Online banks and financial stability

Dong Beom Choi
Seoul National University
Online (internet-only) banks

- No branch
- Lower operational costs
- Price advantages
  - Higher interest rates for depositors
  - Lower loan rates
  → Lower net interest margin (NIM)
- Technological advantages
  - Incumbent may catch up eventually…
Benefits: more competition markets

- Lack of competition $\rightarrow$ large margin (i.e., NIM)
  - Lower deposit rates, higher loan rates

- Internet banks offer more attractive pricing
  $\rightarrow$ incumbent changing their pricing to compete
  $\rightarrow$ Good for consumers

- This would decrease bank profitability
- (too much) competition may impair financial stability
- Particularly so in some economies…
Bank profitability and interest rate environment

- Banks borrow short-term to lend long-term
- Long-term rate > short-term rate, making profits
  - Positively sloped yield curve necessary
- When yield curve flat, banks’ net interest margin gets squeezed
  - Online banks’ NIM < (normal) banks’ NIM
- In Japan or Europe, banks are suffering from low NIM (flat yield curve, short-term rate=long-term rate)
Low for too long

- Yield curve flattens, bank cannot make money from their normal business
- Threat financial stability
- More critical for internet banks, or markets with internet banks.
Impairing financial stability

- Capitalization issue
- Risk shifting (reaching for yield), riskier investment
- When yield curve gets flat, not sure if the online bank business model is viable
- Sometimes there is a reason for limiting bank competition to maintain profitability/stability
Funding stability

- Deposits outflow during the crisis (bank run), in particular if public deposit protection is not very credible

- Online bank depositors are yield seekers, (relatively more) sophisticated financially

- Their funding can be flightier during the disruptions