

Corporate Finance and the Macroeconomic Crisis
Graduate Program
University of Athens
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- **Overview**

The purpose of this course is to introduce students in a new literature attempting to explain how demand for and supply of liquid assets affect the macroeconomic stability. I use insights from modern corporate finance in order to study how such a theory can explain the pricing of assets, the role of liquidity management, decision on real investment and consumption and how hoarding of liquidity or hedging liquidity risk affect, against Modigliani –Miller irrelevance results.

After a brief focus on the new developments in corporate finance we devote our discussion on Industrial organization issues and explicit microeconomic aspects of banking ignoring traditional textbook material on money and banking. By studying financial imperfections for banking industry as well as the role of financial intermediaries we discuss macroeconomic consequences of financial market imperfections with respect to the transmission channels of monetary policy, the fragility of financial system the existence of financial cycles and the real effects of financial intermediation.

Turning finally our investigation on how governments, along and in conjunction with international investors, provide liquidity (collateral), (through industry and banking bailouts, deposit insurance, the discount window and open market operations i.e. a new inside for Ricardian equivalence), we aim to understand the role of liquidity shortages in financial crisis. We drop first the assumption that income streams are fully pledgeable and second contrary to Arrow – Debreu we introduce a wedge between income and pledgeable income in order to introduce the students on how to the current literature of liquidity supply and liquidity management in lights effective macro policies in a close economy with strong currency regimes.

- **Main textbooks**

Xavier Freixas + J.Charles Rochet “microeconomics of Banking” MIT press **1998**

B. Holmstrom + J. Tirole “inside and outside liquidity” MIT press **2011**

- **Topics to be discussed**

- ❖ **A liquidity Asset Pricing Model**

*[H+T] chapters 1-4.

* Holmstrom B. and J. Tirole, .Private and Public Supply of Liquidity,. Journal of Political Economy, 106(1), pp.1-40, February 1998

Woodford, M., .Public Debt as Private Liquidity, American Economic Review Papers and proceedings, 80(2), pp.382-388, May 1990.

Kiyotaki, N. and J. Moore, .Liquidity and Asset Prices,. in Liquidity and Crises, ed by F. Allen, E. Carletti, J.P. Krahnen, and M. Tyrell, Ch 15, Oxford University Press, 2011

* Caballero, R.J. and A. Krishnamurthy, .Collective Risk Management in a Flight to Quality Episode,.Journal of Finance, 63 (5), pp.2195-2230, October 2008

- ❖ **Aggregate and Wasted Liquidity**

* Caballero, R.J. and A. Simsek, .Fire Sales in a Model of Complexity,. Journal of Finance, 68(6), pp.2549-2587, 2013

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Feijer, D., .Information Panics and Liquidity Crises,.MIT mimeo 2015

Acemoglu, D., A. Ozdaglar, and A. Tahbaz-Salehi, .Systemic Risk and Stability in Financial Networks,.American Economic Review, February 2015

Allen, F., and D. Gale, .Financial Contagion,. Journal of Political Economy, 108(1), pp.1-33, February 2000

❖ Shortage of Assets

Caballero, R.J., .The Other Imbalance and the Financial Crisis, Lezioni Paolo Baç di Moneta e Finanza, Bank of Italy, December 2009

* Caballero, R.J., and E. Farhi, .The Safety Trap,,MIT mimeo March 2015

*Gorton, G.B., and G.L. Ordóñez, .The Supply and Demand for Safe Assets," NBER Working Paper No.18732, January 2013.

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* Stein, Jeremy, .Monetary Policy as Financial Stability Regulation, Quarterly Journal of Economics, 127(1), pp.57-95, February 2012

* Holmstrom, B., .Understanding the Role of Debt in the Financial System,,BIS Working Paper 479, 2015

Caballero, R.J., E. Farhi, and P.O. Gourinchas, .Financial Crash, Commodity Prices, and Global Imbalances,, Brookings Papers on Economic Activity, pp.1-55, Fall 2008

Brunnermeier, M.K, and Y. Sannikov, .The I Theory of Money,, Princeton mimeo, April 2014

Reinhart, C.M., V. Reinhart, and K. Rogoꝛ, .Dealing with Debt, HKS RWP15-009, February 2015

Eggertsson, G. & Mehrotra, N. A Model of Secular Stagnation. Manuscript, Brown University, 2014

Simsek, A. Speculation and Risk Sharing with New Financial Assets, Quarterly Journal of Economics, pp.1365-1396, May 2013

❖ The Transmission channels of monetary policy

*[F+R] chapters 6

Bernanke and Gertler 1987 Banking in general equilibrium *in new approaches to monetary economics* CuP.

Scheinkman J. and L. Weiss 1986 Borrowing constraints and aggregate economic activity *Econometrica*

Tirole J. Lecture notes IDEI Toulouse

❖ Efficient Bank Runs

*[F+L] chapter 7

Bhattacharya and Gale 1987 "preference shocks, liquidity and central bank policy". *New approaches in monetary economics*

Diamond D.W. and Dydvig 1983 "Bank runs, deposit insurance and liquidity". *Journal of Political economy*

❖ Institutional Aspects of Credit Risk

*[F+L] chapter 8.4

❖ Artificial Liquidity

*Martin, A. and J.Ventura: .Theoretical Notes on Bubbles and the Current Crisis, CREI Mimeo February 2011

Caballero, R.J. and A. Krishnamurthy, .Bubbles and Capital Flow Volatility: Causes and Risk Management, Journal of Monetary Economics 53, 33-53, 2006

Martin, A. and J.Ventura: .Managing Credit Bubbles,. CREI Mimeo June 2014

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* Farhi, E. and J.Tirole, .Bubbly Liquidity, Review of Economic Studies, 79(2), pp.678-706, May 2012.

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Caballero, R.J, The Other imbalance and the Financial Crisis., NBER Working Paper No.15636, January 2010

Giglio, S., Maggiori, M. & Stroebe, J. No-Bubble Condition: Model-free Tests in Housing Markets, NBER Working Paper No.20154, May 2014

❖ **Intermediaries and Investment**

Dixit, A., .The Art of Smooth Pasting., Routledge, 1993

*Brunnermeier, M.K. and Y. Sannikov, .A Macroeconomic Model with a Financial Sector., American Economic Review, 104(2), pp.379..421, February 2014

He, Z. and A. Krishnamurthy, Intermediary Asset Pricing., American Economic Review, 103(2), pp.732..770, April 2013

* Bolton, P., H. Chen, and N. Wang. .A Unified Theory of Tobin's q, Corporate Investment, Financing, and Risk Management., Journal of Finance, 66(5), pp.1545..1578, October 2011

❖ **Optimism, Pessimism, and Mistakes**

Akerlof, G.A., .Behavioral Macroeconomics and Macroeconomic Behavior, American Economic Review, 92(3), pp.411-433, June 2002.

Harrison, J.M. & Kreps, D.M., .Speculative Investor Behavior in a Stock Market with Heterogeneous Expectations., Quarterly Journal of Economics, 92(2), pp.323..336, May 1978
Geanakoplos, J., .The Leverage Cycle., NBER Macroeconomics Annual, 24, pp.1..87, October 2009
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* Scheinkman, J.A., and W. Xiong. .Overconfidence and Speculative Bubbles., Journal of Political Economy 111(6), pp.1183-1219, December 2003.

* Simsek, A., .Belief Disagreements and Collateral Constraints., . Econometrica, 81(1), pp.1..53., January 2013.

Brunnermeier, M.A., F. Papakonstantinou, and J.A. Parker, .Optimal Time-Inconsistent Beliefs: Misplanning, Procrastination, and Commitment., Mimeo July 2013.

Beaudy, P. and F. Portier, .News-Driven Business Cycles: Insights and Challenges., Journal of Economic Literature, 52(4), pp.993..1074, December 2014

Lopez-Salido, D., J.C. Stein, and E. Zakrajsek, .Credit-Market Sentiment and the Business Cycle., Harvard mimeo 2014

Benabou, R. and J. Tirole, .Self-Confidence and Personal Motivation," Quarterly Journal of Economics, 117(3), pp.871..915, August 2002

Assenza, T., W.A. Brock, C.H. Hommes, .Animal Spirits, Heterogeneous Expectations and the Emergence of Booms and Busts., Wisconsin mimeo
December 2013

Benabou, R., .Groupthink: Collective Delusions in Organizations and Markets., Review of Economic Studies, 80(2), pp.429..462., January 2013

*Gennaioli, N., A. Shleifer, and R. Vishny, .Neglected Risks: The Psychology of Financial Crises, Harvard mimeo, December 2014

❖ **Waste Liquidity and public policy**

*[H+T] chapter 7

❖ **From an information insensitive to an information sensitive security system**

*Pagano M. and G. Volpin 2009 " Securitization transparency and liquidity Mimeo University of Naples and LBS.

*Dang T.V., G. Gordon and B. Holmstrom 2010 "financial crisis and the optimality of debt for liquidity provision" working paper Yale University

*Amador M. 2008 "sovereign debt and the tragedy of commons" working paper Stanford University