Optimal Credit Allocations*

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Abstract

This paper examines how commercial banks should allocate their deposits among three different agents: households, firms, and the government to achieve socially optimal allocations. The paper finds that the main driving force of the allocation of loans among three agents are the discount factor, which represents the interest rate, and the risk factor, which is associated with each agent. The discount factor does not exert an important influence on optimal loan allocations when risk is high but becomes highly influential in the presence of low risk. Quantitatively, when the risk of households increases, optimal loan to households converges to zero. On the other hand, when the risk of the government decreases, the optimal loan to the government reaches its upper bound, which is 55% of total loans. Also, a standard calibration of the model reveals that 60% of the total loan should allocate equally between households and firms and the rest should allocate to the government.

Keywords: Risk and discount factors, Real shocks, Social optimal allocation
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