

Financial Markets and the Macroeconomy.

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This course investigates the interrelationship between macroeconomics, financial markets and financial frictions, presenting some recent developments in that literature, but broadening into nearby areas as well.

Topic 1: Starting from the classic perspective on bank runs, we examine systemic risk, complexity risk and bank networks.

Topic 2: Next, we proceed to DSGE models. We discuss some DSGE models incorporating financial frictions via bank lending constraints. As background, we provide a brief review of solution and estimation techniques for simple benchmark DSGE models.

Topic 3: We will discuss the interrelationship between housing markets and credit markets, and examine booms and banking crises generally.

Topic 4: We examine a measure of macroeconomic financial distress and discuss some empirical challenges.

Topic 5: We investigate asset pricing in DSGE models, and ask how reasonable risk premia might arise. Starting from a log-linearized perspective on asset pricing and macroeconomic dynamics, we discuss Epstein-Zin preferences and large disasters. Code will be distributed and discussed, enabling participants to pursue further quantitative research on some of these topics.

Papers and material for these topics:

1. Bank Networks and Complexity Risk. **Distributed Paper:** Eisenberg-Noe, “Systemic Risk in Financial Systems,” *Management Science* (2001). **Papers which will be discussed:** Caballero-Simsek, “Fire Sales in a Model of Complexity”, *Journal of Finance*, December 2013. Farboodi, “Intermediation and Voluntary Exposure to Counterparty Risk”. **Material:** Slides.
2. DSGE models and banking.
 - (a) Incorporating banks and financial frictions in DSGE models. **Distributed Paper:** Gertler-Kiyotaki, “Financial Intermediation and Credit Policy in Business Cycle Analysis”, in Benjamin M. Friedman & Michael Woodford (ed.), 2010. ‘Handbook of Monetary Economics,’ Elsevier, volume 3, chapter 11. **Material:** Slides. Code for Gertler-Karadi, “A model of unconventional monetary policy”, *Journal of Monetary Economics* 58 (2011), 17-34. Code for Görtz-Tsoukalas, “News and Financial Intermediation in Aggregate and Sectoral Fluctuations”, draft, University of Glasgow, 2012.
 - (b) A brief review of stochastic dynamic macroeconomic modeling: log-linear solutions, solution and estimation with Dynare. **Material:** Slides. Dynare code for a simple neoclassical growth model with taxation will be distributed and discussed.
3. Housing and credit markets, booms and busts: **Distributed Papers:** Guerrieri-Uhlig, “Housing and Credit Markets: Bubbles and Crashes,” draft, *Handbook of Macroeconomics*, J. Taylor and H. Uhlig, eds., to appear. Boissay-Collard-Smets, “Booms and Systemic Banking Crises”, *Journal of Political Economy* 2016 124:2, 489-538. **Material:** Slides. Code for Boissay-Collard-Smets.
4. Measuring aggregate financial frictions. **Distributed Papers:** none. **Papers which will be discussed:** Atkeson-Eisfeldt-Weill, “Measuring the Financial Soundness of US Firms 1926-2012”, draft, UCLA, 2012. **Material:** Slides.
5. A brief review of risk premia, using a log-linear perspective. A brief review of large disasters. **Material:** Slides.