

Syllabus

This module covers a range of topics in asset pricing, corporate finance and banking. The goal of the course is to shed light on the workings of financial markets and financial intermediation and understand their impact on the real economy. The first part focuses on the ‘ubiquitous’ notion of liquidity: we analyze some determinants of market liquidity in the context of simple market microstructure models with frictions, and we discuss the determinants of funding liquidity in the light of basic corporate finance applications of contract theory. The second part of the course focuses on financial (in)stability. We analyze how the inherent fragilities of a securitized banking system played out during the 2008 crisis, we study the amplification of shocks through asset market feedbacks, we discuss policy responses to the crisis and its real effects on the US economy. We also reflect on the central role played by safe assets in the international financial system and analyze the world supply and demand for safe government debt. The last part of the course takes a longer view on asset market valuation. We provide a framework to decompose return volatility into shocks on cashflows and discount rates and we review the insights from standard consumption-based asset pricing models to interpret stock market fluctuations. The lectures are based on selected papers, both theoretical and empirical. Lecture notes will be posted every week on the course webpage <https://sites.google.com/site/sguibaud/FinEcon>

Lecture 1: Market Liquidity, Funding Liquidity and Liquidity Management

- Tirole, J., 2011, “Illiquidity and All Its Friends,” *Journal of Economics Literature*, 49:2, 287-325.

Lecture 2: Determinants of Market Liquidity

- Greenwood, R., 2005, “Short- and Long-Term Demand Curves for Stocks,” *Journal of Financial Economics*, 75, 607-649.
- Vayanos, D. and J. Wang, 2009, “Liquidity and Asset Prices: A Unified Framework,” working paper.
- Vayanos, D. and J. Wang, 2011, “Theories of Liquidity,” *Foundations and Trends in Finance*, vol. 6(4), 221-317.

Lecture 3: Limits to Arbitrage and Intermediary Asset Pricing

- Shleifer, A. and R. Vishny, 1997, “The Limits of Arbitrage,” *Journal of Finance*, 52(1), 35-55.
- Coval J. and E. Stafford, 2007, “Asset Fire Sales (and Purchases) in Equity Markets,” *Journal of Financial Economics*, 86, 479-512.

- Lamont, O., and R. Thaler, 2003, “Can the Market Add and Subtract?,” *Journal of Political Economy*, 2003, 111(2), 227-268.
- Gromb, D. and D. Vayanos, 2002, “Equilibrium and Welfare in Markets with Financially Constrained Arbitrageurs,” *Journal of Financial Economics*, 2002, 66, 361-407.
- Gromb, D. and D. Vayanos, 2010, “Limits of Arbitrage: the State of the Theory,” *Annual Review of Financial Economics*, 2, 251-275.

Lecture 4: External Financing under Moral Hazard and Adverse Selection

- Tirole, J., 2006. *The Theory of Corporate Finance*, MIT Press. Chapters 3, 4, and 6.
- Holmstrom, B. and J. Tirole, 1997, “Financial Intermediation, Loanable Funds, and the Real Sector,” *Quarterly Journal of Economics*, 112(3), 663-691.

Lecture 5: Evidence on Firm’s Access to External Financing

- Fazzari, S., G. Hubbard, and B. Petersen, 1988, “Financing Constraints and Corporate Investment,” *Brookings Papers on Economic Activity*, 141-195.
- Kaplan, S. and L. Zingales, 1997, “Do Investment-Cash Flow Sensitivities Provide Useful Measures of Financing Constraints?,” *Quarterly Journal of Economics*, 112(1), 169-215.
- Lamont, O., 1997, “Cash Flow and Investment: Evidence from Internal Capital Markets,” *Journal of Finance*, 52(1), 831-909.
- Rauh, J., 2006, “Investment and Financing Constraints: Evidence from the Funding of Corporate Pension Plans,” *Journal of Finance*, 61(1), 337-371.
- Chaney, T., D. Sraer, and D. Thesmar, 2012, “The Collateral Channel: How Real Estate Shocks Affect Corporate Investment,” *American Economic Review*, 102(6), 2381-2409.
- Benmelech, E. and N. Bergman, 2009, “Collateral Pricing,” *Journal of Financial Economics*, 91, 339-360.

Lecture 6: The Securitized Banking System and the 2008 Crisis

- Brunnermeier, M., 2009, “Deciphering The Liquidity And Credit Crunch 2007-2008,” *Journal of Economic Perspectives*, 23(1), 77-100.
- Coval, J., Jurek J., and E. Stafford, 2009, “The Economics of Structured Finance,” *Journal of Economic Perspectives*, 23(1), 3-25.
- Acharya, V., Schnabl P., and G. Suarez, 2013, “Securitization without Risk Transfer,” *Journal of Financial Economics*, 107, 515-536.
- Gorton, G. and A. Metrick, 2012, “Securitized Banking and the Run on Repo,” *Journal of Financial Economics*, 104, 425-451.

- Covitz, D., Liang N. and G. Suarez, 2013, “The Evolution of a Financial Crisis: Collapse of the Asset-Backed Commercial Paper Market,” *Journal of Finance*, 68(3), 815-848.
- Pozsar, Z., Adrian T., Ashcraft A., and H. Boesky, 2010, “Shadow Banking,” Federal Reserve Bank of New York Staff Report.
- Mian, A., and A. Sufi, 2011, “House Prices, Home Equity-Based Borrowing, and the US Household Leverage Crisis,” *American Economic Review*, 101(5), 213256.

Lecture 7: Deleveraging and Asset Market Feedbacks

- Kiyotaki, N. and J. Moore, 1997, “Credit Cycles,” *Journal of Political Economy*, 105(2), 211-248.
- Shleifer, A. and R. Vishny, 1992, “Liquidation Values and Debt Capacity: A Market Equilibrium Approach,” *Journal of Finance*, 47(4), 134-166.
- Geanakoplos, J., 2009, “The Leverage Cycle,” *NBER Macroeconomics Annual*, 24, 1-66.
- Fostel, A. and J. Geanakoplos, 2008, “Leverage Cycles and the Anxious Economy,” *American Economic Review*, 98(4), 1211-44.
- Greenwood, R., A. Landier and D. Thesmar, 2015, “Vulnerable Banks,” *Journal of Financial Economics*, 115, 471-485.

Lecture 8: Policy Response to the 2008 Crisis and Real Effects

- Tirole, J., 2012, “Overcoming Adverse Selection: How Public Intervention Can Restore Market Functioning,” *American Economic Review*, 102(1), 29-59.
- Ivashina, V. and D. Scharfstein, 2010, “Bank Lending During the Financial Crisis of 2008,” *Journal of Financial Economics*, 97(3), 319-338.
- Puri, M., Rochol, J. and S. Steffen, 2011, “Global Lending in the Aftermath of the US Financial Crisis,” *Journal of Financial Economics*, 100(3), 556-578.
- Campello, M., J. Graham, C.R. Harvey, 2010, “The Real Effects of Financial Constraints: Evidence from a Financial Crisis,” *Journal of Financial Economics*, 97(3), 470-487.

Lecture 9: The World Supply and Demand for Safe Assets

- Farhi, E., and M. Maggiori, 2016, “A Model of the International Monetary System,” working paper.
- He, Z., A. Krishnamurthy, and K. Milbradt, 2016, “A Model of Safe Asset Determination,” working paper.

Lecture 10: A Variance Decomposition for Asset Market Fluctuations

- Campbell, J., and R. Shiller, 1988, “The Dividend-Price Ratio and Expectations of Future Dividends and Discount Factors,” *Review of Financial Studies*, 1(3), 195-227.
- Campbell, J., 1991, “A Variance Decomposition for Stock Returns,” *Economic Journal*, 101, 157-179.

Lecture 11: Insights from Consumption-Based Asset Pricing Models

- Lucas, Robert, 1978, “Asset Prices in an Exchange Economy,” *Econometrica*, 46(6), 1429-1445.
- Mehra, R., and E. Prescott, 1985, “The Equity Premium: A Puzzle,” *Journal of Monetary Economics*, 15, 145-161.
- Epstein, L., and S. Zin, 1989, “Substitution, Risk Aversion, and the Temporal Behavior of Consumption and Asset Returns: A Theoretical Framework,” *Econometrica*, 57, 937-968.
- Campbell, J., and J. Cochrane, 1999, “By Force of Habits: A Consumption-Based Explanation of Aggregate Stock Market Behavior,” *Journal of Political Economy*, 107, 205-251.
- Bansal, R., and A. Yaron, 2004, “Risks for the Long Run: A Potential Resolution of Asset Pricing Puzzles,” *Journal of Finance*, 59, 1481-1509.
- Campbell, J., S. Giglio, and C. Polk, 2013, “Hard Times,” *Review of Asset Pricing Studies*, 3(1), 95-132.