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:

$$(Z_t + Q_t^*)K_{t-1}^b \leq R_t D_{t-1}$$

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?

Comments

- 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?