Negative Interbank Rates, Regulation and Bank Behavior

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Abstract

In 2015 the Euro Interbank Offered Rate ($EURIBOR$) has become negative for the first time in history. Interbank interest rates play an important role for the effects that the regulatory instruments of Basel III have on bank behavior. This paper analyzes in a two-period framework based on Pausch (2014) to what extent the optimal bank behavior of a monopolistic credit bank changes compared to the case of a positive interbank rate. It considers the Net Stable Funding Ratio ($NSFR$), the Liquidity Coverage Ratio (LCR) and the Leverage Ratio. Without regulation deposits are completely substituted by a negative interbank position. The $NSFR$ leads to risk averse behavior. The possibility of making arbitrage profits can lead to a high liquidity demand of the bank, implying no regulatory effect of the LCR. The Leverage Ratio fulfills the regulatory objective of effecting bank behavior in a countercyclical way.

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