Nexus between Sovereign and Financial Sectors

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NYU Stern Finance
Ph.D. Elective Course (FINC.GB.4309.P1)
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Meetings:

Thursdays 2-5pm in the Gruber Conference Room (9th floor of KMEC - 44 West 4th St). There will be an ORGANIZATIONAL meeting a week before the course formally starts.

Overview:

The objective of this course is to provide theoretical and empirical foundation for the nexus of credit risk between financial sector and sovereigns. This nexus has recently been at the heart of the ongoing sovereign and financial sector crises in Europe, while historically having been a greater focus in emerging market debt crises and Japan.

The course will focus on

(1) Providing micro-foundations of sovereign debt given that there is no explicit institutional structure such as bankruptcy code which allows creditors to extract repayments, and how political economy considerations such as government myopia and populism affect the demand and nature of sovereign debt;
(2) Understanding how credit risk migrates from the financial sector to the sovereign and vice-versa, in what is increasingly being called the “unholy nexus” or “doom loop” or the “diabolical loop”;
(3) Tying this nexus to micro-foundations of sovereign debt repayments as well as to incentives of highly-leveraged intermediaries such as banks;
(4) Tracing out the real-sector consequences of this nexus and isolating the channel through which it affects the real-sector; and,
(5) Finally, studying the efficacy of regulatory interventions that have been designed such as the regulatory stress tests of banks, design of risk weights in bank capital requirements, and unconventional monetary policy and lender-of-last-resort actions of central banks.

The ultimate objective is to make sense of the following flow-chart of risks and their sources, from my forthcoming Toulouse Lectures in Economics on “The Nexus Between Financial Sector and Sovereign Credit Risks”.
**Structure of Meetings and Evaluation:**

Several of the in-class presentations will be done by Viral Acharya, especially on the theory and models; the rest by the doctoral students enrolled in the course. We will sort out who presents what at the organizational meeting. Jack Shim will serve as an administrative aide.

Regardless of the presentation, all enrolled or attending the course will be required to write a high-quality literature survey of up to 10 pages covering any one of the topics and the related papers (included below or otherwise). The survey will be due one week after the course is over.

The grade for the course will be based on assessment of this survey.

I will give some OPTIONAL homework in the form of exercises and/or open questions around the theoretical models we discuss. Those who submit these will receive EXTRA credit towards the grade based on quality of their work.

Those presenting and actively participating in the class will get a dinner out of me! 😊
Week 1-2: Micro-foundations for Sovereign Debt Repayment

Course overview by Viral Acharya

Students will present paper(s) based on the following literature:

Week 1 (2/6):

Week 2 (2/13):

Week 3-4: Sovereign and Financial Sector Nexus: Role of Government Myopia

Viral Acharya will present

Week 3 (2/20):

Week 4 (2/27):

Recommended related literature:

Week 5-6: Sovereign and Financial Sector Nexus: Banking Crises and Bailouts

Week 5 (3/5): Viral Acharya will present
Professor Matteo Crosignani (Michigan Ross) or a student will present


Week 6 (3/12): Students will present:


and from the Recommended related literature:


Week 7 (3/26): Sovereign and Financial Sector Nexus: Bank and Regulatory Moral Hazard

Students will present the papers:


Recommended related literature:


Week 8 (4/2): Real Effects of Sovereign Crises: Active and Passive Banking Channels

Students will present:

and from the Recommended related literature:


**Week 9 (4/9): The Impact of Central Bank Interventions During Sovereign Crises**

Students will present:


and from the Recommended related literature:

- **BORIO, C. E. AND B. HOFMANN** (2017): “Is monetary policy less effective when interest rates are persistently low?” *Working Paper*
Week 10-12 (4/16, 4/23, 4/30): Unintended Consequences of Ultra-Accommodative Monetary Policy

Viral Acharya will present the papers:

- Acharya, V. V., M. Crosignani, T. Eisert and C. Eufinger, “Zombie Credit and (Dis-)Inflation: Evidence from Europe”, Working Paper

Recommended related literature:

Week 13 (5/7): Newer Topics, Research Frontiers, Open Questions, Student Surveys...

Required literature:

Recommended related literature:
- Geneva Report 22 | Banking Disrupted? Financial Intermediation in an Era of Transformational Technology