The Safer, the Riskier: 
A Model of Bank Leverage and Financial Instability*

Ryo Kato† and Takayuki Tsuruga‡

This version: March 1, 2011
First draft: February 14, 2011

Abstract

This note provides an example of a case where financial instability can be amplified by stable fundamentals rather than risky fundamentals, using a variation of Diamond and Rajan (2009).

JEL Classification: E3, G01, G21

Keywords: Bank runs, Great moderation, Financial crisis, Maturity mismatch

*We thank seminar participants at the Bank of Japan, Kyoto University, and University of Tokyo. We are also indebted by helpful discussion with Daisuke Oyama and other members of the Banking Theory Study Group. Takayuki Tsuruga gratefully acknowledges the financial support of the Grant-in-aid for Scientific Research (21243027). Views expressed in this paper are those of the authors and do not necessarily reflect the official views of the Bank of Japan.

†Bank of Japan; e-mail: ryou.katou@boj.or.jp
‡Graduate School of Economics, Kyoto University; e-mail: tsuruga@econ.kyoto-u.ac.jp