

Course Syllabus

Banking and Securitization

University of Bonn

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This Version: March 10, 2020

Time: Tuesday 4:15-5:45pm & Thursday 8.30-10.00

Rooms: 0.042 & LH F

Level: Master Economics, Open for PhD

Requirements: Microeconomic Theory, Bank Management, Corporate Finance

Course Description

This course builds on basic financial theory and the principles courses in economics. It addresses topics that are important for understanding the role of financial institutions for the economy in a rapidly changing international and technological environment. Upon successful completion of the course, students should be able to understand the basic characteristics of financial intermediation; explain why banks are (or used to be) unique, and therefore merit special attention from policymakers; to understand the analytical foundations underlying financial regulation, supervision, and monetary policy transmission via (non-)banks; and be able to use them to analyze important developments and challenges to the financial system, including fire sales and shadow banking in particular. The focus is on financial theory, while we will also relate to empirical studies when suitable.

Grading

Exam (60min)

Basic Literature

The course actively uses journal articles. The focus is on understanding traditional as well as modern approaches to banking theory. We will also discuss some recent related empirical evidence. Additional reading of the following books is recommended:

- Freixas, X. & Rochet, J.-C. (2008), *Microeconomics of Banking*, 2nd ed., Cambridge, MA: MIT Press
- Allen, F. & Gale, D. (2007), *Understanding Financial Crises*, New York, Oxford University Press
- Freixas, X., Laeven, L. & Peydro, J.L., (2015) *Systemic risk, crises and macroprudential policy*.

Recommended books for non-academic audience:

- McMillan, J. (2014) "The end of banking." *Money, Credit, and the Digital Revolution*, Zurich: Zero/One Economics.
- Admati, A. & Hellwig, M. (2014) *The bankers' new clothes: What's wrong with banking and what to do about it*. Princeton University Press.
- Brunnermeier, M., Harold J., & Landau, J.-P. (2016) *The Euro and the battle of ideas*. Princeton University Press.

Structure of the Lecture

(Preliminary and subject to changes. Not all papers will be read in detail.)

1 Banking Theory: Basic Mechanisms and Predictions

1.1 The Role of Banks

- Gorton, G., and A. Winton, "Financial Intermediation," Chapter 8 in *Handbook of the Economics of Finance (Vol 1A)*, G.M. Constantinides, G.M, Harris, M. and Schultz, R.M. (2004).

1.2 Consumer Liquidity Demand: High Risk Aversion

- Diamond D. and P.H. Dybvig, "Bank Runs, Deposit Insurance, and Liquidity," *Journal of Political Economy*, 91 (1983), 401-419

1.3 Corporate Liquidity Demand: Restriction of pledgeable income

- Holmström B, Tirole J. (2011) Inside and outside liquidity. MIT press; (201) Jan 7. (Chapter 1 & 2)

1.4 Banks as Delegated Monitors

- Diamond, D. "Financial Intermediation and Delegated Monitoring," Review of Economic Studies, 51 (1984), 394-414.

1.5 Relationship Banking

- Holmstrom, B. and J.Tirole, "Financial Intermediation, Loanable Funds and the Real Sector," Quarterly Journal of Economics, 112 (1997), 663-691.

2 Banking and the Real Economy

2.1 Effects of financial frictions on economic activity

- Kiyotaki, N. and J. Moore, "Credit cycles." Journal of Political Economy 105.2 (1997): 211-248.

2.2 The Risk-Taking Channel

- Martinez-Miera, David, and Rafael Repullo. "Search for yield." Econometrica 85.2 (2017): 351-378.

3 Monetary policy transmission through banks

Theory:

- Bernanke, Ben S. and Blinder, Alan S. "Credit, money and aggregate demand" American Economic Review 78.2 (1988):435-439
- Drechsler, Itamar and Savov, Alexi and Schnabl, Philipp "The deposits channel of monetary policy" Quarterly Journal of Economics 132(2017):1819-1876

Empirics:

- Kayshap, A. K. and Stein, J. C. "What do a million observations on banks say about the transmission of monetary policy?" American Economic Review 90 (2000):407-428
- Duquerroy, A. and Matry, A. and Saidi, F. "Sticky Deposit Rates and Allocative Effects of Monetary Policy" Working Paper (2020)

4 Bank Funding Structure

4.1 Debt vs Equity Investors

- Gorton, Gary, and George Pennacchi. "Financial intermediaries and liquidity creation." *The Journal of Finance* 45.1 (1990): 49-71.
- Kashyap, A. and Rajan, R. and Stein, J. C. "Banks As Liquidity Providers: An explanation for the Co-Existence of Lending and Deposit-Taking" *Journal of Finance* 57.1(2002):33.73

4.2 Demand-able debt as a Disciplining Device

- Calomiris, Charles W., and Charles M. Kahn. "The role of demand-able debt in structuring optimal banking arrangements." *The American Economic Review* (1991): 497-513.

5 Banking Regulation and Regulatory Arbitrage

5.1 Bank Capital and Risk Taking

- Stiglitz, Joseph E., and Andrew Weiss. "Credit rationing in markets with imperfect information." *The American economic review* 71.3 (1981): 393-410.

5.2 The Idea and Benefits of Securitization

5.3 Securitization and Neglected Risks

- Gennaioli, Nicola, Andrei Shleifer, and Robert Vishny. "Neglected risks, financial innovation, and financial fragility." *Journal of Financial Economics* 104.3 (2012): 452-468.

6 Financial Crises

6.1 The Financial Crisis 07/08

6.2 Contagion Mechanisms

- Allen, Franklin, and Douglas Gale. "Financial contagion." *Journal of political economy* 108.1 (2000): 1-33.

7 Fire Sales

Theory:

- Shleifer, Andrei and Vishny, Robert. "Liquidation Values and Debt Capacity: A Market Equilibrium Approach." *Journal of Finance* 47.4 (1992): 1343-1366.
- Brunnermeier, Markus K. and Pedersen, Lasse Heje. "Market liquidity and funding liquidity." *Review of Financial Studies* 22.6(2009):2202-2238
- Diamond, Douglas and Rajan, Raghuram. "Fear of fire sales, illiquidity seeking, and credit freezes." *Quarterly Journal of Economics* 126.2 (2011): 557-591.
- Biais, Bruno and Heider, Florian and Hoerova, Marie. "Variation margins, fire sales, and information-constrained optimality." Working Paper (2019)

Empirics:

- Coval, Joshua and Stafford, Erik "Asset fire sales (and purchases) in equity markets" *Journal of Financial Economics* 86 (2007):479-512.
- Ellul, Andrew and Jotikasthira, Chotibhak and Lundblad, Christian T. "Regulatory pressure and fire sales in the corporate bond market." *Journal of Financial Economics* 101 (2011): 596-620.
- Chernenko, Sergey and Sunderam, Adi "Do Fire Sales Create Externalities?" *Journal of Financial Economics*, forthcoming (2018)
- Vuillemeys, Guillaume "Mitigating Fire Sales with Contracts: Theory and Evidence" Working Paper (2019)

8 Shadow banking

Theory:

- Hanson, Samuel G. and Shleifer, Andrei and Stein, Jeremy C. and Vishny, Robert W. "Banks as patient fixed-income investors" *Journal of Financial Economics* 117 (2015):449-469
- Xiao, Kairong "Monetary transmission through shadow banks" *Review of Financial Studies*, forthcoming (2019)
- Buchaek, G. and Matvos, G. and Piskorski, T. and Seru, A. "Beyond the balance sheet model of banking: implications for bank regulation and monetary policy" Working Paper (2020)

Empirics:

- Buchak, G. and Matvos, G. and Piskorski, T. and Seru, A. "Fintech, regulatory arbitrage, and the rise of shadow banks" *Journal of Financial Economics* 130 (2018):453-483
- Irani, R. and Iyer, R. and Meisenzahl, R. and Peydró, J.-L. "The rise of shadow banking: evidence from capital regulation" Working Paper (2019)
- Elliott, D. and Meisenzahl, R. and Peydró, J.-L. and Turner, B. "Non-banks, Banks, and Monetary Policy: U.S. Loan-Level Evidence since the 1990s" Working Paper (2019)