Macroeconomics of Financial Markets  
ECON 406a, Fall 2010  
Yale University

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Course Web Site: https://classesv2.yale.edu/portal/site/econ406_f10

Syllabus

Class Meetings: Mondays and Wednesdays, from 1:00pm to 2:15pm at WLH 114.

Discussion Sections: Mondays from 5:00pm to 5:50pm.

Course Description

The course will give students a good understanding of why there is financial intermediation, why the financial market is so different than other markets, what is so special about financial organizations and why financial activities have not only the potential to spur growth and development but also to generate and spread painful crises. The central question is then, how policies can improve the positive properties of financial markets, reducing their negative ones?

Structure

The course will be divided in two sections. The first section will be more like a traditional lecture class and will focus on theoretical models about the microeconomic foundations and the macroeconomic consequences of financial markets. The second section will be more like a seminar course, with presentations by students and wide discussion about empirical evidence of the models discussed.

In the first three weeks we will cover theoretical explanations about why financial intermediation exists and what makes financial institutions and markets so special. Problem Set 1 will test the student’s understanding of these theoretical explanations.

From week four to six, we will review the role of financial markets in macroeconomic models, the theoretical arguments about why financial markets are important to spur economic growth, why they are so fragile and why financial crises can both generate economic recessions and amplify real activity problems. Problem Set 2 will test the student’s understanding on these theoretical explanations. This first half of the course should give students the toolbox with which to write the end of term paper.
The second half of the course will be a more typical seminar format. At the start of each class, I will provide an overview of the questions, empirical techniques and the relevant literature. This will then be followed by students presenting short summaries of a particular reading from the syllabus and the class discussing the paper together. We will cover empirical studies that try to test quantitatively the effects of financial development on economic development and growth and the channels through which financial crises spread over real activity. Topics will include:

- Financial Development and Economic Growth,
- Financial Liberalization and Economic Development,
- Bubbles, Panics and Crashes,
- History of Financial Crises,
- Policy Responses to Financial Crises,
- The Recent Financial Crisis.

**Grading and Class Dynamics**

You will be graded on a term paper (40%), two problem sets, a take home exam and a short presentation (15% each).

The term paper should be a small piece of original research that draws on the models and empirical techniques we have learnt in the course. You should use this requirement as an opportunity to start exploring a topic of your interest. Ideally this paper will lead to a broader and more ambitious project,… but everything starts from zero! I am eager to discuss your ideas, whether they are theoretical or empirical, and to guide you the best I can towards a relevant question. In terms of evaluation, I will put weight on your efforts and the creativity and quality of the paper, not on its length.

The take-home exam will be a short essay I will assign during the second half of the class in which you are expected to relate media discussions about financial markets (that I will determine when time comes) with the theoretical background introduced in class.

Adam’s discussion sections will cover solutions to the problem sets and other exercises. He will also discuss case studies relevant to the topics we’re covering in class.

Two textbooks that I’ll refer frequently during the semester are Knoop, Todd (2008). “Modern Financial Macroeconomics: Panics, Crashes and Crises” and Freixas, Xavier and Rochet, Jean-Charles (2008) “Microeconomics of Banking” (available at Yale’s Bookstore and on reserve at the Yale’s Library). I will post slides before going through them, so I suggest to print them before classes.

My office hours are Wednesdays 4:00pm-6:00pm. In any case, you are also very welcome to drop me a line so we can schedule a meeting other than those. Finally, I’m planning this class to be very flexible, particularly during the second part. We will be discovering new common interests along the way, so I will try to accommodate them. Hence, the reading list is not exhaustive and may change (most likely get longer) during the semester.
Reading List
An asterisk (*) means alternative, but recommended, reading.

Weeks 1, 2 and 3 - Foundations of Financial Intermediation.


Weeks 4, 5 and 6 – Financial Markets, Macro Models, Economic Growth and Fluctuations.


**Week 7 – Evidence on financial development and economic growth.**


**Week 8 – Evidence on financial liberalization and economic growth.**


**Week 9 – Bubbles, Panics and Crashes.**


**Week 10 and 11–Financial Crises Experiences and Policy Responses.**

- **19th Century Crises**


- **Great Depression**


- **Chile and Mexico (80s)**


- **Japan (90s)**


**Week 12 and 13– The Recent Crisis and Policy Responses.**


* Carey, M., R. Correa, and J. Kotter (2009), "Revenge of the Steamroller: ABCP as a Window on Risk Choices" mimeo, Federal Reserve System.

