

Econ 54
Financial Crises and Macroeconomic Policy
WINTER 2019

Instructor: Pablo Cuba-Borda

Class hours: 01/04: 9:30am-12:30pm and 2:00pm-5:00pm — 01/11 to 01/25: Mon 9:30am-12:30pm, Fr 2-5:00pm.

Location: Greylock Hall. Room TBD.

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Office Hours: Th, 6:30-8:30pm, Skype

Overview

Financial Crises are a common feature of modern economies and have affected emerging and developed countries alike. Frictions in the financial sector can amplify aggregate fluctuations originating in other sectors of the economy or the financial sector can be a source of macroeconomic instability on its own. This course studies both dimensions of financial instability by examining the experiences in the build-up and aftermath of financial Crises in developed and developing countries. We will study empirical regularities across three forms of financial crises: currency crises, sovereign debt crises, and banking crises, and provide a theoretical framework to think about the transmission mechanism of shocks in each of them. Finally we will discuss the role of policy responses like exchange rate policies, interest rate policies and capital controls.

Objectives

There are two key goals of this course: first, to analyze the causes, costs and consequences of financial crises, and second, to work on how to write about economic issues, which will be important both for the spring semester and for the remainder of your professional lives.

Course Requirements

Evaluations for the course will include two (2) written assignments and your participation in class (including the presentation of your final paper). The first written assignment will be a **short piece** (2-3 pages) geared to a general audience (e.g. an article that would appear in the Wall Street Journal or The Economist) describing the crisis in a country other than your own. The second assignment will be a **final paper** (10-12 pages) about your own country, analyzing either a recent financial Crises or its vulnerability to a future one. You are expected to make an effort to find and analyze data that would support the analysis in your final paper. **Student presentations** will be based on your final paper, each student will have 10 minutes to present in class followed by 5 minutes of discussion. Along with the rest of the CDE class, you will receive instruction in writing as well as the opportunity to work with a writing tutor.

Required Readings and Text

The course will be based mainly on readings from journals and working papers. Although there is no required textbook, we will use some chapters from Montiel, P. (2012). *Ten Crisis*. Routledge. I strongly encouraged you to obtain a copy. **Readings indicated with (*) are required.**

Course Outline and Schedule

1 Anatomy of Crises (01/04)

- (*) Mendoza, E. G. and Terrones, M. E. (2012). An Anatomy of Credit Booms and their Demise. Working Paper 18379, National Bureau of Economic Research
- (*) Jorda, O., Schularick, M. H., and Taylor, A. M. (2013). Sovereigns versus Banks: Credit, Crises, and Consequences. Working Paper 19506, National Bureau of Economic Research
- Reinhart, C. M. and Rogoff, K. S. (2014). Recovery from Financial Crises: Evidence from 100 Episodes. *American Economic Review: Papers and Proceedings*, 104(5):50–55
- Chapter 1, Montiel, P. (2012). *Ten Crisis*. Routledge

2 Currency Crises (01/04)

- (*) Chapter 27, Montiel, P. (2011). *Macroeconomics in Emerging Markets*. Cambridge University Press
- (*) Glick, R. and Hutchison, M. (2013). Models of Currency Crises. In Caprio, G., Beck, T., Claessens, S., and Schmukler, S. L., editors, *The Evidence and Impact of Financial Globalization*, pages 485 – 497. Academic Press, San Diego
- Montiel, P. J. (2013). The Simple Analytics of Sudden Stops. *Open Economies Review*, 24(2):267–281
- Reinhart, C., Calvo, G., and Leiderman, L. (1993). Capital Inflows and Real Exchange Rate Appreciation in Latin America: The Role of External Factors. Technical report

3 Banking Crises (01/04)

- (*) Mian, A. and Sufi, A. (2018). Finance and Business Cycles: The Credit-Driven Household Demand Channel. *Journal of Economic Perspectives*, 32(3):31–58
- (*) Laeven, L. and Valencia, F. (2013). Systemic Banking Crises Database. *IMF Economic Review*, 61(2):225–270
- Gerard Caprio, J. and Honohan, P. (2008). Banking Crises. The Institute for International Integration Studies Discussion Paper Series iisd242, IIS
- Calvo, G. (2009). Financial Crisis and Liquidity Shocks: A Bank Run Perspective. Working Paper 15425, National Bureau of Economic Research

4 Debt Crises (01/11)

- (*) Hatchondo, J. C., Martinez, L., and Saprizo, H. (2007). The Economics of Sovereign Defaults. *Economic Quarterly*, (Spr):163–187
- (*) Reinhart, C. M. and Rogoff, K. S. (2011). From Financial Crash to Debt Crisis. *American Economic Review*, 101(5):1676–1706
- Reinhart, C. M., Reinhart, V., and Trebesch, C. (2016). Global Cycles: Capital Flows, Commodities, and Sovereign Defaults, 1815-2015. Working Paper 21958, National Bureau of Economic Research

5 Overlapping Crises (01/11)

- (*) Kaminsky, G. L. and Reinhart, C. M. (1999). The Twin Crises: The Causes of Banking and Balance-of-Payments Problems. *American Economic Review*, 89(3):473–500
- (*) Kaminsky, G. L., Reinhart, C. M., and Vegh, C. A. (2004). When It Rains, It Pours: Procyclical Capital Flows and Macroeconomic Policies. *NBER Macroeconomics Annual*, 19:11–53
- Diaz-Alejandro, C. (1985). Good-bye financial repression, hello financial crash. *Journal of Development Economics*, 19(1):1 – 24
- Reinhart, C. M. (2002). Default, Currency Crises and Sovereign Credit Ratings. Working Paper 8738, National Bureau of Economic Research

***** First written assignment: due on Friday 01/14 in class *****

6 Case Studies (01/14)

The Good Old Nineties: Mexico and East Asia

- (*) Radelet, S. and Sachs, J. (1998). The Onset of the East Asian Financial Crisis. Working Paper 6680, National Bureau of Economic Research
- (*) Calvo, G. A. and Mendoza, E. G. (1996). Mexico's balance-of-payments crisis: a chronicle of death foretold. Technical report
- Chapter 4 and 5: Montiel, P. (2012). *Ten Crisis*. Routledge
- Corsetti, G., Pesenti, P., and Roubini, N. (1998). What Caused the Asian Currency and Financial Crisis? Part I: A Macroeconomic Overview. Working Paper 6833, National Bureau of Economic Research

The New Millenium: Russia, Turkey and Argentina

- (*) 9: Montiel, P. (2012). *Ten Crisis*. Routledge
- (*) Edwards, S. (2002). The Great Exchange Rate Debate After Argentina. Working Paper 9257, National Bureau of Economic Research
- (*) Chiodo, A. J. and Owyang, M. T. (2002). A case study of a currency crisis: the Russian default of 1998. *Review*, (Nov):7–18

- Calvo, G. A., Izquierdo, A., and Talvi, E. (2003). Sudden Stops, the Real Exchange Rate, and Fiscal Sustainability: Argentina's Lessons. Working Paper 9828, National Bureau of Economic Research

7 Recent Financial Crisis (01/18)

The Great Financial Crisis

- (*) Gertler, M. and Gilchrist, S. (2018). What Happened: Financial Factors in the Great Recession. *Journal of Economic Perspectives*, 32(3):3–30
- (*) Reinhart, C. M. and Rogoff, K. S. (2008). Is the 2007 U.S. Subprime Financial Crisis So Different? An International Historical Comparison. *American Economic Review*, 98(2):339–44
- Brunnermeier, M. K. (2009). Deciphering the Liquidity and Credit Crunch 2007-2008. *Journal of Economic Perspectives*, 23(1):77–100

The European Debt Crisis

- (*) Lane, P. R. (2012). The European Sovereign Debt Crisis. *Journal of Economic Perspectives*, 26(3):49–68
- Romer, C. D. and Romer, D. H. (2017). New Evidence on the Aftermath of Financial Crises in Advanced Countries. *American Economic Review*, 107(10):3072–3118

Back to the Future: Turkey and Argentina

- (*) Kalemli-Ozcan, S. (2018). Crisis in Turkey and Lessons for Italy. Technical report
- (*) The New York Times (2018). Why Turkey's Crisis Feels Familiar for Emerging Markets: It's the Debt
- (*) The Wall Street Journal (2018). How Argentina's Evolving Economic Crisis Unfolded

*** Paper presentations: Monday 01/21 ***

*** Final paper: due Friday 01/25 at 5pm ***