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SAFE Working Paper Series No. 12

Center of Excellence SAFE Sustainable Architecture for Finance in Europe

A cooperation of the Center for Financial Studies and Goethe University Frankfurt

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# Endogenous Banks' Networks, Cascades and Systemic Risk\*

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First draft: March 2011. This draft: March 2013.

## Abstract

We develop a dynamic network model whose links are governed by banks' optimizing decisions and by an endogenous tâtonnement market adjustment. Banks in our model can default and engage in firesales: risk is transmitted through direct and cascading counterparty defaults as well as through indirect pecuniary externalities triggered by firesales. We use the model to assess the evolution of the network configuration under various prudential policy regimes, to measure banks' contribution to systemic risk (through Shapley values) in response to shocks and to analyze the effects of systemic risk charges. We complement the analysis by introducing the possibility of central bank liquidity provision.

*Keywords:* Network formation, tâtonnement, contagion.

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\*We are grateful for comments and suggestions to Martin Hellwig, Matthew Shapiro, and Péter Kondor as well as seminar participants at the Bonn Max Planck Institute, Vienna University, LMU Munich, University of Rome, Milan University and conference participants at the 43th Konstanz Seminar on Monetary Theory, the 11th CEPR-Magyar Bank Macroeconomic Workshop and the Bundesbank conference on Financial Networks for valuable comments.

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