



Financial Intermediation and Macroeconomic Analysis

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Abstract

Understanding phenomena such as the recent financial crisis, and possible policy responses, requires the use of a macroeconomic framework in which financial intermediation matters for the allocation of resources. Neither standard macroeconomic models that abstract from financial intermediation nor traditional models of the "bank lending channel" are adequate as a basis for understanding the recent crisis. Instead we need models in which intermediation plays a crucial role, but in which intermediation is modeled in a way that better conforms to current institutional realities. In particular, we need models that recognize that a market-based financial system—one in which intermediaries fund themselves by selling securities in competitive markets, rather than collecting deposits subject to reserve requirements—is not the same as a frictionless system. I sketch the basic elements of an approach that allows financial intermediation and credit frictions to be integrated into macroeconomic analysis in a straightforward way. I show how the model can be

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