

Financial Crises

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Course description: Financial crises are a recurrent feature in modern economies. They are often preceded by a credit boom and a rise in real estate and other asset prices, and often associated with severe disruption in the real economy. This course examines various theories of financial crises. There will be a special emphasis on the role of liquidity in financial crises, the costs and benefits of risk-sharing in financial markets, and the impact of interconnections between financial institutions on systemic risk. The implications for the real economy and the relationship between asset price bubbles and crises will also be addressed at length. The course will be mainly based on both empirical and theoretical research papers.

Course material: The course will be based on research articles. Each class will cover three to four papers as described below.

Class 1 – April 6: *The real effects of financial crises*

- Rajan, R. and L. Zingales. 1998. *Financial Dependence and Growth*. American Economic Review 88, 559-586.
- Dell’Ariccia, G., E. Detragiache, and R. Rajan. 2008. *The Real Effects of Banking Crises*. Journal of Financial Intermediation 17, 89-112.
- Brunnermeier, M. and Y. Sannikov. 2009. *A Macroeconomic Model with a Financial Sector*. Working paper Princeton University.

Class 2 – April 13: *The costs and benefits of risk sharing in financial markets*

- Diamond, D. and P. Dybvig. 1983. *Bank Runs, Deposit Insurance, and Liquidity*. Journal of Political Economy 91, 401-419.
- Bhattacharya, S. and D. Gale. 1987. *Preference Shocks, Liquidity and Central Bank Policy*. In W. Barnett and K. Singleton (eds.), *New Approaches to Monetary Economics*,
- Allen, F. and D. Gale. 2000. *Financial Contagion*. Journal of Political Economy 108, 1-33.
- Babus, A. 2009. *The Formation of Financial Networks*. Discussion Paper 06-093, Tinbergen Institute. 2009

Class 3 – April 20: *Diversification and risk*

- Buraschi, A., P. Porchia and F. Trojani. 2009. *Correlation Risk and Optimal Portfolio Choice*. Working paper Tanaka Business School.

- Ibragimov, R., D. Jaffee and J. Walden. 2009. *Diversification Disasters*. Working paper Harvard University.
- Danielsson, J., H. S. Shin and J. P. Zigrand. 2009. *Risk Appetite and Endogenous Risk*. Working paper Princeton University.

Class 4 – April 22: *The financial crisis of 2008 – 2009*

- Geanakoplos, J. 2009. *The Leverage Cycle*. Working paper Yale University.
- Coval J., J. Jurek and E. Stafford. 2009. *The Economics of Structured Finance*. *Journal of Economic Perspectives* 23, 3–25.
- Allen, F., A. Babus and E. Carletti. 2010. *Financial Connections and Systemic Risk*. Working paper Wharton School.

Class 4 – April 27: *Bubbles*

- TBA

The syllabus is to be updated with background reading.