Monetary Policy Uncertainty in the Banking Sector

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Motivation

- Monetary policy uncertainty can impact the credibility and trust in the Fed
- Forward guidance: communicate to make decisions predictable
- Monetary policy uncertainty is recessionary [1]
- Disagreement on the channels of transmission: through bank or firm subjective beliefs?

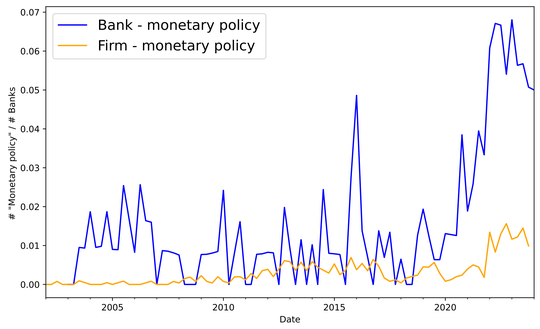

Figure 1:Attention to monetary policy

Research Questions

1. What are the macroeconomic implications of perceived aggregate monetary policy uncertainty in the banking sector?
2. What role do firm-level subjective beliefs play? Does a direct channel exist at the firm level?
3. Is there evidence of a financial friction channel?

Data

The following datasets were used to complete the research:

- 10,957 US bank earnings calls
- 195,732 US firm earnings calls
- Federal Reserve Tealbooks
- Syndicated Loan Transactions from Dealscan

Monetary Policy Uncertainty index

We need a dictionary of monetary policy words. The Tealbooks are a natural candidate:

- Economic in nature
- Select titles about monetary policy
- Most frequent words in following text are monetary policy bi-grams

I count monetary policy uncertainty following [2]

- Identify a monetary policy bi-gram
- Count risk and uncertainty synonyms within 10 words of the monetary policy bi-gram

Identification Strategy

Sources of endogeneity:

1. Economic news affects both bank monetary policy uncertainty (MPU) and monetary policy decisions within quarter
2. Monetary policy decisions impact bank MPU within the same quarter

⇒ Focus on monetary policy uncertainty measured on FOMC days

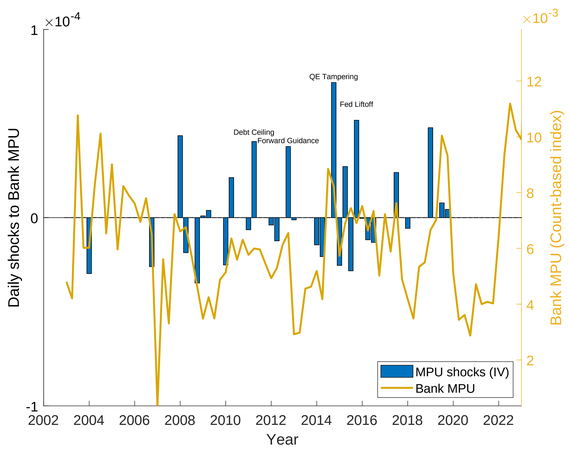

Figure 3:MPU surprises

Macroeconomic Impact

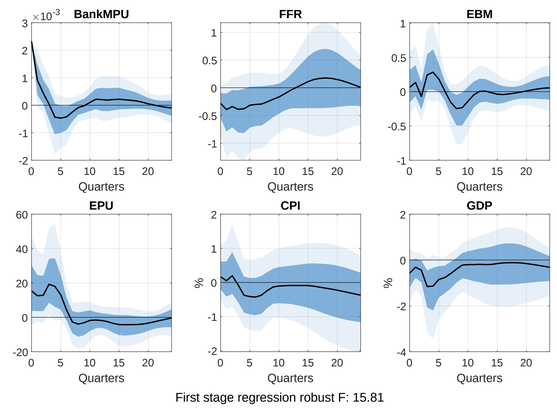

Figure 2:Aggregate Impact

Channels

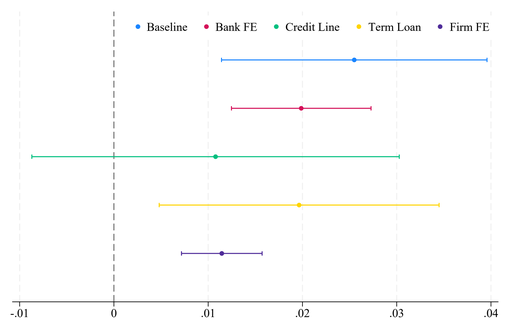

Figure 4:Bank MPU and credit frictions

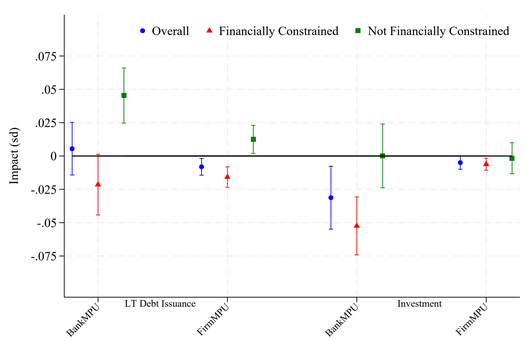

Figure 5:Firm-level regressions

Robustness tests

- SVAR: I do not orthogonalize with bank fundamentals, include News MPU, exploit daily variations in a monthly VAR, and change the dictionary construction
- Loan-level regressions: I control for analysts' MPU, apply weighted least squares (WLS) to account for repeating transactions, lag control variables, implement bank-time and bank-firm clustering, and introduce industry-size-location-time fixed effects (ISLT FE)
- Firm-level regressions: I test alternative monetary policy dictionaries, conduct regressions at the industry level (2-digit and 3-digit SIC codes), and use Local Projections with lagged regressor

Conclusion

Aggregate monetary policy uncertainty in the banking sector leads to a decline in GDP. The primary channel operates through the financing costs. Banks perceiving higher monetary policy uncertainty raise their lending rates. This leads to a fall in investment and long-term debt issuance, particularly for financial constrained firms.

References

[1] Lucas Husted, John Rogers, and Bo Sun. Monetary policy uncertainty. *Journal of Monetary Economics*, 115:20–36, November 2020.

[2] Tarek A Hassan, Stephan Hollander, Laurence van Lent, and Ahmed Tahoun. Firm-Level Political Risk: Measurement and Effects. *The Quarterly Journal of Economics*, 134(4):2135–2202, November 2019.

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