Risk-based pricing in competitive lending markets

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Abstract

We use unique relationship-level data which includes banks' private risk assessments of corporate borrowers to quantify how competition among banks affects the risk sensitivity of interest rates in the Norwegian corporate credit market. We show that an increase in competition makes corporate lending rates less sensitive to banks' own assessment of borrower probability of default and this is more pronounced in market segments with higher degree of asymmetric information. Our results are driven by banks with low franchise values, outlining a novel channel of how the competition-fragility nexus can operate.