A Geopolitical Shock to Bank Assets and Monetary Policy Transmission

Fecht, Greppmair, Imbierowicz

Gazi Kabas
Tilburg University

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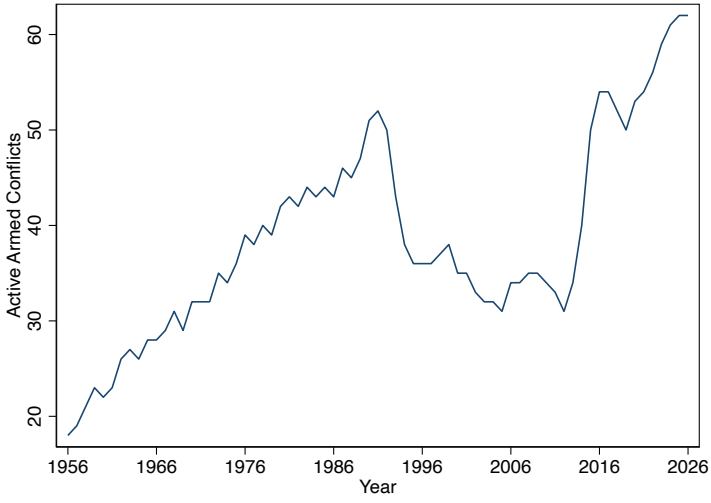
Geopolitical shocks are increasing



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- **What should central banks do after a geopolitical shock?**

1 If the shock is transitory, nothing!

→ There will be a one-time jump in the price level, but not an increase in inflation in subsequent periods

→ Increasing the policy rate wouldn't solve the energy shortage

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2 If the shock isn't transitory, the Stolper–Samuelson mechanism creates winners and losers
   → The shock increases the real return to the factor used in energy production, decreasing the real return to other production factors (mostly labor)
   → Workers bargain against the reduction in real wages, pushing for a wage increase
   → Producers pass the higher wages and energy prices to the consumers, creating inflation

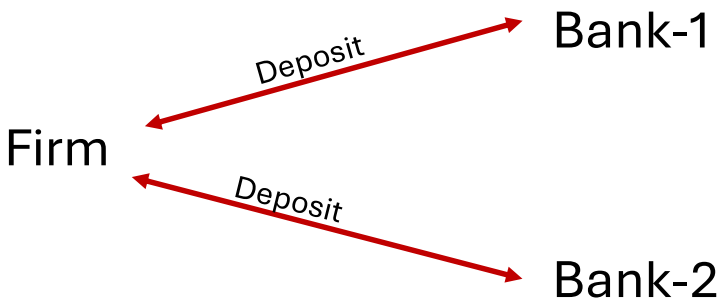
How should central banks react to geopolitical events?

This paper suggests another channel that entails the central bank's reaction

- The geopolitical risk increases the riskiness of the exposed banks
- Depositors (corporates) demand compensation for such risks, increasing the deposit rates
  → Around 15% of the mean
  → Calomiris and Kahn (1991)
- Banks pass this cost to their borrowers by decreasing loan volume
  → Mostly insignificant effect on loan rates
- The monetary policy pass-through is stronger with the exposed banks
- Data: Anacredit for loans, Money Market Statistical Reporting for deposits
- Method: Local projections

Is it depositor disciplining?

- Khwaja-Mian type of within-firm estimation



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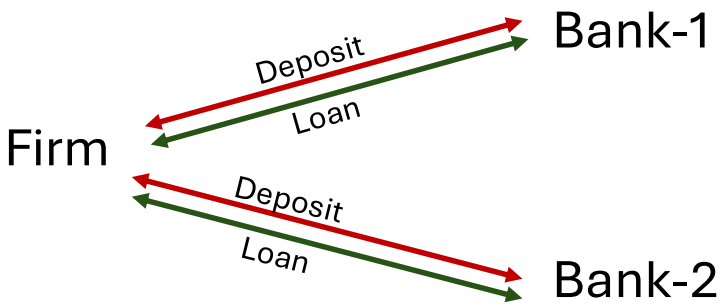
- Firms are very likely to get loans from the banks, in which they keep their deposits



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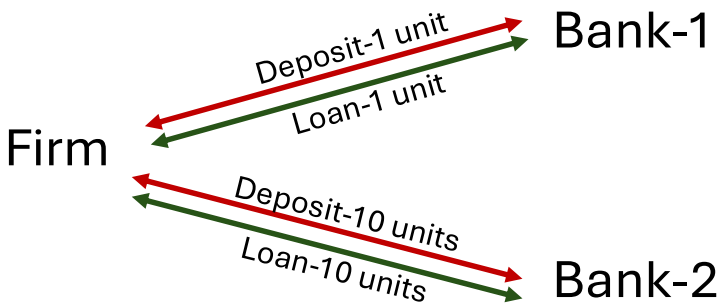
- The deposit and loan amounts are not homogeneous across banks



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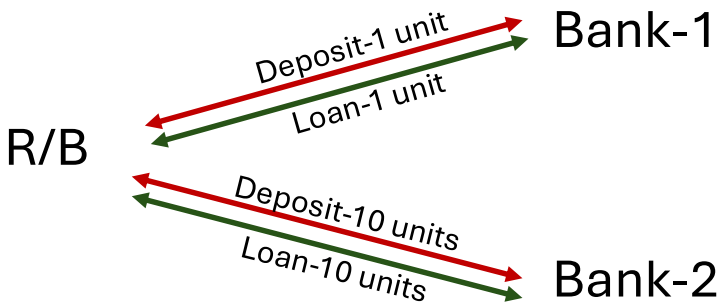
- Consider a case where the firm is a Russian/Belarusian firm



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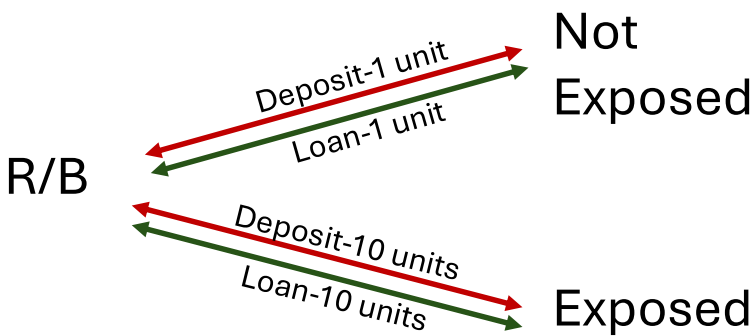
- The deposit-loan relationship induces sorting between R/B firms and exposed banks

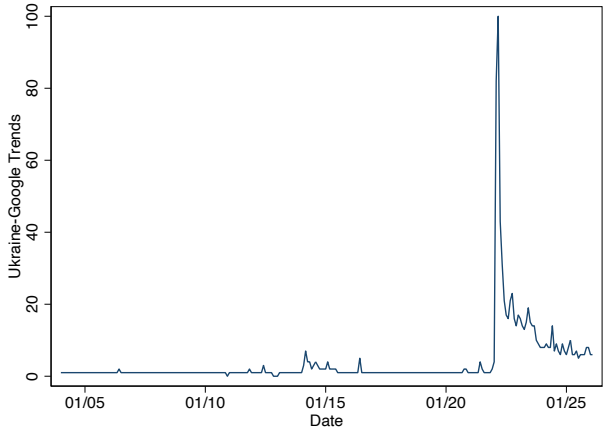


Is it depositor disciplining?

- Due to the political shock, R/B firms withdraw their deposits
- This decreases the exposed banks' deposits, leading to higher deposit demand by the bank
- The bank offers higher deposit rates to other firms to keep their deposit volume unchanged
- However, the loans to R/B firms are still on the exposed banks' books!
- These loans become riskier due to the geopolitical risk
- Due to riskier loans, banks become more cautious and lower the loan supply
- **Note that** including bank×firm fixed effects amplifies this channel!
- The data may allow the authors to check whether this actually happens

Why local projections?

- Is the invasion of Ukraine unexpected? **Yes!**



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Why local projections?

- Is the invasion of Ukraine unexpected? **Yes!**
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- **Why don't you use a dynamic difference-in-differences design?**
- LPs are great to produce impulse-response functions, but your research question doesn't necessarily require an IRF. Instead, it requires assessing the identifying assumption.
- Plotting a dynamic DiD graph will help us to see how credible the identifying assumption is.
- If the parallel trends do not look promising, you can use a matched DiD design, or synthetic DiD.
  → You can use the iMIR sample

Other comments

- The mean of the exposure is 6% of the equity ratio whose mean is 6%
  → 0.36% of the total assets is pretty small
- The non-financial corporations' deposits are around 10%
  → This suggests a limited potential for the channel
- Who are the exposed banks? Are they large ones, or small ones?
  → A comparison table would be helpful for the reader
- Firm×Time FEs reduce the sample to firms that put deposits in two banks on the same day
  → This changes the sample drastically!