

# A Discussion of "The Transmission of Monetary Policy through Banks' Balance Sheets"

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## Briefly summarizing I

- ▶ Examining in detail how policy shocks impact different components of the balance sheet
- ▶ The balance sheet identity

$$E = \sum_i A_i - \sum_j L_j$$

and

$$(1 + r_E)E = \sum_i (1 - p_i)(1 + r_{A,i})A_i - \sum_j (1 + r_{L,j})L_j + (f - c) \sum_i A_i \quad (1)$$

# Interesting finding I

**Graph 1**  
**Major Banks' Interest Rate Risk**



- ▶ What does it imply for their methodology?
- ▶ What does it imply for the DSGE banking model for Australia?

## Interesting finding II

- ▶ imperfect competition in the banking sector; no re-pricing friction (as maturity mismatch doesn't matter for Australia)
- ▶ policy shocks are not attenuated by the banking sector
- ▶ are we back in the Gertler and Karadi (2011) world where monetary policy shocks are amplified by the banking sector?

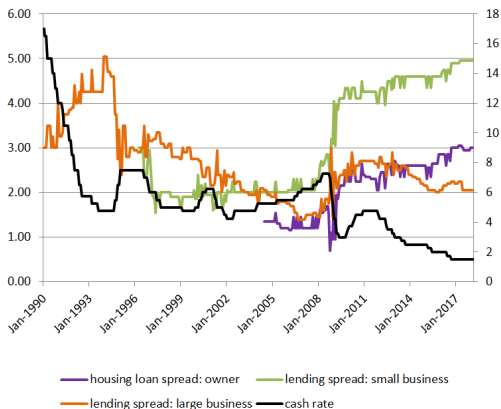
# Non-discretionary items on the balance sheet |

- ▶ Provisions: incomplete pass through, 100 basis point cut in the cash rate reduces annual provision rates by 7 basis points
- ▶ Wholesale debt markets: complete pass through
- ▶ No/low interest rate deposits: spreads change one-for-one
- ▶ Non-loan assets: full pass through
- ▶ Conclusion: almost complete pass-through of cash rate changes to discretionary components

# Lending rates and deposit rates: incomplete pass-through I

- ▶ ROE: not changed much in spite of falling cash rates
- ▶ Balance sheet identity implies even incomplete pass through to discretionary components of the balance sheet
- ▶ Main finding: deviation of 7 basis point from full pass through when offset by both lending and deposit rate; 11 when offset by lending rate alone....
- ▶ Welfare implication; loss in savings?
- ▶ Suggestion: time series analysis

# Spreads I



- ▶ Even though the cash rate has declined, the spreads have either not changed much or even increased in some cases.
- ▶ More evidence of incomplete pass-through

# Mark-ups and mark-downs I

- ▶ Imperfect competition in the banking sector implies that banks will charge interest rates that are a mark-up over their marginal cost

$$r_L = \mu_L R_L = \mu_L r_c$$

$$r_A = \mu_A R_A = \mu_A [(1 - \lambda) R_L + \lambda r^\tau]$$

- ▶ For the 2007-2016 period,  $\mu_L = 0.92$ .
- ▶ And assuming  $\lambda = 0.25$ ,  $r^\tau = 8\%$ ,  $\mu_A = 1.47$



# Competition in the banking sector I

- ▶ "What Drives Bank Competition? Some International Evidence"  
Claessens, S. and L. Laeven. (2004) Journal of Money, Credit, and Banking
- ▶ 50 countries, 1994-2001
- ▶ PR H-statistic:  $H < 0$  indicates monopoly,  $H = 1$  indicates perfect competition and  $0 < H < 1$  indicates monopolistic competition

# Competition in the banking sector II

Country	H-statistic	Standard error	Number of banks	Number of observations
Argentina	0.73	(0.06)	105	278
Australia	0.80	(0.11)	26	126
Austria	0.66	(0.04)	160	760
Bangladesh	0.69	(0.13)	28	132
Belgium	0.73	(0.05)	76	371
Brazil	0.83	(0.06)	96	248
Canada	0.67	(0.07)	49	224
Chile	0.66	(0.07)	31	148
Colombia	0.66	(0.08)	39	167
Costa Rica	0.92	(0.05)	30	111
Croatia	0.56	(0.09)	45	196
Czech Republic	0.73	(0.14)	25	90
Denmark	0.50	(0.05)	100	646
Dominican Republic	0.72	(0.09)	27	121
Ecuador	0.68	(0.09)	35	106
France	0.69	(0.02)	355	1926
Germany	0.58	(0.02)	2226	13,015
Greece	0.76	(0.07)	21	95
Honduras	0.81	(0.11)	21	68
Hong Kong, China	0.70	(0.07)	44	243
Hungary	0.75	(0.07)	26	112
India	0.53	(0.04)	60	399
Indonesia	0.62	(0.06)	97	353
Italy	0.60	(0.03)	472	2508
Japan	0.47	(0.17)	44	100
Kenya	0.58	(0.11)	34	106
Latvia	0.66	(0.14)	24	85
Lebanon	0.69	(0.05)	63	371
Luxembourg	0.82	(0.04)	76	277
Malaysia	0.68	(0.06)	41	228
Mexico	0.78	(0.10)	27	58
Netherlands	0.86	(0.06)	44	227
Nigeria	0.67	(0.06)	42	186
Norway	0.57	(0.08)	48	259
Pakistan	0.48	(0.13)	21	148
Panama	0.74	(0.09)	32	88
Paraguay	0.60	(0.22)	23	92
Peru	0.72	(0.07)	24	132
Philippines	0.66	(0.05)	45	237
Poland	0.77	(0.06)	40	138
Portugal	0.67	(0.06)	37	213
Russian Federation	0.54	(0.07)	106	232
South Africa	0.85	(0.05)	45	186
Spain	0.53	(0.03)	157	839
Switzerland	0.67	(0.03)	227	1048
Turkey	0.46	(0.21)	34	69
Ukraine	0.68	(0.15)	30	71
United Kingdom	0.74	(0.04)	106	569
U.S.	0.41	(0.01)	1135	7261
Venezuela	0.74	(0.07)	55	171

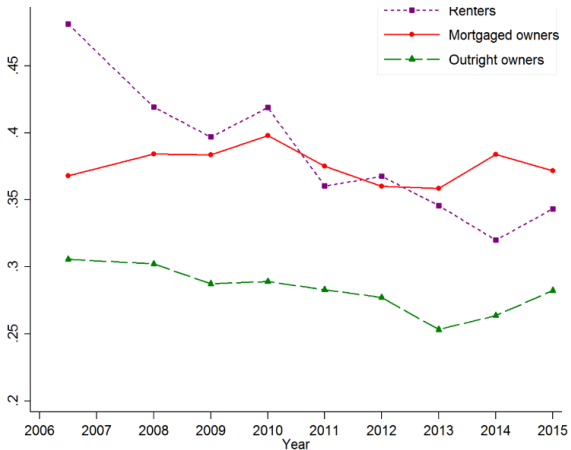
# Final comment I

**Table 1: Simple Linear Relationships of Bank Rates with the Cash Rate<sup>(a)</sup>**

	1986-94 <sup>(b)</sup>	1997-06	2007-11	2012-17
Housing (variable)	0.56	1.00	0.75	0.80
Large business (variable)	0.83	0.72	0.75	1.24
Credit card (variable)	0.36	0.81	0.08	-0.06
Term deposit (1 month)	0.75	0.71	0.27	0.57
Term deposit (12 months)	0.78	1.07	0.59	1.12

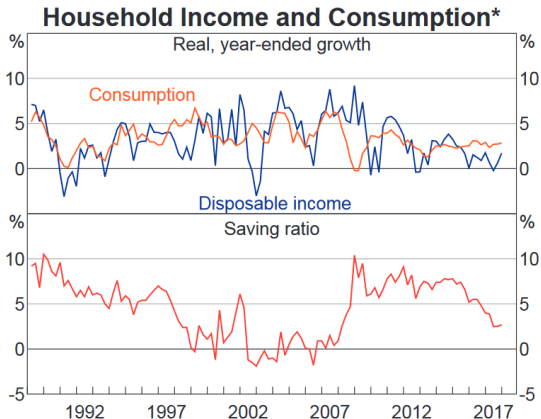
## Final comment II

- ▶ Cho, Morley and Singh, work-in-progress find new evidence of declining MPC out of permanent shocks to residual income



# Final comment III

## ► Saving rate in Australia (RBA)



\* Household sector includes unincorporated enterprises; disposable income is after tax and interest payments; income level smoothed with a two-quarter moving average between March quarter 2000 and March quarter 2002; saving ratio is net of depreciation

Sources: ABS; RBA