

ANALYSING MFI INTEREST RATES AT THE EURO AREA LEVEL

The new MFI interest rate statistics introduced in December 2003 offer many opportunities for analysing developments in euro area interest rates. These statistics are of significantly higher quality than the previous “euro area retail interest rates”, as they are based on a common framework for all euro area countries (see the box entitled “New ECB statistics on MFI interest rates” in the December 2003 issue of the ECB’s Monthly Bulletin).

MFI interest rates on new business are calculated at every compilation level (reporting institution, national and euro area) by weighting the interest rates by the amounts agreed as being borrowed from or deposited with MFIs during the reporting month. Thus, at the final compilation stage, euro area MFI interest rates are obtained by weighting national MFI interest rates on new business by the amounts agreed as being borrowed from or deposited with MFIs in the euro area countries in the month concerned. The euro area MFI interest rates therefore measure the average interest per euro borrowed from or deposited with euro area MFIs in a given period. In terms of statistics, the euro area MFI interest rates are properly aggregated unit values.

Changes in the euro area MFI interest rates reflect not only changes in the individual national MFI interest rates, but also changes in the corresponding weights, that is, the amounts agreed as being borrowed or deposited at these rates. Given that the levels of national MFI interest rates still differ, in part significantly, across the countries of the euro area, changes in the respective country weights can sometimes have a major impact on developments in the euro area MFI interest rates.

The volatility in country weights thereby complicates the analysis of the transmission of changes in market interest rates to the individual interest rates charged or offered by MFIs. It is therefore useful, for analytical purposes, to draw a distinction between the official euro area MFI interest rates (unit values) and a measure indicating the average of the individual interest rates set by MFIs.

Illustration of the effect of changes in country weights on euro area MFI interest rates

The effect that changes in the amounts agreed as being borrowed or deposited have on the level of euro area MFI interest rates can be seen from the MFI interest rate on loans to households for consumption with a floating rate and up to one year initial rate fixation. At the euro area level, this average unit value has been somewhat volatile since January 2003. However, this volatility has largely been due to changes in country weights, which have overshadowed the underlying movements in individual MFI interest rates.

The underlying reason for this volatility is the large disparity that exists in interest rate levels for this instrument category across the countries of the euro area. Despite this disparity, in nearly all euro area countries borrowing costs on loans to households for consumption with a floating rate and up to one year initial rate fixation fell between January 2003 and May 2004, in most cases by 50 basis points or more. The simple average of the national MFI interest rates across the euro area (excluding Luxembourg) fell by 76 basis points over that period, from

Table Aggregate euro area MFI interest rates on loans to households for consumption with a floating rate and up to one year initial rate fixation

(percentages per annum; percentage points; rates on new business)

	January 2003	May 2004	Change January 2003 to May 2004	Average January 2003 to May 2004
Weighted average ¹⁾	7.28	7.30	0.02	7.42
Simple average ²⁾	8.05	7.29	-0.76	7.67
Weight-adjusted average ³⁾	7.80	7.07	-0.73	7.35
Memo item				
Three-month money market interest rate	2.83	2.09	-0.74	2.26

Source: ECB.

1) Official euro area MFI interest rate.

2) The data for Luxembourg are subject to statistical confidentiality and are thus excluded from the simple average for the euro area.

3) The weight-adjusted average MFI interest rate is, for the period from December 2003 onwards, calculated using country weights constructed from a 12-month moving average of new business volumes. For the preceding period, from January to November 2003, the weight-adjusted MFI interest rate is calculated using country weights constructed from the average of new business volumes in 2003.

8.05% in January 2003 to 7.29% in May 2004. However, despite the fact that this MFI interest rate declined in nearly all euro area countries, the corresponding euro area weighted average rose over that period, from 7.28% to 7.30%. This increase was caused by a fall in the weight of Germany in the euro area weighted average, from 51% to 18%, between January 2003 and May 2004. Since this country records one of the lowest MFI interest rates in the euro area for loans to households for consumption with a floating rate and up to one year initial rate fixation, the increase in the weight of other countries with higher MFI interest rates led, accordingly, to the observed increase in the euro area weighted average.

This is an extreme case, which does not reflect the behaviour of most MFI interest rates and which is caused by large cross-country differences in this specific category of MFI interest rates. However, changes in weights may occasionally also affect developments in other series and blur the analysis of the interest rate pass-through from changes in market interest rates, especially in the short term.

Reducing the effects of volatile country weights

In order to better assess the pass-through of market interest rates to individual MFI interest rates, this box introduces, as a new analytical tool, weight-adjusted MFI interest rates, which are derived indicators measuring the average of the individual national interest rates set by euro area MFIs. These indicators reduce, at the euro area level, the impact of changes in country weights. In these indicators, the weights applied to the national unit values do not just reflect the business volumes of the reporting month. Instead, national weights are constructed using a 12-month moving average of the monthly business volumes in those countries.

This adjustment method thereby eliminates most of the month-to-month variability related to changes in country weights. It therefore allows a time series to be constructed which represents the underlying individual interest rate movements more closely than the official MFI interest rate statistics.

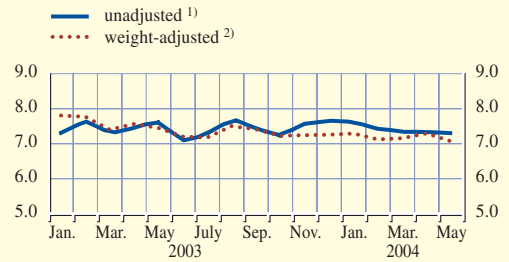
The chart below shows the weight-adjusted euro area MFI interest rate, using a 12-month moving average of business volumes, and the official euro area MFI interest rate for loans to households for consumption with a floating rate and up to one year initial rate fixation. It is

clear that, in the period under review, the weight-adjusted MFI interest rate showed a tendency to decline, falling by 73 basis points from 7.80% in January 2003 to 7.07% in May 2004. In contrast, as mentioned above, the official MFI interest rate rose by 2 basis points over the same period. By way of comparison, the three-month euro area money market interest rate fell by 74 basis points, from 2.83% in January 2003 to 2.09% in May 2004.

The text and the charts relating to MFI interest rates in this section of the Monthly Bulletin will from now on be based on the weight-adjusted series, given its focus on the pass-through from market interest rates to MFI interest rates. Obviously, for other purposes, such as the calculation of interest flows, the official MFI interest rate statistics published in the “Euro area statistics” section of the Monthly Bulletin remain the main reference source.

Chart MFI interest rates on loans to households for consumption with a floating rate and up to one year initial rate fixation

(percentages per annum; rates on new business)



Source: ECB.

1) Official euro area MFI interest rate.

2) The weight-adjusted average MFI interest rate is, for the period from December 2003 onwards, calculated using country weights constructed from a 12-month moving average of new business volumes. For the preceding period, from January to November 2003, the weight-adjusted MFI interest rate is calculated using country weights constructed from the average of new business volumes in 2003.