

Over-the-Counter Markets

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Abstract

We study how intermediation and asset prices in over-the-counter markets are affected by illiquidity associated with search and bargaining. We compute explicitly the prices at which investors trade with each other, as well as marketmakers' bid and ask prices, in a dynamic model with strategic agents. Bid-ask spreads are lower if investors can more easily find other investors or have easier access to multiple marketmakers. With a monopolistic marketmaker, bid-ask spreads are higher if investors have easier access to the marketmaker. We characterize endogenous search and welfare, and discuss empirical implications.

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