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Heterogeneous Capital and Misintermediation

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Abstract

A perennial problem of financial markets is that of maturity mismatch, or *misintermediation*, a situation in which financial intermediaries fund long-term, illiquid loans with short-term liabilities. A previous theory concludes that misintermediation is responsible for business cycles and yields the procyclical behavior of surprises in real interest rates. This paper proposes a finite horizon structural model with the introduction of heterogeneous capital to formalize and develop that theory. An extended model with labor as well as a “harvesting” technology further investigates the impact of misintermediation on real factor prices. The model implied relationship between unanticipated changes in real interest rates and real outputs over time is examined in a subsequent empirical study, which provides preliminary evidence in line with the hypothesis of misintermediation.

JEL classification: B53; C22; E32; E43; G01

Keywords: Misintermediation, Heterogeneous Capital, Term Structure of Interest Rates, Austrian Business Cycle Theory

1. Introduction

The 2007-08 global financial crisis (GFC) and the subsequent world-wide economic downturn have raised questions about the stability of financial systems. This is particularly true for the U.S. where the markets for mortgages, mortgage-backed securities (MBSs), and credit default swaps (CDSs) are widely perceived to be at the root of the financial turmoil (Gorton, 2009). Although government sponsored entities (GSEs) and broker-dealer intermediaries

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