Financial markets are critical for the functioning of the economy, but their effects are still poorly understood. This course discusses state of the art knowledge about the positive and negative effects of financial markets in macroeconomics. We will first study the foundations of financial contracts and the rationale for the existence of financial intermediaries. Then, we will discuss the positive role of financial markets in promoting growth and their negative role in magnifying aggregate fluctuations. We will pay particular attention to financial crises and the fragility of financial markets to bubbles, panics and information surrounding financial products. We will also discuss new theories of business cycles that display financial crises at their core. Finally, we discuss the new financial landscape (securitization and shadow banking) and the regulation challenges (both imposed by the government and induced by the market) that such a new environment introduces.

Just as a commitment device (to myself), I will hold office hours Mondays from 5pm to 6pm. However, you are welcome to drop me a line if you want to schedule a meeting in some other moment. My door is always open in case you want to stop by, go for a coffee and chat.

Finally, I’m planning this class to be very flexible. We will be discovering new common interests along the way, and I rather accommodate them than follow rigorously the contents I plan to cover. Hence, the reading list is not exhaustive and may change (most likely get longer) during the semester.

Grading

You will be graded on a term paper (50% of the grade), a “referee report” (25% of the grade) and a presentation (25% of the grade).

You should see the term paper as an opportunity to start exploring a topic of your interest. Ideally this paper will lead you towards 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. You should let me know the topic you will work on and the way you plan to approach it by March 17.
When time comes, I will assign one paper to each one of you to present and to make a critical “referee report” about it. This paper may be related to your chosen topic for the term paper, but we can talk more about it later. We will schedule these presentations for the last two classes (April 21st and April 28th) to give ample time also to discuss the relation between the paper and your own ideas for the term paper. I may also assign some optional exercises along the way…but I will give you details later, depending on how the class evolves.

Class Schedule

Lecture 4 – February 11: Securitization and Shadow Banking.
Lecture 8 – March 17: Financial Crises – Debt and Information.
Lecture 9 – March 24: Financial Crises – Debt and Information.
Lecture 10 – March 31: Financial Crises and Business Cycles.
Lecture 11 – April 7: Financial Crises and Business Cycles.
Lecture 12 – April 14: Regulation of Financial Markets.
Lecture 13 – April 21: Student Presentations
Lecture 14 – April 28: Student Presentations

Reading List

In bold you can see the papers that I intend to discuss in lectures, * indicates papers that I may not discuss in lectures but you should read. The rest are papers that I consider highly recommended additional reading.

Lectures 1-3: Foundations of Financial Contracts and Intermediation.


a) Liquidity Provision and Consumption Smoothing


**b) Monitoring Delegation**


**c) Information Production**


**d) Incomplete Contracts and Commitment**


e) Information and Liquidity


Lecture 4: Securitization. Shadow Banking.


Lecture 6: Financial Crises - Bubbles.


Lecture 7: Financial Crises - Panics.


Morris, S. and H.S. Shin (2000) “Rethinking Multiple Equilibria in Macroeconomics”, *NBER Macroeconomics Annual*, 139-161. (See also the discussions by Andy Atkeson and Helene Rey).


Lecture 8-9: Financial Crises – Debt and Information.


Lecture 12: Regulation


