Risk-Centric Macroeconomics (14.462a)
Spring 2023

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Course Overview.  Financial markets play an increasingly important role in driving macroeconomic outcomes and policies. Similarly, macroeconomic policies are increasingly central to asset prices and markets. This course reviews the recent literature that delves into the rich set of interactions between financial markets and macroeconomics.

Loosely speaking, financial markets matter for the economy through two main channels: “financial frictions” and “aggregate demand.” Financial frictions refer to informational, behavioral, or institutional factors that constrain the flow of resources from financiers to potential investors, consumers, or firms. Financial intermediaries and markets mitigate financial frictions and therefore facilitate the flow of credit. The failure of intermediaries can lead to credit crunches and financial crises. We covered many of these topics in 14.454. The aggregate demand channel emerges because firms’ and consumers’ spending decisions depend on financial conditions such as interest rates, credit spreads, stock prices, and house prices. Financial conditions are determined in financial markets and drive aggregate demand (hence the “risk-centric”). Monetary policy is concerned with aggregate demand management and therefore closely interacts with financial markets to achieve its objectives.

Although there will be some discussion of the financial frictions channels, the main goal of this course is to introduce the aggregate demand channels of macro-finance interactions and develop their positive and normative implications.

Assignments.

1. One “make-believe” paper outline (40%)
   (a) It must be related to (at least) one of the topics described below
   (b) Structure:
      i. A title and an abstract (100 words or less)
      ii. One intro paragraph based on current news or a very prominent non-model based fact
      iii. One or two paragraphs highlighting how your paper sheds light on the fact (I expect this to be the most “make-believe” part of your outline)
      iv. A five pages (or more) review of the relevant literature. For each subsection, you need to explain what is the value added of your paper over the existing literature (this is also likely to be “make-believe”)
   (c) Due: 04/07/23

2. One long pset (30%). Posted by: 02/10/23. Due: 03/17/23

3. Final (30%). Date: 03/23/23
1 Introduction: asset prices and macroeconomic policy


Suggested further reading:


2 Continuous time macro-finance models and the safe interest rate


Suggested further reading:


3 Risk-centric demand recessions


Suggested further reading:


4 Amplification and large-scale asset purchases


Suggested further reading:


5 Monetary policy shocks and the risk premium


Suggested further reading:


6 Monetary policy with Fed-market disagreements


Suggested further reading:


7 Monetary policy and asset price overshooting


Suggested further reading:


8 Asset pricing implications of optimal monetary policy


Suggested further reading:


9 Safe assets and low interest rates


Suggested further reading on safe assets:


On measuring the convenience yield:


10 Interest rates with supply-demand effects [Reference, only]


*Suggested further reading:*


11 Exchange rates and interest parity


*Suggested further reading:*

- Caballero, R.J. and J.B. Doyle, “Carry Trade and Systemic Risk: Why are FX options so Cheap?” NBER wp18644, December 2012.

12 Exchange rates with supply-demand effects

- Maggiori, Matteo (2022), “International macroeconomics with imperfect financial markets,” *Handbook of international economics*, no. 6, 199-236
Suggested further reading:


13 International capital flows: Stylized facts [Reference, only]


Suggested further reading:


14 International capital flows: A theory of fickleness and retrenchment [Reference, only]


*Suggested further reading:*