

14.09: Financial Crises

IAP 2017
Units: 4-0-2 [P/D/F]
Location: E51-376
8 Lectures in January 2016
From 10:30am-12pm on the following days:
1/23, 1/24, 1/25, 1/26, 1/30, 31/1, 2/1,2/2

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Course Overview and Objectives

This mini-course is an introduction to economic theories of financial crises. We will focus on financial intermediaries (“banks”), and analyze the channels by which their problems are transmitted to the nonfinancial sectors of the economy. We will focus on the amplification mechanisms that exacerbate financial crises, such as leverage, fire sales, bank runs, interconnections, and complexity. We will also explore the different perspectives on the origins of crises, such as mistaken beliefs and moral hazard, and discuss the optimal regulation of the financial system. Throughout, we will draw upon examples from financial crises around the world, especially the recent subprime financial crisis. Our objective is to gain a deeper understanding of these events by using economic theory as well as empirical evidence.

The course will meet for 8 lectures in the last two weeks of IAP from Monday until Thursday. Specifically, the lecture dates are: January 23, 24, 25, 26, 30, 31 and February 1,2. The lectures will take place between 10:30am-12pm in E51-376.

Course website: TBA

Prerequisites: There are not formal prerequisites for the course. But you should be committed to come to the lectures and engage with the material. Calculus (18.01) and introductory macroeconomics (14.02) would be helpful but they are not required.

Requirements and Grading

The course will be graded on a pass/fail scale. Class participation will account for 30% of the grade. A take-home exam will account for the remaining 70%. The exam will be distributed at the end of the last lecture (on February 2) and it will be due in 24 hours (on February 3).

Textbook and Readings

There is no required textbook. We will mainly rely on lecture notes. A number of optional articles complement the lecture notes and will be made available through the website.

Course Plan (Tentative)

January 23 (Mo)	Understanding Financial Crises: Lessons from History
January 24 (Tu)	Borrowing Constraints, the Net Worth Channel, and the Credit Crunch
January 25 (Wed)	Leverage, Fire Sales, and Amplification Mechanisms
January 26 (Th)	Understanding Banks' Losses: Moral Hazard or Mistakes
January 30 (Mon)	Maturity Mismatch and Bank Runs
January 31 (Tu)	Collateralized Debt and Information Based Panics
February 1 (Wed)	Interconnections and Panics
February 2 (Th)	Lessons and Policy Responses
February 2 (Th)	Take Home Exam, due on Friday, February 3

February 1

Interconnections and Panics

McDonald, Robert and Anna Paulson (2015). "AIG in Hindsight." *Journal of Economic Perspectives* 29, no. 2, p.81-106.

(*) Acemoglu, Daron, Asuman Ozdaglar, and Alireza Tahbaz-Salehi (2013). *Systemic Risk and Stability in Financial Networks*. No. w18727. National Bureau of Economic Research.

(*) Caballero, Ricardo J. and Alp Simsek (2013). "Fire Sales in a Model of Complexity." *The Journal of Finance* 68, no. 6, p.2549-2587.

February 2

Lessons and Policy Responses

Bernanke, Ben S. (2009). "The Crisis and the Policy Response." Stamp Lecture, London School of Economics, January 13 (2009).

Kohn, Donald L. (2010). "The Federal Reserve's Policy Actions During the Financial Crisis and Lessons for the Future: A Speech at Carleton University," Ottawa, Canada, May 13 (2010).

Swagel, Phillip (2015). "Legal, Political, and Institutional Constraints on the Financial Crisis Policy Response." *Journal of Economic Perspectives* 29, no. 2, p.107-122.

(*) Caballero, Ricardo J. (2010). "Sudden Financial Arrest." *IMF Economic Review* 58, no. 1, p.6-36.

(*) Hanson, Samuel G., Anil K. Kashyap, and Jeremy C. Stein. "A Macroprudential Approach to Financial Regulation." *Journal of Economic Perspectives* 25, no. 1 (2011): 3-28.

Blanchard, Olivier, Giovanni Dell'Ariccia, and Paolo Mauro (2010). "Rethinking Macroeconomic Policy." *Journal of Money, Credit and Banking*, 42, p.199-215.