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# **Banking Globalization, Monetary Transmission, and the Lending Channel**

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Comments by  
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# Lending Channel

- Monetary tightening makes it difficult for banks to raise reservable funds such as demand deposits
- If credit frictions make it difficult for banks to raise other types of funds, this will lead to contraction in bank lending
- Kashyap and Stein (1994) show small banks more affected than large ones
- Kashyap and Stein (2000) show effect varies depending on liquidity of the bank's balance sheet



# Banking Globalization

- Global Banks account for 70% of U.S. banking system assets (up from about 50% in early 1990s)
- By operating in different countries, global banks can absorb effect of change in monetary policy through internal sources of funding

# Estimation of Lending Channel

- First stage:

$$\Delta \log( Lending_{it} ) = \sum_{j=1}^4 a_{ij} \Delta \log( Lending_{it-1} ) + \beta_t Liquidity_{it-1} + Controls_{it-1} + \varepsilon_{it}$$

- Second stage:

$$\beta_t = \eta + \sum_{j=1}^8 \phi_j MP_{t-j} + \delta Controls_t + \mu_t$$

- Measures of lending: total loans; commercial and industrial (C&I) loans
- Measures of monetary policy: Bernanke-Mihov indicator, nominal FFR, real FFR
- Liquidity measured as log(liquid assets/total assets)
- Over 1-million Bank-quarter observations from Call Report data



# Estimation of Foreign Flows

- Equation for Net Due

$$\Delta NetDue_{it} = \alpha + \sum_{j=1}^4 \phi_j \Delta NetDue_{it-j} + \sum_{j=0}^4 \phi_j MonetaryPolicy_{t-j} + \sum_{j=0}^4 \gamma_j GDP_{t-j}$$

- Maybe dependent variable should be scaled, or size added as a control given large variation in bank size



# Results

- Monetary Policy affects lending by domestic banks but not global ones
- A 100 bp increase in FFR would lower C&I lending growth for median small bank from 1.7 to 1.5 percent; lower total loan growth from 1.9 to 1.7 percent.
- A 100bp increase in FFR would have:
  - Increased Net Due flows by \$47 million in 2005Q4;
  - Using fitted values from the regression of large domestic banks, reduced median global bank lending growth by \$63 million



# Results

- 100bp tightening would reduce foreign C&I and total loans by 3 and 2.2 percentage points; Effect much stronger than for domestic loans
- Paper also shows that monetary policy affects lending of small domestic banks affiliated with larger domestic-oriented banks, but does not affect those of small banks affiliated with global banks





# Comments/Suggestions

- Most measures of financial globalization suggest rapid increase in last two decades; would be interesting to check whether results have changed from first to second half of the sample
- Effect of monetary policy on bank deposits will weaken if banks can offer competitive interest rates on demand deposits
  - Perhaps global banks are in a better position to do that;
  - Or market segmented in a way that returns offered by small domestic banks do not vary as much



# Comments/Suggestions

- Paper could include foreign monetary policy in the analysis. Could add Yen, Euro/DM discount rate as a control
- Effect of US monetary policy stance on global banks likely depends on whether foreign monetary policy is loose or tight. Could create dummies for foreign stance which are then interacted with the U.S. monetary policy variable