Economics 612: Seminar in Macroeconomics  
Financial Frictions and Liquidity in Macroeconomics

Objectives and Learning Outcomes: This course will introduce students to the literature on banking, liquidity and financial crises in a macroeconomic context. We will go through a number of papers in detail, focusing on both economic issues and modeling approaches. In addition to familiarizing students with this literature, a central aim of the course is to prepare students for conducting original research in macroeconomics. Within the context of the topics outlined below, we will discuss the process of doing research: formulating a question, developing an appropriate model, and deriving and interpreting results. Students will also gain experience in giving research presentations.

Course Requirements: Course grades will be based on the following three categories.

Active participation: Students are expected to read the assigned papers before each meeting and to actively participate in all class discussions by asking and answering questions.

Presentations: Each student will give two in-class presentations. The first presentation will be a critical review of one paper from the reading list below, or of a paper not on this list with my approval. The deadline for choosing a paper to present is February 7. The second presentation may be either a critical review of another paper on this list or a research proposal. If the presentation is a critical review, the deadline for choosing a paper to present is April 11. The precise format and dates for these presentations will be discussed in class.

Research proposal: Each student will write a research proposal based on material covered in the course. This proposal may or may not be related to the student’s second-year paper. The proposal should (i) clearly identify a research question, (ii) provide an overview of the existing literature on the topic and how this question fits into that literature, (iii) describe a model that can be used to answer the question, and (iv) describe a plan of action that would lead to a completed research paper. Depending on the specific project, it may or may not be possible to partially solve the model described in point (iii); either way, the primary focus should be on the research question and the methods that will be used to address it, rather than the solution itself.

A short (two-page) pre-proposal is due by Friday, March 30. The pre-proposal should identify the research question and provide a list of relevant references. The final draft of the research proposal is due by Friday, May 4.

Outline and Readings

The outline below may be revised over the course of the semester. We will not have time to cover all of the sections listed; only a subset will be discussed. Papers marked with an asterisk are the ones I am most likely to cover in class.
I. Financial markets, contracts and intermediaries

(a) Background


(b) Liquidity provision and consumption smoothing


(c) Delegated monitoring


(d) Incomplete contracts and commitment


**Information, banking and liquidity**


**Financial frictions and business cycles**


**II. Causes of banking fragility**

(a) **Introduction**


(b) Optimal banking contracts and fragility


(c) Limited commitment


(d) International dimensions


(e) Other models of banking crises


III. Strategic uncertainty and global games


Morris, S. and H.S. Shin (2000) “Rethinking Multiple Equilibria in Macroeconomics”, NBER Macroeconomics Annual, 139-161. (See also the discussions by A. Atkeson and H. Rey).


IV. Financial policy and regulation

(a) Government guarantees and bailouts


*(b) Capital and liquidity regulation*


(c) Information disclosure


(d) Other macroprudential policies


V. Banking and crises in a macroeconomic setting

(a) Dynamic effects of banking crises


(b) Banking crises and sovereign debt


(c) Other macroeconomic issues


VI. Money, banking and liquidity

(a) Trading frictions and liquidity


(b) Money and banking


**VII. Bubbles**


**VII. Securitization and shadow banking**


