LOAN GROWTH AT EUROPEAN BANKS: AN EMPIRICAL TEST OF MARKET INTEGRATION

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ABSTRACT

We analyze the lending decisions for a sample of more than one hundred banks in Germany, France, Switzerland and the United Kingdom, 1992 to 1999. We conclude that, despite regulatory reform intended to eliminate competitive inequalities and enhance cross-border competition, integration of the banking market in Europe remains incomplete.

OVERVIEW

Observed differences in loan growth and capitalization within Europe raise an interesting empirical question: Is the incomplete integration of bank lending markets attributable to bank-specific financial condition or to country-specific economic, cultural, regulatory or other factors? The distinction is important insofar as bank-specific condition, which varies over time and by country, would appear to exert only transitory effects on credit growth over time, while country-specific factors may be more structural in nature.

We determine if loan growth at banks in Europe is dependent upon country-specific factors unrelated to bank-specific financial condition. We compare loan growth rates, 1992 to 1999, for a broad sample of banks in Germany, France, Switzerland and the United Kingdom. These countries constitute the largest lending markets in Europe. But they differ substantially by type of financial system they represent--bank-based versus market-based–by inclusion in the Economic and Monetary Union and by various other structural characteristics.

We use a regression model to explain loan growth at European banks as a function of bank-specific financial characteristics, the average loan growth for all banks in our sample and dummy variables indicating country of origin. Results of various statistical tests provide evidence that banking markets in France, Germany, Switzerland and the United Kingdom are incompletely integrated. This confirms that patterns of loan generation implies that integration of the market for bank lending in Europe is incomplete.

Our unique contribution is that segmentation in the loan market in Europe is evidenced in a model which controls for bank-specific factors. That is, factors which cause loan growth in one country to differ from another country are those which factors influencing loan growth in other countries. This finding has important implications for financial conditions within Europe. Growing integration of euro-area interbank markets, for instance, may propogate a liquidity crisis in the region. It also raises questions concerning the scope of cross-border contagion, financial stability, soundness of the banking system, monetary policy and solvency crises.