CANCAN BANKS PROVIDE LIQUIDITY IN A FINANCIAL CRISIS?

During recent past financial crises, banks have typically been able to meet the credit needs of businesses by using funds from depositors seeking a safe haven from volatile securities markets. In these instances, banks helped avoid financial disruptions and business liquidations that would have resulted from the lack of a liquidity backstop.

But did this dynamic hold true during the financial crisis of 2007-09? In the article “Can Banks Provide Liquidity in a Financial Crisis?” Nada Mora, an economist at the Federal Reserve Bank of Kansas City, examines whether banks were able to serve as a source of liquidity during this period. The article is available in the third quarter edition of the Bank’s Economic Review.

During the 2007-09 crisis, commercial banks were much more exposed to losses than in recent past crises. This key feature questions the notion that banks are a natural source of liquidity during a financial crisis, Mora writes. In the article, she concludes that the bank-centered nature of the 2007-09 crisis made it more challenging for banks to attract deposits and provide liquidity to borrowers who were shut out of the securities markets.

The article is available on the Bank’s website at www.KansasCityFed.org.

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