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Introduction

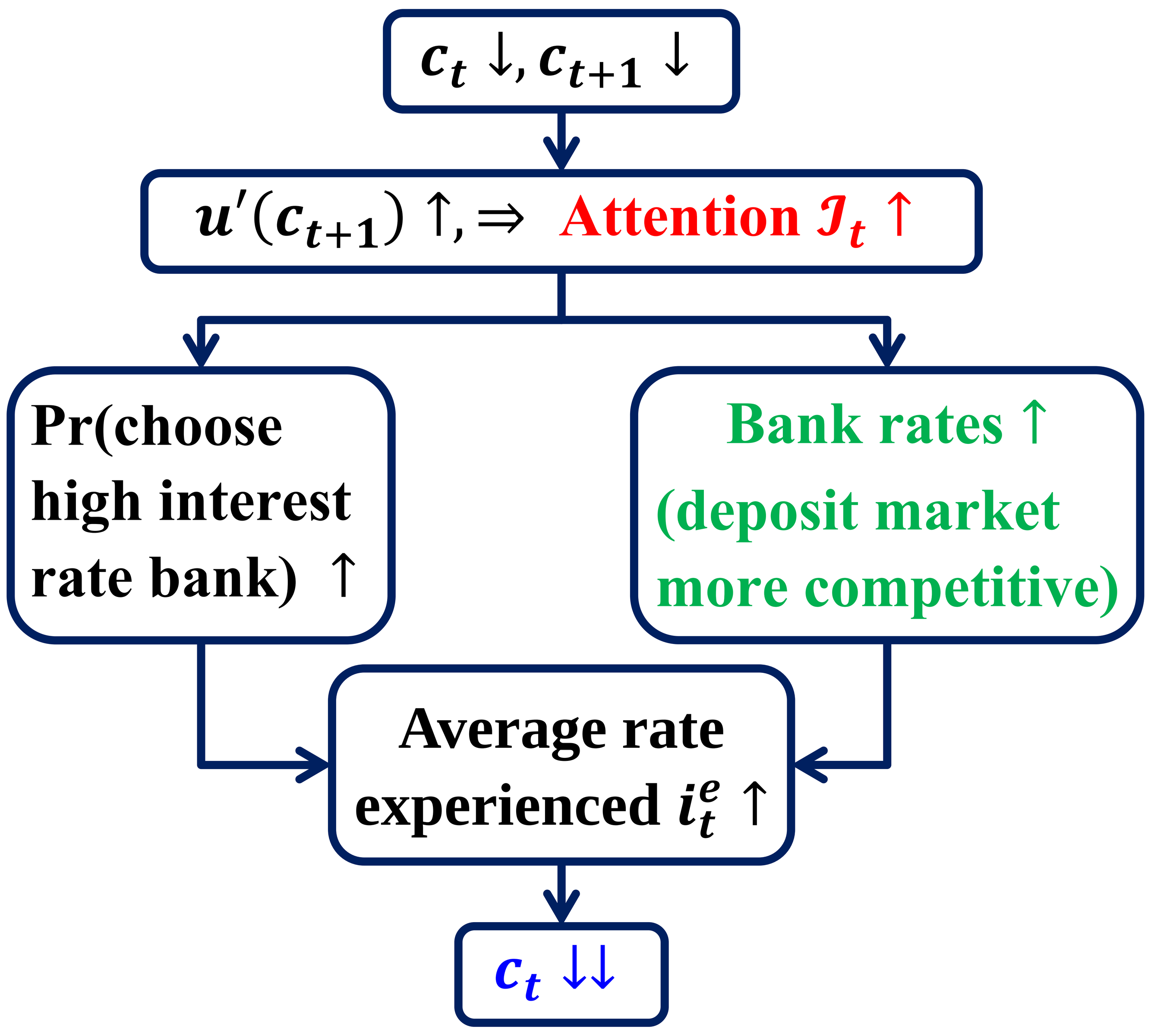
Households can increase the **interest rate** on their savings if they shop around more for their savings products – if they **pay more attention** (e.g. FCA, 2015).

Questions: How does saver attention vary over the business cycle? How do banks respond? And what effect does that have on the business cycle?

Answers: Attention is **countercyclical**. When attention rises in a recession, banks offer higher rates relative to the policy rate. This **amplifies** shocks to consumption.

Theory and mechanism

- Paying more attention $\mathcal{I}$ ⇒ higher Pr(choose high interest rate bank), but is costly (effort, time).
- Therefore $\mathcal{I}$ high when value of extra income is high – i.e. in **contractions**.



Empirical evidence

UK Data: monthly 1996-2009

1. Moneyfacts: interest rate + product features, all retail savings products.
2. Quoted Household Interest Rate (BoE): average interest rate on newly-opened products with particular characteristics.

Identify products in Moneyfacts that qualify for inclusion in the Quoted Rate.
⇒ gives **menu** of close substitutes, and **average price paid**.

Exercise: compare rate achieved with 'no-attention' benchmark rate (average over big 4 banks):

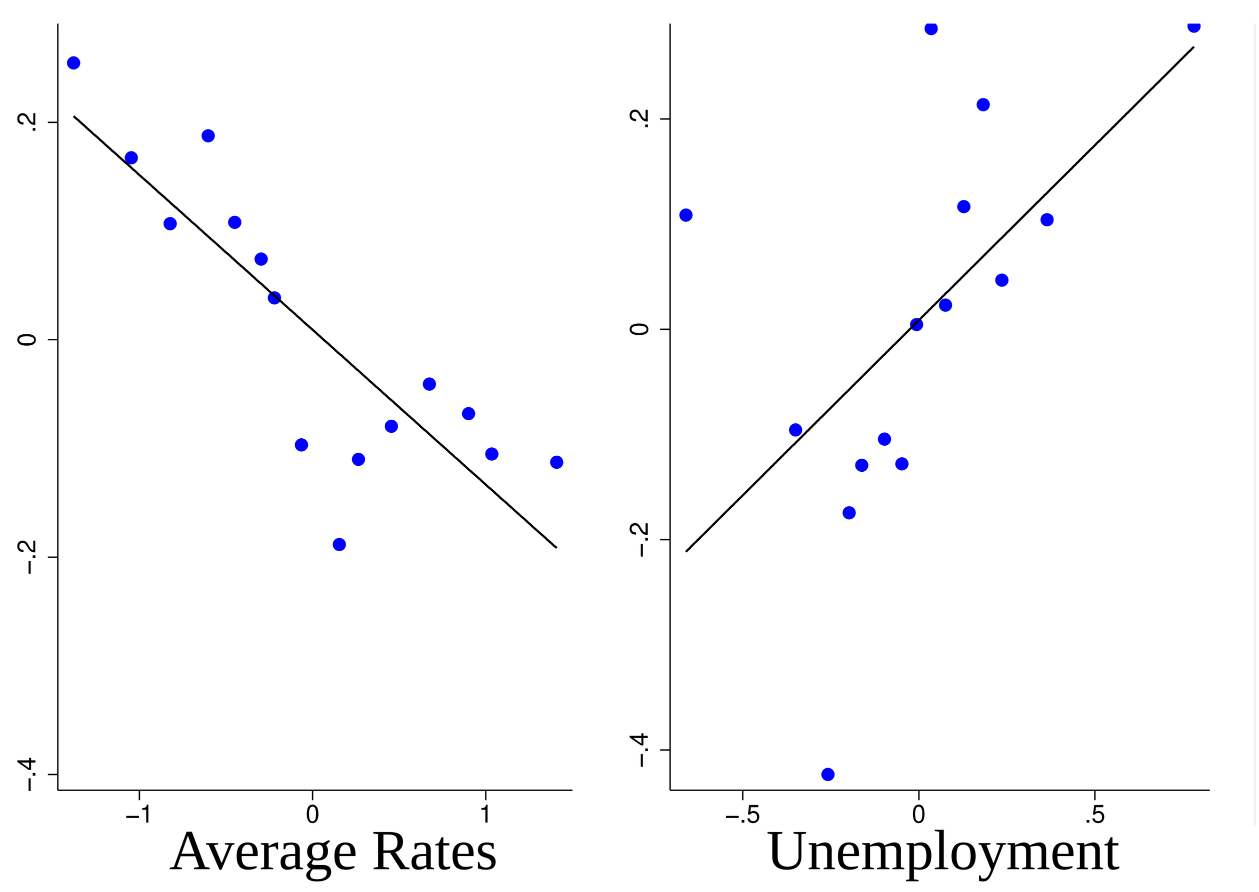
$$\varphi_t = \frac{\mathbb{E}_h i_t^h - i_t^b}{\sigma(i_t)}$$

φ_t is closely related to attention $\mathcal{I}_t$ in the model:

- Attention ↑ ⇒ rate achieved ↑ *relative to* rate achieved with no attention.

Result: φ_t is countercyclical.

Consistent with model:
In contraction
$u'(c) \uparrow \Rightarrow \mathcal{I} \uparrow, \varphi \uparrow$



Binned scatters of phi against average rates and unemployment rate, all HP-filtered. $Corr(\varphi, \bar{\imath}) = -0.28^{***}$, $Corr(\varphi, u) = 0.27^{***}$

Conclusions

Savers pay more attention to their saving choices in recessions. They make better choices – but earning a higher interest rate encourages more saving, which makes the recession worse.

Implication: if it is easier to compare products, attention is always high. No swing in recession ⇒ **recession is weaker**.

Acknowledgements

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References

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