



WP/19/92

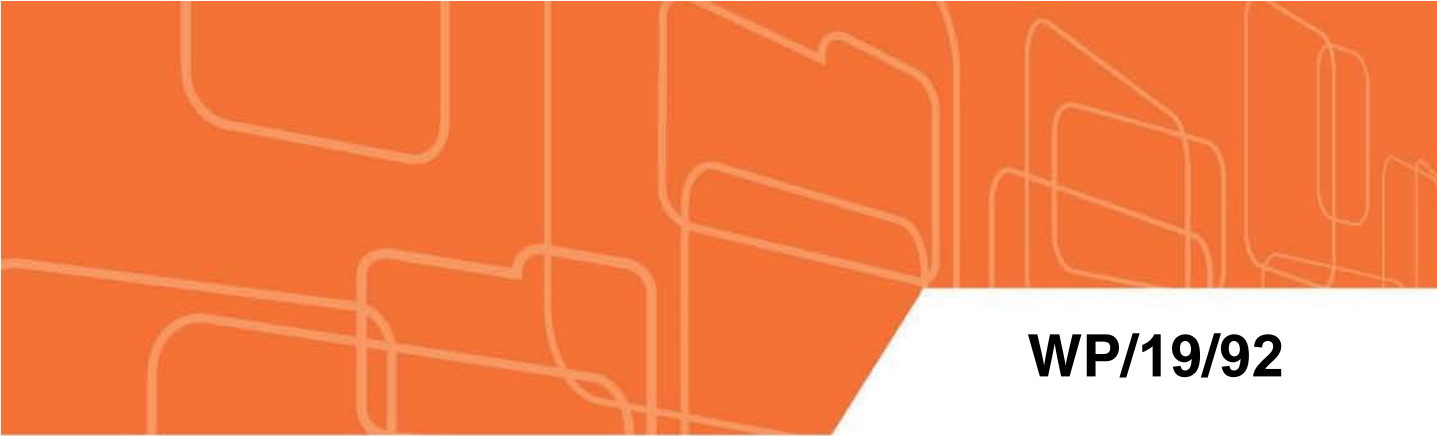
IMF Working Paper

Inefficient Fire-Sales in Decentralized Asset Markets

by Ehsan Ebrahimi

IMF Working Papers describe research in progress by the author(s) and are published to elicit comments and to encourage debate. The views expressed in IMF Working Papers are those of the author(s) and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

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Research Department

Inefficient Fire-Sales in Decentralized Asset Markets¹

Prepared by Ehsan Ebrahimi

Authorized for distribution by Maria Soledad Martinez Peria

May 2019

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Abstract

Classic models of fire-sales that emphasize liquidity-constrained natural buyers can-not fully account for the asset fire-sales during the Financial Crisis of 2008. I present a model to demonstrate that fire-sales may happen even when there is a sizable pool of natural buyers and in the absence of asymmetric information, due to a coordination failure among buyers. In particular, I show that when trade is decentralized and participation is endogenous, constrained asset demand and liquidity needs that are expected to increase over time create complementarity among buyers' decisions to wait. This complementarity makes competitive markets prone to coordination failures and fire-sales which may be inefficient. I also discuss various policy options to eliminate the risk of fire-sales in such a setup.

JEL Classification Numbers: G01, G12, D61, D62, D83, E44

Keywords: fire-sales, coordination failure, decentralized markets, competitive search

Author's E-Mail Address: EEbrahimi@imf.org

¹ I thank seminar participants in the Institute for Capacity Development, IMF Research Department, Bank of Finland/ESRB Conference on Systemic Risk Analytics and Lisbon Meeting on Game Theory and Applications. I thank Giovanni Dell'Ariccia, Anil Ari, Darrell Duffie, Divya Kirti, Romain Ranciere, Felix Vardy and especially Ruchir Agarwal for helpful comments and conversations. I also thank Jing Lu for excellent research assistance. All errors are my own.

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