

### Corrections to Chapter 16, page 319

The text is self-contradictory from line 11 (from below) and onwards. Here is an explanation:

It was shown in the upper half of the page that if the other bank has chosen to be illiquid, then my expected payoff when I am illiquid is  $E\pi_1^I$ , which is better than what I get from being liquid, namely  $E\pi_2$ , except when  $L$  is very low, smaller than  $L_1$ . If the other bank is liquid, then it is too expensive for me to be illiquid, unless when  $L$  is sufficiently high, greater than  $L_2$ .

Thus we get an interval, so that for  $L \leq L_1$ , it is always best to be liquid, for  $L$  between  $L_1$  and  $L_2$  it is best to do what the other bank does, and for  $L \geq L_2$  it is best to be illiquid.

The main point of the whole story comes when we compare with the situation *without* an LLR, where banks are liquid for  $L$  below some  $L^*$  and illiquid above this threshold. It can be checked that  $L^* > L_2$ , so that banks more often choose to be illiquid when there is an LLR, even one with a restrictive policy, and this can be considered as a cost or a side effect of the presence of an LLR.