The profitability of bank capital and household debt

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Abstract:
When does the banking sector profitability exceed the industrial sector profitability? In a benchmark, counterfactual scenario where banks lend to industrial firms only, the industrial profitability exceeds the bank profitability unless the banks' financial intermediation technology is sufficiently advanced and the industrial sector's leverage ratio is sufficiently high. In a more realistic scenario where the banks lend not only to the industrial firms and but also to households, which rely on bank loans for housing, vehicle, education, etc., the bank profitability exceeds the industrial profitability when the household sector's total debt services are sufficiently large, regardless of the levels of the banks' financial technology and the industrial sector's leverage ratio. It suggests that the households' debt and interest payments are potentially a important source of the bank profitability exceeding the industrial profitability. That is, the bank capital beat the industrial capital in terms of profitability by exploiting the households' financial conditions that force them to rely on debt for their full reproduction. Lastly, this result is empirically confirmed through the ARDL cointegration analysis with the U.S. quarterly data for 1984–2020.