Discussion of Financial Considerations in a Small Open Economy Model for Mexico

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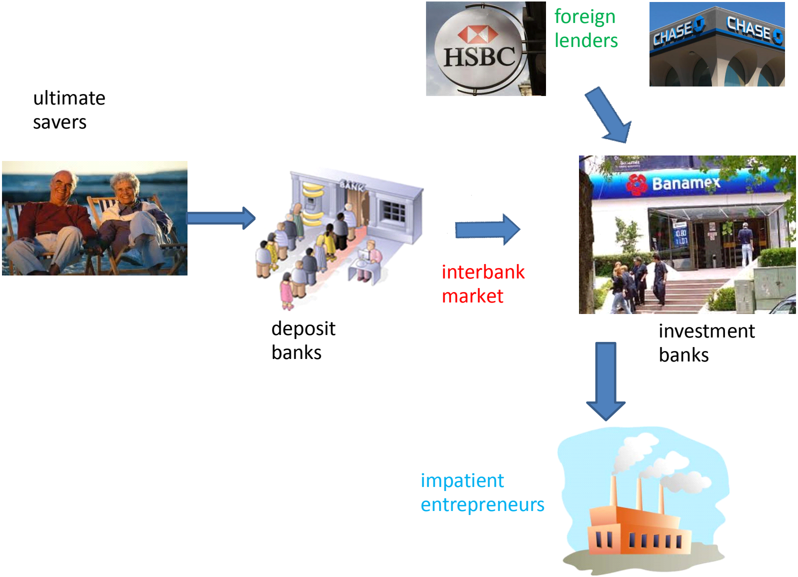
- Two **very** welcome features

1. Financial frictions for **emerging** market economy
2. **Interbank** market


foreign
lenders
HSBC
CHASE
ultimate
savers
Banamex
interbank
market
deposit
banks
investment
banks
impatient
entrepreneurs

Main issues

1. Where should we **locate** financial frictions?
2. What **type** of frictions?
3. **Foreign** lenders and capital flows

Where should we locate financial frictions?

- This paper: everywhere
- Baseline model e.g. Gertler-Karadi (GK): friction between **depositors** and **banks** (no interbank market)
- Classic Holmstrom and Tirole: **two-sided** friction
- Key point to capture in two-sided frictions: banks **more leveraged** than household and/or entrepreneurs

What type of frictions?

- GK: agency/moral hazard friction + **endogenous** net worth
  $\rightarrow$ Feedback with **asset prices**

- This paper

1. monopolistic competition + sticky interest rates
2. exogenous net worth

- Key feature to capture: banks collateralize **long**-term assets and borrow **short** term $\rightarrow$ **Mismatch**
- **Maturity** endogenous

Foreign lenders and capital flows

- Most of capital flows ("hot money") channeled through banks. Why? Difficult to acquire local ETF
- Informational frictions: lending is **short term** + **foreign currency** $\rightarrow$ Both endogenous
- This paper: channel of capital flows is exogenous.

Leverage is endogenous

1. **No** concept of leverage for banks
2. Leverage **constant** for households and entrepreneurs