Variable Deposit Betas and Bank Interest Rate Risk Exposure

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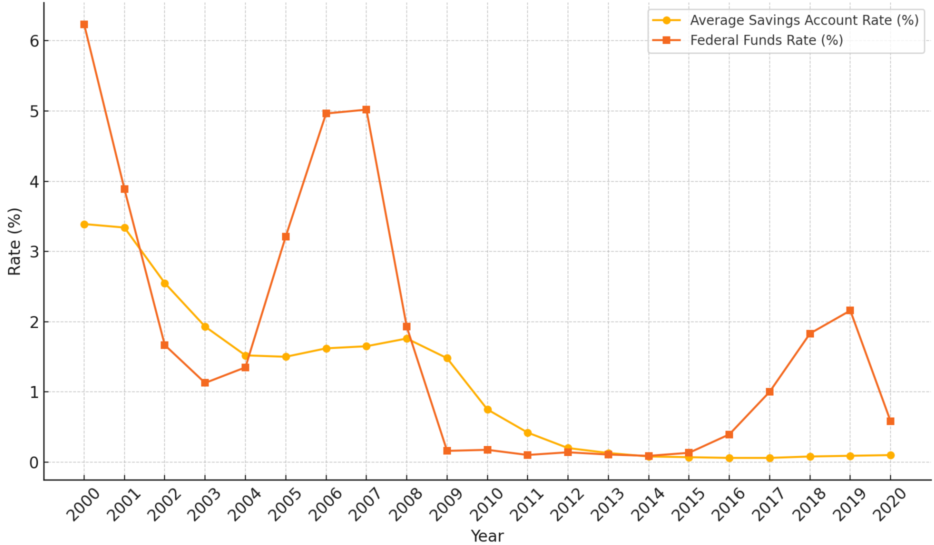
Deposit spreads in the US



Deposit franchise

- Banks are able to pay deposit rates below the market rate
  - Deposit market power – deposit franchise value
- When rates rise, banks' assets shrink
- Banks compensate by keeping their deposit rates low
  - **Deposit franchise value** increases
  - DSSW (2023): franchise value compensates for asset losses

This paper

- Studies deposit rate sensitivity (deposit betas) over time
- **Result 1**: total bank franchise value has negative duration
  - Increase in deposit franchise **overcompensates** for asset losses
- **Result 2**: Deposit betas are procyclical (move with interest rates)
  - Banks can hedge better when interest rates are low

Overview of the comments

- Well-done paper – analysis follows the literature closely
- Important finding – banks' hedging depends on current interest rates
- My comments:

1. Negative duration of banks' total franchise value – disagreement in the literature
2. Contribution regarding the results about varying betas
3. Rise in non-banks (fintechs, shadow banks, etc)

Comment 1: duration of banks' total franchise value

- DSS (2021): banks' **deposit** franchise value has negative duration
  - Not much discussion about total franchise value – examples of just-compensation
- DeMarzo, Krishnamurthy, and Nagel (2024): banks' total franchise value has **positive** duration
  - Lending costs exceed operating costs
  - Bank deposits have longer duration than 10 years (necessary to get negative duration)

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  - Lending costs exceed operating costs
  - Bank deposits have longer duration than 10 years (necessary to get negative duration)
- This paper finds **negative** duration of total franchise value – overcompensation

Suggestion

- The finding is interesting but requires explanation
- Spend more time on it – this result is novel
- Why is there disagreement with DKN (2024)?
- Test their assumptions empirically
- Have your version of the model with time-varying betas

Comment 2: contribution

- Deposit betas depend on **composition of deposits**
  - Time deposits flow out less (Supera (2021))
  - Uninsured deposits have beta close to 1 (DSSW (2023))
- If time and uninsured deposits vary with interest rates, so will betas
- Both increase with interest rates and thus increase betas – consistent with the findings

Suggestion

- Compare with literature and explain the differences
- Elaborate on other channels that are more novel
  - Cash costs, heterogeneity in depositors
- Split the channels using data on cash usage and demographics
  - Data on payment systems might help (Lu, Song, and Zeng (2024))

Comment 3: rise in non-banks

- Sarto and Wang (2023): banks have their market power advantage when rates are high

  because they can pay below the market

- When rates are low, banks lose their advantage and non-banks have more relative power

  - Explains the rise in shadow banks

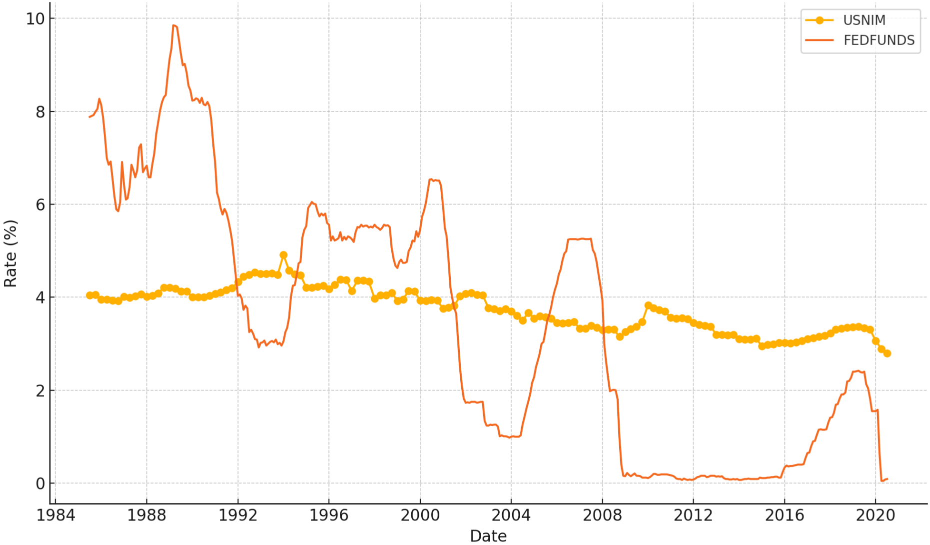
- This channel goes **against** the main findings of the paper

  - Worth exploring or discussing

Minor comments

- No variation depending on the share of insured deposits is surprising
  - Banks should at least reduce the duration of their assets
- Cash channel can get weaker over time as cash usage declines – look at other investments (MMMFs, etc)
- Show how NIM changes over time
- Consider contractionary vs. expansionary policy

Was the hedge indeed poor?



Summary

- Interesting paper with surprising fundings
- Compare more with existing literature
- Consider different channels

Good luck!