

A Cross-Country Exploration of the Deposit Channel of Monetary Policy in Emerging Market Economies

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Abstract

Deposits are the primary source of funding for commercial banks, yet their role in the transmission of monetary policy remains relatively understudied, particularly in emerging and developing economies. This paper examines whether monetary policy affects both the growth of bank deposits and the spread between policy rates and deposit remuneration. Using a panel of more than 1,600 banks across 52 countries between 1996 and 2021, we find that higher policy rates are associated with slower deposit growth and wider deposit spreads. These relationships remain robust after accounting for macroeconomic conditions, bank-specific characteristics, and banking-sector structure. The results are consistent with the view that banks do not fully pass policy-rate increases through to depositors, allowing funding spreads to widen during periods of monetary tightening. By providing broad cross-country evidence from emerging economies, the paper highlights the importance of deposit markets for monetary transmission and suggests that the liability side of bank balance sheets deserves greater attention in both research and policy discussions.

Keywords: Monetary Policy Transmission, Deposit Channel, Bank Deposits, Emerging Markets.

JEL Classification: E52, G21, E44.

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1. Introduction

Monetary policy is ultimately transmitted through financial institutions. When central banks raise or lower policy rates, the effects on economic activity depend not only on how borrowers respond to changes in credit conditions but also on how banks adjust their balance sheets. For decades, the literature on monetary transmission has focused primarily on the asset side of banks' balance sheets, emphasizing the bank lending channel and the effects of monetary policy on the supply of credit. Yet banks are funded largely through deposits, and changes in the availability and pricing of deposits may be just as important for understanding how monetary policy affects financial intermediation.

This issue has become particularly relevant in recent years. Episodes of rapid monetary tightening around the world have renewed interest in the stability of bank funding and the responsiveness of depositors to changes in interest rates. The sharp increases in policy rates observed after the COVID-19 pandemic highlighted that deposits cannot be treated as a passive source of funding. As policy rates rose, banks faced growing pressure to compete for deposits while households and firms increasingly reallocated savings toward alternative financial assets offering higher returns. These developments have underscored the importance of understanding how monetary policy affects deposit behavior and how banks respond to changes in their funding environment.

Recent research suggests that deposits play a central role in monetary transmission. In the framework developed by Drechsler et al. (2017), banks operate in imperfectly competitive deposit markets and therefore possess a degree of market power over depositors. Because deposit rates adjust only partially to changes in policy rates, banks can widen the spread between the policy rate and the remuneration offered on deposits when monetary policy tightens. Higher spreads reduce the attractiveness of deposits relative to competing assets, generating deposit outflows and affecting banks' funding conditions. In this view, monetary policy influences not only the demand and supply of loans but also the quantity and cost of deposits that support financial intermediation.

While the deposit channel has attracted growing attention, the existing evidence remains heavily concentrated in advanced economies, particularly the United States. Much less is known about whether the same mechanism operates in emerging and developing economies. This omission is important because these countries provide a fundamentally different environment in which to study deposit markets. Banking systems in emerging economies are often characterized by higher levels of concentration, lower financial depth, greater macroeconomic volatility, and more limited access to alternative savings instruments. At the same time, deposits typically represent a larger share of bank funding than in many advanced economies. These

characteristics suggest that the liability side of bank balance sheets may be particularly important for the transmission of monetary policy in emerging markets.

The direction of these effects is not obvious a priori. On the one hand, limited competition and fewer outside investment opportunities may allow banks to exercise greater market power over depositors, strengthening the deposit channel. On the other hand, high inflation, weaker monetary-policy credibility, and recurrent episodes of financial instability may increase the sensitivity of depositors to changes in interest rates and encourage a faster reallocation of savings across financial assets. Whether monetary tightening leads to larger deposit spreads and slower deposit growth in emerging markets is therefore ultimately an empirical question.

This paper addresses this question by examining the relationship between monetary policy, deposit growth, and deposit spreads across a broad sample of emerging and developing economies. We construct a unique panel dataset covering more than 1,600 banks in 52 countries over the period 1996-2021. Combining bank-level information from BankFocus with macroeconomic data from the IMF and World Bank, as well as monetary policy rates collected from multiple national and international sources, we investigate two central predictions of the deposit-channel framework. First, we examine whether increases in domestic policy rates reduce bank deposit growth. Second, we analyze whether monetary tightening increases the spread between policy rates and bank deposit rates.

Our empirical findings provide strong support for the existence of a deposit channel in emerging and developing economies. Across a range of specifications, increases in monetary policy rates are associated with lower rates of deposit growth. Moreover, higher policy rates are consistently linked to wider deposit spreads, suggesting that banks do not fully pass monetary tightening through to depositors. These results remain robust after controlling for macroeconomic conditions, bank characteristics, and measures of banking-sector concentration. The evidence is consistent with the view that banks respond to higher policy rates by increasing the cost of deposit intermediation, which in turn weakens deposit accumulation.

Beyond documenting these relationships, our results contribute to a broader understanding of monetary transmission in emerging markets. Much of the existing literature examines how monetary policy affects credit supply, investment, or output. By focusing on deposits, we highlight an important but relatively understudied mechanism operating through the liability side of bank balance sheets. This perspective is particularly relevant in economies where deposits remain the dominant source of bank funding and where financial markets are less developed than in advanced countries.

The paper makes three contributions to the literature. First, it provides one of the first cross-country assessments of the deposit channel of monetary policy in emerging and developing economies. Second, it extends the growing literature on deposit markets by examining the relationship between policy rates and bank-level deposit spreads outside the advanced-economy context where most existing evidence has been generated. Third, by incorporating measures of banking concentration and market structure, the paper sheds light on the role of competition in shaping monetary transmission through deposit markets.

The remainder of the paper proceeds as follows. Section 2 reviews the related literature. Section 3 presents the empirical methodology. Section 4 describes the data and key variables. Section 5 discusses the main results, while Section 6 concludes.

2. Literature Review

Understanding how monetary policy affects the banking sector has been a central concern in both macroeconomics and banking research. Traditional analyses of monetary transmission have focused primarily on the asset side of banks' balance sheets, emphasizing how changes in policy rates influence the supply of credit and, ultimately, real economic activity. In the classic bank lending channel framework, monetary tightening reduces the availability of bank funding and constrains the ability of financial institutions to extend loans. Bernanke and Blinder (1992) were among the first to formally demonstrate that monetary policy affects economic activity not only through market interest rates but also through its impact on bank balance sheets. Subsequent contributions by Kashyap and Stein (2000) showed that these effects are particularly pronounced for banks facing funding constraints, providing compelling evidence that characteristics of financial intermediaries shape the strength of monetary transmission.

Over time, the literature has increasingly recognized that monetary policy operates through a variety of channels that extend beyond lending. Loan-level studies such as Jiménez et al. (2012) have confirmed that monetary policy affects credit supply even after controlling for borrower demand, while Khwaja and Mian (2008) document similar mechanisms in emerging economies. At the same time, research on international banking has shown that monetary shocks can be transmitted across borders through globally integrated financial institutions. Cetorelli and Goldberg (2012) demonstrate that multinational banks actively reallocate liquidity across jurisdictions in response to changes in monetary conditions, while Morais et al. (2019) identify an international bank lending channel through which monetary policy in one country affects credit conditions in another. Related evidence by Schnabl (2012) highlights how funding shocks originating in major financial centers propagate to emerging markets through banking networks. Together, these studies establish that banks

play a pivotal role in the transmission of monetary policy, both domestically and internationally. More recently, Giraldo et al. (2025) show that U.S. monetary policy shocks have significant effects on bank lending in Latin America, highlighting the continued importance of banking channels for the transmission of monetary conditions across emerging-market financial systems.

An additional dimension of monetary transmission arises in financially integrated economies. Cao and Dinger (2022) show that favorable global funding conditions can weaken the effectiveness of domestic monetary policy by allowing banks to rely on alternative sources of funding and expand lending despite domestic policy tightening. Their findings underscore the importance of considering funding structures and financial integration when assessing the transmission of monetary policy, particularly in emerging economies that are increasingly connected to global financial markets.

Despite these advances, most of the literature has concentrated on the asset side of bank balance sheets. Comparatively little attention has been devoted to deposits, even though they remain the primary source of funding for commercial banks in most economies. This omission is important because banks do not operate in perfectly competitive funding markets. Depositors often face search costs, switching costs, informational frictions, and limited financial alternatives, allowing banks to exercise a degree of market power over their funding base. As a result, changes in policy rates need not be fully reflected in the remuneration offered to depositors.

This observation lies at the heart of the deposit channel of monetary policy developed by Drechsler et al. (2017). Their framework departs from the traditional view that deposits passively finance lending activity and instead treats deposit markets as an active component of monetary transmission. In the presence of imperfect competition, banks adjust deposit rates less than one-for-one with changes in policy rates. Consequently, when central banks tighten monetary policy, banks can increase the spread between the policy rate and the interest paid on deposits. This widening spread reduces the relative attractiveness of bank deposits, encourages deposit outflows toward alternative assets, and ultimately affects banks' ability to fund credit creation. Using U.S. data, Drechsler et al. (2017) show that increases in policy rates are associated with lower deposit growth, larger deposit spreads, and weaker loan supply, providing strong empirical support for this mechanism.

The growing importance of the deposit channel has motivated a broader reconsideration of the role of deposits within modern banking. Drechsler et al. (2021) argue that deposits constitute a valuable franchise precisely because banks are not required to fully pass higher interest rates through to depositors. In this sense, deposits provide banks with a relatively stable and inexpensive source of funding, particularly during periods of rising interest rates. Similarly, Egan et al. (2022) show that differences in the value of deposit franchises help explain substantial variation in bank valuations, suggesting that deposits represent a critical source of

bank profitability. From a broader theoretical perspective, Bianchi and Bigio (2022) emphasize the importance of banks' liquidity management decisions in shaping monetary transmission, reinforcing the notion that liability-side adjustments are fundamental to understanding how monetary policy affects financial intermediation.

Recent research has also linked the transmission of monetary policy to broader features of bank balance sheets and funding structures. Gambacorta (2008) shows that banks' interest-rate setting behavior reflects both market conditions and institution-specific characteristics, highlighting the importance of balance-sheet factors in the pass-through of monetary policy. Related work by Borio et al. (2017) documents that monetary policy has important implications for bank profitability, while Gambacorta and Shin (2018) emphasize the role of bank capital in shaping the transmission of policy shocks. Similarly, Altunbas et al. (2010) show that monetary policy can influence banks' risk-taking behavior, suggesting that policy-rate changes affect financial intermediaries through multiple and interconnected channels. Taken together, this literature reinforces the broader view that understanding monetary transmission requires attention not only to lending decisions but also to the funding, profitability, and balance-sheet dynamics of financial institutions.

A key implication of the deposit-channel framework is that market structure should influence the effectiveness of monetary policy. The ability of banks to widen deposit spreads depends critically on the degree of competition they face. Where banks possess substantial market power, they can adjust deposit rates sluggishly following changes in policy rates and retain a larger share of the resulting interest margin. Conversely, more competitive banking systems should exhibit stronger pass-through from policy rates to deposit rates. Wang et al. (2022) provide evidence that bank market power plays a significant role in shaping monetary transmission, while Claessens and Laeven (2004) document substantial differences in competitive conditions across banking systems around the world. Likewise, Beck et al. (2006) show that banking market structure has important implications for financial-sector outcomes. Taken together, these findings suggest that the strength of the deposit channel is likely to vary across countries according to the degree of concentration and competition within their banking sectors.

Recent research has also highlighted the importance of depositor outside options. The sensitivity of deposits to monetary policy depends not only on banks' pricing decisions but also on the availability of competing financial assets. Xiao (2020) argues that the growth of shadow banking expands households' investment opportunities and affects the transmission of monetary policy through deposit markets. Relatedly, Schaffer and Segev (2022) revisit the empirical evidence on the deposits channel and show that the response of lending to monetary policy depends importantly on how market power is measured and on the composition of banks included in the analysis, highlighting that the mechanisms linking deposits, market power, and lending remain an active area of research. Similarly, Lin (2020) documents that households actively reallocate funds

between bank deposits and equity markets as relative returns change. These mechanisms imply that the responsiveness of deposits to monetary policy may differ substantially across financial systems characterized by varying levels of market development and financial sophistication.

While the deposit channel has become an increasingly important topic in banking research, the existing evidence remains concentrated almost entirely on advanced economies, particularly the United States. This represents a significant gap in the literature. Emerging and developing economies differ from advanced countries along several dimensions that are directly relevant to the deposit channel, including the degree of financial development, banking concentration, inflation volatility, monetary-policy credibility, and access to alternative savings instruments. These factors may influence both the willingness of depositors to respond to changes in interest rates and the ability of banks to exercise market power over their funding base. Indeed, Mishra et al. (2014) document substantial heterogeneity in monetary transmission across developing economies, while more recent evidence suggests that banking responses to monetary policy may differ systematically between advanced and emerging-market settings.

Our paper contributes to this literature by providing, to our knowledge, one of the first large-scale cross-country examinations of the deposit channel of monetary policy in emerging and developing economies. Drawing on a panel of more than 1,600 banks across 52 countries between 1996 and 2021, we investigate whether increases in policy rates reduce deposit growth and widen deposit spreads, as predicted by the theoretical framework of Drechsler et al. (2017). We further examine how market concentration and banking-sector structure shape these relationships. By focusing on the liability side of bank balance sheets across a broad set of emerging economies, our analysis provides new evidence on an increasingly important but still understudied dimension of monetary policy transmission.

3. Methodology

We test two hypotheses related to the transmission of monetary policy via the deposit channel, as discussed in the introduction. First, we examine whether changes in the domestic monetary policy interest rate affect deposit dynamics, and whether this association is negative. To this end, we use an unbalanced annual panel of banks with bank and year fixed effects (Two Way Fixed Effects - TWFE). Second, within the same TWFE-panel specification, we test whether an increase in the monetary policy rate of each country has a negative effect on the deposit spread charged by banks.

Following Drechsler et al. (2017), we define the bank-level deposit spread as the difference between the domestic monetary policy rate and the bank's implied deposit rate (interest expenses divided by total customer deposits). Although domestic policy rates are potentially endogenous to country-average deposit spreads, using the bank-level spread as our dependent variable mitigates this concern. The negative relationship between deposit growth and the policy rate, alongside a positive association between the spread and the policy rate, is consistent with an imperfectly competitive market. In this structure, banks maximize profits by widening deposit spreads when the reference rate rises. Both specifications include bank- and country-level controls, while time fixed effects absorb global confounders that simultaneously affect all banks. Finally, standard errors are clustered at the country level, corresponding to the level at which monetary policy is defined.

For the annual change in deposits, we begin with a simple baseline specification that consists only of fixed effects and the monetary policy rate variable (Model 1). We then extend this regression by adding macroeconomic control variables (Model 2). In continuation, we incorporate bank-level controls (Model 3) and, finally, in Model 4, we include an additional indicator of market concentration. The following four equations correspond to our four models of deposits growth:

$$\Delta dep_{it} = \alpha_i + \gamma_t + \beta_{mp} MPR_{it} + \varepsilon_{it}, \quad (1)$$

$$\Delta dep_{it} = \alpha_i + \gamma_t + \beta_{mp} MPR_{ct} + \beta'_c \mathbf{Country}_{ct} + \varepsilon_{it}, \quad (2)$$

$$\Delta dep_{it} = \alpha_i + \gamma_t + \beta_{mp} MPR_{ct} + \beta'_c \mathbf{Country}_{ct} + \beta'_b \mathbf{Bank}_{it} + \varepsilon_{it}, \quad (3)$$

$$\Delta dep_{it} = \alpha_i + \gamma_t + \beta_{mp} MPR_{ct} + \beta'_c \mathbf{Country}_{ct} + \beta'_b \mathbf{Bank}_{it} + \beta'_{co} \mathbf{Conc}_{ct} + \varepsilon_{it}, \quad (4)$$

where Δdep_{it} is annual growth rate of deposits at bank i in year t . α_i and γ_t correspond to bank- and time-fixed effects; MPR_{ct} is the domestic monetary policy rate in country c at year t ; $\mathbf{Country}_{ct}$ is a (4×1) vector that consists of four control variables at the country level, namely, inflation, GDP growth, Market capitalization and Deposits to GDP, the last two measuring the size of the financial system in a given country. $\mathbf{Bank}_{it}$ is a vector of (5×1) controls at the bank level, including solvency, profitability and liquidity ratios, alongside size (log of total assets) and the current ratio. Finally, in $\mathbf{Conc}_{ct}$ which is a vector of (2×1) we have included an indicator of bank concentration (share of the top 3 banks in total assets of banks) and the Herfindahl-Hirschman Index.

In equations 5 to 8 we focus on modelling the deposit spreads. We run the same specifications than before. This time we define as the dependent variable the deposit spread of bank i in year t , $spread_{it}$, as follows:

$$spread_{it} = \alpha_i + \gamma_t + \beta_{mp}MPR_{it} + \varepsilon_{it}, \quad (5)$$

$$spread_{it} = \alpha_i + \gamma_t + \beta_{mp}MPR_{ct} + \beta'_c \mathbf{Country}_{ct} + \varepsilon_{it}, \quad (6)$$

$$spread_{it} = \alpha_i + \gamma_t + \beta_{mp}MPR_{ct} + \beta'_c \mathbf{Country}_{ct} + \beta'_b \mathbf{Bank}_{it} + \varepsilon_{it}, \quad (7)$$

$$spread_{it} = \alpha_i + \gamma_t + \beta_{mp}MPR_{ct} + \beta'_c \mathbf{Country}_{ct} + \beta'_b \mathbf{Bank}_{it} + \beta'_{co} \mathbf{Conc}_{ct} + \varepsilon_{it}, \quad (8)$$

4. Data

Our empirical analysis relies on an unbalanced panel dataset covering a broad sample of emerging and developing economies over the period 1996-2021. Bank-level data from BankFocus were combined with macroeconomic indicators sourced from the IMF and the World Bank, while the domestic monetary policy rate was compiled using information from the IMF, LSEG, Bloomberg, and national central bank sources (see Table 1).

To reduce the influence of extreme observations, all continuous variables were winsorized at the 1st and 99th percentiles. Taking as a reference our empirical specifications for the spread, our baseline sample initially consists of 18,018 observations across 1,635 banks in 52 countries. However, as explained in the last section, our empirical framework requires the inclusion of an extensive set of macroeconomic controls, bank-specific characteristics, and market concentration indicators. Once data availability across all dimensions is considered, the strictest specification employed by our analysis (Model 4) retains 12,117 observations representing 1,301 unique banks across 28 countries. These countries include major emerging and advanced economies such as Argentina, Brazil, China, India, Indonesia, Mexico, Russia, Turkey, and Vietnam, thereby ensuring broad geographic coverage and substantial variation in banking and macroeconomic conditions. See Tables A1 and A2, in the Appendix, for the full set of countries and banks included in our empirical analysis.

Our main analysis focuses primarily on understanding how monetary policy affects bank-deposit growth and the spread charged on those deposits. The main dependent variables are Bank Deposit Growth ($deposits_d$) and the Deposit Spread (dep_spr), both constructed using BankFocus microdata. Bank Deposit Growth has an average value of 10.24% annual growth. At the same time, the relatively large standard deviation of 42.61

highlights substantial heterogeneity across banks and macroeconomic environments in our sample. The distribution ranges from sharp deposit contractions, with a minimum value of -137.66, to periods of notable deposit increments, with a maximum of 194.43.

Our dependent variable, the Deposit Spread, averages -3.39%, while the median stands at 1.03%. Its notably high standard deviation of 29.88 reflects significant cross-country and cross-bank variation in pricing power, funding structures, and intermediation costs within the banking sector.

The key explanatory variable is the domestic Monetary Policy Rate (*mp_rate*). Across the sample, the policy rate averages 9.77%, with a median value of 7 %, ranging from as low as 0.50% in accommodative monetary environments to as high as 74.77% during episodes of severe monetary tightening.

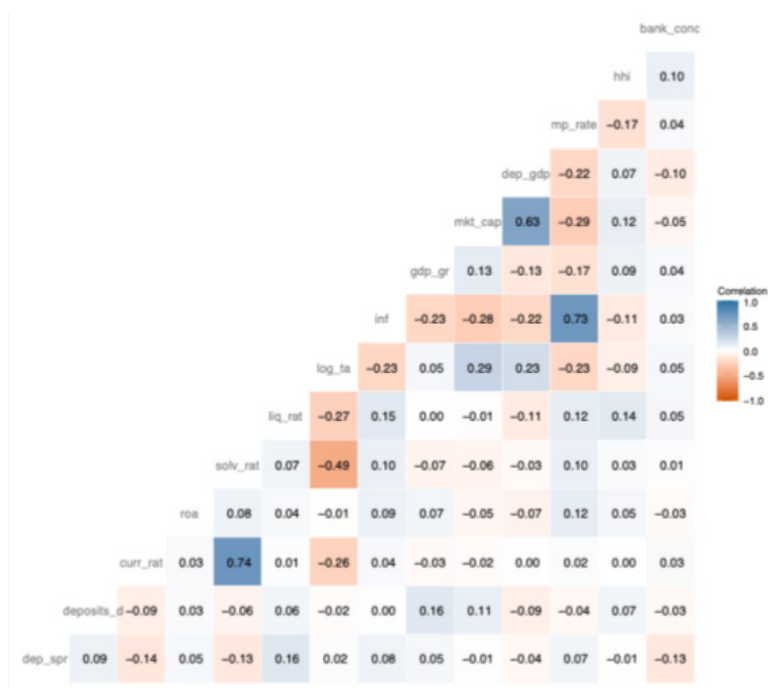
Table 1. Summary Statistics of the Variables in Our Sample

<i>Indicator</i>	<i>Abbreviation</i>	<i>Source</i>	<i>Mean</i>	<i>Median</i>	<i>Std.Dev</i>	<i>Max.</i>	<i>Min.</i>
<i>Deposit Spread</i>	<i>dep_spr</i>	Constructed-Bank Focus	-3.39	1.03	29.88	22.08	-242.56
<i>Bank Dep Growth</i>	<i>deposits_d</i>	Constructed-Bank Focus	12.69	10.24	42.61	194.43	-137.66
<i>Current Ratio</i>	<i>curr_rat</i>	BankFocus	150.24	115.25	170.56	1583.61	100.31
<i>Return on Assets</i>	<i>roa</i>	BankFocus	1.18	1.07	2.56	10.41	-11.36
<i>Solvency Ratio</i>	<i>solv_rat</i>	BankFocus	19.07	13.20	17.26	93.92	0.68
<i>Liquidity Ratio</i>	<i>liq_rat</i>	BankFocus	13.77	10.18	12.90	66.03	0.00
<i>Log Total Assets</i>	<i>log_ta</i>	BankFocus	13.02	13.02	2.36	18.37	7.58
<i>Inflation</i>	<i>inf</i>	IMF	9.37	5.90	13.50	85.70	-1.30
<i>GDP Growth</i>	<i>gdp_gr</i>	IMF	4.32	4.97	4.33	13.97	-10.89
<i>Market Cap</i>	<i>mkt_cap</i>	World Bank	40.43	34.91	27.75	145.59	1.81
<i>Deposits to GDP</i>	<i>dep_gdp</i>	World Bank	38.73	36.65	21.46	118.84	4.68
<i>Monetary Policy Rate</i>	<i>mp_rate</i>	IMF, LSEG, Bloomberg and National sources	9.77	7.00	10.62	74.77	0.50
<i>Herfindahl-Hirschman Index</i>	<i>hhi</i>	Constructed-Bank Focus	0.00	-0.26	1.00	3.80	-0.82
<i>Bank Concentration</i>	<i>bank_conc</i>	World Bank	54.17	51.87	18.68	100.00	19.28

Note: This table presents descriptive statistics (mean, median, standard deviation, minimum, and maximum) for the variables analysed between 1996 and 2021. Bank-specific data are obtained from BankFocus, macroeconomic indicators from the IMF and World Bank, and the Monetary Policy Rate was assembled from different sources including the IMF, LSEG, Bloomberg and national sources. To limit the effects of extreme values, all continuous variables are winsorized at the 1st and 99th percentiles.

To isolate the effects of monetary policy on bank outcomes, the empirical specifications incorporate a broad range of macroeconomic and bank-level controls. GDP Growth (gdp_gr) averages 4.32% across the sample period, although the data capture episodes of severe economic downturns, with a minimum value of -10.89%. Inflation (inf) averages 9.37% but exhibits substantial right skewness, reaching a maximum of 85.70% in high-inflation environments. The correlation matrix reveals a strong positive relationship of 0.73 between inflation and the monetary policy rate (see Figure 1), consistent with conventional central bank reaction functions. Broader financial development and market depth are captured through Market Capitalization (mkt_cap) and Deposits to GDP (dep_gdp), which average 40.43 and 38.73, respectively.

Figure 1. Correlation matrix between the variables in our sample



Note: The figure shows the pair-wise Pearson's correlation between the variables in our sample.

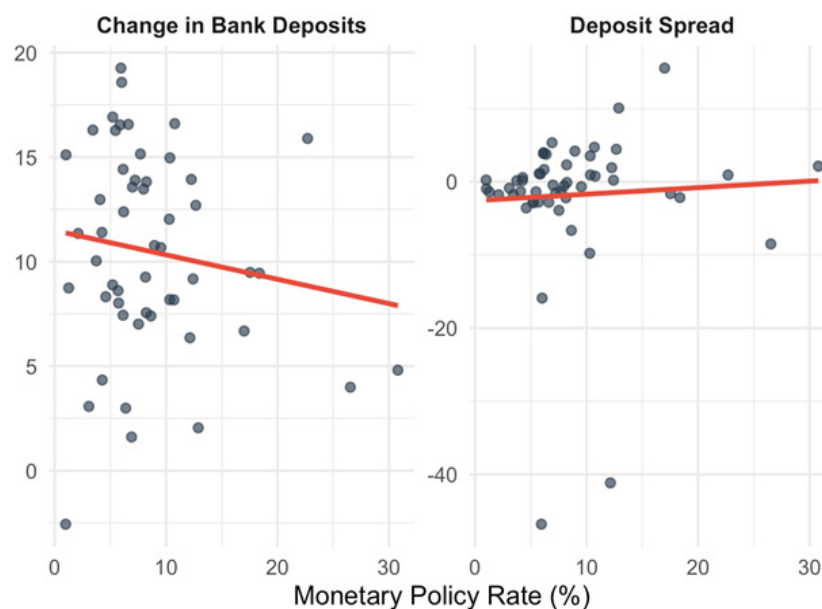
In addition, several bank-specific controls are included to account for institutional resilience and balance sheet structures. Log Total Assets (log_ta) captures bank size and exhibits a relatively normal distribution around a mean value of 13.02. Return on Assets (roa), used as a measure of profitability, averages 1.18% in our sample, although it ranges down to -11.36% for severely distressed institutions. The Solvency Ratio (solv_rat) and Liquidity Ratio (liq_rat), with mean values of 19.07% and 13.77% respectively, account for capital adequacy and prudential liquidity buffers. Finally, the Current Ratio (curr_rat) averages 150.24%, suggesting that banks in the sample generally maintain sufficient short-term assets to meet immediate liabilities.

5. Results

5.1. Deposit Growth

We begin by examining the relationship between monetary policy and bank deposit growth. Figure 2 provides a first look at the data. Countries with higher monetary policy rates tend to exhibit lower rates of deposit growth, suggesting a negative association between monetary tightening and the accumulation of bank funding. While this relationship is only descriptive, it is consistent with the central prediction of the deposit-channel framework.

Figure 2. Preliminary Evidence on the Deposit Channel of Monetary Policy



Note: The figure plots our dependent variables against the monetary policy rate taking averages within countries for the two dependent variables.

Table 2 presents the regression results. Across all specifications, increases in the monetary policy rate are associated with slower deposit growth. The estimated coefficient is negative and statistically significant in every model, and its magnitude remains remarkably stable as controls are introduced sequentially. In the baseline specification, a one-percentage-point increase in the policy rate is associated with a decli-

ne of approximately 0.8 percentage points in annual deposit growth. Once macroeconomic controls are included, the magnitude increases to roughly 1.4 percentage points and remains close to that level after controlling for bank characteristics and measures of market structure.

Table 2. The Impact of the References Interest Rate on Bank Deposits Growth

<i>Dependent Var.:</i>	<i>Model 1 Bank Dep Growth</i>	<i>Model 2 Bank Dep Growth</i>	<i>Model 3 Bank Dep Growth</i>	<i>Model 4 Bank Dep Growth</i>
<i>Monetary Policy Rate</i>	-0.7738* (0.3150)	-1.444* (0.6958)	-1.495* (0.6575)	-1.488* (0.6359)
<i>Inflation</i>		0.5754. (0.3298)	0.7246* (0.3143)	0.7861* (0.3722)
<i>GDP Growth</i>		1.562** (0.4580)	1.784*** (0.4487)	1.619*** (0.3964)
<i>Market Cap</i>		0.2841** (0.0974)	0.2787* (0.1259)	0.3020* (0.1288)
<i>Deposits to GDP</i>		-0.2746* (0.1224)	-0.2720* (0.1260)	-0.5529** (0.1639)
<i>Current Ratio</i>			-0.0385. (0.0193)	-0.0377. (0.0193)
<i>Return on Assets</i>			0.6314* (0.2846)	0.6485* (0.3074)
<i>Solvency Ratio</i>			-0.4135** (0.1385)	-0.4033** (0.1396)
<i>Liquidity Ratio</i>			0.2514*** (0.0682)	0.2101* (0.0801)
<i>Log Total Assets</i>			4.781. (2.763)	6.120* (2.655)
<i>Herfindahl-Hirschman Index</i>				-3.465* (1.570)
<i>Bank Concentration</i>				0.2992*** (0.0791)
Fixed-Effects:				
<i>Bank</i>	Yes	Yes	Yes	Yes
<i>Year</i>	Yes	Yes	Yes	Yes
S.E.: Clustered	by: Country	by: Country	by: Country	by: Country
<i>Observations</i>	17,164	11,828	11,086	11,024
<i>G</i>	52	30	29	28
<i>R2</i>	0.21646	0.23636	0.27082	0.27563
<i>Adj. R2</i>	0.13335	0.14001	0.17714	0.18198
<i>F-test</i>	0.70447	0.40799	0.38517	0.35427

Note: This table outlines panel regression results detailing the influence of monetary policy on bank deposit growth (1996-2021). The dependent variable is Bank Deposit Growth. Macroeconomic, bank-specific and market concentration controls are added stepwise in Models 1 through 4. Unobserved heterogeneity is absorbed using bank and year fixed effects in all regressions. Robust standard errors clustered by country are reported in parentheses. *** p < 0.001, ** p < 0.01, * p < 0.05, . p < 0.1.

The stability of the coefficient is noteworthy. Adding controls for inflation, economic growth, financial development, bank balance-sheet characteristics, and banking concentration does little to alter the estimated relationship between monetary policy and deposits. This suggests that the result captures a broad and systematic response of bank funding to monetary conditions rather than reflecting differences in the composition of banking systems across countries.

The estimated effects are also economically meaningful. Consider a monetary tightening episode involving a five-percentage-point increase in the policy rate, a magnitude that is far from unusual in our sample. Based on the estimates from Model 4, such a policy change would be associated with a reduction of roughly 7.5 percentage points in annual deposit growth. Given that average deposit growth in the sample is around 10 percent, the implied effect is substantial.

These findings are consistent with the mechanism proposed by Drechsler et al. (2017). If banks do not fully pass higher policy rates through to depositors, deposits become relatively less attractive as savings vehicles. Households and firms may then reallocate part of their portfolios toward alternative assets, reducing the growth of deposits within the banking system. While the existing evidence on this mechanism comes primarily from advanced economies, our results suggest that a similar process operates across a broad set of emerging and developing countries.

The finding is particularly interesting because the effect was not obvious ex-ante. Emerging markets differ from advanced economies along several dimensions that could influence deposit behavior. Higher inflation volatility, less developed financial markets, and varying degrees of banking competition all have the potential to alter the transmission of monetary policy. Yet despite this heterogeneity, the negative relationship between policy rates and deposit growth emerges consistently across specifications.

Turning briefly to the controls, GDP growth is positively associated with deposit growth throughout the analysis. This is intuitive: stronger economic activity generates income, profits, and transaction balances that ultimately find their way into the banking system. Market capitalization is also positively related to deposit growth, suggesting that banking development and capital-market development tend to move together rather than acting as substitutes. At the bank level, larger, more profitable, and more liquid institutions generally experience faster deposit growth, consistent with the idea that depositors value safety, reputation, and financial strength.

5.2. Deposit Spreads

Table 3 examines the second prediction of the deposit-channel framework. If banks possess market power in deposit markets, monetary tightening should allow them to widen the spread between policy rates and deposit remuneration. The results strongly support this hypothesis.

Table 3. The Impact of the References Interest Rate on Bank Deposit Spreads

<i>Dependent Var.:</i>	<i>Model 1 Bank Dep Spread</i>	<i>Model 2 Bank Dep Spread</i>	<i>Model 3 Bank Dep Spread</i>	<i>Model 4 Bank Dep Spread</i>
<i>Monetary Policy Rate</i>	0.4520*** (0.0778)	0.3986*** (0.0965)	0.3584** (0.1188)	0.5893** (0.1964)
<i>Inflation</i>		0.1186 (0.1380)	0.1643 (0.1344)	0.2432. (0.1293)
<i>GDP Growth</i>		0.1906 (0.1479)	0.1920 (0.1416)	0.3150* (0.1403)
<i>Market Cap</i>		0.0122 (0.0202)	0.0006 (0.0267)	0.0171 (0.0203)
<i>Current Ratio</i>			-0.0232* (0.0088)	-0.0274** (0.0082)
<i>Return on Assets</i>			0.3016 (0.2508)	0.2118 (0.2287)
<i>Solvency Ratio</i>			-0.0561 (0.1031)	0.0055 (0.0841)
<i>Liquidity Ratio</i>			0.0249 (0.0300)	0.0277 (0.0283)
<i>Log Total Assets</i>			2.055 (1.224)	2.517. (1.386)
<i>Deposits to GDP</i>				0.0828 (0.0821)
<i>Herfindahl-Hirschman Index</i>				0.5202 (0.8891)
<i>Bank Concentration</i>				0.0156 (0.0244)
Fixed-Effects:				
<i>Bank</i>	Yes	Yes	Yes	Yes
<i>Year</i>	Yes	Yes	Yes	Yes
S.E.: Clustered	by: Country	by: Country	by: Country	by: Country
<i>Observations</i>	18,018	12,507	12,202	11,922
<i>G</i>	52	30	29	28
<i>R2</i>	0.64524	0.67397	0.68103	0.68561
<i>Adj. R2</i>	0.60938	0.63432	0.64201	0.64629
<i>F-test</i>	4.6379	2.8548	2.2994	2.0303

Note: This table outlines panel regression results detailing the influence of monetary policy on bank deposit spreads (1996-2021). The dependent variable is Bank Deposit Spread. Macroeconomic, bank-specific and market concentration controls are added stepwise in Models 1 through 4. Unobserved heterogeneity is absorbed using bank and year fixed effects in all regressions. Robust standard errors clustered by country are reported in parentheses. *** p < 0.001, ** p < 0.01, * p < 0.05, . p < 0.1.

The coefficient on the monetary policy rate is positive and statistically significant in every specification. In the baseline model, a one-percentage-point increase in the policy rate is associated with a rise of approximately 0.45 percentage points in the deposit spread. The estimate remains significant after introducing macroeconomic controls, bank characteristics, and measures of banking concentration. In the most demanding specification, the coefficient increases to roughly 0.59.

From an economic perspective, these results are perhaps even more informative than the deposit-growth regressions. A positive relationship between policy rates and deposit spreads indicates that banks do not pass monetary tightening fully through to depositors. Instead, part of the increase in policy rates is retained by banks in the form of higher funding margins.

This pattern is difficult to reconcile with a perfectly competitive deposit market. Under full competition, deposit rates would be expected to adjust nearly one-for-one with changes in policy rates, leaving spreads broadly unchanged. The positive coefficients reported in Table 3 therefore point toward the existence of market power in deposit markets and provide direct support for the mechanism emphasized by Drechsler et al. (2017).

The magnitude of the effect is again sizeable. In the preferred specification, a five-percentage-point increase in the policy rate is associated with an increase in deposit spreads of almost three percentage points. Such changes are likely to have meaningful consequences for bank profitability and funding conditions, particularly during prolonged periods of monetary tightening.

Some of the control variables also yield interesting insights. Banks with stronger liquidity positions tend to exhibit narrower deposit spreads, perhaps because they face less pressure to generate funding income from their deposit base. GDP growth enters positively in the most comprehensive specification, suggesting that stronger economic conditions may increase banks' ability to maintain wider spreads. More broadly, however, the dominant result in Table 3 is the strong and persistent relationship between monetary policy and deposit pricing.

5.3. Discussion

The most important insight from the analysis emerges when Tables 2 and 3 are considered jointly. Monetary tightening is associated with wider deposit spreads and slower deposit growth. These findings are not independent; rather, they appear to be two sides of the same mechanism.

The spread regressions suggest that banks respond to higher policy rates by increasing the gap between policy rates and deposit remuneration. The deposit-growth regressions indicate that deposit accumulation slows at the same time. Taken together, these results are consistent with the view that depositors respond to lower relative returns by reducing the pace at which funds flow into the banking system. In other words, the pricing response of banks and the quantity response of depositors appear to move in the direction predicted by the deposit-channel literature.

More broadly, the results highlight the importance of the liability side of bank balance sheets in the transmission of monetary policy. Much of the existing literature focuses on how policy rates influence lending behavior. Our findings suggest that monetary policy also affects the funding side of banking, altering both the price and the availability of deposits. In economies where deposits remain the dominant source of funding, these effects may be particularly important.

The policy implications are straightforward. First, monetary authorities should pay closer attention to deposit markets when evaluating the transmission of policy decisions. Changes in policy rates affect not only borrowing costs but also the funding conditions faced by banks. Second, the results suggest that the structure of the banking sector may influence the effectiveness of monetary policy. To the extent that market power enables banks to widen deposit spreads, competition in deposit markets becomes relevant for understanding the strength of monetary transmission. Finally, the findings imply that prolonged tightening cycles may affect financial intermediation through channels that extend beyond credit supply. In banking systems heavily reliant on deposits, weaker deposit growth may eventually influence the capacity of banks to expand their balance sheets and support economic activity.

The evidence points to a meaningful deposit channel of monetary policy in emerging and developing economies. While the existing literature has largely documented this mechanism in advanced economies, our results indicate that it is also relevant in countries where banks remain the central institutions of financial intermediation and deposits continue to constitute the primary source of funding.

6. Conclusions

How monetary policy affects the banking system remains one of the central questions in macroeconomics and finance. While most of the literature has focused on the consequences of monetary policy for lending activity, much less attention has been devoted to the funding side of banks' balance sheets. This omission is somewhat surprising. Deposits remain the primary source of funding for commercial banks in most emerging and developing economies, and changes in deposit behavior can shape the ability of banks to intermediate savings and credit.

This paper studies the deposit channel of monetary policy using a large cross-country sample of banks from emerging and developing economies. Drawing on data for more than 1,600 banks across 52 countries over the period 1996-2021, we study whether monetary tightening affects both the quantity of deposits held within the banking system and the spread banks earn on those deposits.

Two findings stand out. First, increases in monetary policy rates are consistently associated with slower deposit growth. Second, higher policy rates are associated with wider deposit spreads. Both results are robust to the inclusion of macroeconomic controls, bank-level characteristics, and measures of banking-sector concentration.

Individually, each finding is informative. Together, they tell a more interesting story. Banks appear to respond to monetary tightening by increasing the gap between policy rates and the remuneration offered to depositors. At the same time, deposit growth weakens. This combination of outcomes is precisely what one would expect if deposits were not supplied in a perfectly competitive market and if depositors responded, at least in part, to changes in the relative attractiveness of alternative assets.

In this sense, our evidence supports the view that deposits are not merely a passive source of bank funding. Rather, they constitute an active component of the monetary transmission mechanism. Monetary policy affects not only the terms on which banks lend but also the conditions under which they attract and retain funding. For emerging economies, where bank-based financial systems continue to dominate the allocation of savings, this distinction is particularly important.

The results also offer a broader lesson. Discussions of monetary transmission often focus on borrowers. Yet every loan has a funding source, and the behavior of depositors is an equally important part of the transmission process. Understanding how households and firms adjust their savings decisions following changes in policy rates is therefore essential for understanding how monetary policy ultimately influences financial intermediation and economic activity.

From a policy perspective, these findings suggest that central banks may benefit from paying closer attention to developments in deposit markets when evaluating the effects of monetary-policy decisions. Changes in policy rates influence not only borrowing costs but also the availability and cost of funding within the banking sector. In banking systems that rely heavily on deposits, these effects may have important implications for the strength and timing of monetary transmission.

Several questions remain open. The strength of the deposit channel is likely to depend on factors such as banking competition, financial development, depositor sophistication, and the availability of alternative savings instruments. Understanding how these factors shape the transmission of monetary policy represents a promising avenue for future research. Likewise, exploring how changes in deposit funding affect lending, risk-taking, and financial stability would help provide a more complete picture of the role played by deposits in modern banking systems.

The renewed attention given to bank funding following the global tightening cycle of the early 2020s has reminded policymakers and researchers alike that liabilities matter. The evidence presented in this paper suggests that they matter not only for financial stability, but also for the transmission of monetary policy itself. Any comprehensive account of how monetary policy affects banks, particularly in emerging economies, must therefore look beyond credit and consider the dynamics of deposits as well.

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Appendix

Table A1. Countries in Our Sample

<i>Countries in Model 1</i>			<i>Countries in Model 4</i>	
1	Afghanistan	Kyrgyzstan	Argentina	Uzbekistan
2	Albania	Laos	Armenia	Vietnam
3	Argentina	Malaysia	Azerbaijan	
4	Armenia	Mexico	Bangladesh	
5	Azerbaijan	Moldova	Belarus	
6	Bangladesh	Mongolia	Brazil	
7	Belarus	Myanmar (Burma)	Bulgaria	
8	Belize	Nepal	Chile	
9	Brazil	Nicaragua	China	
10	Bulgaria	North Macedonia	Colombia	
11	Chile	Pakistan	Costa Rica	
12	China	Papua New Guinea	Hungary	
13	Colombia	Paraguay	India	
14	Costa Rica	Peru	Indonesia	
15	Dominican Republic	Philippines	Jamaica	
16	Fiji	Romania	Kazakhstan	
17	Georgia	Russia	Malaysia	
18	Grenada	Serbia	Mexico	
19	Guatemala	St. Lucia	Pakistan	
20	Haiti	Tajikistan	Peru	
21	Honduras	Thailand	Romania	
22	Hungary	Turkey	Russia	
23	India	Ukraine	Serbia	
24	Indonesia	Uruguay	Thailand	
25	Jamaica	Uzbekistan	Turkey	
26	Kazakhstan	Vietnam	Ukraine	

Note: This tables shows countries with information for at least one bank in our sample for the most restrictive (model 4) and the less restrictive model (model 1).

Table A2. Number of Banks per Country in Our Extended Sample (Model 1)

<i>ISO-3 Code</i>	<i>Country Name</i>	<i>N. of Banks</i>	<i>N. of Obs</i>	<i>ISO-3 Code</i>	<i>Country Name</i>	<i>N. of Banks</i>	<i>N. of Obs</i>
AFG	Afghanistan	10	55	KGZ	Kyrgyzstan	14	117
ALB	Albania	7	66	LAO	Laos	13	52
ARG	Argentina	52	570	LCA	St. Lucia	3	13
ARM	Armenia	10	96	MDA	Moldova	9	84
AZE	Azerbaijan	16	126	MEX	Mexico	41	430
BGD	Bangladesh	46	503	MKD	North Macedonia	10	115
BGR	Bulgaria	14	140	MMR	Myanmar (Burma)	12	68
BLR	Belarus	20	366	MNG	Mongolia	9	78
BLZ	Belize	6	54	MYS	Malaysia	27	250
BRA	Brazil	107	938	NIC	Nicaragua	5	10
CHL	Chile	3	31	NPL	Nepal	65	659
CHN	China	144	1217	PAK	Pakistan	24	168
COL	Colombia	20	257	PER	Peru	21	311
CRI	Costa Rica	12	142	PHL	Philippines	23	240
DOM	Dominican Republic	30	266	PNG	Papua New Guinea	4	18
FJI	Fiji	6	65	PRY	Paraguay	11	107
GEO	Georgia	12	66	ROU	Romania	16	142
GRD	Grenada	2	13	RUS	Russia	292	5473
GTM	Guatemala	15	217	SRB	Serbia	17	185
HND	Honduras	17	145	THA	Thailand	23	255
HTI	Haiti	8	16	TJK	Tajikistan	6	34
HUN	Hungary	16	84	TUR	Turkey	32	327
IDN	Indonesia	92	926	UKR	Ukraine	63	742
IND	India	47	623	URY	Uruguay	11	37
JAM	Jamaica	5	44	UZB	Uzbekistan	12	73
KAZ	Kazakhstan	18	140	VNM	Vietnam	137	864

Note: This tables shows the number of banks per country in our less restrictive model (1).



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