Determinants of Bank Interest Margins: 
Impact of Maturity Transformation

September 2011

Abstract

This paper explores the extent to which interest and credit risk premia are priced in bank margins. Our contribution to the literature is twofold: First, we present an extended model of Ho and Saunders (1981) that explicitly captures interest rate risk from maturity transformation. Banks price interest risk premia according to their individual exposure separately in loan and deposit rates. Second, using a comprehensive dataset covering the German universal banks between 2000 and 2009, we test the model-implied hypotheses not only for the commonly investigated net interest income, but additionally for interest income and expenses, separately. Controlling income and expenses for characteristics of the bank portfolios and their maturities, we find macroeconomic interest risk drivers, in general, to significantly impact margins of all banks. Microeconomic on-balance interest risk exposure, however, only affects the smaller savings and cooperative banks, but not private commercial banks.

Keywords: Interest rate risk; Interest margins; Maturity transformation

JEL classification: D21; G21

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