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# One Monetary Policy and Two Bank Lending Standards: A Tale of Two Europes

## CAMA Working Paper 56/2023
## October 2023

**Sangyup Choi**
Yonsei University
Centre for Applied Macroeconomic Analysis, ANU

**Kimoon Jeong**
University of Virginia

**Jiseob Kim**
Yonsei University

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**Keywords**

Euro area, mortgage credit, monetary policy stance gap, bank lending survey, macroprudential policy, cross-border banking flows

**JEL Classification**

E21, E32, E44, F52, G21

**Address for correspondence:**

(E) cama.admin@anu.edu.au

**ISSN 2206-0332**

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Sangyup Choi†
Yonsei University and CAMA
(Australian National University)

Kimoon Jeong‡
University of Virginia

Jiseob Kim◊
Yonsei University

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* We are thankful to Ahmad Hassan Ahmad, Vivien Chu, and Daehwan Kim (discussants), Collin Constantine, Charles Engel, Yunjong Eo, Stephanie Ettmeier, Davide Furceri, Yuriy Gorodnichenko, Jiri Havel, Cosar Kerem, Kyunghun Kim, Jae Won Lee, Eunseong Ma, Seunghoon Na, JungJae Park, Fabio Parla, Valarie Ramey, Jamel Saadaoui, and the seminar participants at the Workshop on Asymmetric Regional Effects of Macroeconomic Policies and Shocks at University of Palermo, 15th Joint Economics Symposium of Six Leading East Asian Universities at National Chengchi University, International Conference on Empirical Economics at PSU Altoona, KIFA International Finance Symposium, 2022 IEFS-EAER Conference, 2022 Korean Econometric Society Meeting, 2023 Annual Meeting of Korea's Allied Economic Associations, Korea Institute for International Economic Policy, and Yonsei University for their helpful comments. Sangyup Choi was supported by the Yonsei Signature Research Cluster Program of 2023 (2023-22-0019) and Yonsei University and Yongwoon Scholarship Foundation (Yonsei-Yongwoon Research Grant No. 2023-11-1234). Jiseob Kim was supported by the Yonsei University and Yongwoon Scholarship Foundation (2021-11-0410). Any errors are the authors' responsibility.

† School of Economics, Yonsei University, 50 Yonsei-ro, Seodaemun-gu, Seoul 03722, South Korea.
Center for Applied Macroeconomic Analysis (CAMA), Crawford School of Public Policy, Australian National University. Email address: sangyupchoi@yonsei.ac.kr.

‡ Department of Economics, University of Virginia, 248 McCormick Rd, Charlottesville, VA 22904, USA. Email address: bxm2vk@virginia.edu.

◊ School of Economics, Yonsei University, 50 Yonsei-ro, Seodaemun-gu, Seoul 03722, South Korea. Email address: jiseob.kim@yonsei.ac.kr.

# I. Introduction

Since the introduction of the euro and a common monetary policy framework, core and periphery countries in the euro area experienced very different economic trajectories, resulting in the sovereign debt crisis and slower recovery in periphery countries. What accounts for such divergent economic outcomes between the regions? Existing studies have typically focused on the external debt problem (e.g., Arellano et al., 2015), the failure of structural reforms (e.g., Fernández-Villaverde et al., 2013), capital misallocation between core and periphery countries (e.g., Gopinath et al., 2017), and the lack of an internal stabilizing mechanism under a common currency framework (e.g., Lane, 2012), which are not necessarily mutually exclusive explanations.

Building on earlier works, we provide a complementary explanation focusing on private bank *mortgage lending standards* as a crucial factor of different economic outcomes; different bank lending behaviors exacerbated the imbalance created by the common monetary policy framework in the euro area. Our focus on mortgage credit is motivated by recent literature that has paid great attention to its role in amplifying booms and busts, especially via housing prices. Since the global financial crisis, many empirical studies have focused on the interaction among mortgage credit, housing prices, and growth (e.g., Dell'Ariccia et al., 2014; Jordà et al., 2015; Mian et al., 2017; Cesa-Binachi et al., 2018) to understand the role of private credit supply in macroeconomic fluctuations.

To identify the underlying mechanism leading to divergent economic trajectories, we carefully quantify the imbalance created by the common monetary policy framework. To the extent that economic conditions vary greatly among the countries in the euro area, common monetary policy changes can be too stringent or too accommodative at the same time, yielding a source of distortion (e.g., Barigozzi et al., 2014; Beckworth, 2017). Since their economic conditions are different, to begin with, it may not be surprising that many studies found the heterogeneous effects of euro area monetary policy shocks across member countries (e.g., Ciccarelli et al., 2013; Georgiadis, 2015; Burriel and Galesi, 2018; Corsetti et al., 2022; Mandler et al., 2022).

In contrast, our study is motivated by the so-called "one size does not fit all" concern for the euro area (Nechio, 2011), and is distinct from those focusing on the heterogeneous effects of common monetary policy *shocks*. Instead, we are interested in how systematically different were behaviors of the private sector between core and periphery countries in response to the *imbalance* created by common monetary policy. To this end, we place each member country on the same economic condition by creating a measure summarizing its relative cyclical position to the entire euro area. Following Albuquerque (2019) who computes U.S. state-specific monetary policy stances as deviations from an aggregate Taylor rule, we estimate the monetary policy stance gap (MPSG) for each member country. The MPSG is computed as the difference between the interest rate prescribed by the Taylor rules for each country and that from the euro area aggregate. Thus, it measures how expansionary or contractionary the common monetary policy is for each country given its economic conditions.

We first document that the dispersion of the MPSG in the euro area is indeed substantially larger than that in the U.S. economy computed by Albuquerque (2019), underscoring the size of imbalances in the euro area. We then investigate the effect of rising monetary policy imbalance (i.e., an exogenous increase in the MPSG) on the macroeconomy, with a particular focus on mortgage credit as a transmission mechanism. To further identify whether the supply or demand side of mortgage credit accounts for the difference in key variables between the two Europes, we employ the ECB Bank Lending Survey, which provides information on bank lending conditions in the euro area, such as information on the supply and demand for loans to households and businesses.

Equipped with a measure of monetary policy imbalance and proxies for the supply and demand side of mortgage credit, we estimate the panel Vector Autoregression (PVAR) model of twelve euro area countries from 2003Q1 to 2019Q4, but separately for six core countries (Austria, Belgium, Finland, France, Germany, Luxembourg) and six periphery countries (Cyprus, Greece, Italy, Malta, Portugal, Spain). Considering the relatively short history of the common monetary policy framework in the euro area, we assume homogeneity in the slope coefficients among the

countries within the same group but still allow for heterogeneity in the intercept coefficients via country-fixed effects and in the slope coefficients across the regions.

We find that the more accommodative common monetary policy stance relative to what is warranted by given economic conditions, captured by the widening MPSG, has had sharply different consequences between the two Europes. While household mortgage credit expanded rapidly in the periphery, it did not increase in the core countries. This sharp distinction can also explain the fact that periphery countries experienced much stronger increases in residential investment and housing prices than did core countries. We further provide more direct evidence of the underlying mechanism exacerbating the imbalance created by common monetary policy by exploiting data from the bank lending survey, cross-border banking flows, and macroprudential policy.

First, mortgage lending standards show a markedly different pattern: banks in the periphery relaxed their standards, while banks in the core tightened their standards for mortgage lending. This is in sharp contrast to a similar increase in loan demand in both regions. As we already controlled for different initial economic conditions between the regions, such distinct bank lending behaviors speak to the main driver of distinct credit market outcomes between the regions. Given the symmetry in the VAR model, the excessive risk-taking behavior of periphery banks during good times (i.e., under loose monetary conditions) is followed by their excessive reluctance to lend during bad times (i.e., under tightened monetary conditions), thereby contributing to macroeconomic instability. In contrast, more "leaning against the wind" bank lending standards in core countries dampen the buildup of credit and housing price booms during good times, which also allows them to avoid busts during bad times.

An important question still remains. How can periphery banks relax their lending standards and significantly extend mortgage credit to households? In searching for the answer, we extend the baseline model to consider the intra-region financial flows in the euro area. We find that in response to the widening MPSG, only periphery countries receive significant net capital inflows. Using bilateral cross-border bank lending data from the Bank for International Settlements (BIS), we

further confirm that banks in periphery countries indeed increase their borrowing from core counterparts, allowing them to lend more to domestic borrowers, explaining the asymmetry in bank lending standards between the two Europes.

Then, the last missing link in this chain of actions is why core banks increased their lending to foreign borrowers in periphery countries, but not to domestic borrowers. By employing a new comprehensive database on macroprudential policy in Alam et al. (2019), we show that macroprudential policies regarding mortgage credit (e.g., LTV, DTI, LTD, and loan restrictions) were tightened in response to widening MPSG in core countries. Moreover, bank lending margin sharply decreases only in core countries. These findings provide a potential explanation for the aggressive cross-border lending of core banks to periphery countries, given the restrictions on domestic mortgage lending and low profitability.

In sum, our empirical analysis reveals unintended consequences of countercyclical mortgage-targeting macroprudential policies in core on periphery countries. While being optimal for core countries in pursuing macroeconomic stability of their own, macroprudential policies encourage the aggressive cross-border risk-taking of domestic banks with limited lending opportunities at home, leading to procyclical bank mortgage lending behaviors and housing boom and bust in periphery countries. Our findings suggest that the active use of macroprudential policies within the monetary union could present challenges if not carefully coordinated.

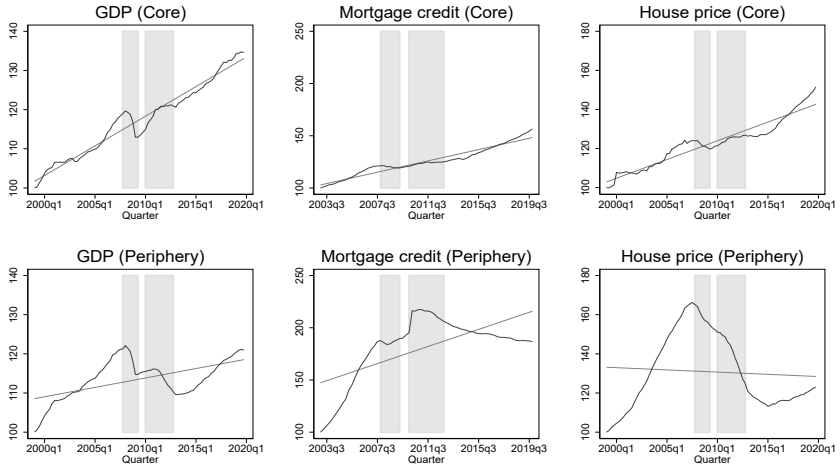
The remainder of the paper is organized as follows. Section II explains the empirical framework adopted in the paper, including the estimation procedure of the MPSG and the PVAR model. Section III presents the main findings regarding different mortgage lending behaviors, provides a series of robustness checks, and discusses the underlying mechanism to rationalize the main findings. Section IV concludes.

## II. Empirical Framework

## A. Data

Figure 1 shows the main economic indicators (real GDP, real mortgage credit, and real housing prices) for both core and periphery countries. We take the GDP-weighted average of these variables for each group and, to enhance visualization, normalize the data to 100 for a base period. Figure 1 clearly shows distinct trajectories of key economic outcomes between the regions. Compared with core countries, periphery countries experienced much stronger booms and busts in these variables. Such divergent economic conditions between the regions also suggest that the common monetary policy of the ECB is unlikely to achieve simultaneous stability in both regions.

**Figure 1.** Evolution of output, mortgage credit, and housing prices




Note: The graph shows the evolution of real GDP, real mortgage credit, and real housing prices for each group (top: core; bottom: periphery) by taking a GDP-weighted average of those values for the countries in the group. The data are normalized to 100 for the base year. The shaded areas in the graph represent the global financial crisis (2007Q4 to 2009Q2) and the European sovereign debt crisis (2010Q1 to 2012Q4).

In contrast to prior studies that have identified common monetary policy shocks in the euro area, our interest is in the size of a sustained or persistent imbalance created by the common monetary policy framework and its effects on economic outcomes, especially through bank lending behaviors. To reflect the monetary policy stance felt by a given country in the currency union, we first estimate the monetary policy stance gap (MPSG) for each member country. The MPSG is derived by estimating the aggregate Taylor rule of the European Central Bank (ECB) and embedding economic conditions in each member country.

First, in the estimation of the euro area Taylor rule, we use the Euro Overnight Index Average (EONIA) as the central bank policy rate[1] and employ real-time expectations data based on ECB staff projections of annual percentage changes in the Harmonized Index of Consumer Prices (HICP) and the real GDP growth rate for the euro area.[2] In addition, as a proxy for economic slack, we use an output gap series from the European Commission for the entire euro area. Second, when deriving the prescribed interest rate for each country according to the estimated Taylor rule, we use the real GDP growth rate, output gaps, and the annualized inflation rate from the HICP overall index of Eurostat in the absence of country-specific real-time expectation data at a quarterly frequency. Output gaps of each country are derived from the log of each country's real GDP from 1995Q1 to 2019Q4 by applying the Hamilton filter (Hamilton, 2018).[3]

In addition to the country-specific MPSG, the baseline econometric model includes quarterly data on bank mortgage credit as a key variable. Our focus on mortgage credit is motivated by the recent observation of the contrasting macroeconomic implications of household and business credit (e.g., Büyükkarabacak and Valev, 2010; Bahadir and Gumus, 2016; Mian et al., 2017). Mortgage credit is outstanding amounts of loans for house purchases, originating from the balance sheets of Monetary Financial Institutions (MFIs).[4] In addition to mortgage credit, we include mortgage interest rates, which are applied to mortgage loans. These mortgage interest rates are calculated from the average value of interest rates of outstanding mortgage loans. The econometric analysis

[1] Using the EONIA rate has an important advantage given the presence of non-standard policy measures during our sample period. Although the ECB has been lending liquidity through fixed-rate full-allotment auctions since October 2008, changes in the EONIA rate, determined in the market, also reflect non-standard policy measures (Ciccarelli et al., 2015).

[2] The ECB publishes a staff assessment of the economic outlook every last month of its quarters, providing important economic analysis that the ECB's Governing Council considers when deciding its monetary policy stance.

[3] The Hamilton filter estimates the cyclical component from detrending nonstationary time series data; it is suggested as an alternative filtering method to the Hodrick-Prescott filter.

[4] MFIs refer to the collection of financial institutions including the Eurosystem, credit institutions, and non-credit institutions that receive deposits and lend credit to other non-MFIs, i.e., households or firms, or invest them in securities.

also contains residential investment and the real residential property price index from BIS statistics to trace the consequence of changes in the mortgage loan market.

To complete the description of the mortgage loan market, we further include quarterly Bank Lending Survey (BLS) data in our empirical analysis, which is one of the main novelty of our work. A bank loan officer survey is especially useful in identifying an underlying cause of fluctuations in bank credit when the bank lending rate does not instantly adjust toward equilibrium due to credit market imperfections or banking sector regulations (Choi, 2021), as the main information (bank lending standards and loan demand) provides information on supply and demand factors of bank credit beyond what is typically captured by its prices (e.g., Lown and Morgan, 2006; Helbling et al., 2011; Meeks, 2012; Bassett et al., 2014; Ciccarelli et al., 2015). In particular, to the extent that the pass-through of monetary policy rates to bank lending rates is not perfect (Hristov et al., 2014; Horvath et al., 2018) or time-varying and heterogeneous (Altavilla et al., 2020) in the euro area, this feature of the survey helps identify whether the supply or demand side of credit markets accounts for differences in the evolution of mortgage credit and housing prices between core and periphery countries.

The ECB conducts a quarterly-basis survey on bank lending standards and loan demand; the survey contains questions about behavioral aspects of representative banks, acquiring information by requesting a survey be completed by senior officers. The survey involves data on past and future assessments of each commercial bank's overall bank lending standard and loan demand for each type of loan.[5] To assess the credit market impact of monetary policy stances, our econometric analysis focuses on loans for house purchases, which account for about 40% of private credit in the euro area. Survey data is available from 2003, so this dictates the beginning of the main sample period.

[5] For further details on the euro-area BLS data, see Maddaloni and Peydró (2011), Ciccarelli et al. (2015), and Neuenkirch and Nöckel (2018).

We use a diffusion index on bank lending standards and loan demand for household mortgage credit, shown in Figure A.1 in Appendix A for core and periphery countries, respectively.[6] Before the global financial crisis, lending standards for mortgage credit in both core and periphery countries were quite relaxed, reflecting strong economic activity, which drives a rapid expansion of credit. Standards were tightened during the global financial crisis and again during the European sovereign debt crisis, with a simultaneous decline in the demand for mortgage loans. Interestingly, bank lending standards show qualitatively similar patterns between the two regions despite the contrasting economic conditions between the regions.

To consider the consequences of the common monetary policy framework from an intra-regional perspective, we collect data on current accounts and cross-border banking flows. Current account data are taken from Eurostat; we include a ratio of current accounts to nominal GDP in the PVAR model to proxy the response of aggregate capital flows to changes in the monetary policy stance. We collect bilateral data on cross-border banking flows from the Bank for International Settlements (BIS) Locational Banking Statistics (LBS).

Lastly, we collect information on country-specific macroprudential policy to shed light on whether policy responses of the financial authority can explain the different economic outcomes, especially those related to mortgage lending behavior, between regions. As a measure of macroprudential policy, we use the integrated Macroprudential Policy (iMaPP) of the International Monetary Fund (IMF), which collects country-level information on macroprudential policy worldwide. The database divides macroprudential policy actions into 17 categories.[7] By focusing on

[6] In the Bank Lending Survey data, the diffusion index refers to the weighted difference between the share of banks reporting credit standards of "considerably tightened" and "somewhat tightened" and the share of banks reporting "considerably eased" and "somewhat eased". As this is a weighted measure of the difference, a respondent who answered "considerably" will be given twice as high a score as a respondent who answered "somewhat". In the case of loan demand, the diffusion index will be the weighted difference between the share of banks which reported "increase" and the share of banks which reported "decline".

[7] The major feature of this database is that it contains country-specific monthly data on financial regulations with dummy-type variables for 17 instruments. A value of 1 represents tightening of macroprudential actions; a value of -1 represents loosening actions.

policies regarding mortgage credit, we examine how macroprudential policies respond to the monetary policy stance in the euro area and whether responses differ systematically between the core and periphery countries. The choice of twelve sample countries is dictated by the availability of these data in a consistent manner. The list and sources of the data used in our analysis are summarized in Table A.1 in Appendix A.

## B. Estimation of monetary policy stance gap

Under the standard Taylor rule, the central bank adjusts the target interest rate to deviations of inflation from its desired level and to deviations of real GDP (or unemployment) from its potential (or natural) level. Although economists do not necessarily agree on how much emphasis to place on each deviation, the Taylor rule framework continues to be a useful benchmark for central banks. Similar to Albuquerque (2019) who computed U.S. state-specific monetary policy stances as deviations from an aggregate Taylor rule, estimating a measure of country-specific monetary policy stance gap starts with the estimation of the Taylor rule coefficients of the ECB, which makes monetary policy decisions based on aggregate macroeconomic variables of the entire euro area. Following Carvalho et al. (2021), the estimation of the Taylor rule coefficients is based on the Ordinary Least Squares (OLS) method with Newey-West robust standard errors, given by the equation below:

$$i_t = c + \delta i_{t-1} + \varphi_\pi E_{t-}\pi_{t+1,t+2} + \varphi_x E_{t-}x_t + \varphi_{\Delta y} E_{t-}\Delta y_t + \varepsilon_t, \tag{1}$$

where the interest rate $i_t$ is EONIA, which is frequently referred to as the policy rate of the ECB; $\pi_t$ is the annualized inflation rate, which is the year-on-year growth rate of the aggregate euro area HICP; $x_t$ is output gap; and $\Delta y_t$ is the quarterly real GDP growth rate.

Following Coibion and Gorodnichenko (2012), to capture the persistence of policy interest rates, the equation contains a lagged variable of the interest rate at $t$-1. At the moment of decision, because the central bank's decision on the policy rate is confined to the interest rate, the policy rate usually features inertia of policy action. The constant term, $c$ includes time-invariant factors of the

Taylor rule. Unlike the classical Taylor rule, the equation contains forward-looking variables, which can address the endogeneity problems of the OLS regression of the Taylor rule coefficients. The forward-looking variables are the expectations of inflation and real GDP growth. Each variable with an indicator $E_{t-}$ is a forecast of the macroeconomic variable before the monetary decision of the ECB. We employ the staff assessment of the aggregate euro area to obtain the expectational values of macroeconomic variables.

We use the output gap data at time $t$ to measure the degree of economic slack. For the expectational values of future inflation $\pi$, we take the average forecast values of $t$+1 and $t$+2, as in Coibion and Gorodnichenko (2012). For the forecast values of the real GDP growth rate $\Delta y$, we include the staff assessment value of time $t$, but this value is acquired before the central bank's policy decision. As these forecast indicators are reported to the Governing Council and the ECB's Executive Board and published after the press conference date of the end of its quarter, we adjust the meeting dates to the press conference dates of each quarter. In other words, we take daily EONIA data on the press conference dates at the end of each quarter. The sample period encompasses 1999Q1 to 2016Q1 because the ECB faced a Zero Lower Bound (ZLB) in 2016Q1.[8]

$$\underset{}{\hat{i}_t} = \underset{}{-0.2} + \underset{(0.05)}{0.82^{***} i_{t-1}} + \underset{(0.06)}{0.20^{***} E_{t-}\pi_{t+1,t+2}} + \underset{(0.05)}{0.09^{**} E_{t-} x_t} + \underset{(0.17)}{0.53^{***} E_{t-}\Delta y_t} + \varepsilon_t. \tag{2}$$

Equation (2) reports the estimation results of the aforementioned Taylor rule. The coefficients of the included terms show statistically significant results with the expected sign. The coefficient of the lagged dependent variable indicates a substantial persistence, which is consistent with findings in the literature. The high R-squared value (0.98) of the regression confirms that most of the variables included in Equation (1) can explain the ECB's policy decisions or policy rate changes in our sample period before the ZLB. In addition, the ECB appears to follow the Taylor

[8] One of the key ECB interest rates, the Main Refinancing Operation (MRO) rate, reached zero on March 12, 2016. The ECB's policy rate under normal circumstances refers to MRO. Estimating the Taylor rule including the ZLB period can distort the relationship between monetary policy and the real economy, so we exclude it from the sample.

principle as the long-run coefficient of inflation is greater than one. Figure A.2 in Appendix A plots both the actual EONIA rate and the estimated Taylor rule (i.e., the fitted policy rate). These estimated values of the Taylor coefficients are employed in constructing the country-specific MPSG.

Based on the estimated coefficients of the euro area Taylor rule, we construct a measure of the deviation of country-specific monetary policy stance from the common monetary policy stance (MPSG). As the ECB does not consider a particular country's economic conditions as input for its decision-making, each of the member countries will face heterogeneous impacts from changes in ECB monetary policy unless all member countries are under the same economic condition. The MPSG gives a measure of the relative monetary policy stance of each country, taking the ECB's aggregate Taylor rule for the entire euro area as a benchmark. By differencing the prescribed interest rates at the country level and the aggregate level, we construct the MPSG. The following equation shows the idea more concretely:

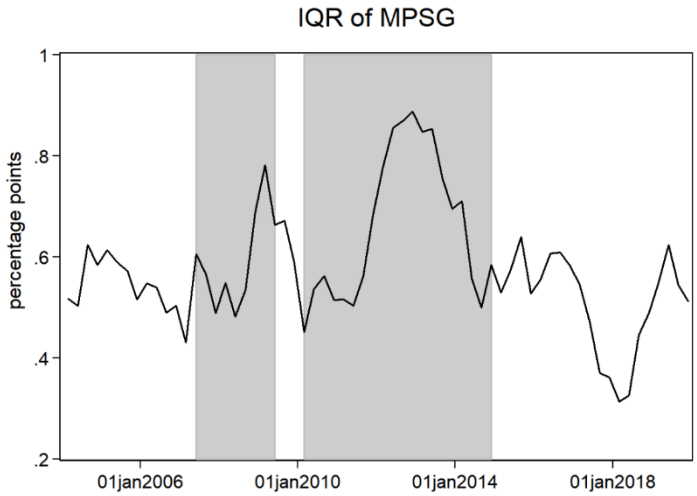
$$MPSG_{i,t} = \hat{\imath}_{i,t} - \hat{\imath}_t \text{ and } \hat{\imath}_{i,t} = c + \hat{\delta} i_{t-1} + \hat{\varphi}_x x_{i,t} + \hat{\varphi}_\pi \pi_{i,t+1,t+2} + \hat{\varphi}_{\Delta y} \Delta y_{i,t}, \tag{3}$$

where each of the coefficients in Equation (3) is taken from the estimated aggregate Taylor rule in (2): $\hat{\varphi}_x$ refers to the estimated coefficient of output gap measure, $\hat{\varphi}_\pi$ represents the coefficient of the expected inflation rate, and $\hat{\varphi}_{\Delta y}$ stands for the Taylor coefficient of the expected GDP growth rate term in (2). As we assume the same reaction function for all countries, the Taylor rules for each country have the same coefficients as those of the aggregate Taylor rule. By differencing the prescribed interest rates $\hat{\imath}_{i,t}$ for country $i$ and the aggregate euro area $\hat{\imath}_t$, we obtain the MPSG.

As all the coefficients in (2) are positive, if individual country $i$ experiences a boom relative to the entire euro area (i.e., higher output, higher output gaps, or higher inflation rate), the same monetary policy stance will be relatively accommodative or expansionary, with a positive value of $MPSG_{i,t}$, for country $i$. On the contrary, a negative value for $MPSG_{i,t}$ implies the country $i$ faces a relatively tightened monetary policy stance compared to the entire euro area. As in Albuquerque (2019), we present the dispersion in the MPSG across sample countries in Figure 2 by taking the

four-quarter moving average of the interquartile range. First, the size of dispersion is about 50% larger than that of the U.S. states documented in Albuquerque (2019), quantifying the degree of heterogeneity in the euro area economic conditions relative to the U.S. economy. Second, the dispersion tends to increase during crisis periods, suggesting that the imbalance problem is exacerbated during bad times.

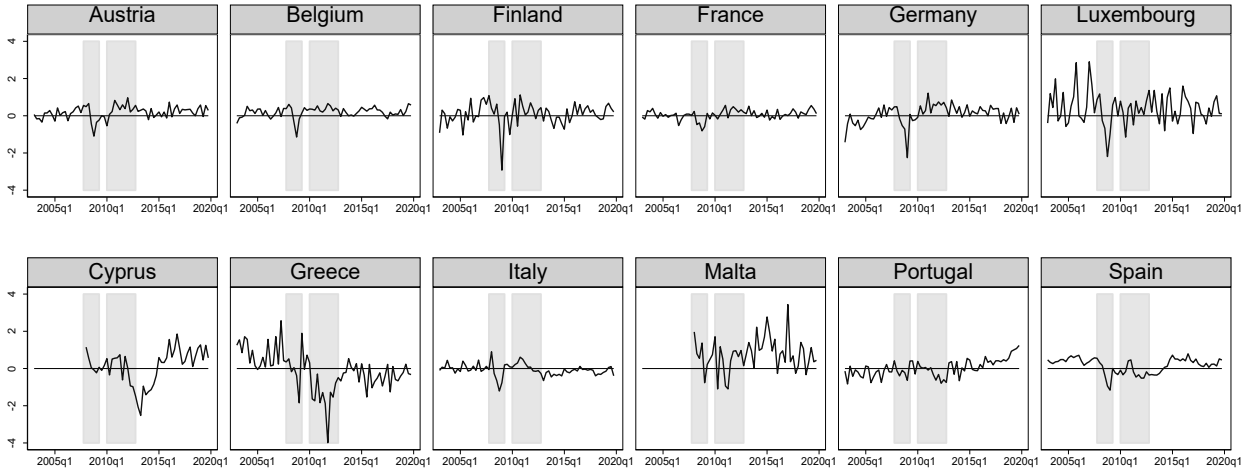
**Figure 2.** Dispersion of monetary policy stance gap among euro area countries




Note: The graph shows the four-quarter moving average of the interquartile range of the MPSG of twelve euro area countries. The shaded areas in the graph represent the global financial crisis (2007Q4 to 2009Q2) and the European sovereign debt crisis (2010Q1 to 2012Q4).

Figure 3 shows the value of MPSG over the sample period for each economy. The MPSGs of periphery countries tended to be larger in absolute terms than those of core countries in the run-up to the global financial crisis, corroborating the "one size does not fit all" narrative (e.g., Nechio, 2011). Moreover, from the perspective of periphery countries, ECB monetary policy was too expansionary during good times, while too contractionary during bad times. This is one of the common explanations for the sovereign debt crisis and the diverging economic paths between core and periphery countries (e.g., Beckworth, 2017). However, our goal is to investigate how such an imbalance created by the common monetary policy framework interacts with the banking sector's lending behavior in generating a credit boom and bust cycle, and whether there is a systematic difference in this interplay between core and periphery countries.

**Figure 3.** Monetary policy stance gap of euro area countries




Note: The first row represents the monetary policy stance gap of core countries; the second row displays that gap of periphery countries. This time series starts in 2003Q1 and ends in 2019Q4, except for Cyprus and Malta. For these countries, the data start in 2008Q1, because they became euro-area members later, in 2008. The shaded areas in the graph represent the global financial crisis (2007Q4 to 2009Q2) and the European sovereign debt crisis (2010Q1 to 2012Q4).

## C. Panel Vector Autoregression model

In this section, we briefly describe the main empirical framework used in the paper. We use the PVAR model to estimate responses of various macroeconomic variables to widening MPSG (i.e., common monetary policy becomes accommodative given individual economic conditions). By pooling information from each unit (country), we estimate the model more efficiently while accounting for cross-country heterogeneity, which is invariant over time. Since we are interested in the forces driving sharply different economic outcomes between core and periphery countries, we pool countries belonging to each region, assuming homogeneity in slope coefficients across countries in the same region but allowing for heterogeneity in slope coefficients across regions.[9]

Consider the following reduced-form VAR system with seven endogenous variables:

$$Y_{i,t} = A(L)Y_{i,t-1} + \lambda_i + e_{i,t}, \qquad e_{i,t} \sim N(0, \Sigma_i) \tag{4}$$

[9] See Canova and Ciccarelli (2013) for further details of the estimation of the panel VAR model and its distinct features compared with alternative models such as the large-scale Bayesian VAR model or the Global VAR model.

where $Y_{i,t} = [MPSG_{i,t}, Credit^{D}_{i,t}, Credit^{S}_{i,t}, Credit_{i,t}, Rate_{i,t}, INV_{i,t}, HP_{i,t}]'$ in the baseline VAR model, $A(L)$ is a polynomial of coefficients associated to the lagged variables, $e_{i,t}$ is a vector of residuals, $t = 1, \ldots, T$ indexes time (quarter) and $i = 1, \ldots, N$ indexes country, and $\lambda_i$ are country-fixed effects. We assume that reduced-form residuals $e_{i,t}$ follow an $i.i.d$ normal distribution and are linear combinations of the underlying structural shocks.

In the baseline seven-variable model, $MPSG_{i,t}$ is the country-specific monetary policy stance gap explained above, which also summarizes relative economic conditions to the entire euro area. One distinct aspect of our model from a standard VAR model of monetary policy and credit is a complete characterization of the individual country mortgage market equilibrium by including a proxy for the demand $Credit^{D}_{i,t}$ and supply factor $Credit^{S}_{i,t}$ of mortgage credit, in addition to the real value of mortgage credit $Credit_{i,t}$ and the mortgage loan interest rate. Such consideration is motivated by persistent financial fragmentation in the euro area (Mayordomo et al., 2015; Claessens, 2017) and its different mortgage securitization practices from the United States (Wachter, 2015).[10] To complete the transmission channel of a widening MPSG, we also include the log of real residential investment and the log of real housing prices. Country-fixed effects are introduced to control for time-invariant country-level heterogeneity, which could affect the dynamics of endogenous variables, such as geographical location, industry share, and demographic structure.[11]

Our identification strategy uses a Cholesky decomposition with a lower triangular matrix restriction and the same ordering as Equation (4). This setup indicates that variables that appear later in the ordering affect variables that appear earlier only with a lag. Our identification strategy

[10] Mortgage debt remained an obligation of the banking system in Europe, as securitization took a different form from the United States, with covered bonds being the primary mortgage securitization vehicle. Covered bonds are debt securities backed by cash flows from mortgages, which remain on the issuer's consolidated balance sheet, and therefore an obligation of the originating bank lender.

[11] It is true that a country's industry share and demographic structure vary over time, but they change only gradually. Given the quarterly frequency of our analysis, country-fixed effects will largely absorb any persistent cross-country heterogeneity.

builds on the unique institutional setting in the euro area, where the monetary policy stance is largely independent of developments in each member country. Under this identifying assumption, we treat real housing prices as the most endogenous variable. Our identifying assumption also allows the equilibrium quantity and price of mortgage credit to be contemporaneously affected by not only the monetary policy stance gap but also by the supply and demand factors of mortgage credit, which becomes relevant in the sensitivity test of treating the MPSG as the most endogenous variable.

When estimating the panel model, dealing with the non-stationarity of endogenous variables is an important issue that often yields different estimation results and implications; thus, we discuss this issue in greater detail. First, the monetary policy stance gap is stationary by construction, and its stationarity cannot be rejected at a conventional significance level, so it is always included in levels. Second, volumes of credit and investment and housing prices are non-stationary, so they are I(1) variables. Third, factors proxying the supply and demand for credit are stationary. When we estimate VARs, all variables are entered in (log) levels to preserve potential medium to long-term dynamics among the variables. Estimating the system in levels will produce consistent estimates of impulse responses and this type of estimation is robust to the cointegration of unknown forms.[12]

The baseline PVAR model spans 2003Q1 to 2019Q4 for the six core countries (Austria, Belgium, Finland, France, Germany, and Luxembourg) and the six periphery countries (Cyprus, Greece, Italy, Malta, Portugal, and Spain). Like Holtz-Eakin et al. (1988), we abstract from the heterogeneous dynamic effects of the MPSG by assuming that the cross-sectional units share the same underlying data-generating process within each group. As discussed above, this choice is driven by practical consideration of the properties of our data and the main research question. We estimate the model with four lags; this approach appears conservative compared to the statistics provided by the Akaike Information Criterion (AIC) and Bayesian Information Criterion (BIC). We report a 68%

[12] When there is uncertainty about the nature of common trends in the data, estimating the VAR in levels is a conservative approach, as advocated by, for example, Hamilton (2020).

and 90% confidence interval of the impulse response functions using 200 repetitions of the Monte Carlo simulation.

Note that in our PVAR model, the size of the time ($T$) dimension is greater than that of the cross-sectional dimension ($N$).[13] In a $T > N$ setting like ours, concern about the Nickell bias may not be too much of an issue because the Nickell bias from OLS tends toward zero as $T$ goes to infinity (Alvarez and Arellano, 2003).[14] Given the quarterly availability of data spanning 15 years, providing us $T \gg 30$, we estimate the model using OLS, following Judson and Owen's (1999) suggestion.

# III. Empirical Findings

## A. Main results

Before providing the key results of the baseline analysis, we demonstrate why considering a country-specific monetary policy stance is crucial to answering our question. In doing so, we show that common monetary policy action can have contrasting macroeconomic effects between core and periphery countries because the seemingly tightening of euro area monetary policy can still be expansionary for countries with strong inflationary pressure and positive output gaps. To the extent that core and periphery countries have systematically different economic conditions on average, this

[13] On the one hand, if $T \gg N$, then one can use the mean-group estimator proposed by Pesaran and Smith (1995). The mean-group estimator exploits many time-series observations available for each country and provides an important alternative to the fixed-effect estimator, while allowing for heterogeneous dynamic effects. In other words, when $T$ is large, the average of the responses estimated unit by unit is consistent with the mean response. On the other hand, if $N \gg T$, then we should not use the Ordinary Least Squares (OLS) estimator because bias induced by the joint inclusion of lagged dependent variables and country-fixed effects can be substantial (Nickell, 1981). In this case, it is desirable to use the dynamic panel GMM estimators proposed by Anderson and Hsiao (1982) or Arellano and Bover (1995), which use past information as instruments.

[14] As Nickell (1981) demonstrated, bias arises because the demeaning process, which subtracts the individual's mean value of the dependent variable and each covariate from the respective variable, creates a correlation between regressor and error. The size of the bias is proportional to 1/T, so Nickell bias is a serious problem in the small T and large N setup, which is unlikely in our case. For example, Kiviet (1995) and Judson and Owen (1999) demonstrate that fixed-effect panel regression using lagged dependent variables performs relatively well when the time dimension is relatively large ($T > 30$).

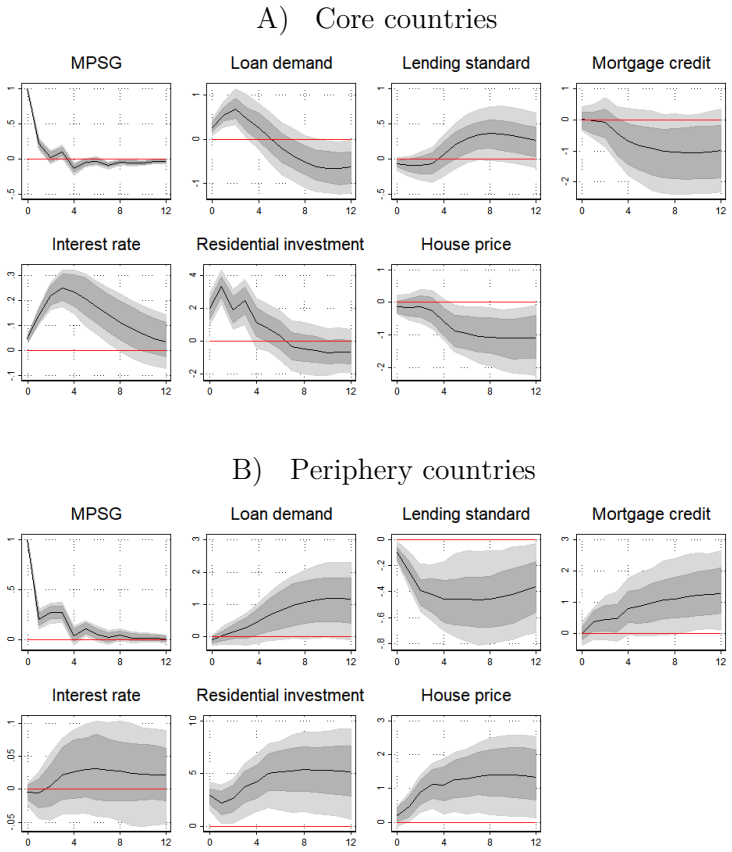
feature of the common monetary policy induces an imbalance between the two regions. While using an exogenous shock to the common monetary policy (e.g., identified by aggregate Taylor residuals or a high-frequency approach using financial data) can sharpen the identification of the causal effect on economic outcomes, it cannot tell us much about how imbalances driven by the common monetary policy stance interact with private sector responses. To demonstrate this point, we estimate the PVAR model by replacing $MPSG_{i,t}$ in Equation (4) with euro area Taylor residuals (i.e., $i_t - \hat{i}_t$).

Figure B.1 in Appendix B reports estimation results obtained using the common monetary policy shocks. Here, the sign of the shock is switched to denote exogenous easing of the euro area monetary policy. In core countries, real GDP starts to increase after two quarters and a maximum increase of 1.5% occurs after three years, consistent with many theoretical predictions and empirical evidence on the effects of monetary easing. There is no price puzzle observed. However, in periphery countries, real GDP decreases statistically significantly on impact and it never increases during the three-year horizon. While stronger output response to common monetary policy shock in the core countries than in the periphery countries is largely consistent with the recent findings in Mandler et al. (2022), the absence of output increase after monetary easing in periphery countries highlights the pitfall of the common monetary policy framework in stabilizing the economic conditions of member countries.

As a result, the responses of other variables of interest are also counterintuitive, especially in periphery countries. For example, given exogenous monetary policy easing at the aggregate level, mortgage credit persistently decreases and residential investment falls, except for some increase on impact, which is difficult to be reconciled with the standard theoretical prediction. These results should be seen as a pitfall of the common monetary policy framework in the euro area, where the same policy action by the ECB is felt differently between regions given their different economic conditions. Though interesting, they do not offer much insight into whether private agents behave differently under the same circumstances.

With this caveat, we now investigate how a widening monetary policy stance gap interacts with bank lending standards toward mortgage loans and how this interplay can explain developments in mortgage credit and housing prices by estimating the baseline PVAR model outlined in Equation (4). Figure 5 shows the effects of a one percent increase in the country-specific MPSG for the panel of six core countries and the panel of six periphery countries, respectively.

**Figure 4.** Effects of widening monetary policy stance gap on mortgage credit




Note: This figure shows the impulse response functions to a one percent increase in the MPSG in the core (top) and periphery (bottom) countries. The horizontal axis indicates quarters and the vertical axis indicates percentage change. Each graph plots 68% and 90% confidence intervals with shaded areas. The confidence interval is calculated using a Monte Carlo simulation with 200 repetitions.

As expected, household demand for mortgage loans increases in both regions because a widening MPSG indicates that the euro area monetary policy stance becomes accommodative compared to what is warranted by economic conditions in the given region, on average. However,

bank lending standards respond differently between the regions: banks in core countries tighten their lending standards, whereas those in periphery countries relax their standards.

While the lending standard response in periphery countries is consistent with the risk-taking channel of monetary policy in the euro area (Gambacorta, 2009; Delis and Kouretas, 2011; Neuenkirch and Nöckel, 2018), the distinct response between core and periphery countries is not documented in existing studies. For example, Neuenkirch and Nöckel (2018) found that bank lending standards were relaxed in both crisis and non-crisis countries after expansionary monetary policy shocks when the main refinancing rate, which is common to all euro-area countries, is used as a measure of monetary policy. The contrasting lending standard response also accounts for an increase in the volume of mortgage loans in periphery countries and a decline in mortgage loans in core countries, although both regions experience the same degree of expansionary ECB monetary policy given their economic conditions.

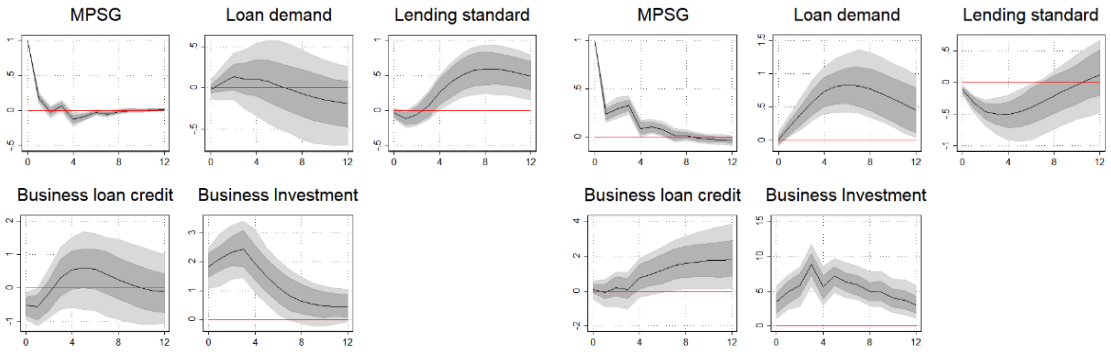
The response of country-level mortgage loan rates also supports the idea of different bank lending behaviors between the regions as a key mechanism: the mortgage rate increases significantly in core countries, whereas it barely responds in periphery countries, which is consistent with the simple supply-demand model of the mortgage credit market. As a result, while residential investment increases in both regions, the increase is much larger and more persistent in periphery countries. Driven by a sharp increase in mortgage credit, periphery countries also experience a strong housing market boom, which is absent in core countries.

This finding is interesting because we identify an underappreciated factor explaining the different economic trajectories between core and periphery countries. It appears that what drives different economic outcomes between the two Europes, especially for mortgage credit, residential investment, and housing prices, is the supply side of credit, which is captured by contrasting bank lending behaviors. Bank mortgage loan demands are procyclical in both regions, but bank mortgage lending standards are countercyclical in core countries, which dampens any excessive buildup of

credit, residential investment boom, or housing price appreciation.[15] This stabilizing mechanism is missing in periphery countries because of procyclical bank mortgage lending standards; the lack of prudential bank lending behaviors amplifies macroeconomic instability in the region induced by imbalances created by the common monetary policy framework.

Though not our main interest, we estimate the comparable model of business loans (loan-related variables are replaced with those concerning business loans and residential investment is replaced with non-residential investment) and provide the results in Figure 5. Similar to household mortgage credit, lending standards toward business credit also show sharply different responses between the regions, suggesting that our preferred explanation for mortgage and housing also holds for firm investment but not for household consumption.

**Figure 5.** Effects of widening monetary policy stance gap on business credit




Note: This figure shows the impulse response function to a one percent increase in the MPSG in the core (left) and periphery (right) countries. The horizontal axis indicates quarters and the vertical axis indicates percentage change. Each graph plots 68% and 90% confidence intervals with shaded areas. The confidence interval is calculated using a Monte Carlo simulation with 200 repetitions.

[15] In an unreported analysis, we find that lending standards for consumer credit behave similarly in both regions, suggesting a different lending practice toward mortgage loans compared to consumer loans.

## B. Robustness checks

In this section, we provide a battery of sensitivity tests to confirm that contrasting bank mortgage lending behaviors in response to widening MPSG between the two Europes are robust to various specifications. First, as there can be an issue in our baseline PVAR model with giving equal weight to small countries like Cyprus, Malta, and Luxembourg, we check whether dropping these countries from the sample influences our main findings. Figure B.2 in Appendix B shows results consistent with the main findings, in which mortgage lending standards still show markedly different responses between core and periphery countries, and responses of other key variables are in line with the baseline results.

As an alternative to MPSG, which is the difference in predicted values, we use the difference between the realization of the EONIA rate and the country-specific prescribed rate (i.e., $\hat{i}_{i,t} - i_t$), which incorporates unexpected changes in the policy rate. As shown in Figure B.3, the responses of mortgage lending standards are still sharply different between the regions, while the responses of mortgage loan demand are similar between core and periphery countries. This result is not surprising given the minor difference between the actual and fitted value of the policy rate in Figure A.2.

In our baseline VAR model, we treated the MPSG variable as the most exogenous in the system, which is based on the notion that macroeconomic conditions embedded in MPSG can exercise immediate effect on credit and housing markets. Although this identifying assumption is reasonable, we still test the robustness of our findings by placing the MPSG variable at the bottom of the VAR system (i.e., affecting other variables only with a lag). Figure B.4 confirms that our conclusion does not depend on the ordering of the VAR model.

Our sample starts from 2003Q1 because BLS data is available from this time; the reason it ends in 2019Q4 is to have as long a sample as possible pre-pandemic. If we restrict the VAR sample from 2003Q1 to 2016Q1 (before the ECB faced negative interest rates), our main results do not change, which is confirmed in Figure B.5. In the baseline analysis, the estimation of the euro-area Taylor rule used the sample up to 2016Q1, which raises a concern of overfitting stemming from

vastly different economic outcomes experienced between core and periphery countries. In other words, the contrasting behaviors between the two Europes documented in Figure 4 might be an artificial product of using the entire crisis sample when estimating the Taylor rule. To guard against this possibility, we re-estimate the Taylor rule in Equation (2) using data only up to 2007Q4. As shown in Figure B.6, the main finding about different mortgage lending behaviors between the regions hardly changes.

A remaining concern is the homogeneity assumption of the slope coefficients in the VAR system belonging to the same group in our panel VAR model. To the extent that all economies still experienced different economic paths, even within a group, the common parameter assumption might have disregarded interesting heterogeneity. Moreover, the grouping of crisis countries vs. non-crisis countries seems clear with the benefit of hindsight now but it might have exploited too much *ex-post* information on economic outcomes. To check whether our main finding is forced by the homogeneity assumption, we use the mean-group estimator proposed by Pesaran and Smith (1995), which allows for heterogeneous dynamic effects. Although this approach does not impose any commonality among countries in the same group, Figure B.7 shows that contrasting mortgage lending behaviors amid similar increases in loan demand are still found.[16]

## C. Discussions

*Cross-border capital flows and domestic bank lending standards.* We extend the baseline model to reflect the intra-regional feature of the euro area by including current accounts and cross-border banking flows in the VAR model. The rapid increase in intra-region financial flows from the core to periphery countries since the adoption of the euro has been identified as a source of credit and housing booms in periphery countries (Hobza and Zeugner, 2014; Hale and Obstfeld, 2016). We

[16] A practical problem in this approach is that the time-series dimension of our sample is not sufficiently long, which restricts the number of parameters to be estimated. To keep the model parsimonious, we instead estimate the trivariate VAR model only with MPSG, mortgage loan demand, and mortgage lending standards.

provide corroborating evidence by showing that the imbalance created by the common monetary policy is associated with the asymmetric financial flows between the core and periphery countries.

Other than the current account to the GDP ratio as a proxy for aggregate capital flows, we use bilateral data on cross-border banking flows from the BIS LBS. This dataset provides a geographical breakdown of banks' counterparties and information about the currency composition of their balance sheets. In this regard, the major advantage of the BIS LBS data, compared to the banking flows collected from the BoP statistics, is a detailed breakdown of reported series by counterpart countries. See Bank for International Settlements (2017) and Albrizio et al. (2020) for further details on the LBS data.[17] For each country in the sample, we take the sum of cross-border bank borrowing from counterparty countries only if a counterparty country belongs to the other region (i.e., periphery countries for a given core country and core countries for a given periphery country). By doing so, we can directly measure banking flows between core and periphery countries.

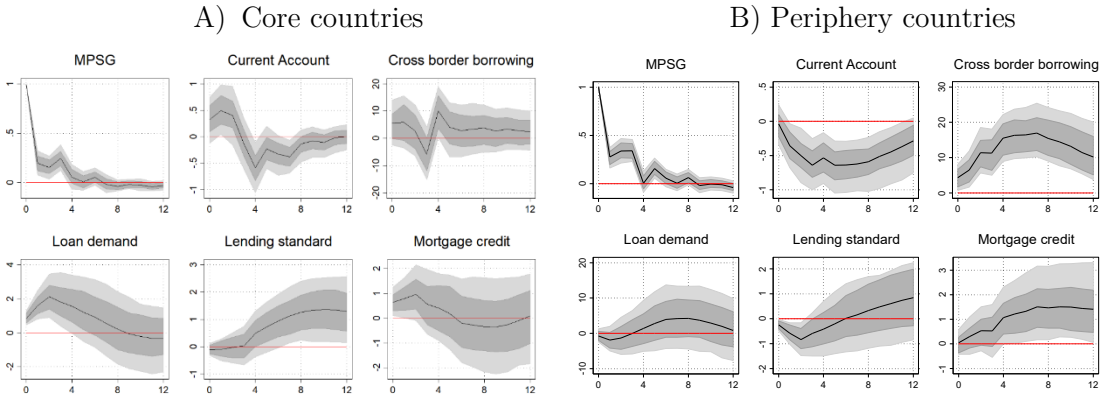
To keep the number of parameters to be estimated manageable, the model does not include the mortgage loan rate, residential investment, and housing prices. Figure 6 displays the responses of current accounts capturing the balance of payment conditions in each economy and actual cross-border banking flows between the two regions. A decline in current accounts after a widening MPSG is much larger and more statistically significant in periphery countries, suggesting that they experience substantial net capital inflows. Although mortgage markets in the euro area are quite segmented and domestic households mostly borrow from domestic banks (e.g., Rughoo and Sarantis,

[17] The LBS dataset captures outstanding claims and liabilities of internationally active banks located in reporting countries against counterparties residing in more than 200 countries. The data is compiled following the residency principle, which is consistent with the BoP statistics. Banks record their positions on an unconsolidated basis, including intragroup positions between offices of the same banking group. Currently, banking offices located in 46 countries, including many offshore financial centers, report to LBS. The LBS dataset captures around 95 percent of all cross-border interbank business (Bank for International Settlement, 2017). The bulk of cross-border bank claims and liabilities takes the form of loans and securities of the domestic banking sector vis-à-vis all counterparty sectors (including banks and non-banks, and the private and public sectors). Another main advantage of the BIS LBS is that the currency composition of cross-border claims and liabilities is available, so that cross-border banking flows, expressed in USD, are adjusted for movements in exchange rates.

2014), banks in periphery countries could have relaxed their lending standards through foreign borrowing, as implied in net capital inflows.

We confirm that in response to the widening MPSG, periphery countries' foreign borrowing from banks in core countries indeed increases persistently, while core countries' foreign borrowing from banks in periphery countries does not respond much. Given that most recent severe financial crises have been combinations of substantial current account deficits and credit booms (e.g., Laeven and Valencia, 2013), and that banking crises preceded by credit booms are significantly more likely to occur when they are fueled by sizeable external borrowing (e.g., Davis et al., 2016), the asymmetric capital flow responses driven by the imbalance in monetary policy can account for different bank lending behaviors toward domestic mortgage loans and different trajectories in key variables.[18]

**Figure 6.** Effects of widening monetary policy stance gap on capital flows

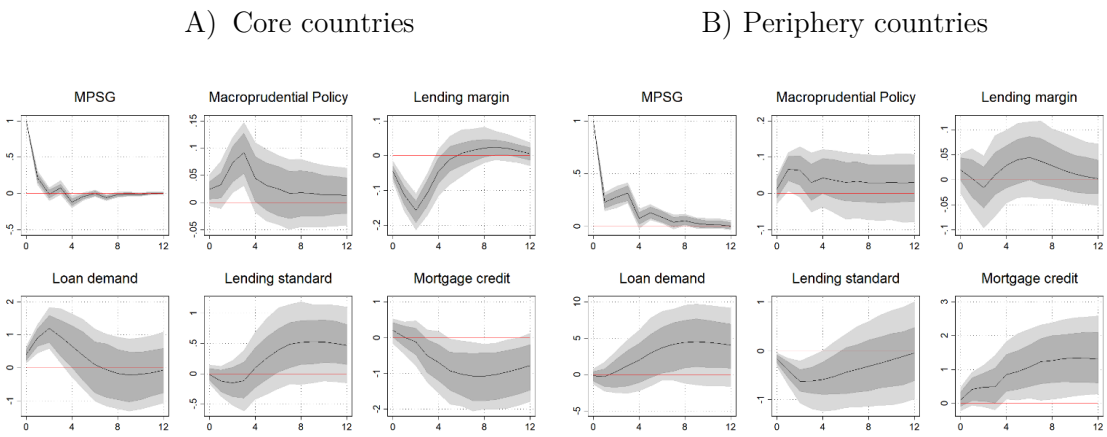



Note: This figure shows the impulse response functions to a one percent increase in the MPSG in the core (left) and periphery (right) countries. The horizontal axis indicates quarters and the vertical axis indicates percentage change. Each graph plots 68% and 90% confidence intervals with shaded areas. The confidence interval is calculated using a Monte Carlo simulation with 200 repetitions.

[18] Especially during the pre-crisis period, there existed a divergence between domestic deposit growth and credit growth in the European banking system. To finance the discrepancy between them, banks issued bonds and raised funds by borrowing short-term on international money markets, suggesting that the domestic credit boom was accelerated by inter-bank lending; this resonates with the fact that current account deficits and credit growth are positively correlated (Lane and McQuade, 2014).

*Unintended consequences of macroprudential policies.* Then what explains asymmetric cross-border capital flows between the regions? We extend our analysis to investigate the role of macroprudential policy in driving different bank lending behaviors toward household mortgage credit. Since some ingredients of these macroprudential policies are not directly applied to household mortgage credit, we narrow our focus to policies aimed at directly regulating household lending, including the loan-to-value (LTV) ratio, the debt-service-to-income (DSTI) ratio, the loan-to-deposit (LTD) ratio, and loan prohibitions based on household loan characteristics (e.g., maturity, size, and type of interest rate).

**Figure 7.** Effects of widening monetary policy stance gap on mortgage macroprudential policies




Note: This figure shows the impulse response functions to a one percent increase in the MPSG in the core (left) and periphery (right) countries. The horizontal axis indicates quarters and the vertical axis indicates percentage change. Each graph plots 68% and 90% confidence intervals with shaded areas. The confidence interval is calculated using a Monte Carlo simulation with 200 repetitions.

The responses of mortgage-targeted macroprudential policy to a widening MPSG in core and periphery countries are presented in Figure 7, which shows tightening in both regions. The tightened mortgage-targeted macroprudential policy in core countries provides a potential explanation for the aggressive cross-border lending to periphery countries documented in Figure 7. Given the restrictions on domestic mortgage lending, core banks could have an incentive to expand their business to periphery countries to search for yield. The response of the bank lending margin—computed as the difference between MFIs' interest rates on new loans and a weighted average interest rate on new deposits from households and non-financial corporations supports this interpretation. In response to

the widening MPSG, bank profitability proxied by lending margin declines sharply in core countries, whereas it barely changes in periphery countries.

As a further validity check, we use a non-mortgage-related macroprudential policy index—the remaining sum of the categories in iMaPP. Interestingly, measures of macroprudential policy not directly targeted to mortgage credit, including those on bank capital or liquidity requirements and foreign currency loans, are not tightened in core countries (see Figure B.8), highlighting the distinct role of mortgage credit in the build-up of macroeconomic instability. In contrast, no such discrepancy is found in periphery countries, implying that domestic macroprudential policies in periphery countries were countercyclical but failed to offset the unintended consequences of macroprudential policies in core countries.

# IV. Conclusion

We have shown that systematically different bank lending behaviors in response to the imbalance created by the common monetary policy framework in the euro area are key to understanding the dramatic contrast between the two Europes (i.e., stronger booms and busts in mortgage credit, residential investment, and housing prices in periphery countries compared with core countries). Although countercyclical bank lending standards in core countries dampen the expansion of mortgage credit and the appreciation of housing prices driven by the relatively accommodative ECB monetary policy stance, procyclical bank lending standards in periphery countries accelerate the growth in mortgage credit and housing prices under the same condition.

The extension of the baseline analysis offers a potential explanation for different bank lending behaviors between the two Europes and completes the transmission mechanism suggested in the paper. In response to the widening monetary policy stance gap, capital flows out of core countries and moves into periphery countries, which can explain why mortgage lending standards behave differently. Aggressive cross-border lending by core banks to periphery countries is likely driven by limited domestic mortgage lending opportunities, implying an unintended consequence of

countercyclical macroprudential policy targeted at mortgage credit in core countries. In other words, given the inevitable imbalance under the common monetary policy framework, uncoordinated macroprudential policies between the regions can be another source of macroeconomic instability, which deserves deeper analysis in future research.

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# Appendix

## Appendix A. Data description

**Table A.1.** Definition and sources of data

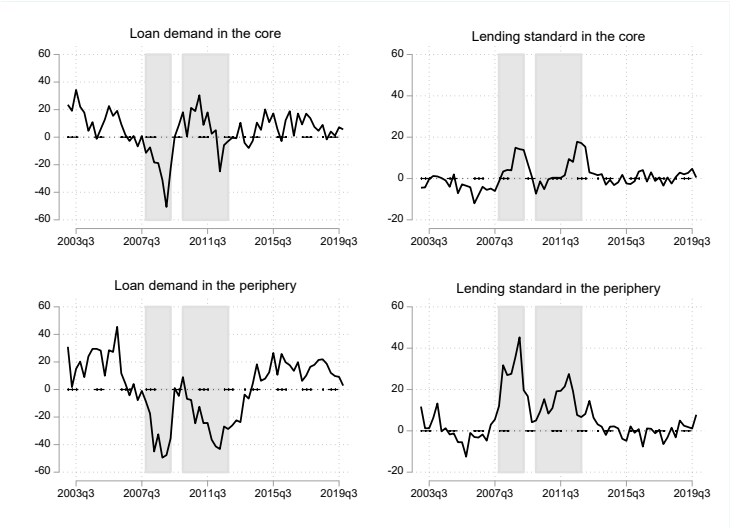
| Variables | Definition | Time span | Data source |
|---|---|---|---|
| **Aggregate Euro area data** | | | |
| Euro Overnight Index Average (EONIA) | EONIA rate of monetary policy decision date for every last month of its quarter | 1999:Q1-2019:Q4 | ECB Data Warehouse |
| Inflation (forecast) | Staff assessment of inflation rate | 1999:Q1-2019:Q4 | ECB Macroeconomic Projection Database |
| GDP growth (forecast) | Staff assessment of GDP growth | 1999:Q1-2019:Q4 | ECB Macroeconomic Projection Database |
| Output gap (forecast) | Estimated data from the Output Gaps Working Group in the European Commission (annual) | 1999-2019 | European Commission |
| **12 Euro area country data** | | | |
| Inflation | Quarterly average of the monthly inflation rate | 2003:Q1-2019:Q4 | ECB Data Warehouse |
| GDP growth | Quarterly growth rate of real GDP | 2003:Q1-2019:Q4 | Author's calculation |
| Output gap | Cyclical component of real GDP from Hamilton filter (Hamilton, 2018) | 2003:Q1-2019:Q4 | Author's calculation |
| (Real) GDP | Gross domestic product at market prices, constant prices (the base year of 2015), calendar-adjusted | 1995:Q1-2019:Q4 | Datastream |
| HICP | Quarterly average of the monthly HICP index (the base year of 2015), Seasonally adjusted with X-12 ARIMA | 2003:Q1-2019:Q4 | ECB Data Warehouse, author's calculation |
| Loan demand for mortgage loans | Diffusion index, the weighted difference between the share of banks reporting "substantially stronger" and "moderately stronger" and the share of "moderately weaker" and "substantially weaker" for mortgage loans in the percentage of the total number of banks | 2003:Q1-2019:Q4 | ECB's Bank Lending Survey data |
| Lending standard for mortgage | Diffusion index, the weighted difference between the share of banks reporting "substantially tightened" and "moderately tightened" and the share of "moderately | 2003:Q1-2019:Q4 | ECB's Bank Lending Survey data |

| | | | |
|---|---|---|---|
| | eased" and "substantially eased" for mortgage loans in the percentage of the total number of banks | | |
| Loan demand for consumer loans | Diffusion index, the weighted difference between the share of banks reporting "substantially stronger" and "moderately stronger" and the share of "moderately weaker" and "substantially weaker" for consumer loans in the percentage of the total number of banks | 2003:Q1-2019:Q4 | ECB's Bank Lending Survey data |
| Lending standard for consumer loans | Diffusion index, the weighted difference between the share of banks reporting "substantially tightened" and "moderately tightened" and the share of "moderately eased" and "substantially eased" for consumer loans in the percentage of the total number of banks | 2003:Q1-2019:Q4 | ECB's Bank Lending Survey data |
| Mortgage credit outstanding | Outstanding amounts of mortgage loans at the end of the period | 2003:Q1-2019:Q4 | ECB Data Warehouse |
| Mortgage interest rate | Quarterly average of the mortgage interest rate for outstanding loans | 2003:Q1-2019:Q4 | ECB Data Warehouse |
| Lending margin | The difference between MFIs' interest rates on new loans and a weighted average interest rate on new deposits from households and non-financial corporations. | 2003:Q1-2019:Q4 | ECB Data Warehouse |
| House price | Residential property price index from BIS statistics (the base year of 2010) | 2003:Q1-2019:Q4 | BIS |
| Residential investment | Gross fixed capital formation in the housing sector, constant prices | 2003:Q1-2019:Q4 | Datastream |
| Total consumption | GDP Expenditure approach, Private Final Consumption, Chained volume estimates, National reference year, Quarterly, SA | 2003:Q1-2019:Q4 | OECD statistics |
| Macroprudential policy measure | Alam et al. (2019): Dummy-type variables for 17 instruments of macroprudential policy. We used the sum of dummy-type variables for 17 instruments and the sum of those for the loan-targeted macroprudential policy in each quarter. | 2003:Q1-2019:Q4 | Alam et al. (2019), |
| Current accounts | External balance of goods and services and international transfers of capital | 2003:Q1-2019:Q4 | Eurostat |
| Cross-border bank flows | Bilateral cross-border claims, loans, and deposits | 2003:Q1-2019:Q4 | BIS Locational Banking Statistics |

| | | | |
|---|---|---|---|
| Non-performing loans ratio | Share of non-performing loans in total bank loans (annual) | 2003-2019 | IMF Financial Soundness Indicators |

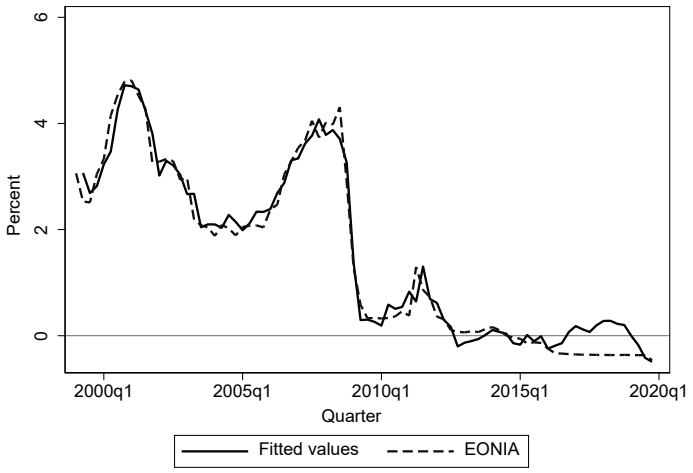
Note: This table provides the definition, time span, and sources of variables used in the analysis.

**Figure A.1.** Bank lending standards and loan demand for household mortgage credit




Note: The graph shows the average lending standards and loan demands for household mortgage credit. The first column shows the average mortgage loan demands for core and periphery countries. The second column shows the average mortgage leading standards. The shaded areas in the graph represent the global financial crisis (2007Q4 to 2009Q2) and the European sovereign debt crisis (2010Q1 to 2012Q4).

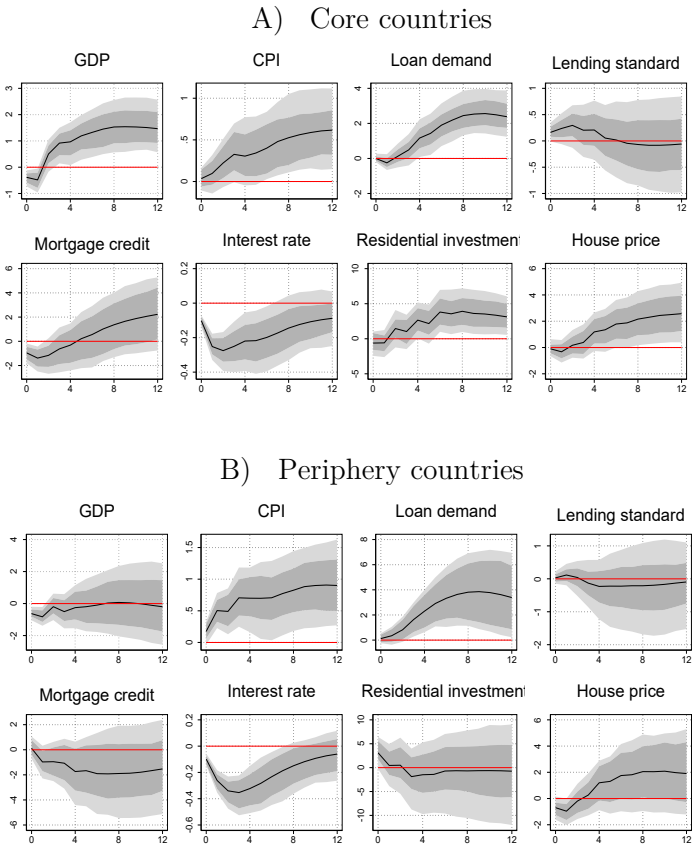
**Figure A.2.** Actual vs. fitted policy rate in the euro area




Note: The dashed line shows the EONIA rate and the solid line represents the fitted value of the aggregate Taylor rule from 1999Q1 to 2019Q4. When estimating the aggregate Taylor rule coefficients, we use the sample period ranging from 1999Q1 to 2016Q1, as the official key interest rate of the ECB reached the Zero Lower Bound in March 2016. Thus, the fitted values between 2016Q2 and 2019Q4 represent out-of-sample estimates.

## Appendix B. Additional results and robustness checks

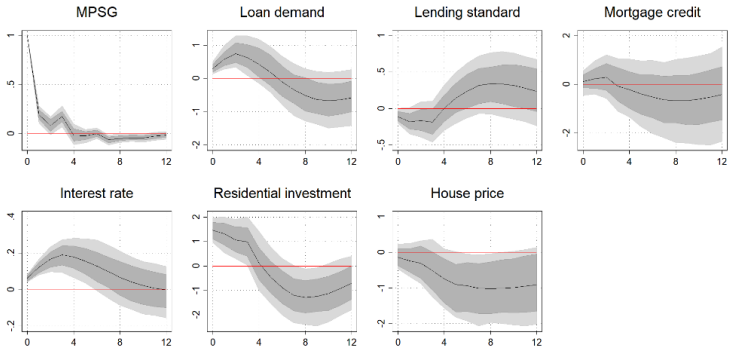
**Figure B.1.** Effects of common monetary policy shocks



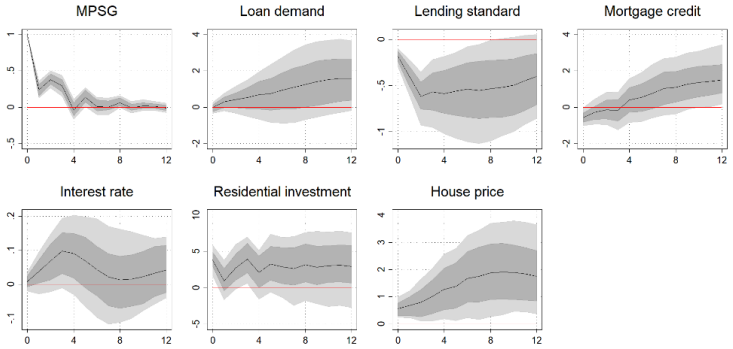

Note: This figure shows impulse response functions to a one percent increase in the euro-area Taylor residuals in the core (top) and periphery (bottom) countries. The horizontal axis indicates quarters and the vertical axis indicates percentage change. Each graph plots 68% and 90% confidence intervals with shaded areas. The confidence intervals were calculated using a Monte Carlo simulation with 200 repetitions.

**Figure B.2.** Robustness checks: alternative classification of core and periphery countries

A) Core countries



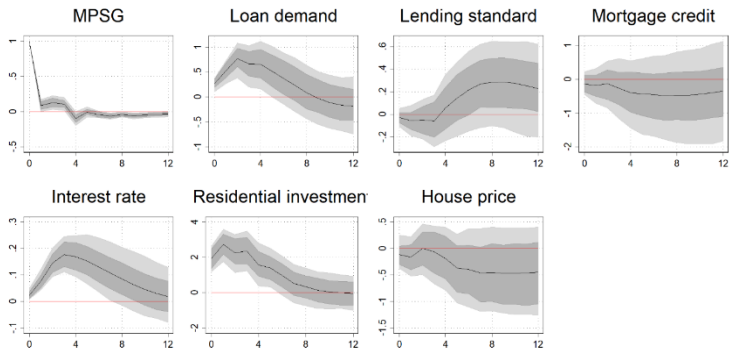

B) Periphery countries



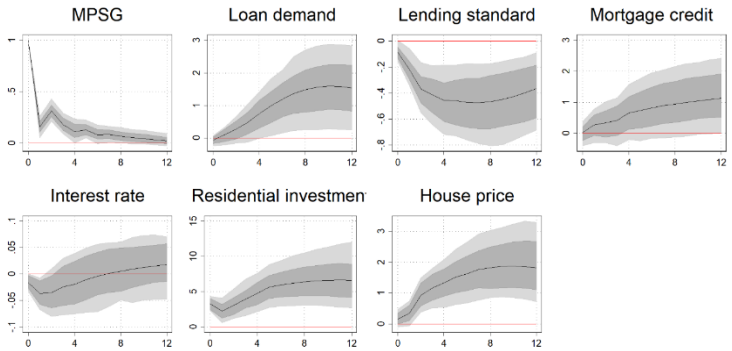

Note: This figure shows the impulse response functions to a one percent increase in the MPSG in the core (top) and periphery (bottom) countries. Core countries are Austria, Belgium, France, Germany, and Finland. Periphery countries are Greece, Italy, Portugal, and Spain. The horizontal axis indicates quarters and the vertical axis indicates percentage change. Each graph plots 68% and 90% confidence intervals with shaded areas. The confidence interval is calculated using a Monte Carlo simulation with 200 repetitions.

**Figure B.3.** Robustness checks: alternative measure of MPSG

A) Core countries

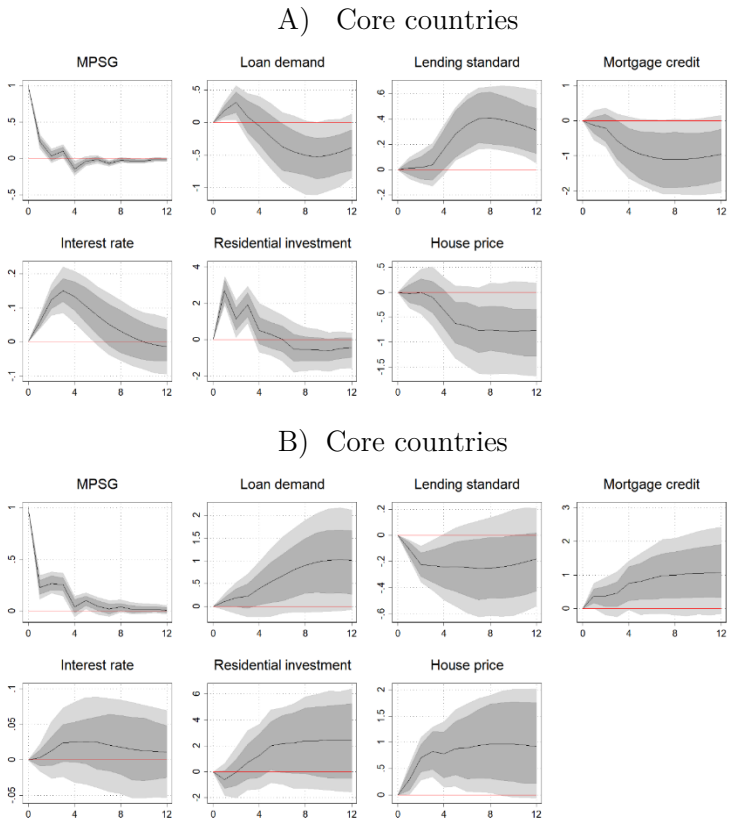



B) Periphery countries



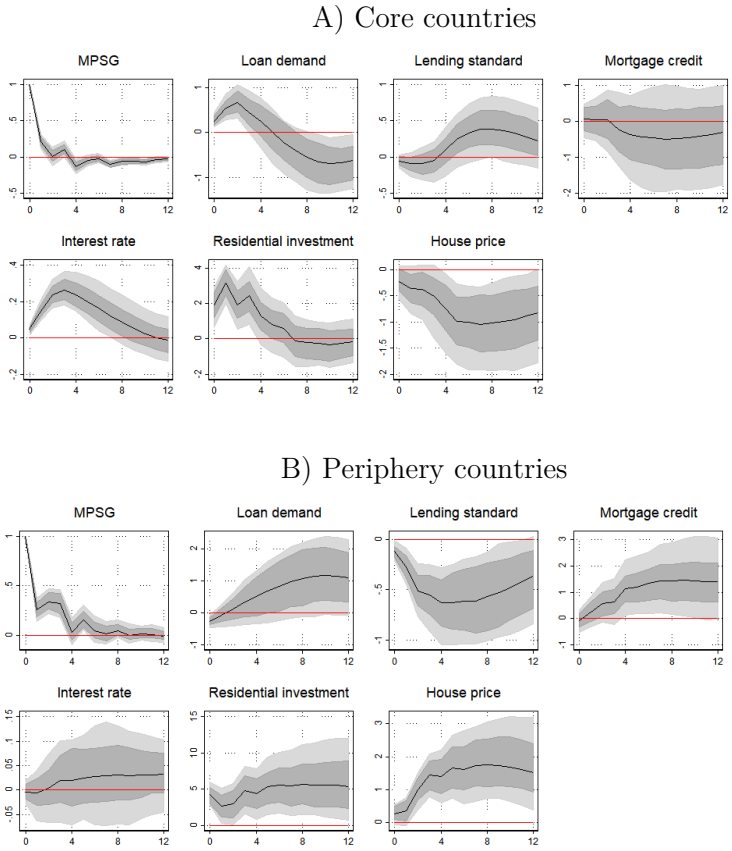

Note: This figure shows the impulse response functions to a one percent increase in the alternative measure of MPSG in the core (top) and periphery (bottom) countries. The horizontal axis indicates quarters and the vertical axis indicates percentage change. Each graph plots 68% and 90% confidence intervals with shaded areas. The confidence interval is calculated using a Monte Carlo simulation with 200 repetitions.

**Figure B.4.** Robustness checks: alternative VAR ordering




Note: This figure shows the impulse response functions to a one percent increase in the MPSG in the core (top) and periphery (bottom) countries using an alternative ordering of the PVAR model. The horizontal axis indicates quarters and the vertical axis indicates percentage change. Each graph plots 68% and 90% confidence intervals with shaded areas. The confidence interval is calculated using a Monte Carlo simulation with 200 repetitions.

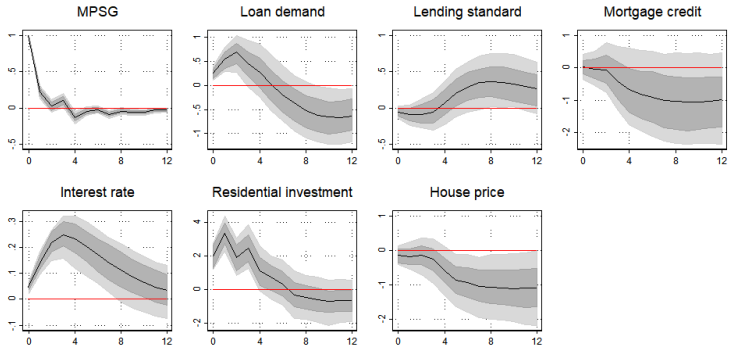
**Figure B.5.** Robustness checks: dropping the ELB period



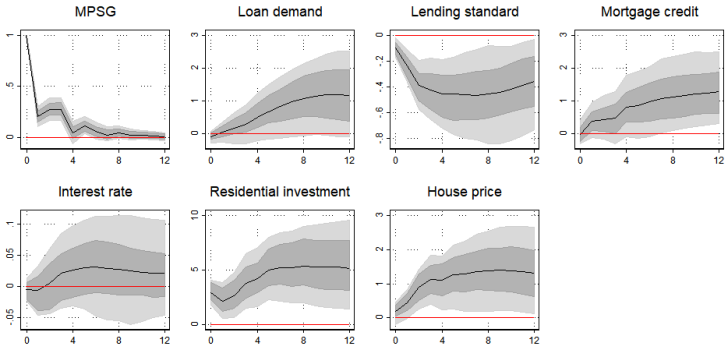

Note: This figure shows the impulse response functions to a one percent increase in the MPSG in the core (top) and periphery (bottom) countries. The estimation sample runs from 2003Q1 to 2016Q1. The horizontal axis indicates quarters and the vertical axis indicates percentage change. Each graph plots 68% and 90% confidence intervals with shaded areas. The confidence interval is calculated using a Monte Carlo simulation with 200 repetitions.

**Figure B.6.** Robustness checks: estimating the Taylor rule using pre-crisis data only

A) Core countries

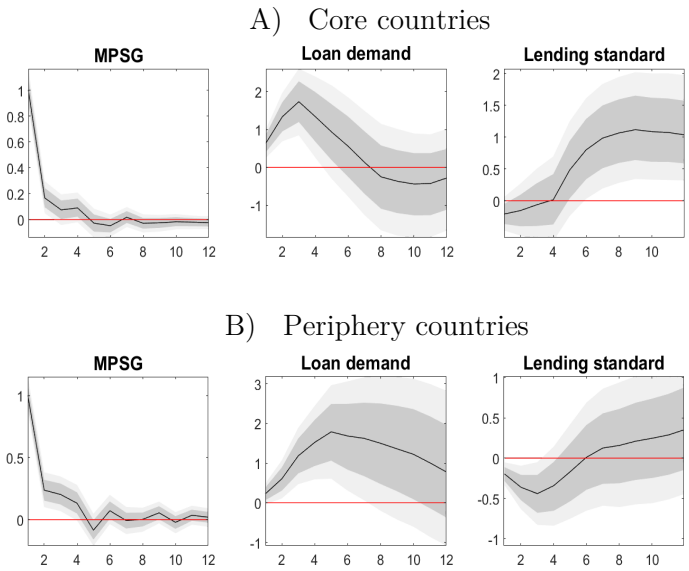



B) Periphery countries



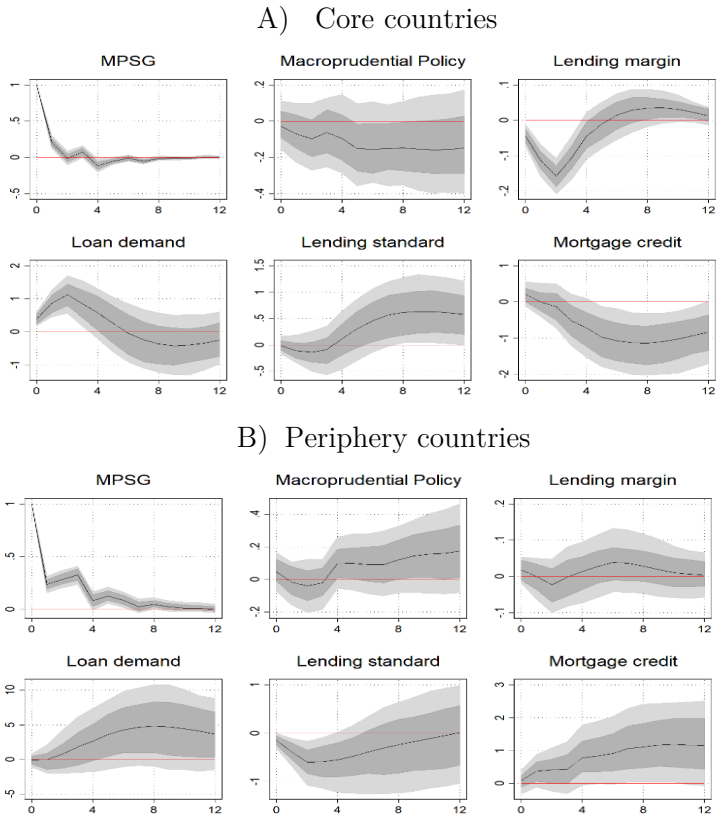

Note: This figure shows the impulse response functions to a one percent increase in the MPSG in the core (top) and periphery (bottom) countries. The euro-area Taylor rule is estimated using the pre-crisis data only (until 2007Q4). The horizontal axis indicates quarters and the vertical axis indicates percentage change. Each graph plots 68% and 90% confidence intervals with shaded areas. The confidence interval is calculated using a Monte Carlo simulation with 200 repetitions.

**Figure B.7.** Robustness checks: using a mean-group estimator




Note: This figure shows the impulse response functions to a one percent increase in the MPSG using a mean-group estimator in the core (top) and periphery (bottom) countries. The horizontal axis indicates quarters and the vertical axis indicates percentage change. Each graph plots 68% and 90% confidence intervals with shaded areas. The confidence interval is calculated by using a bootstrapping with 5,000 resamples.

**Figure B.8.** Effects of widening monetary policy stance gap on non-mortgage macroprudential policies




Note: This figure shows the impulse response functions to a one percent increase in the MPSG in the core (top) and periphery (bottom) countries. The horizontal axis indicates quarters and the vertical axis indicates percentage change. Each graph plots 68% and 90% confidence intervals with shaded areas. The confidence interval is calculated using a Monte Carlo simulation with 200 repetitions.