To Sell or to Borrow?

Discussion by

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Summary of the model

- There is a set of identical banks that over time become heterogeneous
- Initial portfolio allocation decision between liquid and illiquid assets in the spirit of Diamond and Dybvig (1983)
- In the interim period banks are hit by productivity and liquidity shocks. Four bank types are generated

Summary – cont.

- The presence of risky banks can create adverse selection and impair the functioning of interbank markets
- The model generates a preference over financial instruments: self insurance, interbank loans and secondary market sales
- Sales are absorbed by investors who are assumed to have an elastic demand for assets
- Results on liquidity injections are “negative”

General Remarks

- The model provides a good tool to think about the interbank market and potential policy interventions to prevent financial troubles associated with it
- Results largely due to multiplicity of equilibria
- Why are results on liquidity injections are "negative"?
- Advertisement:
    - Antinolfi and Keister (2006)
    - Antinolfi and Kawamura (2008)

Specific remarks about the model

- No deposit contract
- Why can't a central bank help?
- "Ex-ante possibilities:" liquidity requirements, transparency requirements
- "Ex-post possibilities:" monetary injections, loan guarantees, government asset purchases, nationalization

Specific remarks – cont.

- Could banks not know their own type?
- Could a contingent claim market perform the same function as the interbank market?
- Other arrangements, i.e. monopoly instead of perfect competition etc.
- Add an example
- Why investors at t=1?