IWH-DPE/CGDE

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October 30, 2018 – November 2, 2018

SPECIAL COURSE
Microeconomics of Banking

Course Description

Based on a solid understanding of the main frictions prevailing in financial we will first discuss the key frameworks in banking theory which allow to understand how banks mitigate these frictions. Second, we will analyze why banks that perform these tasks are necessarily fragile and entail the risk of financial contagion. This permits us then to study in a third step the effect of competition in the banking sector in particular and in the financial system in general on financial stability. Finally, we will discuss whether and if so how the government should intervene in the banking sector to mitigate excessive fragility and contain financial contagion.

Schedule

Part 1: Economic Role of Banks in the Financial System

October 30: 10:00–12:30 and 13:30–16:00

Part 2: Financial Contagion

October 31: 10:00–12:30 and 13:30–16:00

Part 3: Banking Competition and Financial Stability

November 1: 10:00–12:30 and 13:30–16:00

Part 4: Government Intervention

November 2: 09:00–12:00

Exam

There will be two problem sets distributed during the course. They jointly account for 40% of your grade. In addition, you will have to write a referee report on an assigned paper. Referee reports are due 4 weeks after the course and account for 60% of your grade.

Venue

Halle Institute for Economic Research (IWH) – Member of the Leibniz Association, Kleine Maerkerstrasse 8, 06108 Halle (Saale), Germany, conference room (ground floor).

Registration

Please contact Annett Hartung, Phone: +49 345 7753 751, E-mail: annett.hartung@iwh-halle.de, until October 15, 2018.

The course is designed for at most 25 participants.

Review Papers

Part 0: Adverse Selection and Moral Hazard in Financial Markets

*Tirole, J. (2006), “The Theory of Corporate Finance”, chapters 3.2 & 6.2, Princeton University Press.

Part 1: Economic Role of Banks in the Financial System

*Diamond, D. (1984), "Financial Intermediation and Delegated Monitoring," Review of Economic Studies, vol. 51, pp. 393-414.

*Diamond, D.W., and Dybvig, P.H. (1983), "Bank Runs, Deposit Insurance, and Liquidity," Journal of Political Economy, vol. 91, pp. 401-419.

*Diamond, D. and R. Rajan (2001), "Liquidity Risk, Liquidity Creation and Financial Fragility: A Theory of Banking," Journal of Political Economy, vol. 109, pp. 287-327.

*Holmström, B. and J. Tirole (1997), "Financial Intermediation, Loanable funds and the Real Sector ," Quarterly Journal of Economics, vol. 112, pp. 663- 691.

Kashyap, A. K., R. Rajan and J. C. Stein (2002), "Banks as Liquidity Providers: An Explanation for the Coexistence of Lending and Deposit Taking," Journal of Finance, vol. 57, pp. 33-73.

Rajan, R G (1992), " Insiders and Outsiders: The Choice between Informed and Arm's-Length Debt," Journal of Finance, American Finance Association, vol. 47(4), pages 1367-400, September.

Part 2: Financial Contagion

*Allen, F. and D. Gale (2000), "Financial Contagion," Journal of Political Economy, vol. 108, pp. 1-33.

Diamond, D. W. & R. G. Rajan, 2005. "Liquidity Shortages and Banking Crises," Journal of Finance, Vol. 60(2), pages 615-647, 04.

*Fecht, F. (2004), "On the Stability of Different Financial Systems," Journal of the European Economic Association, vol. 6, pp. 969-1014.

Fecht, F. & Grüner, H. & Hartmann, P. (2012), "Financial integration, specialization, and systemic risk," Journal of International Economics, Elsevier, vol. 88(1), pages 150-161.

Heider, F., Hoerova, M., & Holthausen, C. (2015). Liquidity hoarding and interbank market rates: The role of counterparty risk. Journal of Financial Economics, 118(2), 336–354.

Part 3: Banking Competition and Financial Stability

*Allen, F. and D. Gale, D. (2004) „Competition and Financial Stability,“ Journal of Money, Credit, and Banking, vol. 36, pp. 433–480.

*Boyd, J. H. and D. De Nicolo, G. (2005) „The Theory of Bank Risk Taking and Competition Revisited,“ Journal of Finance, vol. 60, pp. 1329–1343.

*Dell'Ariccia, G. & R. Marquez (2006) "Lending Booms and Lending Standards," Journal of Finance, vol. 61(5), pages 2511-2546, October.

Hellmann, T., K. Murdock, and J. Stiglitz (2000) “Liberalization, Moral Hazard in Banking, and Prudential Regulation: Are Capital Requirements Enough?” American Economic Review, vol. 90, pp. 147-165.

Keeley, M. (1990)“Deposit Insurance, Risk, and Market Power in Banking,” American Economic Review, vol. 80, pp. 1183–200.

*Perotti, E. C. & Suarez, J. (2002), "Last bank standing: What do I gain if you fail?," European Economic Review, Elsevier vol. 46(9), pages 1599-1622, October.

Part 4: Government Intervention

*Acharya, V. and T. Yorulmazer (2007) „Too Many to Fail - An Analysis of Time Inconsistency in Bank Closure Policies,“ Journal of Financial Intermediation, vol. 16, pp. 1-31.

Diamond, D. W. & R. G. Rajan (2000), "A Theory of Bank Capital," Journal of Finance, vol. 55(6), pages 2431-2465, December.

Fahri, E. and J. Tirole (2012), "Collective Moral Hazard, Maturity Mismatch, and Systemic Bailouts," American Economic Review, vol. 102, pp. 60–93

Freixas, X. & J. Rochet & B. Parigi (2004) "The Lender of Last Resort: A Twenty-First Century Approach," Journal of the European Economic Association, vol. 2(6), pages 1085-1115, December.

Repullo, R. (2004) "Capital requirements, market power, and risk-taking in banking," Journal of Financial Intermediation, vol. 13(2), pages 156-182, April.