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# Do Net Interest Margins for Small and Large Banks Vary Differently with Interest Rates?

by: Rajdeep Sengupta and Fei Xue

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Lowering interest rates may be disadvantageous to small banks relative to large banks, but raising interest rates is not necessarily advantageous for them.

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Bank net interest margins (NIMs), which denote profitability from core banking operations, have dropped sharply since 2019, renewing concerns on the viability of the traditional banking model. Any downward pressure on NIMs puts small banks at a disadvantage because a relatively greater share of small bank income comes from interest on loans. Understanding differences in small and large bank NIM behavior can shed light on the viability of different banking business models.

Rajdeep Sengupta and Fei Xue examine the relative contributions of activities that compose bank NIMs as well as their sensitivities to interest rates. They find that the recent decline in bank NIMs was largely driven by changes in interest rates rather than changes in the composition of NIM components in bank portfolios. After controlling for financial and economic conditions that also affect bank NIMs, they find that NIM contributions from loans and deposits are highly sensitive to interest rates. However, these sensitivities are not always symmetric between large and small banks and between increases and decreases in interest rates. Although lowering interest rates may be relatively disadvantageous for small banks by lowering NIMs, raising interest rates is not necessarily advantageous for them.

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