18M023B Policy Lessons

Firm Debt and Macroeconomics –
Joachim Jungherr

3 ECTS

Overview and Objectives

This course is an introduction to the role of firm debt in the macroeconomy. It provides an empirical and theoretical view on the mechanisms through which debt shapes macroeconomic outcomes (cyclical fluctuations and growth). An analysis of influential models of debt provides a framework to assess the effects of various government policies, e.g. macroprudential regulation.

First, we establish a set of stylized empirical facts about debt in the U.S. and in Europe (covering the balance sheets of households, businesses, the government, and banks and other financial intermediaries). We look at the empirical behavior of these variables in the long-run as well as along the business cycle. These facts are useful to assess the strengths and weaknesses of alternative theoretical models.

Second, we examine different theoretical approaches which are used to model the role of debt in macroeconomics. All of these approaches feature some deviation from complete markets and a violation of the Modigliani–Miller irrelevance principle. In these models, the way in which investment is financed (e.g. internal funds vs external funds, equity vs debt) matters for real macroeconomic outcomes. The two most common approaches are (1) asymmetric information (as in Bernanke and Gertler, 1989), and (2) limited enforcement (Kiyotaki and Moore, 1997).

Third, we study how these approaches can be applied to model credit booms and busts, financial fragility, and financial shocks. These models provide a formal framework to assess the effects of

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various government policies, e.g. macroprudential regulation. Fourth, we also discuss how these models help us to think about monetary policy.

Preliminary Course Outline and Readings

1. General Reading

- Markus K. Brunnermeier, Thomas M. Eisenbach, Yuliy Sannikov (2012): Macroeconomics with Financial Frictions: A Survey
- Stijn Claessens and M. Ayhan Kose (2017): Macroeconomic Implications of Financial Imperfections: A Survey
- Vincenzo Quadrini (2011): Financial Frictions in Macroeconomic Fluctuations
- Federal Reserve Bank of Chicago (1990): Two Faces of Debt

2. Endogenous Market Incompleteness

- Ben Bernanke and Mark Gertler (1989): Agency Costs, Net Worth, and Business Fluctuations

18M023B Policy Lessons

Firm Debt and Macroeconomics – Joachim Jungherr

3 ECTS

- Nobuhiro Kiyotaki and John Moore (1997): Credit Cycles

3. **Credit Booms and Busts, and Macroprudential Policy**

- Frederic Boissay, Fabrice Collard, Frank Smets (2016): Booms and Banking Crises
- Javier Bianchi and Enrique G. Mendoza (2010): Overborrowing, Financial Crises, and 'Macro-prudential' Taxes
- Markus K. Brunnermeier and Yuliy Sannikov (2014): A Macroeconomic Model with a Financial Sector
- Lawrence J. Christiano, Roberto Motto, Massimo Rostagno (2014): Risk Shocks
- Mark Gertler and Nobuhiro Kiyotaki (2010): Financial Intermediation and Credit Policy in Business Cycle Analysis
- Samuel G. Hanson, Anil K. Kashyap, Jeremy C. Stein (2011): A Macroprudential Approach To Financial Regulation
- Urban Jermann and Vincenzo Quadrini (2012): Macroeconomic Effects of Financial Shocks
- Moritz Schularick and Alan M. Taylor (2012): Credit Booms Gone Bust

18M023B Policy Lessons

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3 ECTS

4. Financial Frictions and Monetary Policy

- Mark Gertler and Peter Karadi (2011): A Model of Unconventional Monetary Policy
- Joao Gomes, Urban Jermann, Lukas Schmid (2016): Sticky Leverage

Evaluation

This course will have a final exam which will represent 100% of the final grade. The exam will last one hour.