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Resaleable debt and systemic risk☆

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Abstract

Many debt claims, such as bonds, are resaleable; others, such as repos, are not. There was a fivefold increase in repo borrowing before the 2008–2009 financial crisis. Why? Did banks' dependence on non-resaleable debt precipitate the crisis? In this paper, we develop a model of bank lending with credit frictions. The key feature of the model is that debt claims are heterogenous in their resaleability. We find that decreasing credit market frictions leads to an increase in borrowing via non-resaleable debt. Such borrowing has a dark side: It causes credit chains to form, because, if a bank makes a loan via non-resaleable debt and needs liquidity, it cannot sell the loan but must

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