Discussion of:
Net Interest Margins and the Monetary Transmission Mechanism
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IMF Advances in Monetary Economics Conference
September 19, 2024

Summary

- ▶ Asymmetric response of both NIM and real economic activity to contractionary MP shocks across low and high policy-rate states:
  - ▶ NIM increases in low-rate states and decreases in high-rate states
  - ▶ Real GDP and consumption decline by more in low-rate states

- ▶ Explanation for *joint* asymmetric response of NIM and growth.
  - ▶ NIM asymmetric response $\implies$ in low-rate states 'profits' go to low MPC people, and in high-rate states to high MPC people
  - ▶ In high-rate states consumption declines less $\implies$ GDP declines less

- ▶ Theory behind asymmetry in:
  - ▶ NIM: Share of households attentive to deposit rates change differently following low- and high-rate states;
  - ▶ Economic activity: households' interest-income interacts with their high MPC, so when interest-income is high (NIM low), economic activity decline less

Key points

▶ This study documents a new asymmetry in economic response to MP shocks and the explanation puts forward is intriguing

My comments aim at making sure that:

▶ Asymmetric response is robustly estimated (as it is the motivation for entire study, and empirical IRFs are used to calibrate theoretical IRFs)
  ▶ This mostly depends on the measures of MP shocks

▶ Proposed mechanism is in the aggregate quantitatively relevant
  ▶ Is it capturing key features of distribution of financial assets?
  ▶ Are implications for asset risk in line with empirical evidence?

Measures of MP shocks do not seem fully exogenous

▶ Inflation is not responding correctly to tightening shocks

▶ If MP shocks identified by instances in which expected policy rate moves in opposite direction of expected inflation and GDP (D'Amico and King, JME 2023), inflation down significantly;

▶ Same is true in Jarocinski and Karadi (2020) and Miranda-Agrippino and Ricco (2021);

▶ This might suggest MP shocks used are not fully exogenous and magnitude of IRF is biased downward by endogenous component.

▶ Bauer-Swanson measures eliminate some but not all instances in which expected policy rate, inflation, and GDP move in same direction;

▶ If those instances are not equally distributed across low- and high-rate states, relative size of IRF across states could be affected.

Measures of MP shocks less appropriate in low-rate state

▶ Low-rate state ($\overline{FFR} < 4\%$ in previous 6Q) mostly post 2001 $\implies$ large overlap with ZLB;

▶ If in low-rate state, MP has been done mostly through FG and QE, and Fed communication has been quite different from high-rate state;

▶ Since MP shocks measured using FFR or very short-term ED futures;

▶ Size of MP shocks could be underestimated, as those measures of actual and expected policy rates do not vary much at ZLB;

▶ Better to use longer-horizon actual and expected interest rates to capture MP at the ZLB, otherwise in low-rate state MP shocks are biased downward relative to those in high-rate state.

Comparison of MP shocks across states

▶ If in low-rate state a one-standard-deviation MP shock is on average smaller than a one-standard-deviation MP shock in high-rate state;

▶ and, a one-standard-deviation MP shock has similar effects across the two states;

▶ Then, when one-standard-deviation MP shocks are re-scaled up to induce a 100bp change in FFR, the MP shocks in low-rate state will be re-scaled up by a larger number;

▶ This re-scaling could mechanically induce larger IRF in low-rate state than high-rate state;

▶ So it would be good to see also IRFs to a one-standard-deviation MP shock across states.

Assumptions on ownership of financial assets

▶ Ownership of commercial bank stocks seems concentrated in low-MPC households, which doesn't help growth in low-rate states;

▶ High-MPC households do not own bank stocks, but also don't seem to hold any other assets except bank deposits;

▶ In reality, between these two extremes there are households that hold stocks, bonds, and bank deposits and have decent MPC.

▶ Is the share of these two extremes large enough to affect growth asymmetrically across the two states?

▶ Could ownership of bank stocks be less concentrated in low-MPC households (e.g., through 401(k)) than assumed in the model?

▶ If high-MPC households hold other securities, would losses in interest-income be offset by other profits and therefore become less relevant?

Implications for financial asset risk

▶ Joint state-dependence in response of NIM and growth implies their *covariance switch* from negative (NIM up, growth down) in low-rate states to positive (both down a bit) in high-rate states;

▶ Hence, stocks of commercial banks seem to be a good hedge in tightening cycles following low-rate states: they deliver high profits when growth is declining;

▶ But, stocks of commercial banks are usually considered high-beta stocks, as highly pro-cyclical;

▶ Is there empirical evidence that stocks of commercial banks perform well in tightening cycles that follow a low-rate environment and perform poorly in tightening cycles that follow a high-rate environment?