Taiwanese Mortgage Rate, Central Bank Discount Rate & Conditional Heteroscedasticity in Post-1997 Asian Financial Crisis

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Abstract

Asymmetries in the Taiwanese mortgage loan-central bank discount rates spread (mortgage loan premium) were documented. Empirical results revealed that the mortgage loan premium adjusts to the threshold faster when the central bank discount rate increases relative to the mortgage loan rates than when the discount rate moves in the opposite direction. Additionally, the empirical findings indicate that Taiwanese commercial banks still exhibit predatory rate setting behavior, despite of the recent deregulations in banking sector. The empirical results also revealed the bidirectional Granger causality between the Taiwanese mortgage loan rate and the discount rate, indicating that the mortgage loan rate and the discount rate affect each other’s movements. These empirical results suggest that Taiwanese monetary authority can use its countercyclical monetary policy instrument to achieve its macroeconomics objectives in the short run.

I. Introduction

ONE OF THE most important roles commercial banks play as financial intermediaries is to determine the spread between the lending rate they charge the borrowers and their costs of funds. This spread not only provides interest income to financial intermediaries, but it also influences a country’s level of savings and investment. Empirically, the costs of funds or their proxies may be rates on short-term government securities, deposit rates, or the central bank discount rate for examples. If the spread is between the home mortgage rate and the cost of funds of the lending institutions, it would influence the housing market of the country which is the major segment of any economy. Additionally, if the spread is between the mortgage rate and the central bank discount rate, it influences

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