Discussion of:

The Declining Role of Deposits in Credit Creation

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I buy a house for $100

Assets		**Liabilities**	
My mortgage	$100	Stable deposits D	$0
		My checking-account deposit	$100
		Wholesale funding W	$0
Total	$100	**Total**	$100

The bank originates my $100 mortgage and credits my account by $100.

Credit creation adds a loan asset and an equal checking-account deposit liability.

I pay the seller $100

Assets		**Liabilities**	
My mortgage	$100	Stable deposits D	$0
		Seller's checking-account deposit	$100
		Wholesale funding W	$0
Total	$100	**Total**	$100

The deposit moves to the seller's checking account; the mortgage remains a bank asset.

At the aggregate-bank level, the $100 deposit changes owner, but it does not disappear.

How much additional credit? $\lambda = 0.7$

Assets		**Liabilities**	
My mortgage	\$100	Stable deposits D	\$100
New credit	\$70	New borrowers' checking deposits	\$70
		Wholesale funding W	\$0
Total	\$170	**Total**	\$170

Credit response λ: new bank credit per dollar of additional stable deposits.

The seller's stable \$100 supports \$70 of new credit, creating \$70 in new checking deposits.

Where does the new \$70 go? $\theta = 0.9$

Assets		**Liabilities**	
My mortgage	\$100	Stable deposits D	\$163
New credit	\$70	New borrowers' checking deposits	\$0
		Wholesale funding W	\$7
Total	\$170	**Total**	\$170

Recycling share θ: share of new credit proceeds settling as stable deposits.

Here, \$63 becomes stable deposits; \$7 can fund newly issued bank debt via a prime MMF.

Deposit multiplier: the \$63 supports more lending and deposit creation.

$$m_D = \frac{\$100 + \$63 + \$39.69 + \cdots}{\$100} = \frac{1}{1 - \lambda\theta} \approx 2.70.$$

With fixed λ and θ, stable deposits reach \$270.27, including the original \$100.

What does the paper find?

- **Reduced form:** Deposit inflows instrumented with Treasury settlement timing; the estimated deposit multiplier falls from 2.38 to 1.36 (2005–2010 versus 2011–2019).
- **Structural model:** Banks face capital and liquidity costs and compete with nonbanks; credit proceeds partly recycle into stable deposits.
- **Model estimates:** Credit response λ: 0.88 $\rightarrow$ 0.58; recycling θ: 0.65 $\rightarrow$ 0.47. Bank credit per \$1 recycled-deposit inflow falls from \$2.13 to \$0.88.
- **Mechanisms:** Higher capital costs curb lending. Lower recycling may reflect more securities purchases and recipients shifting toward nonbank savings.

The reduced-form exercise

- **Local projection (IV):** Estimate separately for $h = 0, \ldots, 6$ weeks:

$$\Delta D_{t-1,t+h} = \alpha_h + m_D^h \Delta D_t + \Gamma_h X_t + \varepsilon_{t+h}.$$

  ΔD: log changes in core deposits.

- **Empirical challenge:** Persistent demand for core deposits can raise current and future deposits even without new lending: omitted variable bias.

- **Horizon-specific multiplier m_D^h:** Cumulative deposit increase through week h per \$1 initial inflow, including that dollar (local approximation).

- **Treasury instrument:** Unexpected net Treasury cash flows, after removing calendar effects and lagged flows, instrument current deposit growth.
  Assumption: Treasury surprises affect future deposits only through the initial inflow.

Core-deposit growth need not imply new credit

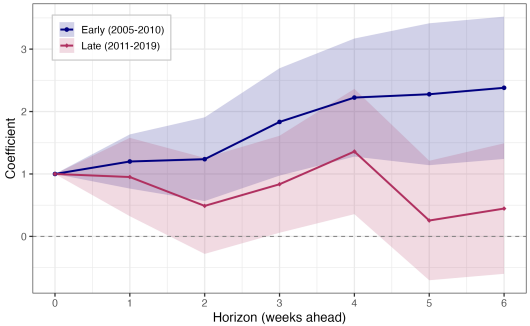
- **Possible mechanism:** Treasury inflows lower CD renewal rates; some maturing large CDs move into checking or savings. Core deposits rise without additional total deposits or credit.

- **Accounting check:** For an initial \$100 inflow, the following responses would account for extra core deposits through composition:

Core deposits	Large time deposits	Total deposits
$+\$140$	$-\$40$	$+\$100$

- **Suggestion:** Estimate core/total deposits, large CDs, loans, and securities jointly with the same IV, sample, and dollar scaling. Conditional on a valid IV, this is a mechanism question.

The peak response need not be the long-run multiplier



Koont and Walz (2026), Figure 3(b); shaded bands: 95% confidence intervals.

- **Peak versus plateau:** Late estimates are 1.36, 0.25, and 0.45 at weeks 4–6. Wide bands establish neither convergence nor a definite reversal.
- **Suggestion:** Selecting the highest noisy estimate favors positive errors. Show longer paths and common horizons; account for peak selection in inference.

What drives the decline in deposit recycling?

- **Credit response λ:** Liquidity and capital costs determine new lending; higher capital costs explain much of its decline.
- **Recycling θ:** Estimated share of credit proceeds settling as stable deposits; recipients' retention decisions are not modeled.
- **Two possible channels:**
  - *Different recipients:* More securities purchases route funds toward institutional investors, who may retain fewer stable deposits.
  - *Different behavior:* Recipients increasingly prefer alternatives to stable deposits.
- **Suggestion:** Test recipient composition and portfolio behavior separately; quantify each channel's contribution to lower θ.

Banks also finance nonbanks

- Can nonbanks offset the decline in the total-credit response from \$1.14 to \$0.50 per dollar of deposit inflow?
- **Paper's funding channel:** New bank credit $\rightarrow$ payments $\rightarrow$ money-market funds $\rightarrow$ nonbanks.
  The required funding-cost benefit is calculated; its actual strength is not estimated.
- **Missing bank link:** Better deposit funding can support bank loans and credit lines to nonbanks, helping them expand lending.
- **Suggestion:** Add bank lending to nonbanks, discipline it with data, and recalculate total-credit responses in both periods.
  Closing the gap requires a larger boost in the late period.

Evidence on bank financing of nonbanks: Jiang (2023), among others

Conclusion

- **An important contribution:** A clear framework for quantifying the feedback between deposits and credit creation.
- **Credit creation or funding substitution?** Use joint deposit and credit responses to distinguish the mechanisms behind core-deposit growth.
- **Peak or lasting response?** Compare common horizons, show longer paths, and account for peak selection in inference.
- **Why does recycling decline?** Separate changes in recipient composition from changes in recipients' portfolio choices.
- **Can nonbanks compensate?** Include bank financing of nonbanks and compare total-credit responses across periods.