

Topics in Financial Economics

Financial Fragility

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We will discuss recent theoretical research related to banking and financial fragility with an emphasis on the Global Financial Crisis of 2007 - 2009. The structure of the course is as follows. In the first part of the course, I will provide an overview of the financial crisis followed by theoretical models of financial fragility. In the second part of the course, each participant will present at least one paper from those provided below. The length of each presentation and the number of presentations per-person will be determined by the number of participants. In the third part of the course, each participant will write a short report on one of the topics covered (e.g. government guarantees) and propose an idea for an extension. Lectures: Tuesdays 14:00 to 16:00 in Jur/Horsaal N.

Reading list

Additional topics and papers will be added to the reading list. Feel free to contact me if you have any questions or suggestions.

The Financial Crisis of 2007 – 2009

Brunnermeier, Markus (2009) “Deciphering the Liquidity and Credit Crunch 2007-8,” *Journal of Economic Perspectives* 23:77-100.

Yorulmazer, Tanju (2014) “Case Studies on Disruptions During the Crisis,” *Federal Reserve Bank of New York Economic Policy Review*, 20, 17-28.

Gorton, G., and A. Metrick. (2012). “Securitized Banking and the Run on Repo.” *Journal of Financial Economics* 104, no. 3 (June): 425-51.

Models of financial fragility

Diamond, Douglas W. and Phillip H. Dybvig (1983) “Bank Runs, Deposit Insurance, and Liquidity,” *Journal of Political Economy* 91: 401-419.

Allen F. and D. Gale (1998), “Optimal Financial Crises”, *Journal of Finance, Papers and Proceedings*, 53, 1245-1284.

Cooper, R., Ross, T.W., 1998. Bank runs: liquidity costs and investment distortions. *Journal of Monetary Economics* 41, 27–38.

Chari, V.V., Jagannathan, R., 1988. Banking panics, information, and rational expectations equilibrium. *Journal of Finance* 43, 749–761.

Allen, F and D. Gale (2004) “Financial Intermediaries and Markets”, *Econometrica*, 72, 1023-1062.

Morris, S. and H.S. Shin (1998) “Unique Equilibrium in a Model of Self-Fulfilling Currency Attacks”, *American Economic Review*, 88, 587-597.

Goldstein, I., Pauzner, A., 2005. Demand deposit contracts and the probability of bank runs. *Journal of Finance* 60, 1293–1327.

Acharya, V., D. Gale, and T. Yorulmazer. 2011. “Rollover Risk and Market Freezes.” *Journal of Finance* 66, no. 4 (August): 1177- 1209.

Bernardo, Antonio E. and Ivo Welch (2004) “Liquidity and Financial Market Runs,” *Quarterly Journal of Economics* 119:135-158.

Banerjee, A. (1992) “A Simple Model of Herd Behavior” *Quarterly Journal of Economics*, 107, 797-817.

Suspension of payments

Ennis, Huberto M. and Todd Keister (2009) “Bank Runs and Institutions: The Perils of Intervention,” *American Economic Review* 99:1588-1607.

Engineer, M., 1989. Bank runs and the suspension of deposit convertibility. *Journal of Monetary Economics* 24, 443–454.

Wallace, N., 1990. A banking model in which partial suspension is best. *Federal Reserve Bank of Minneapolis Quarterly Review* 14, 11–23 (Fall).

Government guarantees

Keister, Todd (2016) “Bailouts and Financial Fragility,” *Review of Economic Studies* 83: 211-271.

Farhi, E. and Tirole, J. (2012) “Collective moral hazard, maturity mismatch and systemic bailouts” *American Economic Review*, 102, 60-93.

Chari, V.V. and Kehoe, P.J. (2016) “Bailouts, time inconsistency, and optimal regulation: A macroeconomic view” *American Economic Review*, 106, 2458-93.

Gorton, G and L. Huang (2004) “Liquidity, Efficiency, and Bank Bailouts”, *American Economic Review*, 94, 455-483.

Cooper, Russell and Hubert Kempf (2016) “Deposit insurance and bank liquidation without commitment: Can we sleep well?” *Economic Theory* 61:265-392.

Macroprudential regulation

Erol S. and G. Ordonez. (2016) “Network Reactions to Banking Regulations”, *Journal of Monetary Economics*, forthcoming.

Jeanne, O. and A. Korinek (2016). “Macroprudential Regulation Versus Mopping Up After the Crash.” JHU Working Paper.

Nosal J. and G. Ordonez (2013) “Uncertainty as Commitment”, *Journal of Monetary Economics*, 80, 124-140.

Diamond, D. and A. Kashyap (2016). “Liquidity Requirements, Liquidity Choice and Financial Stability.” NBER Working Paper 22053.

Farhi, E., M. Golosov and A. Tsyvinski (2009) “A Theory of Liquidity and Regulation of Financial Intermediation”, *Review of Economic Studies*, 76, 973-992.

Hanson, S. Kashyap, A. and J. Stein (2010) “A Macroprudential Approach to Financial Regulation”. *Journal of Economic Perspectives*. 25, 3-28.

Narrow banking

Wallace, Neil (1996) “Narrow banking meets the Diamond-Dybvig model,” *Federal Reserve Bank of Minneapolis Quarterly Review* 20 (Winter): 3-13.

Chamley, Christophe, Laurence J. Kotlikoff, and Herakles Polemarchakis (2012) “Limited-Purpose Banking—Moving from ‘Trust Me’ to ‘Show Me’ Banking,” *American Economic Review Papers and Proceedings* 102(3): 113-119.

Jacklin, Charles (1987) “Demand Deposits, Trading Restrictions and Risk Sharing,” in: E. Prescott & N. Wallace, eds., *Contractual Arrangement for Intertemporal Trade*, University of Minnesota Press, pp. 26-47.

Cochrane, John H. (2014) “Toward a run-free financial system” in N.B. Martin and J.B. *Across the Great Divide: New Perspectives on the Financial Crisis*, Hoover Press.

Securitization and Shadow Banking

Gorton, G and A. Metrick (2010 “Regulating the Shadow Banking System.” *Brookings Papers on Economic Activity*, Fall.

Ordóñez G. (2016) “Sustainable Shadow Banking”, *NBER Working Paper* 19022.

Gennaioli, N. and Shleifer A., and R. Vishny (2013) “A Model of Shadow Banking”, *Journal of Finance*. 68: 1331-1363

Caballero, Ricardo (2006), “On the Macroeconomics of Asset Shortages,” *NBER Working Paper* 12753.

Nadauld, Taylor and Michael Weisbach (2012), “Did Securitization Affect the Cost of Corporate Debt?,” *Journal of Financial Economics* 105, 332-352.

Textbook references

Franklin Allen and Douglas Gale (2007) *Understanding Financial Crises*, Oxford University Press.

Freixas, Xavier, and Jean-Charles Rochet (1997): *The Microeconomics of Banking*. Cambridge, MIT Press