Abstract

We analyze the root causes of the current crisis by studying the determinants of bank lending standards in the Euro Area using the answers from the confidential Bank Lending Survey, where national central banks request quarterly information on the lending standards banks apply to customers. We find that low short-term interest rates soften lending standards for both businesses and households and, by exploiting crosscountry variation of Taylor-rule implied rates, that *rates too low for too long* soften standards even further. The softening is over and above the improvement of borrowers' creditworthiness and all the relevant lending standards are softened, thus implying that banks' appetite for (loan) risk increases. In addition, high securitization activity and weak banking supervision standards amplify the positive impact of low short-term interest rates on bank risk-taking, even when we instrument securitization. Moreover, short-term rates – directly and in conjunction with securitization activity and supervision standards – have a stronger impact on bank risk-taking than long-term interest rates. These results help shed light on the origins of the current crisis and have important policy implications.