Lecture 7: Brunnermeier and Reis, Ch. 1-4

ECON 43370: Financial Crises

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Ch. 2: Theory

How do bubbles exist/persist with sophisticated investors?

- Extrapolative expectations
- Hyman Minsky
- $k-$level reasoning
- Keynesian beauty contests
- Macroprudential regulation

Chapter 2: Applications

1. Japanese bubble of mid 1980s
2. US “dot-com” bubble

Chapter 2: Discussion

- Isaac Newton: "I can calculate the motion of heavenly bodies, but not the madness of people." Should we try to identify and prick bubbles?

- Why did the dot-com bubble bursting <u>not</u> trigger a widespread financial crisis?

- Are bubbles all bad?

- Cyclical of capital ratios

Chapter 3: Theory

Capital tends to flow from high- to low-income countries. Why?

Low-income countries are often poor at allocating capital. Why?

- Within- and across-sector misallocation
- Production possibilities

Chapter 3: Applications

1. Portugese 21st century slump
    - Current and capital account
    - Maastricht Treaty
2. Chilean liberalization

Chapter 3: Discussion

- How does asymmetric information help explain poor allocation of capital in developing countries?
- What about rule of law and health of institutions? Lessons for the US?

Chapter 4: Traditional vs. Shadow Banking

- Wholesale funding
- Mark-to-market
- Securitization
- Haircut
- Repurchase agreement (repo)
- Collateral and seniority

Chapter 4: Applications

1. US subprime mortgages
2. Spanish credit boom
   - European non-financial firms are more reliant on bank loans than US firms (capital markets relatively more important)

Chapter 4: Discussion

- Why is that modern shadow banks can grow so quickly?
- Financial accelerator
- Capital and moral hazard
- Why <u>dynamic</u> regulation?