The Subprime Mortgage Crisis and the Theory of Finance

The year 2008 will undoubtedly go into history books as the time of global financial crisis. Stock markets across the world plummeted down in a way not seen since the Great Depression. Dow Jones index of the U.S. stock markets lost a staggering 45 % since January 2008. Governments and central banks across the world engaged in unprecedented wave of bailouts of troubled financial institutions. Most of the industrialized countries went into recession. The crisis has its roots in mortgage markets, in particular, reckless lending to the so-called subprime borrowers and misjudgment of risks in trading mortgage-backed securities.

The objective of the course is to discuss some aspects of the subprime mortgage crisis from the perspective of modern theory of finance. We will focus on such aspects as pricing bubbles, speculative trading, market crashes, and market liquidity. The discussion of these topics will be based on journal articles and working papers, and it will be rigorous in terms of theoretical tools.

As the crisis is still unfolding, every class meeting will start with a brief discussion of current events in financial markets worldwide. This discussion will be based on reading of daily business press.

The course is intended for doctoral students in economics and finance preparing for research in financial economics. Advance undergraduate students may also find the course useful.

The following topics will be covered:

    I. Asset Pricing Bubbles.

   II. Speculative Trading.

  III. Market Crashes.

  IV. Market Liquidity.

Course Schedule: Monday, Tuesday, Friday – 10:00 - 13:00; Thursday – 14:00 - 17:00.

Course Website: MOKD website, and www.econ.umn.edu/˜jwerner/teaching.htm

Exams, Homework and Presentations:
There will be a final exam. Homework assignments will be regularly given. Students are encouraged to make in-class presentations of research articles.

Course Readings: A list of articles and books will be announced in class.