

Monetary policy transmission and non-bank financial intermediation: Four lessons

Discussant: Olivier Darmouni, HEC Paris and CEPR

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ChaMP Conference - Challenges for Monetary Policy Transmission in a Changing World

Loved reading the paper!

- Impressive body of work
- Extreme relevance for policy-makers and academics alike
- Many thought-provoking results

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The Rise of NBFIs

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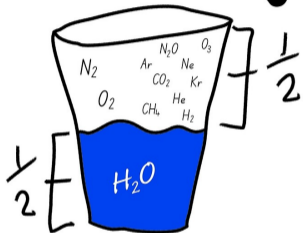
If monetary policy is transmitted through the financial system...

then we better understand its recent radical transformation

My talk: four lessons from the rise of NBFIs

Lesson # 1: The False Dichotomy

Technically

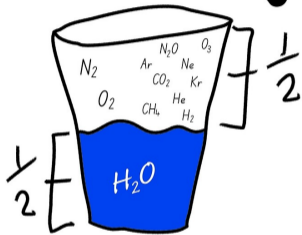


IT'S ALWAYS FULL

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Lesson # 1: The False Dichotomy

Technically



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- “Market-based” finance:
NBFIs embedded in bond/money markets
- but balance sheets + relationships still matter!
- Monetary policy \implies moves markets
 \implies balance sheets of NBFIs
(inflows/outflows, ptf rebalancing)

False dichotomy between market- and intermediated- financing

Lesson # 2: Fragmentation

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Lesson # 2: Fragmentation



- \neq universal banks \implies NBFIs have widely different business model
- Often specializing in certain asset classes
- Some fund themselves short-term, others long-term
e.g.
fund holding HY bonds, liquid liabilities
vs.
insurer holding IG bonds, long-term liabilities
- Complexity of monetary transmission

More fragmentation than ever - across assets/institutions/countries

Lesson # 3: (Un)Conventional Monetary Policy



"Never, ever, think outside the box."

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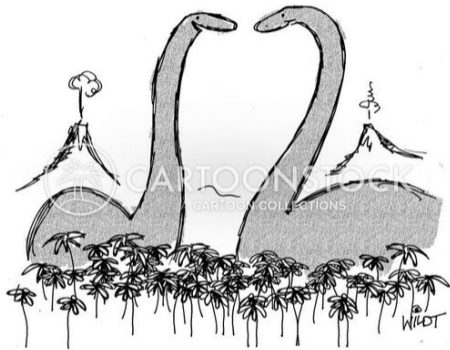
"Never, ever, think outside the box."

- Central bankers need more tools to deal with the complexity of fragmentation
- Unconventional monetary policy tools adapted to rise of NBFIs
- Being able to target specific assets or institutions is a powerful tool
- On the asset side: asset purchases/QE
- Liabilities: liquidity facilities, collateral framework

Unconventional monetary is now conventional

Lesson # 4: Systematic risk

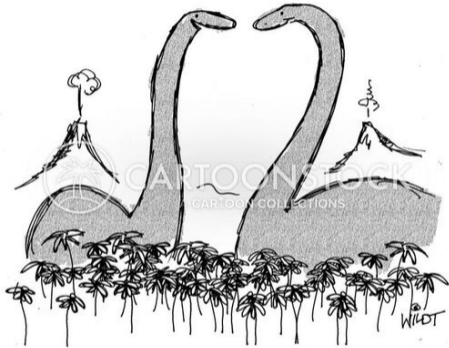
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"You really think so...that we're just too big to fail?"

Lesson # 4: Systematic risk

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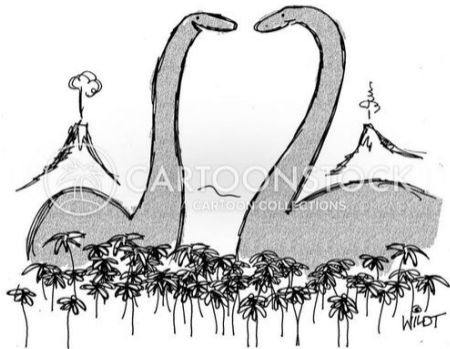


"You really think so...that we're just too big to fail?"

- Traditional crisis: too big, too much leverage
- 2020 bond market turmoil: outflows from many small equity-funded mutual funds
⇒ Systematic risk has not disappeared, it has just transformed

Lesson # 4: Systematic risk

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"You really think so...that we're just too big to fail?"

- Traditional crisis: too big, too much leverage
- 2020 bond market turmoil: outflows from many small equity-funded mutual funds
⇒ Systematic risk has not disappeared, it has just transformed
- Higher capital ratios and breaking down big institutions was not the answer
- Address liquidity spirals and connectedness at the *market/sector* level
⇒ Ex-ante risk-taking and ex-post bailouts have not disappeared, they have just transformed

Systematic risk no longer just about size/leverage

Four lessons of rise of NBFIs

1. **False dichotomy between market- and intermediated- financing**
2. **More fragmentation than ever - across assets/institutions/countries**
3. **Unconventional monetary policy now conventional**
4. **Systematic risk no longer just about size/leverage**

Four lessons of rise of NBFIs

1. **False dichotomy between market- and intermediated- financing**
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Today, we can't understand monetary transmission if we don't understand NBFIs

Causal chain from interest rates to investment, consumption, inflation, now more complex than ever