Monetary Policy, State-Dependent Bank Capital Requirements and the role of Non-Bank Financial Intermediation

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[1] The views expressed here are my own, and do not necessarily represent the views of the Bank of Finland.

Recap of the model

- A New Keynesian DSGE model with frictional credit markets with banks and non-banks
- Perfect market segmentation on borrower side
- Friction in supply of deposits to NBFIs due to agency problem; friction in banking sector due to monopolistic competition both in deposit and loan markets
- NBFI sector not subject to costly macroprudential regulation, but does not benefit from deposit insurance
- NBFI leverage, and hence credit supply and credit spread, sensitive to bond prices

Main contribution of the paper

- Explores the role of NBFIs for strength of monetary policy transmission + non-linearities related to banks' capital regulation and ZLB
- **Main findings**: NBFIs amplify transmission of contractionary shocks, because their lending capacity is sensitive to asset valuations; amplification stronger at the left tail of GDP growth distribution
- Trade-off between short-run volatility and long-run growth: greater share of non-bank sources finance improves long-run growth through reduced costs of regulation

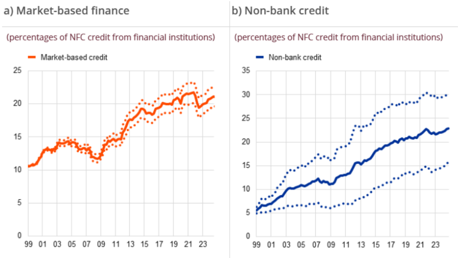
My main comments

1. Characteristics of non-bank financial intermediation
2. Normative analysis and the source of inefficiencies

Corporate credit in the euro area – A rise in non-bank intermediation or a disintermediation?

Chart 1

After a slight decline, market-based finance and non-bank credit to NFCs returned to growth thanks to flow and valuation effects



Sources: ECB and ESRB calculations.
Notes: Market-based credit reflects the share of market-based debt finance (debt securities and non-retained securitised loans) relative to the total external debt of euro area NFCs, irrespective of which sector provided the credit. Non-bank credit reflects the relative share of investment funds and OFIs in providing debt financing to euro area NFCs compared with credit provided by all financial institutions (the non-bank financial sector and banks), irrespective of whether that financing is provided in the form of loans or debt securities. The solid line reflects an average of the dotted lines, which include (dotted line at the top) or exclude (dotted line at the bottom) loans granted by a residual of OFIs. Due to data limitations, it is unclear whether a financing vehicle of an NFC should be classified as pertaining to the NBFI sector or not. The methodology is similar to that described in Box 2 of European Central Bank (2022), " Financial Integration and Structure in the Euro Area", April, but insurance corporations and pension funds are excluded. The latest observations are for 2024.

Source: ESRB, EU Non-bank Financial Intermediation Risk Monitor 2025

What are non-bank financial intermediaries?

- What makes a bank?
  - Deposit-taking financial intermediary
  - Technology to overcome information frictions (monitoring, relationship lending, ...)
  - Covered by deposit insurance; access to CB facilities; subject to macropru regulation

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  - Intermediation technology different from that of banks?
  - Not regulated as a bank?
  - Funding of the intermediary: deposit issuance vs. market-based
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- **Here:** NBFIs collect risky deposits from households, invest funds into long-term secured debt claims. Assets vulnerable to valuation changes. Some sort of investment funds?

Welfare analysis: where are the inefficiencies?

- Collateral constraints on the firm and capital constraints on the bank exogenously assumed (reduced form)
- These constraints are a source of inefficiency and costly in themselves
- Banking sector subject to long-run inefficiency from monopolistic competition
- What is the role of banks, if NBFIs are more efficient at intermediating credit?
- What friction in the banking sector is the capital regulation trying to solve? Why is market discipline not enough?
- Non-linearities in recessions may be very important for the trade-off between long-run level of output and increased volatility from larger NBFI sector – taking them into account may change results

Concluding remarks

- Topical and policy-relevant work on interactions between monetary policy transmission and macroprudential regulation in the presence of NBFIs
- Highlights potentially amplifying role of asset valuations in lending capacity of NBFIs, contrasting Gebauer and Mazelis (2023)
- My main comments:
  - Clarify what part of the (vast) NBFI sector you want to capture, what are the main distinctions with traditional bank credit that you think are important
  - For normative analysis, focus on what are the relevant market failures and the rationale for bank capital regulation
- Many avenues for future research: optimal degree and scope of banking regulation, optimal policy coordination