

Finance 305: Financial Markets, Institutions, and Economic Activity
Spring 2012

Professor: Dean Corbae

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Office Hours: Tuesday 2-5

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This class will be taught in 2 parts. The first part is designed to understand a particular financial institution - commercial banks - which intermediate between savers (typically households) and borrowers (firms or other households). While there is no required text for this part, a relatively advanced book entitled Microeconomics of Banking (2nd edition) by X. Freixas and J-C Rochet (MIT Press, 2008, FR) will serve as background material (and is available at the UW bookstore). The second part is designed to understand the macroeconomic determinants of saving and borrowing. The lectures will be drawn from terse notes that I will post on my website so I highly recommend class attendance.

Understanding economic and financial data is also critical to the class. To this end, you will be required to read (copies available at the UW bookstore) the NYTimes bestseller This Time is Different; Eight Centuries of Financial Folly by C. Reinhart and K. Rogoff (Princeton University Press, 2010, RR). This book hypothesizes that banking, sovereign default, and exchange rate crises for the last 800 years are the consequence of over leveraging. Each Tuesday, a group will present a 15 minute synopsis of part of a chapter and be prepared to take questions from another group.

Lectures will be based on the following topics

1. The Microeconomics of Financial Intermediation

- (a) Why do financial intermediaries exist? We will focus on diversification and information problems.
- (b) How does regulation impact financial intermediaries?

2. The Macroeconomics of Financial Intermediation

- (a) How do financial intermediaries fit in a global economy? We will focus on the interaction between financial markets and real economic activity. Background texts available at the business school library include S. Williamson Macroeconomics, 4E (Prentice Hall, 2010) or R. Barro Macroeconomics (MITPress, 1997). I have written a set of notes (C) which will be available at the business school copy center.
- (b) How does government fiscal and monetary policy affect financial markets and real economic activity?

Each Thursday there will also be a 15 minute set of 3 group presentations analyzing what happened in the bond, stock, and foreign exchange markets the previous week. The presentation should relate current events to what is learned in class.

There will be a midterm (worth 25 percent) based on 1.a-1.b and a cumulative final (worth 45 percent). Class participation on Reinhart and Rogoff is worth 10 percent. Class participation on current financial analysis is worth 10 percent. Homeworks are worth 10 percent. There will be no makeup exams after the assigned date unless there is a doctor's medical excuse.

Tentative Schedule (Week of):

1/23, FR1 (Introduction to Banking), RR1 (Varieties of Crises and Their Dates)
 1/30, FR3 (Industrial Organization of Banking), RR2 (Debt Intolerance: The Genesis of Serial Default)
 2/6, FR2&7 (Information Problems in Banking), RR4 (A Digression on the Theory of Debt Crises)
 2/13, FR2&7 (Info Problems cont.), RR5 (Cycles of Sovereign Default on External Debt)
 2/20, FR4&5 (Screening, Collateral, & Credit Rationing), RR6 (External Default through History)
 2/27, FR6&8 (Default Risk and Financial Fragility) , RR7 (The Stylized Facts of Domestic Debt and Default)
 3/5, FR9 (Banking Regulation), RR8&9 (Domestic and External Default)
 3/12, C1&2 (Measurement of Aggregate Economic Activity), Tentative Midterm Date
 3/19, C3&9 (Production Decisions), RR10 (Banking Crises)
 3/26, C4,5,&10 (Borrowing and Savings Decisions), RR11&12 (Inflation and Modern Currency Crashes)
 4/9, C4,5,&10 cont. RR13&14 (The U.S. Subprime Crisis: An International and Historical Comparison)
 4/16, C6,7,&8 (Money and Banking), RR15 (The International Dimensions of the Subprime Crisis)
 4/23, C9 (Fiscal and Monetary Policy), RR16 (Composite Measures of Financial Turmoil)
 4/30, C10 (International Trade and Exchange Rates), RR17 (Early Warnings and Policy Responses)
 5/7, Review