Discussion of: “Shadow Banks and the Dynamic Effects of Monetary Policy on Small Business Lending”

By Gopal, Sarto, Supera and Wang

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Opinions in this presentation are my own and do not reflect the opinions of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

Monetary policy and commercial lending

Various ways lower rates can affect bank lending via bank fin frictions ("bank lending channel") :

1. Lending *rises* as deposits/reserves flow to banks (Drechsler et al 2017; Kashyap-Stein 2000)
2. Lending *falls* via lower bank profitability (Abadi et al. 2023; Sarto and Wang 2023)
3. Commercial lending *falls* due to lower supply of time deposits (Supera 2022)

(Other channels: "risk-taking" Jiminez et al. 2014; "bank balance sheet" Jiminez et al. 2012 etc.)

This paper: What's the net effect of these channels at different time horizons?

- But how to isolate role of bank frictions, since e.g., loan *demand* also changes?
- *Strategy*: use nonbanks as a comparison group (assumed not affected by above channels)
- Also exploit cross-section of banks -- e.g., some banks more reliant on time deposits ex ante

Findings

1. **Short-run (e.g., 1 year)**: *deposit* channel dominates – banks capture market share from nonbanks after interest rates fall

2. **Medium/long run (3+ years)**: *profitability* and *time deposit* channels dominate; banks lose mkt share after interest rates fall
   - Especially banks more exposed to lower rates based on ex ante asset / liability mix

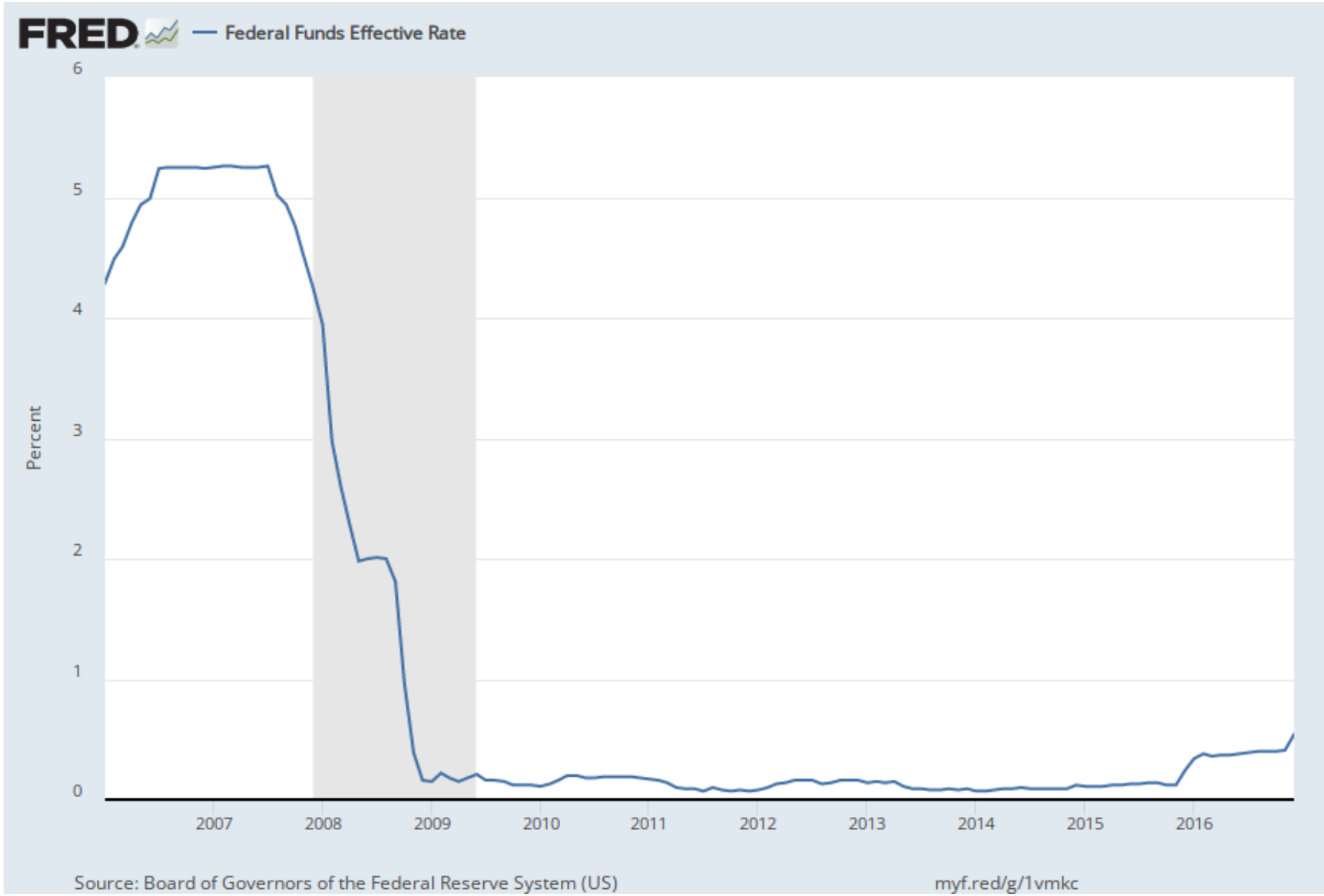
3. Substitution to nonbanks seems imperfect – e.g., slower employment growth in counties exposed to time deposit and profitability shocks

Reactions

- Interesting and thought-provoking paper
- Important for policy to understand net/joint effect of different monetary channels, not each in isolation (and to understand dynamics)
- Early draft – lots of room to further sharpen analysis

Main comments:

1. Sample period and identification
2. Taking nonbanks more seriously
3. NIM vs profitability


FRED
Federal Funds Effective Rate
Percent
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Source: Board of Governors of the Federal Reserve System (US)
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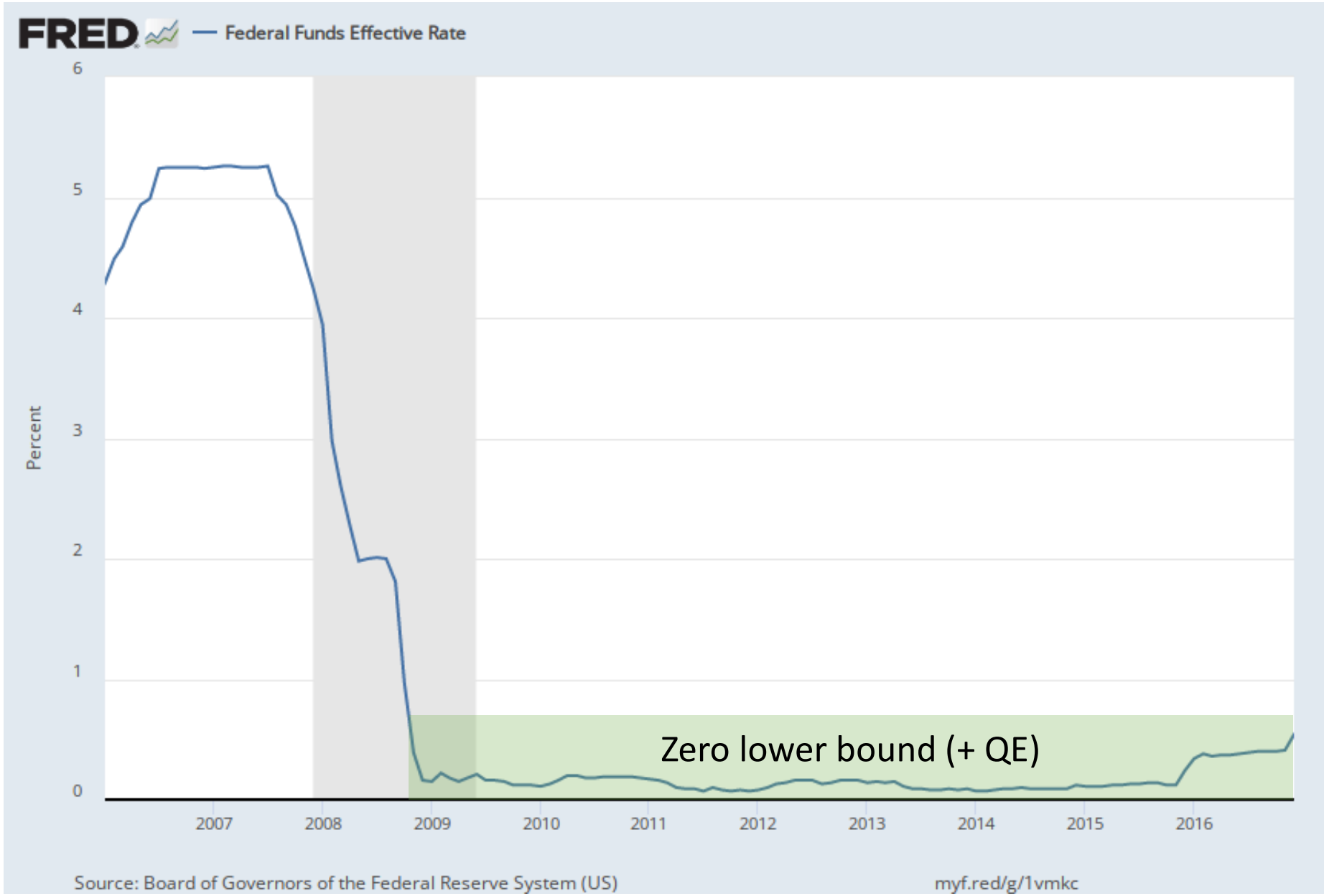
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Zero lower bound (+ QE)
Source: Board of Governors of the Federal Reserve System (US)
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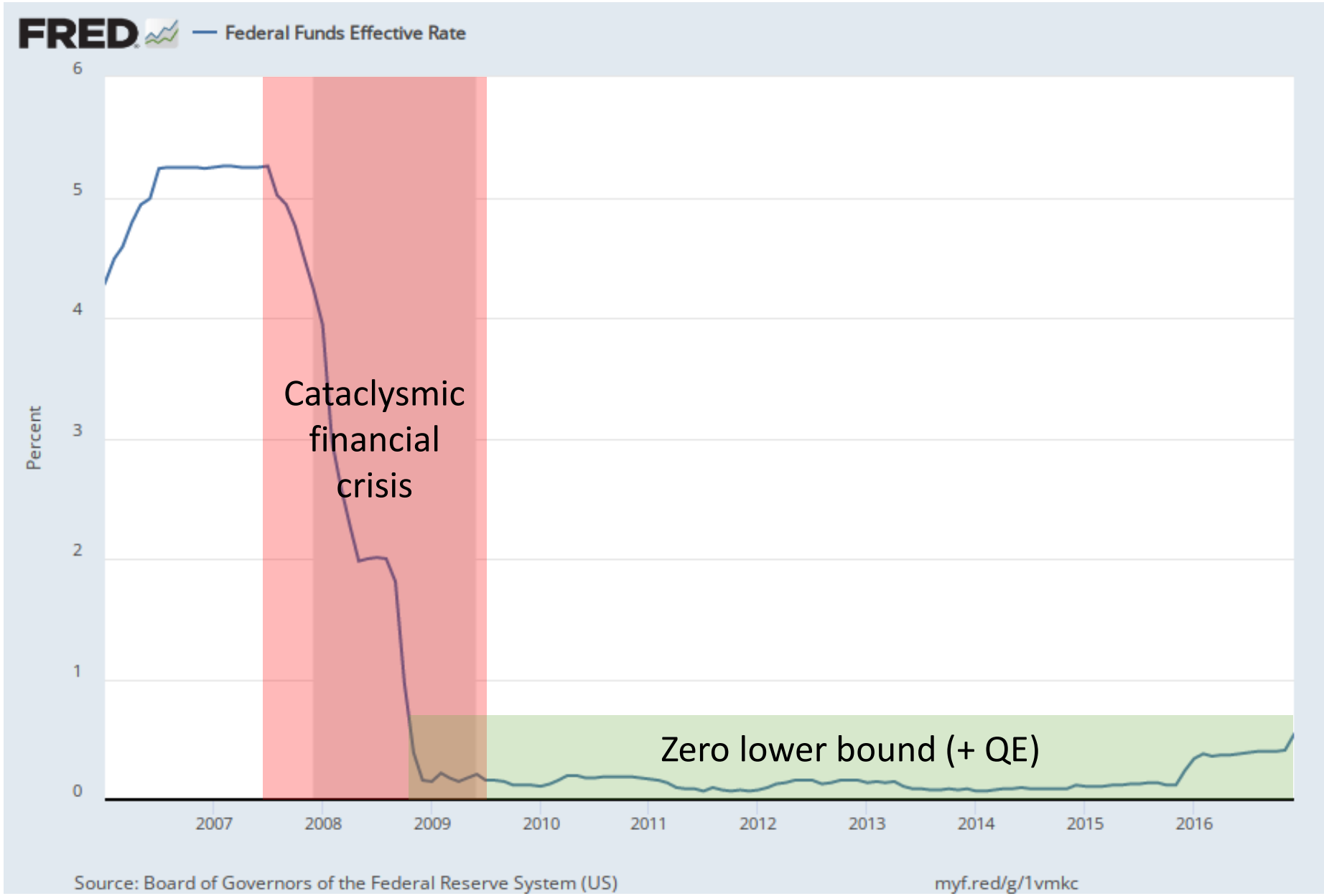
FRED
Federal Funds Effective Rate
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Cataclysmic financial crisis
Zero lower bound (+ QE)
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Source: Board of Governors of the Federal Reserve System (US)
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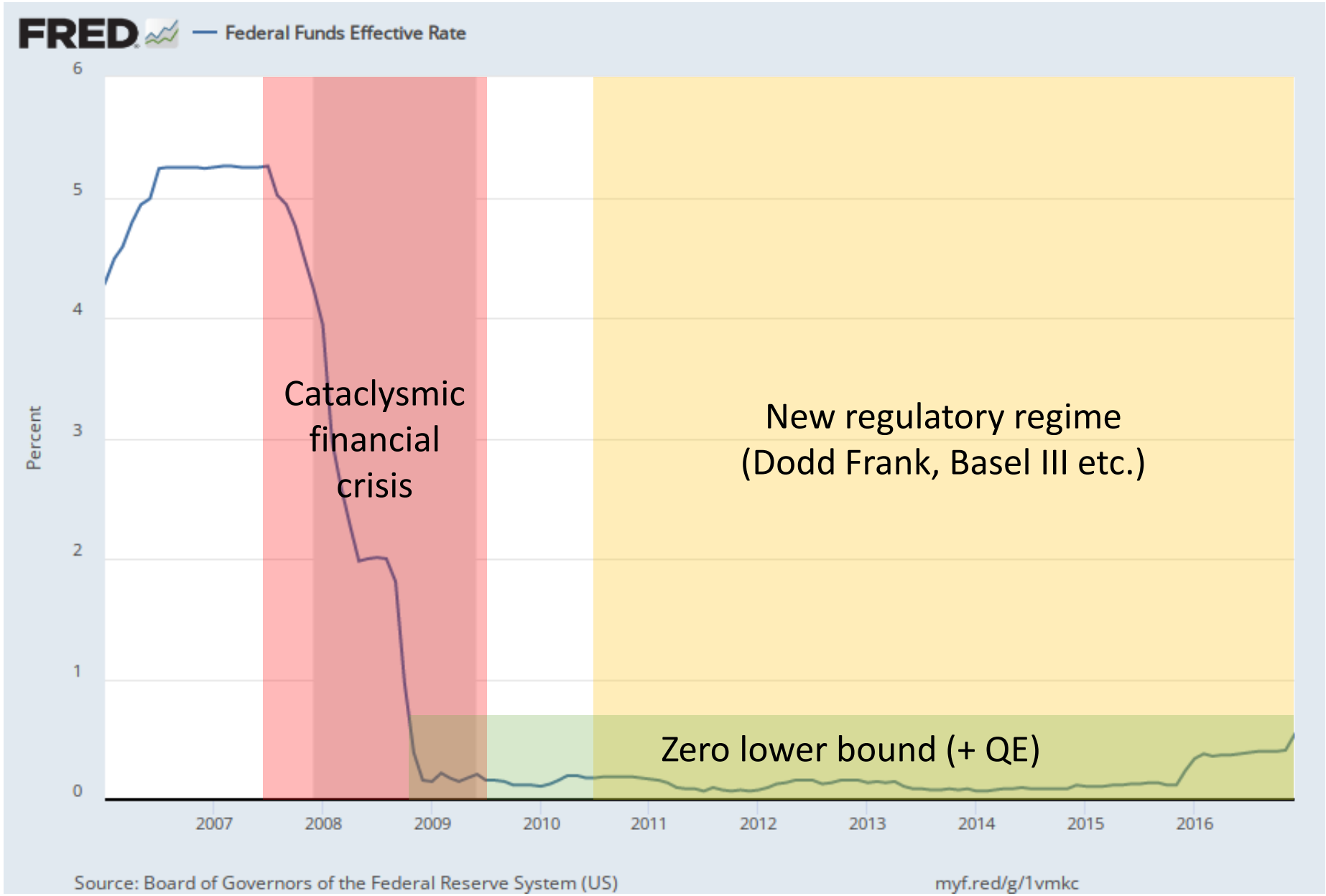
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Federal Funds Effective Rate
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Cataclysmic financial crisis
New regulatory regime (Dodd Frank, Basel III etc.)
Zero lower bound (+ QE)
Source: Board of Governors of the Federal Reserve System (US)
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1. Sample period and identification

Lots of other shocks – various regulatory changes, ZLB, QE, financial crisis – which likely had *differential* effects on lending across banks, e.g.,

- Regulation esp. reduced small business lending by big banks (Chen-Hanson-Stein 2017)
- Financial crisis presumably hit weaker banks harder, and may have had persistent effects. (In tables 9-10, is Δ FFR effectively a "crisis" dummy?)

Are we sure results not affected/driven by these other shocks? Suggestions:

1. Can you extend to longer sample period including full (or multiple) rate cycles?
   - Use CRA data -- longer coverage (using cross-bank variation in dep. beta, e_b, TD_b)?
   - Can UCC data be extended to include lift-off period?
2. Which banks have high initial values for e_b and TD_b? (bigger? riskier? better-capitalized?)
3. How robust are results to different combinations of controls?

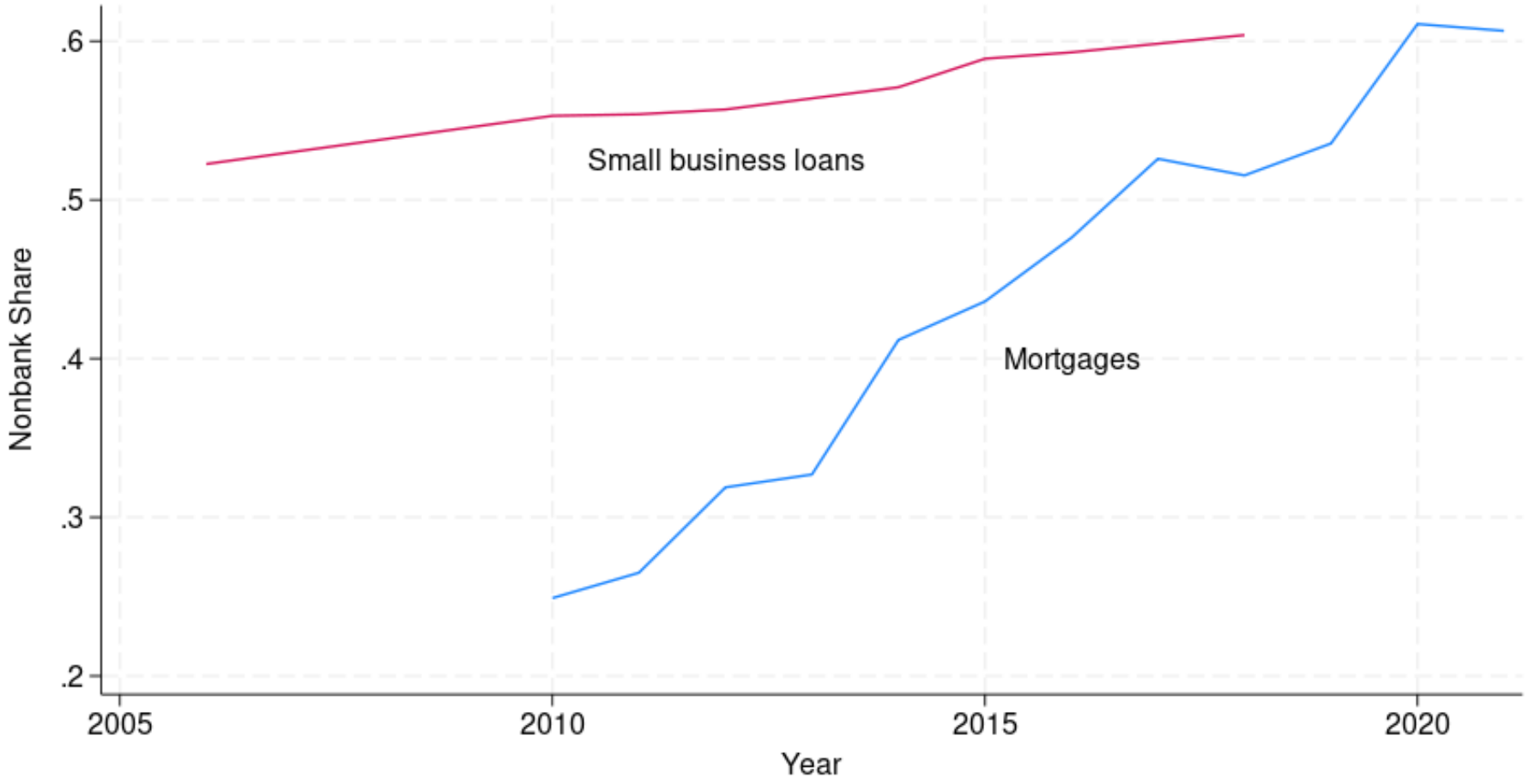
2. Taking nonbanks more seriously

- Assumption seems to be that nonbanks are essentially “neutral” – all changes in bank share of lending are attributed to frictions *within* the banking system

- Many questions:
  - What shocks did these nonbank competitors face during this period?
    - Less affected by tighter regulations? (Gopal and Schnabl 2022 says “yes”) Variation?
    - Effects of the financial crisis due to lack of access to bailouts, LLR?
    - Effect of monetary policy on access to funding?
    - Role of technology?
  - Composition of nonbanks across locations, loan types? (e.g., captive vs independent)

- Realize there are data constraints, but think we need more than is currently in the paper...

Why has nonbank lending share *always* been high for small business loans?



Sources: HMDA, Gopal et al. 2024

3. NIM vs profitability

Net interest margin (NIM) ≠ profitability [but paper equates the two: “profitability channel”]

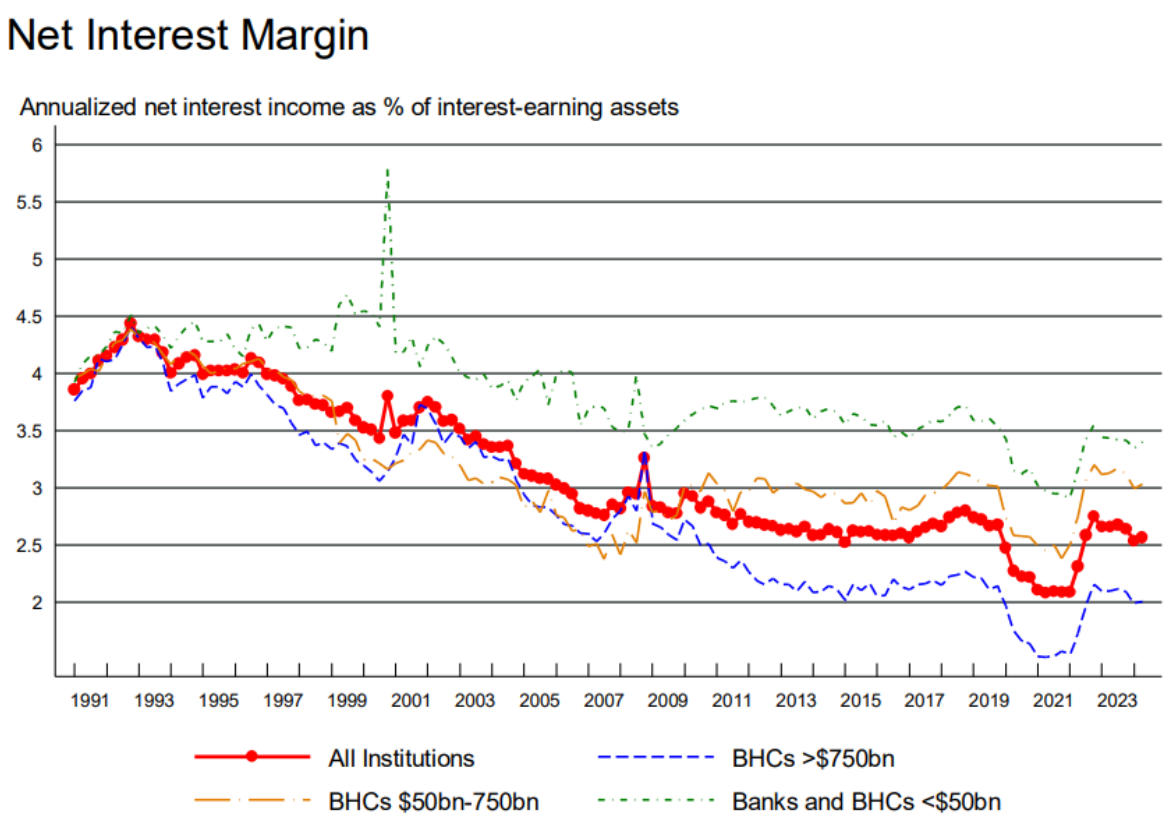
- Why is distinction important?? Activities with higher NIM …
  - … also have higher credit risk / credit losses (e.g., credit card lending)
  - … are more resource-intensive (e.g., construction loans vs holding T-bonds) – higher noninterest expense
  - … can help generate noninterest income (e.g., underwriting fees, other banking services)

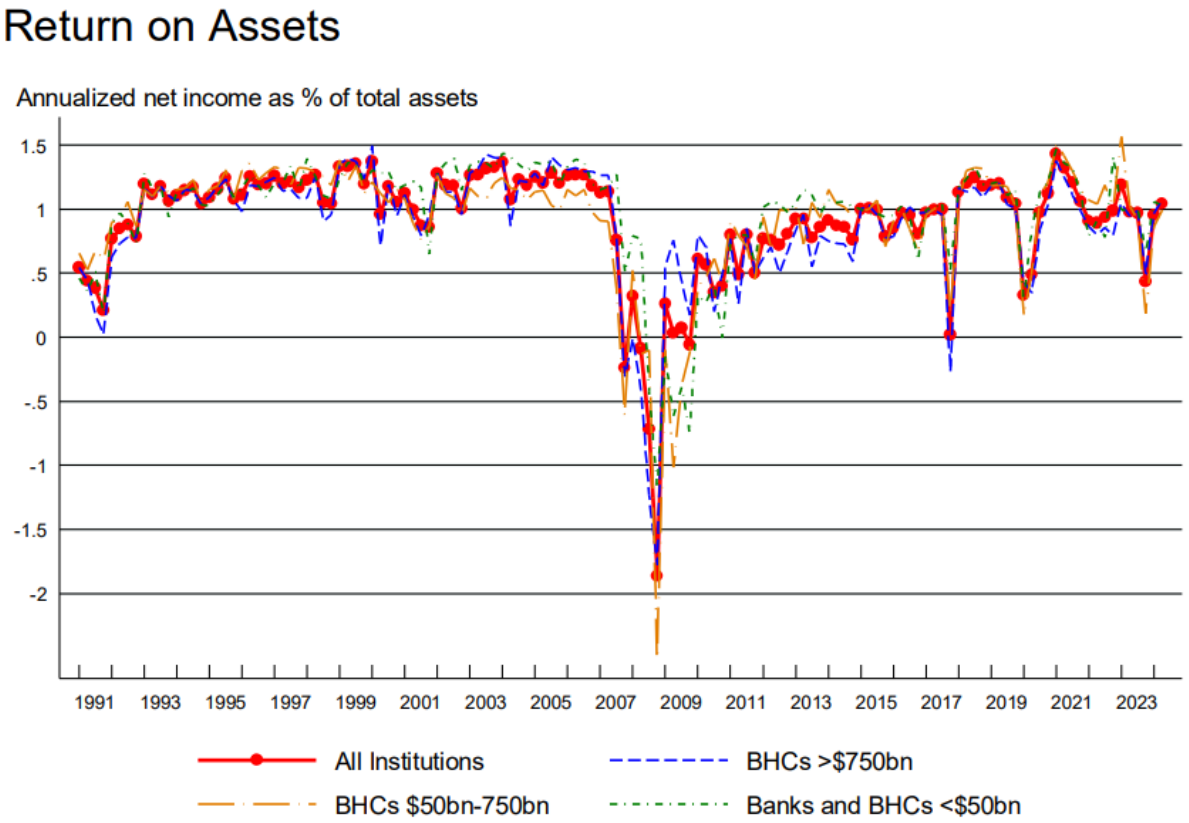
- Secular decline in NIM, to significant extent, reflects compositional changes in bank activities

- Starting point: Are “exposed” banks less *profitable* after rates fall?

NIM ≠ profitability

Secular and fairly steady decline in NIM since 1991 -- not so for profitability





Source: FRBNY Quarterly Trends report

4. Some other comments

- The low rate period studied is “special” because rates are at ZLB (many deposit rates were at zero floor, squeezing bank profitability). How much is this driving the results? Does it matter?
- Related: How to reconcile with Abadi et al. (2022) – why doesn’t profitability channel flip?
- How to reconcile imperfect substitution findings with Gopal and Schnabl (2022), who find that nonbank substitution entirely picked up the slack from banks after 2008 crisis?
- Time deposits typically have 1yr maturity; given laddering, implies avg. maturity outstanding is ≈ 6 months. So why does it take three years for “time deposit” channel to show up??
- Why does sample period keep shifting around?
  - E.g. Table 1 reports data up to 2018, but 2017-18 not used in analysis. Why is fig 1 only 2010-16?
- Taking long difference in lending volume between 2006 and 2016 means that you’re only relying on those two years, which may be non-representative. Robustness?
- There are lots of mergers etc. during the sample period – how is the paper dealing with these?

My hobby horse…

Shadow bank

Nonbank financial intermediary

- Do we have to call every nonbank a “shadow bank”? Feels like a pejorative term to me.
- I realize this is probably a lost cause…

Summing up

- Proliferation of many different flavors of the bank lending channel – need synthesis!
- This paper seeks to make progress here – what is relative strength of different channels and at what frequency / lag do they operate? Important!
- I learned a lot, and look forward to seeing the paper develop in future versions

Thanks!