# Discussion: Household income dynamics in a lower-income small open economy: A comparison of banking and creowdfunding regimes

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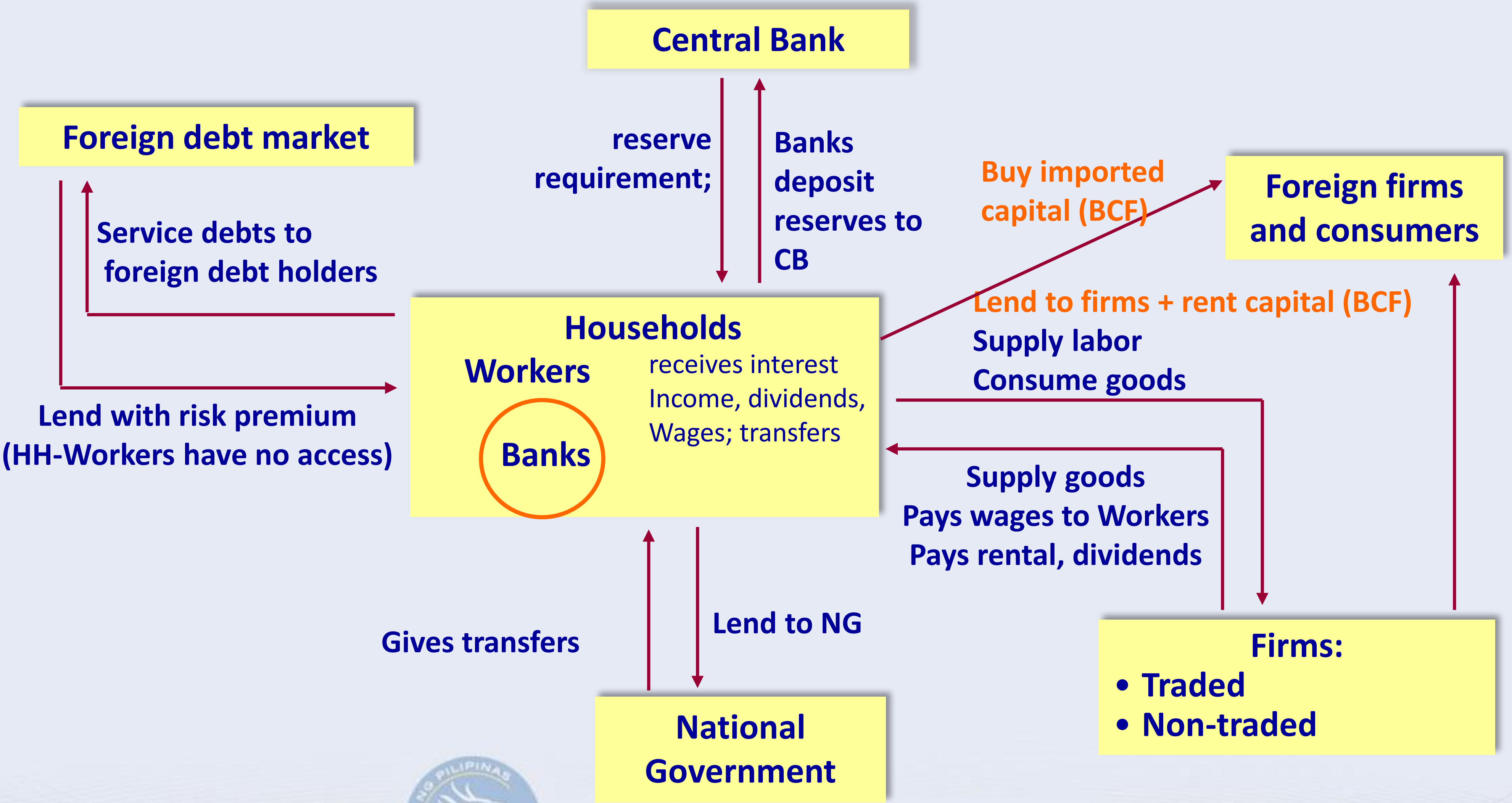
*The usual disclaimer applies.*

# Illustration of the Model



# Banking sector as source of friction a la GK (2011)

- borrows from households and pay a gross rate, holds reserves on these deposits, at the central bank, given by the ratio $\psi_t$. They also lend to firms a total of $Q_t S_t$ which yields a gross return of $R^k_{t+1}$
- Banking sector maximize terminal wealth $V_t$
- $V_t$ must be greater than divertible assets, otherwise, depositors will not lend to bank

$$V_t \geq \lambda_t Q_t S_t^b$$

# Banking sector as source of friction

- $\Lambda_t$ : no-confidence factor; portion of total lending $Q_tS_t$ that depositors believe bankers can divert
  - Gertler and Karadi (2011): banking sector as the source of financial frictions due to the presence of this moral hazard problem
- Bernanke et al. (1996): credit- constrained firms as the source of frictions
- Villa (2014): GK specification is superior as the banking sector is a powerful “amplification” channel and provides a better solution to the “small shocks, large cycles” puzzle