Spring: The Theory of Financial Crises
Instructor: Andrew Mountford
Office: Horton 309
Phone: +44 (0) 1784 443906
E-mail: A.Mountford@rhul.ac.uk
Office hours: TBA

Aims
The course's aim is to provide a theoretical economic analysis of the fragility of the financial system and its relevance to the current financial crisis. The course's textbook will be Freixas and Rochet “Microeconomics of Banking”. But will also use "Understanding Financial Crises", Clarendon Lectures in Finance by Franklin Allen and Douglas Gale. It will include analysis of bank runs and the theory of financial regulation and analysis of the implications of asset price bubbles for financial stability.

Learning Outcomes
Upon completion of this course students should:
• Develop a critical understanding of some models of bank runs and financial fragility
• be able to solve the sort of problems that will be assigned in class
• be able to identify applications and limitations of the models learned
• be able to suggest ways in which the models learned might be extended or improved

Course Delivery
The course is a one semester course which will be given in the Spring semester. There will be one two-hour lecture per week and one seminar per week. The lectures will be used primarily for expounding economic theory and the seminars for going through problem sets although there may be some reversal of this demarcation of lectures and seminars in some weeks. Although these will not be part of the formal method of evaluation, you are advised that solving the problems will be of enormous help in examinations and tests. Seminar attendance is compulsory and you should prepare answers to the problems before the weekly seminars and expect to present them to the rest of the group.

Textbooks
Microeconomics of Banking, Xavier Freixas and Jean-Charles Rochet, MIT Press (2008)
Understanding Financial Crises, Clarendon Lectures in Finance by Franklin Allen and Douglas Gale OUP (2009)

Assessment
A Mid-Term exam during one of the lecture periods will comprise 25% of the final mark. An unseen examination in the summer term will contribute the remaining 75% to the final mark. Please refer to the student handbook for the scheduling of these exams.
Timetable
Note that the following timetable is indicative and that not all topics may be covered

**Week 1 Introductory Concepts and Financial Crises in History**
At the end of this part of the course you should understand the concepts of solvency and liquidity and the broad facts about the history of banking crises and the associated literature on their predictability.
Readings
Allen and Gale, chapter 1
This Time is Different, Eight Centuries of Financial Folly, Carmen Reinhart and Kenneth Rogoff, Princeton University Press (2009)

**Homeworks**

**Week 2 The Diamond and Dybvig Model of Bank Runs**
At the end of this part of the course you should understand a model of bank runs based on the analysis of Diamond and Dybvig and demonstrate an ability to solve problems based on this model.
Readings
Freixas and Rochet, Chapter 7

**Homework**

**Week 3 The Allen and Gale Model of Bank Runs**
At the end of this part of the course you should understand a model of bank runs based on the analysis of Allen and Gale and demonstrate an ability to solve problems based on this model.
Readings
Freixas and Rochet, Chapter 7
Allen and Gale, chapter 3.

**Homework –**

**Week 4 Policy Responses for dealing with Financial Crises**
At the end of this part of the course you should understand and be able to answer questions based on deposit insurance, suspension of convertibility and the problem of moral hazard
Readings
Freixas and Rochet, chapter 2 and chapter 7
Week 5 Asset Price Bubbles and Financial Crisis
At the end of this part of the course you should understand a model of asset price bubbles and financial crises and demonstrate an ability to solve problems based on this model.
Readings
Allen and Gale, chapter 10.
Homework –

READING WEEK

Week 6 MID-TERM EXAM

Week 7 The Crisis of 2007-8 and its aftermath
At the end of this part of the course you should understand the broad facts about the 2007-8 financial crisis including the growth of securitization
Readings
Homeworks

Week 8 Contagion and Financial Stability
At the end of this part of the course you should understand a model of contagion and financial stability and demonstrate an ability to solve problems based on this model.
Readings
Freixas and Rochet, Chapter 7
Allen and Gale, chapter 11.
Homework –

Week 9 The Macroeconomics of Financial crises
At the end of this part of the course you should understand a model of the macroeconomic implications of financial crises and demonstrate an ability to solve problems based on this model.
Readings
Freixas and Rochet, Chapter 5 and 6
Homework –

Week 10 Revision