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Jeffrey R. Gerlach, Nada Mora, Pinar Uysal

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Jeffrey R. Gerlach[a], Nada Mora[a], Pinar Uysal[a]

[a]*Federal Reserve Bank of Richmond*

Abstract

One key risk to the banking system is how funding costs will change as monetary policy is normalized and interest rates rise after almost a decade of near-zero rates. Our contribution is to develop a model that jointly estimates banks' balance sheets and retail interest rates to arrive at a consistent estimate of the change in bank funding costs as market rates change. Our estimates imply a 100 basis-point shock to the Federal Funds rate would increase overall deposit funding costs by about $40 billion, which is roughly equal to 25% of aggregate annual net income for commercial banks and savings institutions. We also find that deposit rate responses are largely symmetric, in contrast to some previous research showing retail rates are less responsive to upward movements in reference rates. We introduce unique and confidential data on bank deposit betas to anchor our results.

Keywords: Bank Funding Costs; Monetary Policy; Deposit Betas; Deposit Mix

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