# Discussion of
# **Bank Market Power and Monetary Policy Transmission: Evidence from Structural Estimation**

Wang, Whited, Wu, and Xiao (2022, JF)

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Households Finance

November, 2023

# Overview

**How does monetary policy affect bank lending?**

1. Reserves channel (Bernanke and Blinder, 1988)
   - higher rates $\rightarrow$ higher reserves cost $\rightarrow$ shrinks (reservable) Deposit
2. Bank capital channel (Bolton and Freixas, 2000)
   - duration mismatch $\rightarrow$ higher rates $\rightarrow$ reduce scarce equity capital $\rightarrow$ reduce lending
3. Deposit channel (Drechsler, Savov, and Schnabl, 2017)
   - banks have market power $\rightarrow$ higher rate $\rightarrow$ keep deposit rate unchanged $\rightarrow$ lower deposit supply $\rightarrow$ lower lending

**This paper:**

1. Build and estimate a model with all three channels
2. **Finding:** Deposit channel is the most important channel, followed by the capital channel, and then the reserves channel

## Methodology

Of course Structural Estimation!

1. Estimate deposit and loan demand curves using BLP framework (Berry, Levinsohn, and Pakes, 1995)
2. Plug demand curves into a banks' optimization problem (They have 6 representative banks)
3. Estimate the model using SMD
4. Examine the counterfactual by removing each channel

# Comments

1. **Missing channel**
2. **External validity**
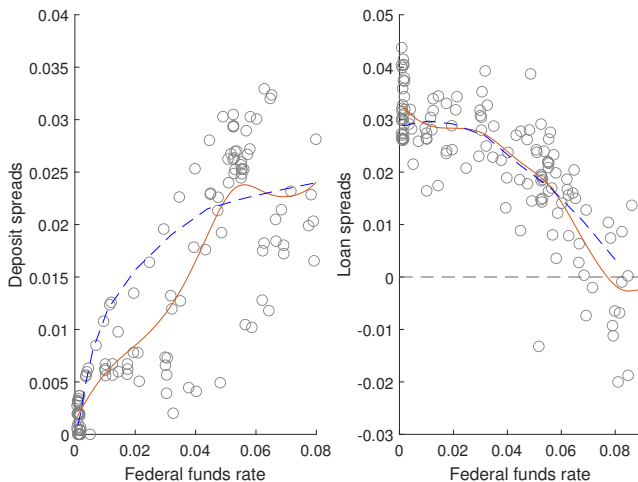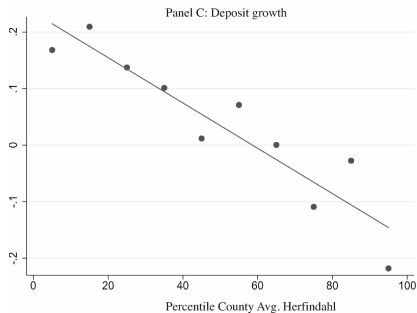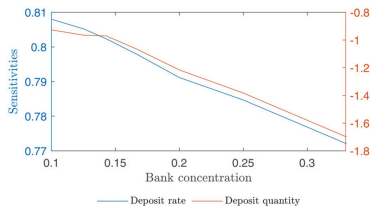3. **Counterfactuals**

# Missing channel
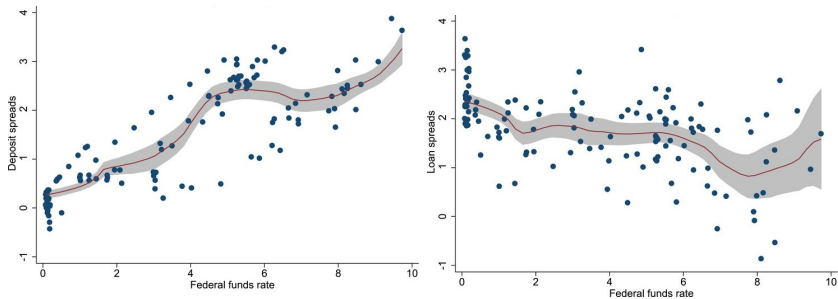
# External validity
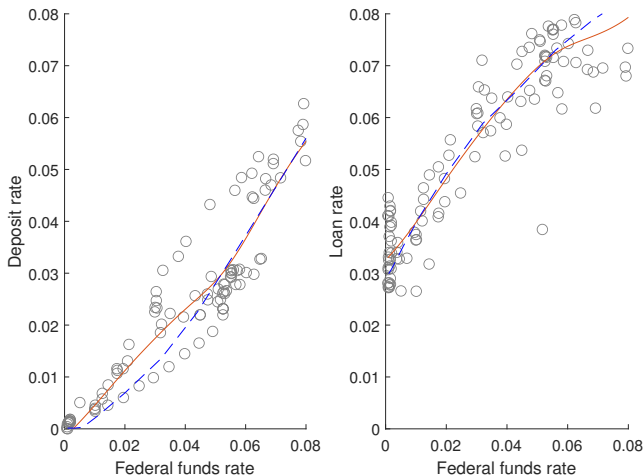
# External validity
Replication

|     |                           | Sensitivity | Change (%) |
|-----|---------------------------|-------------|------------|
| (1) | All frictions             | $-1.641$    | -          |
| (2) | - Reserve regulation      | $-1.499$    | 8.65%      |
| (3) | - Capital regulation      | $-1.248$    | 23.91%     |
| (4) | - Deposit market power    | $-1.132$    | 31.00%     |
| (5) | - Loan market power       | $-1.951$    | $-18.91$%  |
| (6) | Only Loan market power    | $-0.913$    | 44.36%     |
| (7) | Only Deposit market power | $-1.951$    | $-18.88$%  |
| (8) | No frictions              | ?           | ?          |

# Conclusion

1. This paper builds and estimates a model with all three channels: deposit, capital, and reserves. And the deposit channel is found to be the most important channel

2. The missing channel in this paper is the risk taking behavior of banks, which could be an interesting avenue for future research.

3. The external validity of the model is not fully supported by replication results and comparison with other studies.

4. The paper needed to provide more details on the counterfactuals. For example, how much of the deposit channel is due to the deposit market power and how much is due to the loan market power?

**Bernanke, Ben S, and Alan S Blinder.** 1988. "Credit, money, and aggregate demand."

**Berry, Steven, James Levinsohn, and Ariel Pakes.** 1995. "Automobile Prices in Market Equilibrium." *Econometrica*, 63(4): 841–890.

**Bolton, Patrick, and Xavier Freixas.** 2000. "Equity, bonds, and bank debt: Capital structure and financial market equilibrium under asymmetric information." *Journal of Political Economy*, 108(2): 324–351.

**Drechsler, Itamar, Alexi Savov, and Philipp Schnabl.** 2017. "The deposits channel of monetary policy." *The Quarterly Journal of Economics*, 132(4): 1819–1876.