uea.ac.uk

ABOUT THE AUTHORS

- **Dr John Ashton** is a lecturer in regulation in the Norwich Business School and a member of the ESRC Centre for Competition Policy. John has published widely on topics including competition in financial services markets, performance of banks and water companies and financial regulation.

W: www.ccp.uea.ac.uk
 T: +44 (0)1603 593715
 A: UEA, Norwich, NR4 7TJ

