

# Bank loan portfolios, Federal Home Loan Bank advances and monetary transmission

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## **ABSTRACT**

Using a cross sectional data set from a panel of federally-insured commercial banks that filed Call Reports over the period from 2000:Q1 to 2010:Q4, we examine the sensitivity of loan growth to funding banks obtain from the Federal Home Loan Bank (FHLB) advances program. FHLB advances are a low-risk, low-cost source of loan funding and overall liquidity. Commercial banks may have used FHLB advances to grow their loan portfolio. As a stable source of low-cost funds to commercial banks, FHLB advances may be substituted for deposits drawn out of the financial system during periods of tight monetary policy or when other external funding sources are under financial stress as during the onset of the recent financial crisis. In addition, the availability and use of FHLB advances might insulate commercial banks from the full impact of contractionary monetary policy. This paper also examines this monetary policy insensitivity question.

Our findings strongly support the hypothesis that the sensitivity of loan growth to FHLB advances growth varies over different periods associated with funding conditions in financial markets, in part, because there is little, if any, external finance risk premium embedded in the pricing of FHLB advances. These findings are consistent with the hypothesis that FHLB advances provide a layer of insulation to commercial banks that reduces the impact of distress in financial markets and tight monetary policy, at least initially, on loan growth.

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