

Kobe University
Graduate School of Economics

Economic and Financial Crises

Syllabus

Third Quarter, 2018

Instructor

Clinton Watkins Ph.D
Office: Building III Room 406
Hours: By appointment

Teaching Assistant

Li Qian

Lecture Times: Tuesday and Thursday, Period 5 (17:00 - 18:30)

Room: I320

Course Description:

The Global Financial Crisis of 2008 took the world by surprise. As the crisis developed, advanced and emerging economies experienced substantial decline in GDP, increase in unemployment, a collapse in international trade, and for several economies the threat of entering a deflationary spiral. Financial markets were volatile, at times illiquid, and largely driven by fluctuations in risk sentiment. Large and systemically important financial institutions became insolvent and major corporations entered bankruptcy. Instability spread across countries and eventually propagated the European sovereign debt crisis. Subsequently, the world has experienced a very slow recovery, and the crisis has been a driving force behind monetary and fiscal policy in many countries over the following decade. Arguably, many economies are poorly prepared in terms of monetary and fiscal policy for the eventual next crisis.

Economic and financial crises are unfortunately a fact of life. During your career, you will likely need to deal with the fallout of several national or international crises. Understanding i) the warning signs to look out for ahead of a crisis, ii) how the economy may change during a crisis cycle, iii) international linkages that may help spread a crisis around the world, and iv) the policies government may use to counter a crisis, can help you and your organisation survive.

We will examine the salient features of past crises in both emerging and developed economies and cover Hyman Minsky's financial instability model in detail. The course will include aspects of economic history, international macroeconomics, international finance, banking and financial markets, regulation, government finances, international relations and politics. By successfully completing this course, students will develop a deep understanding of economic and financial crises, their causes and consequences.

Course Objectives:

By the end of the course, students should be able to identify and and knowledgeably discuss:

1. The warning signs ahead of a crisis.
2. The nature of asset price bubbles.
3. The stages of a typical crisis and the different types of crises.
4. Economic theories of crises, including Minsky's Financial Instability Hypothesis.
5. Implications of crises for the macroeconomy and financial markets.
6. Pros and cons of policy measures used to deal with a crises.
7. The history and lessons of various financial crises.

Credits: 2.0

Language: English

Evaluation:

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| Brief assignments | 10% |
| Presentation and Report on a Financial Crisis | 35% |
| Final Exam | 55% |

Assignments: Brief assignments will be issued approximately weekly. Doing these assignments will help you to learn the concepts covered in the course and prepare you for the questions asked in the final exam. The assignments will be graded coarsely as “good”, “pass” and “fail”.

Report and Presentation: You are required to select a financial crisis, write a report on the crisis and present your research to the class. The report should be around 3000 words, and the presentation around 25 minutes in duration. You may do the report and presentation individually or in a group of two people. Separate guidelines explain what is required of you in more detail. The presentations will be scheduled for the lectures during the last week of the course. The report is due on **Monday 19 November 2018**. The report and presentation should be submitted as PDF files, and these will be made available to the other students in the course on BEEF.

Final Exam: The final exam will be held on **Tuesday 27 November 2018**. In principle, no supplementary exams will be provided unless there are extenuating circumstances. The exam will be closed book. A calculator may be required. Mobile telephones, tablets or other devices are not permitted.

It is your responsibility to make sure you attend the final exam and hand in the required assignments and give the presentation on time.

Prerequisites & Preparation: Revise macroeconomics, finance theory and statistics. Students who have not taken a finance course may need to supplement their knowledge with self study of relevant topics. Refer to one of the following textbooks:

Cecchetti, S. G. and Schoenholtz, K. L. (2015). *Money, Banking and Financial Markets*. McGraw-Hill

Mishkin, F. S. (2013). *The Economics of Money, Banking and Financial Markets*. Pearson

Fabozzi, F. J., Modigliani, F., and Jones, F. J. (2014). *Foundations of Financial Markets and Institutions*. Pearson Education

Textbooks: We will use the following books. Photocopies of the relevant chapters will be provided in the lectures.

Aliber, R. Z. and Kindleberger, C. P. (2015). *Manias, panics and crashes: a history of financial crises*. Palgrave Macmillan, fifth ed. edition

Reinhart, C. M. and Rogoff, K. S. (2009). *This time is different: eight centuries of financial folly*. Princeton University Press

References and Required Readings: References are listed for each topic in the Topic and References Guide. Some of the references will be covered selectively. I will give guidance on the readings in the lectures. Students should aim to read the textbook chapters and are encouraged to read the articles listed for each topic. For some of the articles, reading the introduction may be sufficient. Additional readings from financial newspapers or the Economist may be given and are very short. Optional reading provides more detailed information on the topic and is not required, but will be useful to gain a deeper understanding of the topic for those who are interested. Important references will be provided as handouts during the lectures, and other references will be made available on BEEF.

Books About Financial Crises and Related Topics: The following books are interesting, easy to read and a good way to support your learning during this course. I recommend you read at least one of these

books. Listed in order of priority: Lewis (2011), Wessel (2010), Shiller (2015), Paulson (2010), Cohan (2010).

Andrew Lo reviews 21 books about the financial crisis in the following article.

Lo, A. W. (2012). Reading About the Financial Crisis: A 21-Book Review. *Journal of Economic Literature*, 50(1):151–178.

A great book about Hyman Minsky's ideas is:

Wray, L. R. (2016). *Why Minsky matters: an introduction to the work of a maverick economist*. Princeton University Press, first ed. edition.

Useful Academic Journals: Journals containing theoretical and empirical research on financial crises include: *Journal of Finance*, *American Economic Review*, *Journal of Economic Perspectives*, *Journal of Financial Stability*, *Global Finance Journal*, *International Journal of Central Banking*.

Finance Glossary: Investopedia (www.investopedia.com) or The Economist Economic Terms (<http://www.economist.com/economics-a-to-z>) are useful references for financial terminology. Finance textbooks such as Pilbeam (2010) also contain lists of financial terms.

Useful Websites: The following websites are useful references.

- This Time is Different: <http://reinhartandrogoff.com/>
- NBER Financial Crises in Emerging Markets: <http://www.nber.org/crisis/>
- Philadelphia Federal Reserve: <https://www.philadelphiafed.org/financial-crisis-resources/>
- St Louis Federal Reserve: <https://www.stlouisfed.org/financial-crisis>
- Levy Institute: <http://www.levyinstitute.org/topics/global-financial-crisis>
- International Economics Network: <http://www.internationaleconomics.net/crisis.html>
- Global Issues: <http://www.globalissues.org/article/768/global-financial-crisis>
- Bloomberg: <http://www.bloomberg.com>
- Reuters: <http://www.reuters.com>
- The Wall Street Journal: <http://online.wsj.com/>
- The Financial Times: <http://www.ft.com/>
- The Economist: <http://www.economist.com/>
 - A paper copy of The Economist is available in the library.
- Freakonomics: <http://freakonomics.com/>
- Shiller: <http://www.econ.yale.edu/~shiller/>
- Seeking Alpha: <http://seekingalpha.com/>
- The Calculating Investor: <http://www.calculatinginvestor.com/>
- Top Economics Blogs: <https://www.intelligenteconomist.com/economics-blogs/>
- Yahoo Finance: <http://finance.yahoo.com/>

Topic and References Guide

Topic 1: Course Introduction

References:

- Syllabus.
- Reinhart and Rogoff (2009) Preamble.

Topic 2: Financial System

References:

- Ball, R. (2009). The Global Financial Crisis and the Efficient Market Hypothesis: What Have We Learned? *Journal of Applied Corporate Finance*, 21(4):8–16.
- Coval, J. D., Jurek, J. W., and Stafford, E. (2009). The Economics of Structured Finance. *Journal of Economic Perspectives*, 23(1):3–25.
- Obstfeld, M. (1998). The Global Capital Market: Benefactor or Menace? *Journal of Economic Perspectives*, 12(4):9–30.
- **Optional reading:**
 - For background on the topic, refer to an intermediate finance text.

Topic 3: Crises Overview

References:

- Aliber and Kindleberger (2015), Chapter 1.
- Reinhart and Rogoff (2009) Chapters 1, 2 and 3.
- Zanalda, G. (2015). History of Financial Crises. In *International Encyclopedia of the Social & Behavioral Sciences: Second Edition*, volume 9, pages 183–190. Elsevier, second edition.
- C.W. and A.J.K.D. (2013). Economic history: Was tulipmania irrational ? *The Economist*, October 4
- Claessens, S. and Kose, M. A. (2013). Financial Crises: Explanations , Types , and Implications. International Monetary Fund Working Paper, WP/13/28 (covered selectively).
- **Optional reading:**
 - Eichengreen, B. and Portes, R. (1987). Anatomy of of Financial Crises. NBER Working Paper Series, No. 2126.
 - .

Topic 4: External Sovereign Debt Crises

References:

- Reinhart and Rogoff (2009) Chapters 4, 5 and 6.
- **Optional reading:**
 - Reinhart and Rogoff (2009) Chapters 7, 8 and 9 (on domestic sovereign default).

Topic 5: Banking Crises

References:

- Reinhart and Rogoff (2009) Chapter 10.
- Diamond, D. W. (2007). Banks and Liquidity Creation: A Simple Exposition of the Diamond-Dybvig Model. *Federal Reserve Bank of Richmond Economic Quarterly*, 93(2):189–200.
- **Optional reading:**
 - Diamond, D. W. and Dybvig, P. H. (1983). Bank Runs, Deposit Insurance, and Liquidity. *Journal of Political Economy*, 91(3):401–419.

Topic 6: Inflation and Currency Crises

References:

- Reinhart and Rogoff (2009) Chapter 12.
- **Optional reading:**
 - Reinhart and Rogoff (2009) Chapter 11 (on historical currency debasement).

Topic 7: Minsky's Financial Instability Hypothesis

References:

- Aliber and Kindleberger (2015) Chapter 2.
- The Economist (2016). Economics Briefs Six Big Economic Ideas (Minsky section only).
- **Optional reading:**
 - Minsky, H. P. (1992). The Financial Instability Hypothesis. Levy Economics Institute, Working Paper No. 74

Topic 8: Before a Crisis*

References:

- Aliber and Kindleberger (2015) Chapters 3, 4, 5 and 9 (covered selectively).

Topic 9: International Contagion*

References:

- Reinhart and Rogoff (2009) Chapter 15.
- Aliber and Kindleberger (2015) Chapter 7.

Topic 10: Crisis Resolution***References:**

- Reinhart and Rogoff (2009) Chapter 14 and 17.
- Mishkin, F. S. (2009). Is Monetary Policy Effective during Financial Crises? *The American Economic Review: Papers & Proceedings*, 99(2):573–577.
- C.R. (2013). What can we learn from the Depression? *The Economist*, November 8.
- **Optional reading:**
 - Aliber and Kindleberger (2015) Chapters 10, 11 and 12.

Topic 11: Measuring Financial Turmoil***References:**

- Reinhart and Rogoff (2009) Chapter 16.

Topic 12: Analysis of Selected Financial Crises**References:**

- Student reports and presentations.

Note:

- The topics and schedule may be adjusted during the course.
- Topics marked with an asterisk will be covered selectively depending on the time available. We likely will not have time to cover all of these topics fully.
- Additional readings may be assigned in lectures.

References

- Aliber, R. Z. and Kindleberger, C. P. (2015). *Manias, panics and crashes: a history of financial crises*. Palgrave Macmillan, fifth ed. edition.
- Ball, R. (2009). The Global Financial Crisis and the Efficient Market Hypothesis: What Have We Learned? *Journal of Applied Corporate Finance*, 21(4):8–16.
- Cecchetti, S. G. and Schoenholtz, K. L. (2015). *Money, Banking and Financial Markets*. McGraw-Hill.
- Claessens, S. and Kose, M. A. (2013). Financial Crises: Explanations , Types , and Implications. International Monetary Fund Working Paper, WP/13/28.
- Cohan, W. D. (2010). *House of cards: a tale of hubris and wretched excess on Wall Street*. Anchor Books.
- Coval, J. D., Jurek, J. W., and Stafford, E. (2009). The Economics of Structured Finance. *Journal of Economic Perspectives*, 23(1):3–25.
- C.R. (2013). What can we learn from the Depression? *The Economist*, November 8.
- C.W. and A.J.K.D. (2013). Economic history: Was tulipmania irrational ? *The Economist*, October 4.
- Diamond, D. W. (2007). Banks and Liquidity Creation: A Simple Exposition of the Diamond-Dybvig Model. *Federal Reserve Bank of Richmond Economic Quarterly*, 93(2):189–200.
- Diamond, D. W. and Dybvig, P. H. (1983). Bank Runs, Deposit Insurance, and Liquidity. *Journal of Political Economy*, 91(3):401–419.
- Eichengreen, B. and Portes, R. (1987). Anatomy of of Financial Crises. NBER Working Paper Series, No. 2126.
- Fabozzi, F. J., Modigliani, F., and Jones, F. J. (2014). *Foundations of Financial Markets and Institutions*. Pearson Education.
- Lewis, M. M. (2011). *The Big Short: Inside the Doomsday Machine*. W.W. Norton, first edition.
- Lo, A. W. (2012). Reading About the Financial Crisis: A 21-Book Review. *Journal of Economic Literature*, 50(1):151–178.
- Minsky, H. P. (1992). The Financial Instability Hypothesis. Levy Economics Institute, Working Paper No. 74.
- Mishkin, F. S. (2009). Is Monetary Policy Effective during Financial Crises? *The American Economic Review: Papers & Proceedings*, 99(2):573–577.
- Mishkin, F. S. (2013). *The Economics of Money, Banking and Financial Markets*. Pearson.
- Obstfeld, M. (1998). The Global Capital Market: Benefactor or Menace? *Journal of Economic Perspectives*, 12(4):9–30.
- Paulson, H. M. (2010). *On the brink: inside the race to stop the collapse of the global financial system*. Business Plus.
- Pilbeam, K. (2010). *Finance and Financial Markets*. Palgrave Macmillan.
- Reinhart, C. M. and Rogoff, K. S. (2009). *This time is different: eight centuries of financial folly*.

Princeton University Press.

Shiller, R. J. (2015). *Irrational Exuberance*. Princeton University Press.

The Economist (2016). Economics Briefs Six Big Economic Ideas.

Wessel, D. (2010). *In Fed we trust: Ben Bernanke's war on the great panic*. Three Rivers Press.

Wray, L. R. (2016). *Why Minsky matters: an introduction to the work of a maverick economist*. Princeton University Press, first ed. edition.

Zanaldà, G. (2015). History of Financial Crises. In *International Encyclopedia of the Social & Behavioral Sciences: Second Edition*, volume 9, pages 183–190. Elsevier, second edi edition.