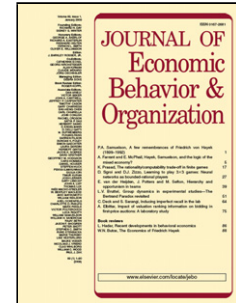


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Bank Networks: Contagion, Systemic Risk and Prudential Policy

Highlights

- Network model of the interbank market.
- Channels of contagion: credit interlinkages, fire sale externalities, liquidity hoarding
- Impact of regulation: increase in liquidity requirement reduces systemic risk more than increase in equity requirement
- As banks hold more liquidity, they reduce exposure in the interbank market.
- The fall in interbank supply makes the interbank interest rate go up. Fall in non-liquid asset investment mitigates contagion.
- With an increase in the equity requirement instead the demand of interbank borrowing falls and so does the interbank rate.
- Systemic risk is mitigated but less than with an increase in liquidity requirements.

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