

Discussion of:

# Monetary Policy Complementarity: Bank Regulation and Interest Rates

by Stefan Walz

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*The views expressed in this discussion are solely the responsibility of the author and should not be interpreted as reflecting the views of the New York Fed or of anyone else associated with the Federal Reserve System.*

# In a nutshell

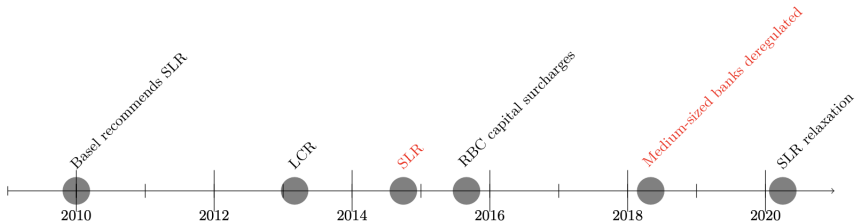
- **Bank capital regulation increases banks' demand for long-term government bonds**
    - Bank capital regulation increases banks' demand for long-term government bonds
    - Unweighted capital requirement → SLR
  - **Long-term bonds are an attractive asset for hedging**
    - As rates ↓, long-term Treasuries increase in price helping with the drop in net interest margin
    - As rates ↓, long-term Treasuries can be ... not marked-to-market
    - Treated favorably by “weighted” capital regulations
- **Capital regulation reduces long-term yields, acting as unconventional monetary policy**

# SLR

- SLR announced in 2014:Q3 based on tier 1 capital/total exposures (comply by 2018:Q1)
- Applies to banks with assets  $> \$250\text{B}$  (or foreign exposures  $> \$10\text{B}$ )
- Baseline SLR 3% (for systemically important banks SLR is 5%)

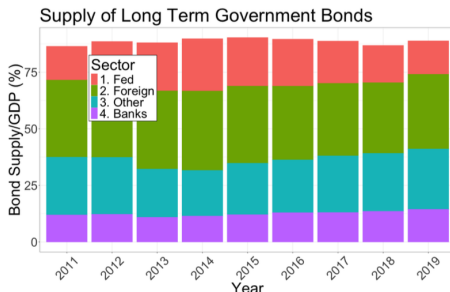
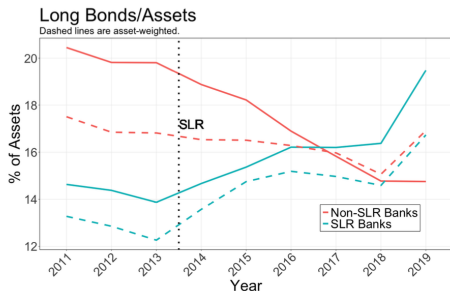
→ SLR has become the binding constraint

- Greenwood et al. (2017) shows SLR was the binding constraints for the top-5 banks in 2017
- Ex-post evidence: SLR relaxed in 2020 as banks got inundated with deposits
- SLR being binding is crucial for this paper → direct evidence would help a lot



# Reduced form: SLR $\rightarrow$ $\uparrow$ Holdings of LT Treasuries

- Main diff-in-diff at the time-month level: SLR vs non-SLR (pre-/post-2014:Q3)
- Price effect rests on the inelasticity in long term bond markets
  - More descriptive about the holders of long-term Treasuries (e.g., “others” increasing)
  - “Long-term” bonds are bonds with maturity  $>1Y$  in the paper



## Reduced form: SLR $\rightarrow$ $\uparrow$ Holdings of LT Treasuries

- Standard diff-in-diff (then also using deregulation of medium-sized banks in 2018)
  - What is the rationale for the triple diff (as opposed to a “horse race” specification)?
  - Why are the results more pronounced for low capital banks (unweighted capital ratio)?

	Long Bonds/Assets	Long Bonds/Assets
SLR Bank x Post	5.63*** (0.72)	1.77 (1.39)
SLR Bank x Low Capital x Post		5.46*** (1.38)
SLR Bank x LCR Gap x Post		-0.42 (0.30)
SLR Bank x Low RBC x Post		-1.35 (1.04)
Sample	All	All
Bank Controls	Yes	Yes
Bank FE	Yes	Yes
Date FE	Yes	Yes
Num. obs.	18058	13906
R <sup>2</sup>	0.84	0.82

\*\*\* $p < 0.01$ ; \*\* $p < 0.05$ ; \* $p < 0.1$

# Literature on capital regulation and govt bond holdings

- Large literature on this topic during the eurozone crisis
  - Bank capital and govt bond holdings: [Farhi and Tirole \(2018\)](#), [Crosignani \(2021\)](#)
  - ECB and banks' govt bond holdings/yields: [Schnabl et al. \(2016\)](#), [Crosignani et al. \(2020\)](#)
- More generally, see [Reis "Fiscal Footprint of Macroprudential Policy"](#)  
+ large macro literature on "financial repression"
- Link the analysis more closely to monetary policy
  - e.g., discuss time series evolution of shock to demand of the banking sector  $GIV_t$

# Are countercyclical capital requirements necessarily desirable?

- Domestic banks absorb large quantity of Treasuries, keeping yields low
- Credit to firms and households increasingly provided by NBFIs
- But MTM losses as rates *increase*. Are banks gambling, while being protected by limited liability? (Low capital banks increase govt bond holdings the most)

# Overall

- Impressive paper, highly topical given the increasing size of the Treasury market and foreigners potentially reducing their demand for Treasuries
- Nice combination of reduced form, model, and calibrated counterfactuals
- My suggestions/comments:
  - Interpretation of the results as “unconventional monetary policy”
  - What if rates go up?
  - More work to understand which regulatory capital constraint binds