

Liquidity Matters: Addressing the Puzzle of Negative Bank Output on Loans

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Paper Abstract: We develop a method for calculating bank output on loans that addresses the flaws of the current System of National Account (SNA) approach. We build on Colangelo and Inklaar (2012) and borrow from the literature on liquidity risk premium to determine some reference rates that represent the pure credit risk premium and exclude the impact of liquidity risk from these reference rates. Our method produces bank output estimates that are consistent with the evolution of the economic activity and that remain always positive including in periods of financial stress. In normal times, our results are similar to Colangelo and Inklaar (2012) and confirm that the current SNA approach overestimates bank output.