Discussion of “Monetary Policy Transmission Through Cross-selling Banks” by C. Basten and R. Juelsrud

Discussion by:

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1st ChaMP Conference

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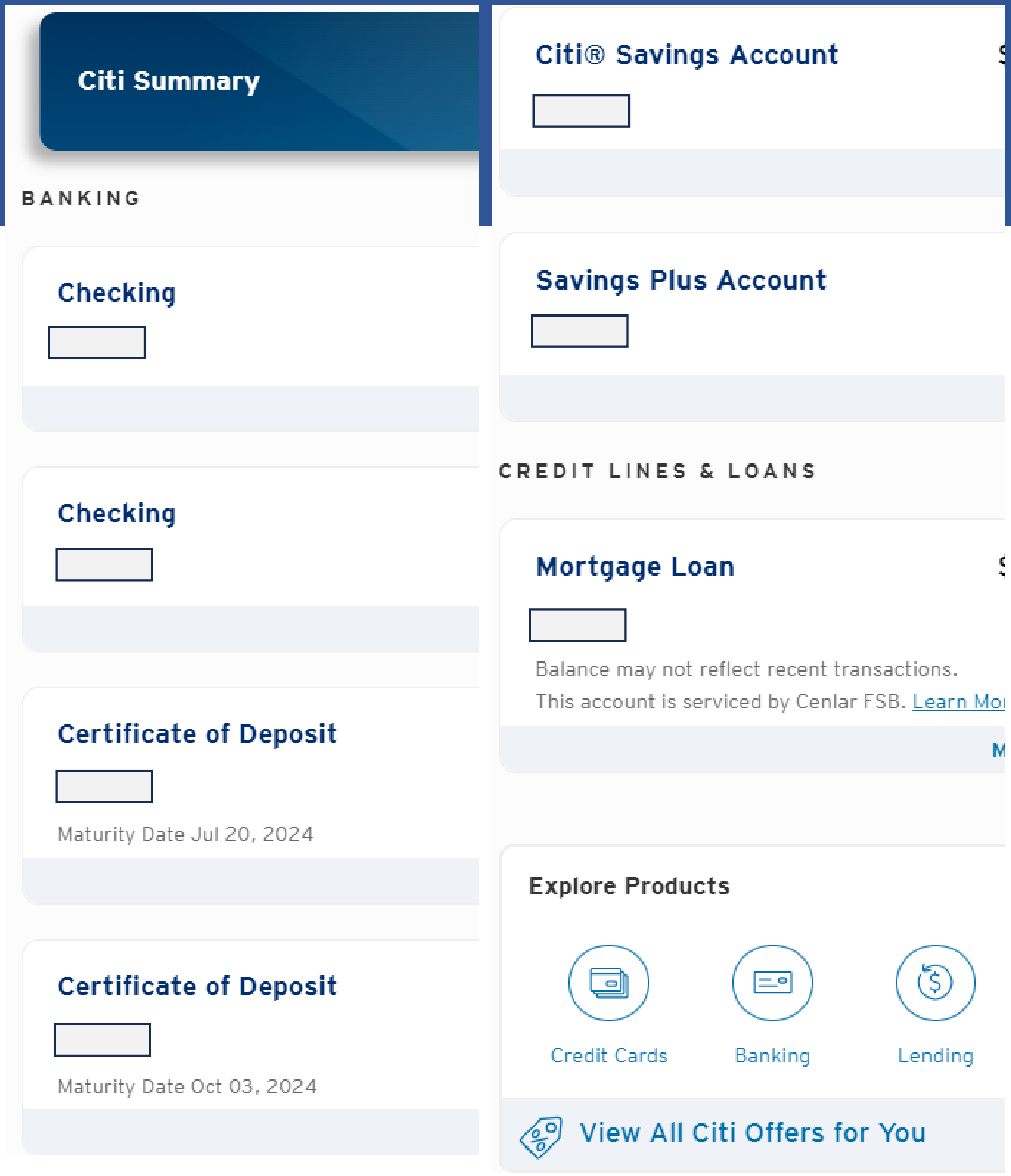
This Paper

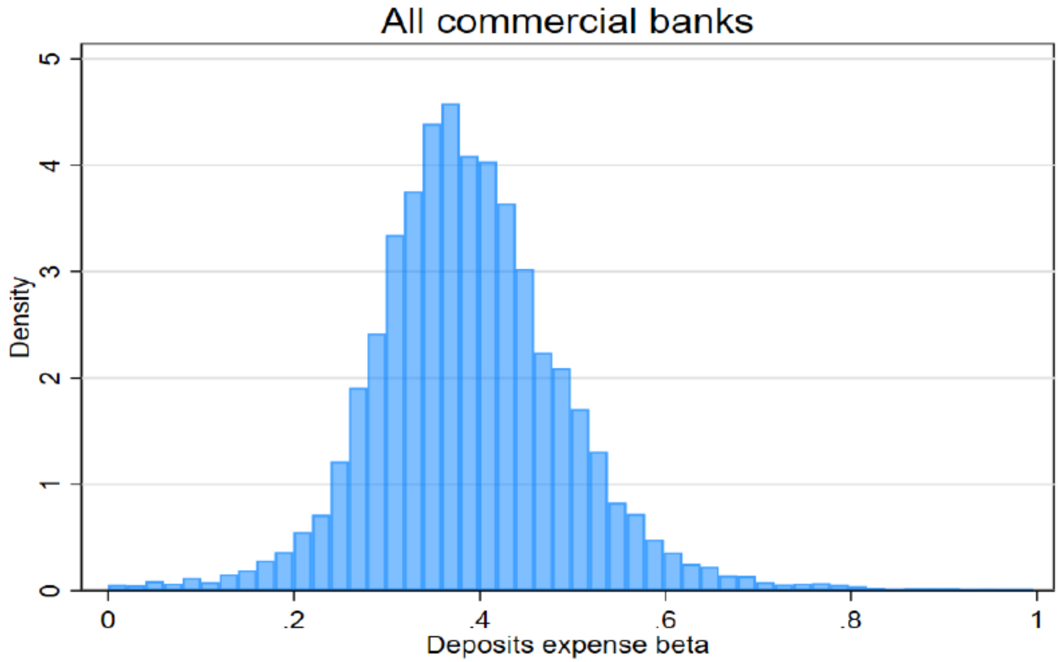
1. Monetary policy effectiveness differs across banks via deposit rates as a function of cross-selling opportunities
2. Cross-selling financial products and services is prevalent across banks and affords them market power
3. Cross-selling explains deposit spread betas 10x more than does deposit market power alone → powerful channel



Relevance to Current Environment [1]

- **Deposits** ($18T) are a critical source of funding for banks and key savings tool for households
- The **deposit beta** is pass-through of the policy rate to deposit rates (historical average of 0.4)
- **Recent tightening cycle**, deposit betas reached 0.4 in 2022:Q4 but much faster than in previous tightening episodes (e.g. 2015-2019)

Historical Deposit Betas

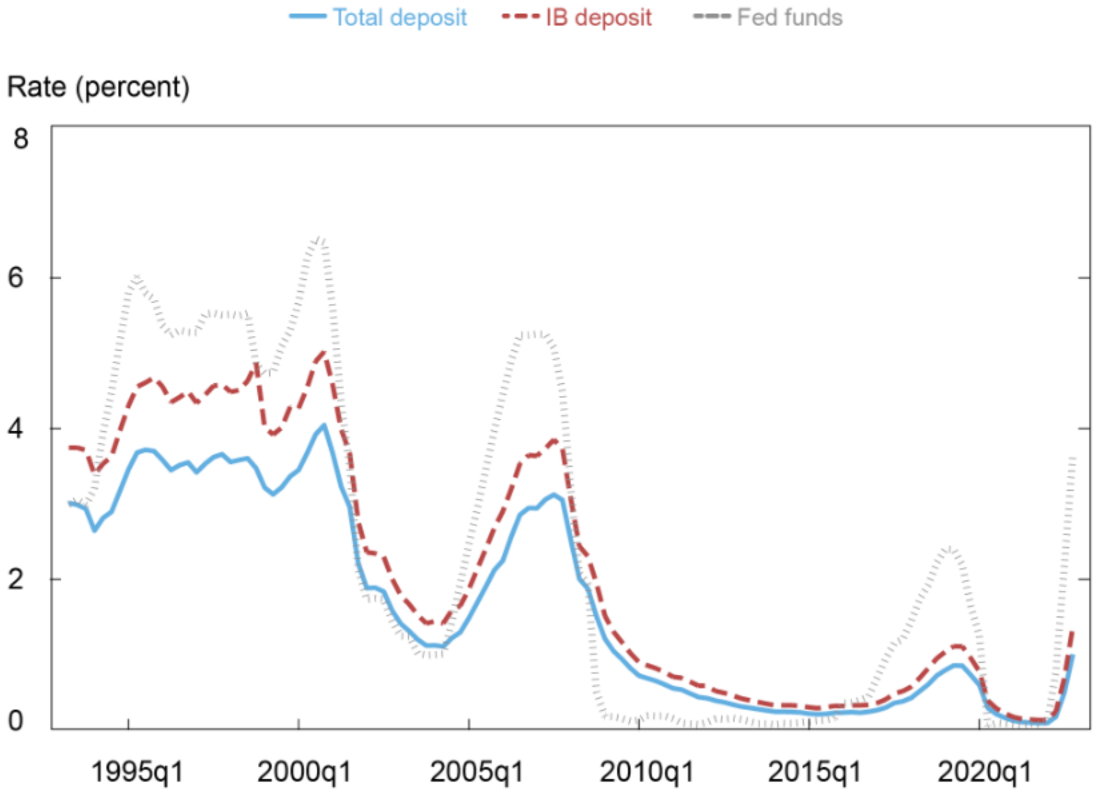


Source: Philipp Schnabl, 2023 using Call Report data for U.S. banks.

Relevance to Current Environment [2]

- More generally,
  - Deposit rates are **upwards-sticky and downwards-flexible**
  - **Deposit spread** widens during monetary policy tightenings
- **Deposit franchise** of banks
  - Makes deposits very valuable (+$525bn per year)
  - Helps maintain constant NIMs
  - Works as a natural hedge against falling values of long-term fixed assets when policy rates rise

Deposit Rates Lag the Fed Funds Rate

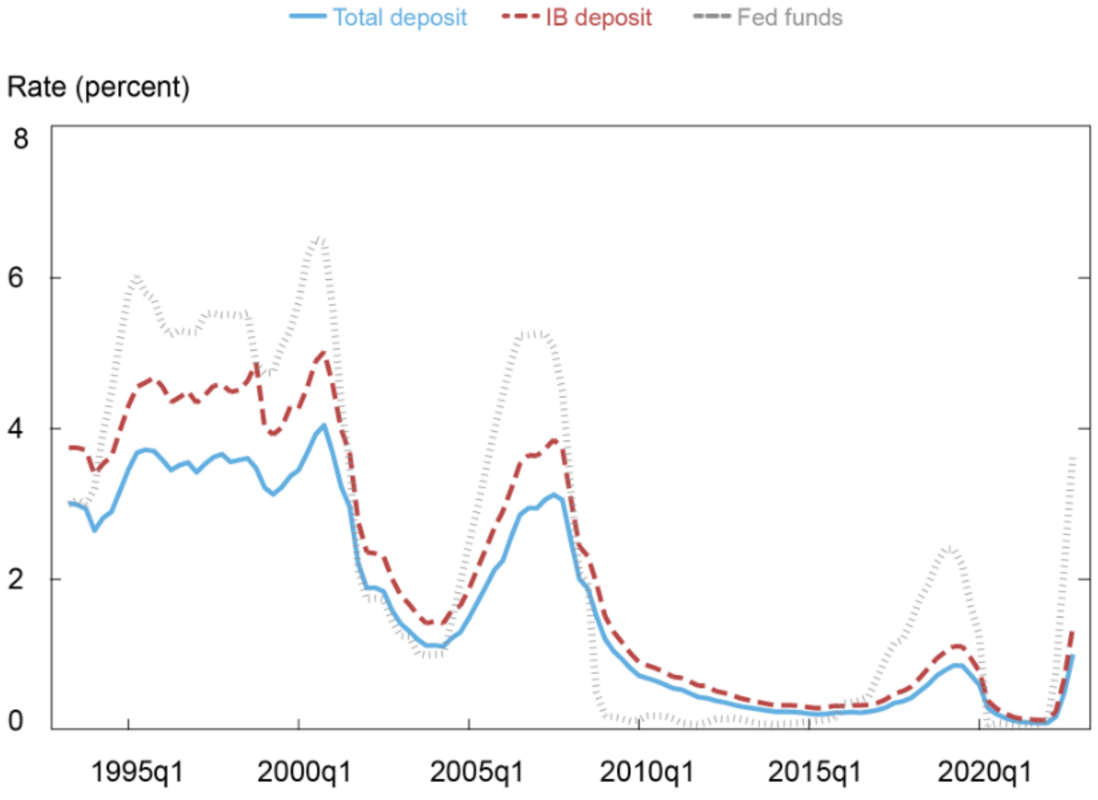


Source: Kang-Landsberg, Luck and Plosser (2023), Liberty Street Economics (link).

Relevance to Current Environment [3]

- Current environment characterized by the powerful workings of the deposit channel of monetary policy (DSS 2017)
- Monetary policy increases the deposit spread and **reduces the supply of deposits** *because* banks have market power in supplying deposits
- <u>This paper</u>: Cross-selling is a significant source of market power

Deposit Rates Lag the Fed Funds Rate



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What Is Cross-selling?

- Household depositors receive more future loans from their relationship bank (Basten and Jelsrud, 2023)
  - A bank is 20ppt more likely to sell a loan to existing depositor than another hh
  - The cross-sold loan is typically priced at a premium
- Cross-selling is common to <u>both households and firms</u>
- Cross-selling for firms:
  - Banks offering loans to firms cross-sell them other <u>very profitable services</u>: account and card services, cash management services, trade finance and supply chain services, payment processing, forex services, leasing (Qi 2024)
  - Relationship lenders often sell additional **information-sensitive products** to borrowers (Bharath et al 2006)
  - Banks offering certain loans such as credit lines require firms to hold their deposits with the bank (anecdotal evidence re: SVB)

Some Questions and Suggestions

1. Two questions
   - core intuition of the cross-selling channel of monetary policy
   - the profit maximization problem of the bank

2. Suggestions
   - cross-selling to corporate clients
   - aggregate effects of the cross-selling channel

Comment #1a: Profit Maximizing Problem

$$\max_{r_d} \underbrace{(r - r_d) * D(r - r_d)}_{\text{Profits on deposits today}} + \frac{1}{1+r} * \underbrace{l(r) * L(D(r - r_d))}_{\text{Profits from cross-selling tomorrow}}$$

- The bank maximizes the summation of profits on deposits today (1st term) and NPV of cross-selling profits tomorrow (2nd term)
- Tomorrow's cross-sold loan amounts are only affected by today's rates $l(r)$ – can the bank offer a **new loan rate tomorrow**?
- It would be realistic to assume that banks, even for a given depositor, would offer a new loan rate tomorrow → Implications from allowing loan rates to vary over time?

Comment #1b: Core Intuition

Why does cross-selling increase the DSB? The intuition is as follows. When the policy rate increases, the net present value of future cross-selling potential declines both because of higher discounting and lower loan spreads. As a result, the marginal benefit of increasing deposit rates declines, the pass-through to deposit rates is lower, and hence the deposit spread increase.

- The intuition is that the profit margin from cross-selling products declines (loan spreads compress) as policy rates increase
- Total profits: **profit margin x quantity** → loan spreads may compress (empirical question) but what happens to quantity? Can the bank do more cross-selling so that the quantity effect outweighs the profit margin effect? Both questions strike me as empirical questions.

Comment #2: There Are More Cross-Selling Opportunities in the Corporate World…

- **Since banks also cross-sell products to firms** – this cross-selling channel should apply more broadly to corporate borrowers as well
- **Identification** could come from the step-wise repeal of the Glass-Steagal Act in the U.S. – with the November 1999 Gramm-Leach-Bliley Act – which permitted commercial and investment banking within commercial banks and prompted the rise of **universal banking**
- Starting 1987, commercial banks were able to open Section 20 subsidiaries and offer corporate debt and bond underwriting services – **universal banks were able to engage in cross-selling and realize economies of scope across financial products** (Neuhann and Saidi, 2018)
- This could provide additional evidence / external validity exercise

Comment #3: Effectiveness of Monetary Policy the Aggregate

- Ultimately, policymakers care about the effects of monetary policy on the real economy
- Paper provides very interesting cross-sectional evidence but could say more about the implications of this channel in the aggregate
- Is monetary policy more effective in markets with more cross-selling (country- or geographical level evidence, time series evidence)
- Demographics are used for identification but cannot be affected by regulatory / monetary policy...

	(1) Loan Growth	(2) Loan Growth	(3) Loan Growth
Deposit Growth	0.668***	0.654***	0.489***
	(0.010)	(0.018)	(0.107)
Constant	-3.379**	-3.379***	
	(1.351)	(0.043)	
Observations	40’910	40’895	38’859
R2	0.095	0.148	0.086
F	4291.140	1361.850	20.680
Reg	OLS	OLS	IV
BYFE	No	Yes	Yes

To Sum Up

- Exciting paper about MP transmission to household deposit rates and lending as a function of bank cross-selling

- Main comments:
  - Develop further the intuition and more flexible optimization problem
  - Does this channel work for cross-selling to firms?
  - Implications for MP effects in the aggregate

- Extremely promising and thought-provoking work!