

Accepted Manuscript

Bank liabilities channel

Vincenzo Quadrini

PII: S0304-3932(17)30030-2
DOI: [10.1016/j.jmoneco.2017.03.006](https://doi.org/10.1016/j.jmoneco.2017.03.006)
Reference: MONEC 2913

To appear in: *Journal of Monetary Economics*

Received date: 5 March 2017
Revised date: 29 March 2017
Accepted date: 29 March 2017

Please cite this article as: Vincenzo Quadrini, Bank liabilities channel, *Journal of Monetary Economics* (2017), doi: [10.1016/j.jmoneco.2017.03.006](https://doi.org/10.1016/j.jmoneco.2017.03.006)



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BANK LIABILITIES CHANNEL^{*}Vincenzo Quadrini[†]*University of Southern California and CEPR**701 Exposition Blvd, Los Angeles, CA 90089*

April 25, 2017

Abstract

The financial intermediation sector is important not only for channeling resources from agents in excess of funds to agents in need of funds (lending channel). By issuing liabilities it also creates financial assets held by other sectors of the economy for insurance or liquidity purpose. When the intermediation sector creates less liabilities or their value falls, agents are less willing to engage in activities that are individually risky but desirable in aggregate (bank liabilities channel). The paper shows how financial crises driven by self-fulfilling expectations about the liquidity of the banking sector are transmitted to the real sector of the economy. Since the government could also create financial assets by borrowing, the paper analyzes how public debt affects the issuance of liabilities by the financial intermediation sector.

JEL classification: E32, G21**Keywords:** Financial intermediation, Financial crises

^{*}Paper presented at the November 2016 Carnegie Rochester NYU Conference on Public Policy.

[†]I would like to thank Satyajit Chatterjee and Egon Zakrajsek for insightful discussions and seminar participants at Bank of Mexico, Bank of Portugal, Boston College, Carlos III University, Cemfi, Cheung Kong Graduate School of Business, EEA meeting in Geneve, Federal Reserve Board, Istanbul school of Central Banking, ITAM Mexico, NOVA University in Lisbon, Purdue University, Shanghai University of Finance and Economics, University of Maryland, University of Melbourne, University of Notre Dame, University of Pittsburgh, UQAM in Montreal. Financial support from NSF Grant 1460013 is gratefully acknowledged.

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