UG Course Outline
EC3315: Understanding Financial Crises’
2017/18

Aims
The course’s aim is to provide an economic analysis of the fragility of the financial system and to relate it to the current financial situation. The course’s analysis will broadly follow the analysis found in "Understanding Financial Crises”, Clarendon Lectures in Finance by Franklin Allen and Douglas Gale and will include an analysis of bank runs, financial fragility and 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

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 the 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. You are advised that solving the homework problems will be of enormous help in preparing for the final examination, although they will not be part of the formal method of evaluation. You should prepare answers to the problems before the weekly seminars and expect to present them to the rest of the group. As with all courses in the department, failure to attend seminars can lead to students being issued with a formal warning, which could lead to the termination of registration (please see the college regulations for more information).

Note that lecture notes and homework answer sheets are NOT given out or placed on Moodle in this course. This has been a successful policy in previous years and will not be changing this year. Please note that while seminar attendance is compulsory and is monitored by the department, attendance at lectures is also an essential part of the course.

Assessment
This course is assessed 100% by an unseen examination in the summer term. There will be a mid-term test but this is to provide students with feedback and exam practise and will not contribute to the final grade. Please refer to the student handbook for the scheduling of the summer exam.
Communication and Office Hours
I will endeavour to answer emails within three working days during term time. Most questions will be answered by going over the material at the start of the next lecture or seminar so that all students can benefit. However if you do want to go through something directly with me then you can email to arrange a slot during my office hours. Please note that I do not answer homework questions directly by email.

Textbooks
Understanding Financial Crises, Clarendon Lectures in Finance by Franklin Allen and Douglas Gale, OUP (2009)

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 students should understand the concepts of solvency and liquidity in the context of banking and some broad facts about the history of banking crises.

Readings
Allen and Gale, chapter 1

Homework-- On Banks’ Balance sheets, Leverage and Solvency.

Week 2 The Market for Liquidity Insurance
At the end of this part of the course you should understand the demand for liquidity insurance and how the market can provide this.

Readings
Allen and Gale, chapter 3.

Homework -- On liquidity insurance

Week 3 Equilibrium Banks Runs and 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 Allen and Gale and demonstrate an ability to solve problems based on this model.

Readings
Allen and Gale, chapter 3.

Homework -- Exercizes on models of the Diamond and Dybvig Model of bank runs
Week 4 Equilibrium Banks Runs and 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
Allen and Gale, chapter 3.

Homework – Exercises on Allen and Gale model of bank runs

Week 5 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
Allen and Gale, chapter 3.
Freixas X. and J. Rochet (2008), The Microeconomics of Banking, MIT press

Homework Exercizes

Week 6 READING WEEK

Week 7 MID-TERM EXAM

Week 8 Asset Price Bubbles and Financial Crisis
At the end of this part of the course you should understand the implications of asset price bubbles for financial stability and demonstrate an ability to solve problems based on this model.

Readings
Allen and Gale, chapter 9.

Homework – Exercises

Week 9 Contagion and Financial Stability
At the end of this part of the course you should understand a model of financial stability and contagion based on the analysis of Allen and Gale and demonstrate an ability to solve problems based on this model.
Readings
Allen and Gale, chapter 10.
Freixas X. and J. Rochet (2008), The Microeconomics of Banking, MIT press

Homework – on markets structures and contagion

Week 10 The Crisis of 2007 and its aftermath

At the end of this part of the course you should understand the broad facts about the 2007 including the securitization

Readings
Reinhart C., and K. Rogoff, This Time is Different , Eight Centuries of Financial Folly, Princeton University Press (2009)

Homework – discussion of literature and revision

Week 11 Revision