

# Financial Macroeconomics

Spring 2011

## Introduction

Tommaso Monacelli

Università Bocconi and IGER

# A New Course

- Three reasons

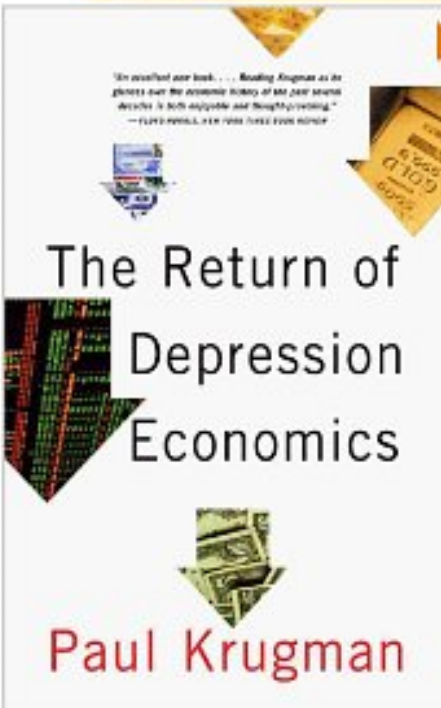
1. **New topic:** integration of finance and macroeconomics.

# A New Course (con't)

2. We will use a blend of **books** and textbooks

- Krugman P., *The Return of Depression Economics and the Crisis of 2008*, Norton & Company.
- Rajan G.R, *Fault Lines: How Hidden Fractures Still Threaten the World Economy*, Princeton University Press.
- Roubini N. and S. Mihm, *Crisis Economics: A Crash Course in the Future of Finance*, Penguin Group.
- Koo R.C., *The Holy Grail of Macroeconomics: Lessons from Japan's Great Recession*, Wiley.

Click to **LOOK INSIDE!**



"An excellent new book . . . Reading Krugman as he pines over the economic misery of our post-9/11 world teaches a rich, enjoyable and thought-provoking."  
—TYLER DURDEN, PEN PALS (2002) FOR BOND

The Return of  
Depression  
Economics

Paul Krugman

RAGHURAM G. RAJAN

# FAULT LINES



HOW HIDDEN FRACTURES STILL  
THREATEN THE WORLD ECONOMY

**CRISIS  
ECONOMICS**

**A CRASH COURSE IN  
THE FUTURE OF FINANCE**

**NOURIEL  
ROUBINI**

**AND  
STEPHEN MIHM**

Click to **LOOK INSIDE!**

REVISED AND UPDATED

THE  
**HOLY  
GRAIL**  
OF **MACRO**  
**ECONOMICS**



LESSONS FROM JAPAN'S  
GREAT RECESSION

"... a brilliant book..." — Martin Wolf, Financial Times

RICHARD C. KOO

# A New Course (con't)

## 3. Grading

<b>final exam</b>	<b>60%</b>
<b>problem sets</b>	<b>20%</b>
<b>extra activities</b>	<b>20%</b>



- Examples of **extra-activities**:

(i) getting a **letter** concerning a macroeconomic and/or financial topic published on the *Economist* and/or the *Financial Times*;

(ii) organizing a **presentation** on one or more of the chapters of the books in the reading list;

(iii) writing an **essay** concerning a topic from the suggested books.

The events of the past two years provide a dramatic demonstration of the importance of credit in the modern economy. As the President said in his inaugural address, “Our workers are no less productive than when this crisis began. Our minds are no less inventive, our goods and services no less needed.” Yet developments in financial markets—rises and falls in home and equity prices and in the availability of credit—have led to a collapse of spending, and hence to a precipitous decline in output and to unemployment for millions.

Source: *Economic Report of the President*, pg. 45, Feb 2010

# Course devoted to several questions

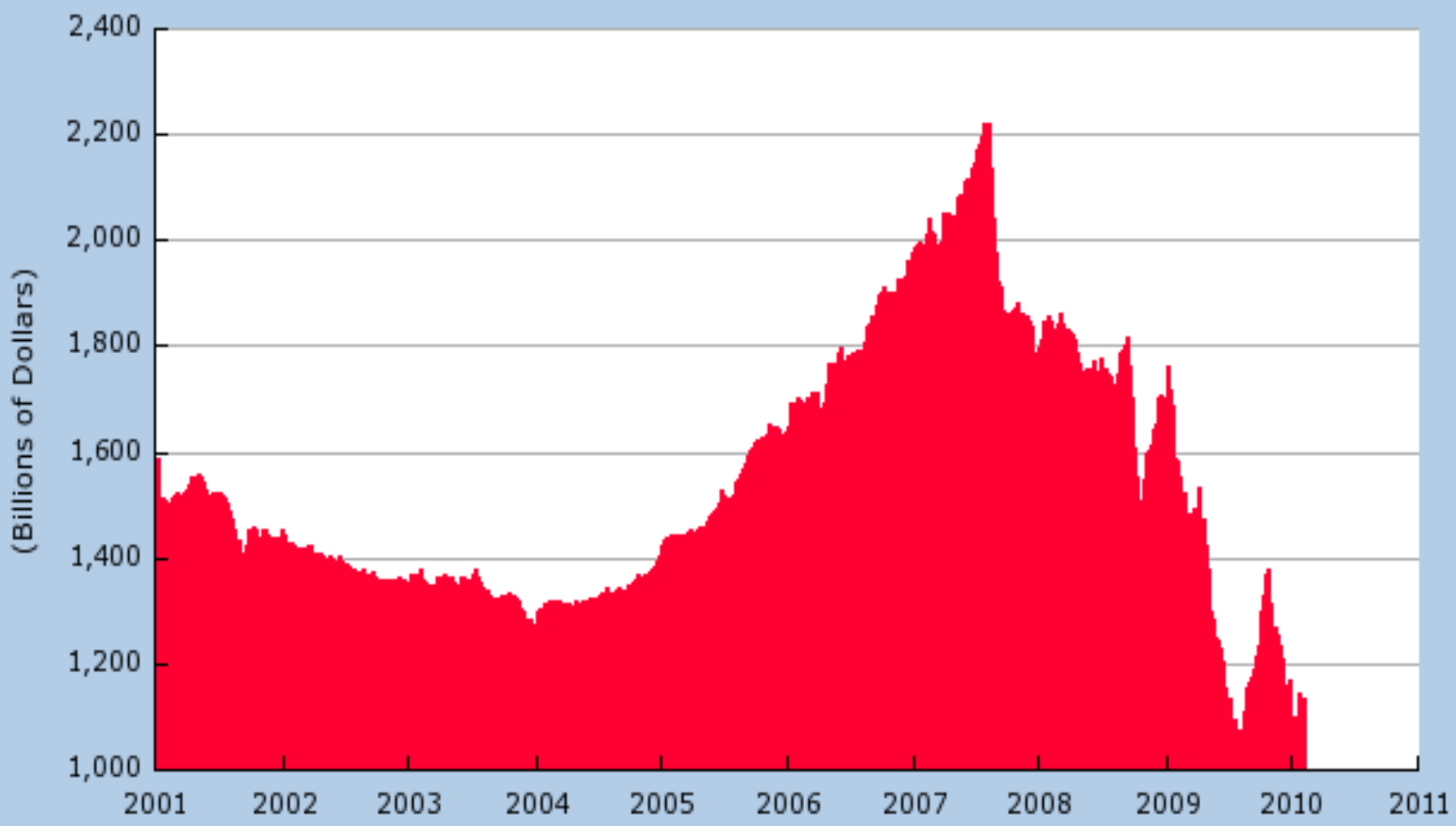
1. Does the **financial** structure matter for (macro)economic activity and the conduct of **monetary policy**?
2. How should basic **macroeconomic** models be amended to allow for the presence of financial factors?
3. What is the role of **asset price** fluctuations for the business cycle?
4. Why are some **financial crisis** more disruptive than others?

5. When monetary policy becomes ineffective (because of the **zero lower bound** problem) does **fiscal** policy help?
  
6. What is a **liquidity trap** and why is it dangerous? What is the **Japanese** lost decade, and why did it occur?

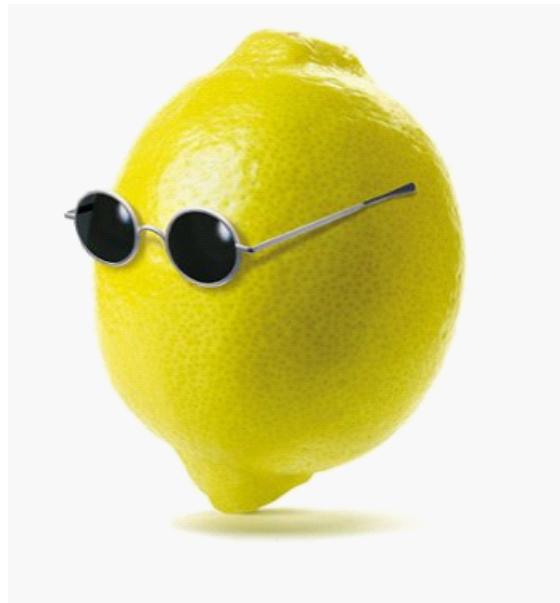
# The Role of Financial and Credit Markets

- Large firms use **commercial paper** to finance their biweekly payrolls and pay suppliers for materials to keep production lines going
- Small firms rely on **bank loans** to meet their payrolls and pay for supplies while they wait for payment of their accounts receivable.
- Home purchases depend on **mortgages**; automobile purchases depend on **car loans**; college educations depend on **student loans**; and purchases of everyday items depend on **credit cards**

Commercial Paper Outstanding (COMPOUT)  
Source: Board of Governors of the Federal Reserve System



# Remember Lemons Market Problem?



- Would you ever buy a Ferrari for 1000 euros in a market for **used** cars?

- A problem of **adverse selection** (asymmetric information in quality)
- The "bad" drives the "good" out of the market
- Prediction: market for used cars will disappear (Akerlof 1970)