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Volume 23, 2013 - Issue 23

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# Bank characteristics and stock reactions to federal funds rate target changes

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Pages 1755-1764 | Published online: 31 Oct 2013

#### **G** Cite this article Attps://doi.org/10.1080/09603107.2013.851770



## Abstract

This study investigates how bank characteristics affect bank stock reactions to changes in the federal funds rate target. Using a data set of all publicly listed banks of the United States from October 1988 through December 2007, we find that (1) the effect of changes in the federal funds rate target is more pronounced on large banks than on small banks; (2) banks that rely more on nondeposit funding sources are more responsive to such changes; (3) banks with higher capital ratios are less sensitive to unexpected target changes, but when the ratio increases to a certain level, the marginal effect diminishes. We observe that business activity mix does not matter to banks' sensitivity to monetary shocks. This study is among the first to investigate how bank stock sensitivity to monetary shocks is conditional on various bank characteristics.

Keywords:



## Notes

<sup>1</sup> The isolation of the surprise elements from the announced target changes is discussed later in the article.

<sup>2</sup> Data is available at

http://chicagoFed.org/economic\_research\_and\_data/bhc\_data\_2001\_2006.cfm, accessed 26 December 2008.

<sup>3</sup> FDIC, http://www2.fdic.gov/hsob/index.asp, accessed 2 January 2009.

 <sup>4</sup> FDIC's Risk Management Manual of Examination Policies (Section 6.1: Liquidity and Funds Management), available at http://www.fdic.gov/regulations/safety/manual/section6-1.html, accessed 5 January 2009.

<sup>5</sup> On 3 October 2008, FDIC deposit insurance temporarily increased from \$100 000 to \$250 000 per depositor per insured bank through 31 December 2009. Later the new coverage of \$250 000 was extended to 31 December 2013.

<sup>6</sup> The method to isolate the unexpected components from the announced or raw changes is discussed in Kuttner (2001) and Bernanke and Kuttner (2005). See Yin et al. (2007) for the separation of expected and unexpected target changes.

<sup>7</sup> Summary statistics for the 183 events are available upon request.

<sup>8</sup> The bank stock prices used to calculate one-day holding period returns are adjusted for dividends.

<sup>9</sup> See Lown et al. (2000) for details.

<sup>10</sup> Returns on assets (ROA) and the capital-to-asset ratios (CAR) for banks are available on an annual basis from Bankscope. Standard deviations of returns on assets (SROA) are calculated only for banks with at least four consecutive years of ROA data.

<sup>11</sup> Correlation data is available upon request.

<sup>12</sup> Results are available upon request.

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