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 that of the book "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
- 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 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. 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 failure to attend can lead to students being awarded an Attendance Fail (AF; please see the college regulations for more information). You should prepare answers to the problems before the weekly seminars and expect to present them to the rest of the group.
Textbook

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 students should understand the concepts of solvency and liquidity and the broad facts about the history of banking crises and their predictability.

Readings

Allen and Gale, chapter 1


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


Homeworks - Exercices on Banks Balance sheets and solvency

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

Allen and Gale, chapter 3.


Homework -- Exercices on models of bank runs based on Diamond and Dybvig
**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**

Allen and Gale, chapter 3.


**Homework – Exercises on models of bank runs**

**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**

Allen and Gale, chapter 3.

Freixas X. and J. Rochet (2008), The Microeconomics of Banking, MIT press

**Homework Exercises**

**Week 5 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 6  MID-TERM EXAM

Week 7 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


Week 8 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.


Homework – on markets structures and contagion

Week 9 Currency Crises

At the end of this part of the course you should have some knowledge and understanding of so called “first generation” models of currency crises where speculative attacks are predictable and caused by inconsistent domestic and exchange rate policies and so called “second generation” models of currency crises where models are unpredictable due to the presence of multiple equilibria. The analysis of Allen and Gale will also be discussed.

Readings

Allen and Gale, chapter 8


Homework – Exercizes

Week 10 Revision