Macro Shocks and Firm Dynamics  
with Oligopolistic Financial Intermediaries  

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Abstract  

This paper studies the macroeconomic effects of oligopolistic competition in the financial inter-
mediation sector. Motivated by a recent increase in the concentration of the US banking industry 
and several empirical facts about the effects of bank competition on firm dynamics, I develop a novel 
dynamic general equilibrium model with oligopolistic banks and heterogeneous firms. Strategic inter-
actions among oligopolistic banks generate endogenous financial frictions that shape firm investment 
and financing dynamics, affecting aggregate productivity. I introduce two sources of aggregate shocks: 
a sudden increase in the aggregate firms’ default probability and a “big bank” failure (e.g., Lehman 
Brothers in 2008). When the probability of firms’ default increases, banks exploit their marker power 
to extract higher markups and credit spreads increase. This mechanism allows banks to compensate 
for the larger losses due to defaults, but it leads to a larger decline in real activity. When the economy 
is also hit by a “Lehman shock”, the model accounts both qualitatively and quantitatively for key 
macroeconomic and financial features of the Great Recession. In an extension, I also study banks’ 
market power in a model with idiosyncratic firms’ TFP shocks and endogenous default. Higher con-
centration in the banking sector reduces the frequency of firms’ default but makes the economy less 
productive.  

Keywords: Financial Intermediaries, Dynamic Oligopoly, Heterogeneous Firms, Great Recession, Dynamic Games, General Equilibrium  

JEL classification: G12, E52, E40, E44  

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