Abstract

We develop a model which aims at providing a framework for the positive and normative analysis of macroprudential policies. The basic model incorporates optimizing financial intermediaries (“bankers") who allocate their scarce wealth (“inside equity") together with funds raised from saving households across two lending activities, mortgage lending and corporate lending. External financing for all borrowers (including banks) takes the form of external debt which is subject to default risk. The model shows the interplay of three interconnected net worth channels as well as distortions due to deposit insurance, and can be extended to analyse the implications of securitization and liquidity risk. The setup allows an explicit welfare analysis of macroprudential policies.