Discussion of Gertler and Kiyotaki’s "Banking, Liquidity and Bank Runs in an Infinite Horizon Economy"

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Motivation

- Persistent macro effects of financial crisis
- Social demand for "forecastability" of crises
Main Ingredients

- Two intermediation technologies: efficient (banks) and inefficient (households)
- Banks’ funding subject to two frictions:
  (i) upper bound on leverage ratio
  (ii) cannot issue new equity
- Possibility of bank runs if:

\[(Z_t + Q_t^{*})K_{t-1}^b \leq R_tD_{t-1}\]
The GK Model in Perspective

- Macro modelling before the financial crisis
- Rethinking macro models: financial frictions
- amplification vs. endogenous financial crises
- The GK model
  - amplification of exogenous shocks ("financial accelerator")
  - further amplification if bank run \( \Rightarrow \) non-linearity
  - possibility of bank runs (and bank run driven crises) is endogenous ("predictability"?)
**Comments/Questions**

- Bank runs without a "sequential service constraint"
  - run possible only if "insolvency after liquidation"
  - not restricted to banks
  - but no advantage to running first...

- Multiplicity of bank run equilibria? (# of banks)
- Key assumption: convexity of household management costs $f(K_t^h)$

$$Q_t = -f'(K_t^h) + E_t \left\{ \sum_{k=1}^{\infty} \Lambda_{t,t+k}(Z_{t+k} - f'(K_{t+k}^h)) \right\}$$

Is it plausible?

- What does direct household intermediation represent? Shadow banking system?
In the model banks do not lend more because of their "financing constraints"

But the ECB is willing to lend "unboundedly" almost for free!
More likely: banks do not lend more because the demand for loans is low

Forecastability in the GK model: financial crisis more likely...
...after prolonged downturn
...after a persistent decline in value of bank assets

Counterfactual!?
Concluding remarks

- Contribution: micro-founded bank runs in infinite horizon macro model
- Extension to a richer framework? (capital accumulation, variable inputs, sticky prices...)
- But do bank runs (as modelled) capture the central features of financial crises?