

## **How do interest rates influence the supply of credit?**

### **Video transcription**

When inflation began to surge in late 2021, central banks responded by sharply raising policy interest rates. As a result, commercial banks not only hiked interest rates on business loans, but also tightened their lending standards.

At the Banco de España we have looked precisely at how monetary policy decisions on interest rates affect the supply of bank credit to businesses. We have reached the following conclusions:

- First, less capitalised banks (those that rely less on equity funding than other banks) are more likely to restrict lending to businesses. Indeed, when interest rates rise, these are the banks that tighten their lending standards for businesses the most.
- Second, SMEs are harder hit than large firms by tighter lending standards, as they have a higher probability of defaulting on their loans.
- And third, all these effects are especially noticeable when interest rates rise sharply.