**Banks versus markets in processing exogenous shocks**

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Abstract

Banks and financial markets co-exist and both contribute to economic growth. Can they also dampen the impact of exogenous shocks on growth? If yes, do they do it equally well? We investigate this on a panel of 63 countries over the period of 1988-2012, including developing and developed economies. Results confirm that market-based economies tend to grow faster, yet this is conditional on the level of financial and/or economic development. The larger is the financial system, the stronger is the advantage of markets in promoting economic growth. However, banks significantly weaken the impact of exogenous volatility on growth. This shock-smoothing role of banks is most evident in commodity-dependent developing countries, which suffer from greater TOT volatility and usually have smaller financial sectors than advanced economies.