# Discussion of:
# *Money and Banking in a New Keynesian Model*

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# This paper

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- Caveat: still feature fundamental weakness of baseline NK model, i.e., excess reliance on intertemporal channel

# Focus: model with banks

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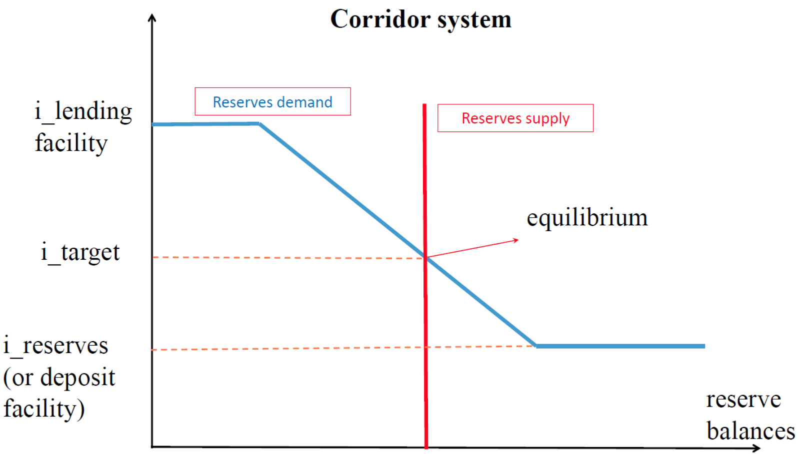
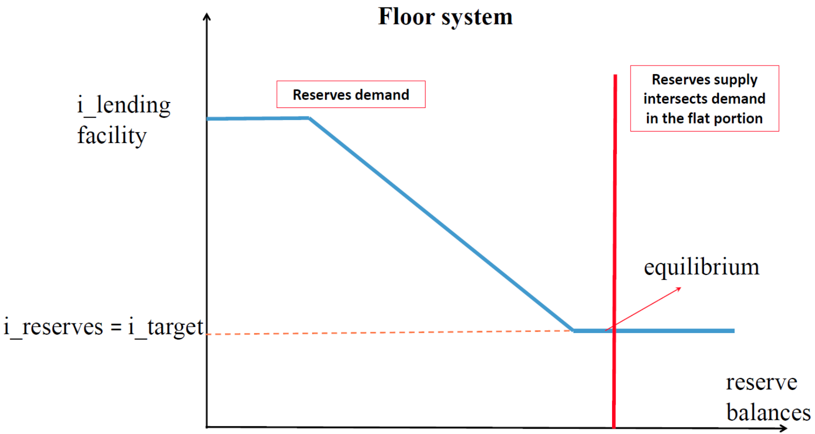
# Traditional corridor system



# Floor system



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# Modelling the transmission mechanism: banks deposits

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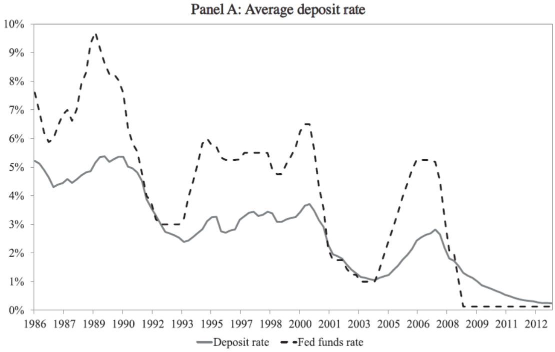
- Drachsel et al. (2016): **100 bp** increase in FFR $\longrightarrow$ Spread with deposit rate increases by **54bp**



# Model with banks and floor system

- In the model deposit spread and policy spread are **proportional**

$$\underbrace{i_t^S - i_t^D}_{\substack{\text{deposit}\\ \text{spread}}} = \mu \cdot \underbrace{\left(i_t^S - i_t^M\right)}_{\substack{\text{policy}\\ \text{spread}}}$$

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# Weakened transmission mechanism: a necessary feature of money and banking in the NK model?

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- **Low pass-through** on banks deposit rates: can be rationalized with "customer base motive" $\longrightarrow$ profit smoothing (deep habits on deposits, eg, Polo 2019)

$$\uparrow \; i_{\text{policy}}: \;\; \text{if} \; \uparrow i_D \longrightarrow \downarrow \; \text{current profits}$$

$$\uparrow \; \mathrm{i}_{\text{policy}}: \;\; \text{if} \; \downarrow i_D \longrightarrow \;\; \downarrow \text{current and future customer base}$$

- In equilibrium: low pass-through on $i_D$ + **outflow** of **deposits**

# Low pass-through on deposit rates and amplification (con't)

- Banks substitute deposit with bonds (at higher cost)

$$\longrightarrow \quad \uparrow i_{\text{bonds}}$$

- $\uparrow$ $\mathrm{i}_{\text{bonds}} \rightarrow \uparrow \mathrm{i}_{\text{mortgage}} \rightarrow \downarrow$ borrowers spending (**high MPC**)

$\rightarrow$ **Amplification**

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3. Want to match low pass through to **banks deposit** rate (X)
4. Want NK model 2.0 to rely less on **intertemporal substitution**. $\longrightarrow$ (2) does not necessarily imply a weakened transmission mechanism

# Conclusions

- Great paper!
- Lots of food for thought
- Needed a **stylized** modeling of banks in baseline NK model
- Still some way to go in modeling the **monetary transmission** mechanism in full