



The Financial System

MULT- UB.0027.01

Integrating Global Economics, Politics and Markets
In a Historical and Contemporary Context

Fall 2014

Profs. Roy C. Smith and Ingo Walter

M-W 11:00 – 12.15 KMEC x.xx

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Course Description:

Recent global financial turbulence has demonstrated both how important the financial system is to the world economy and how complex it is.

Financial systems are centered on key institutions, instruments and markets. But they also involve governments, public policy and regulation. They span the globe from the US, the EU and Japan to Russia, China and the Emerging Markets. In critical ways, country-level financial architectures are integrating to form a more seamless, high-performance whole. This is good for efficiency, innovation and growth, yet it also amplifies problems during times of crisis.

This course provides students with a broad understanding of (i) How the global financial system works and what purposes it serves, (ii) What the major elements are and how they operate, and (iii) What risks and challenges the global financial system creates for individuals, business firms and policymakers.

In seeking to achieve these objectives, the course provides a perspective that helps students understand and make the most of their own professional opportunities. Along with a working knowledge of the global macroeconomy, foundations of finance and corporate finance, this course will be extremely helpful for students as a lens to focus on the key dimensions of the modern business environment.

Faculty:

Roy C. Smith is *Kenneth Langone Professor of Finance and Entrepreneurship* and a former partner of Goldman, Sachs & Co. and President of Goldman Sachs International. (rsmith@stern.nyu.edu)

Ingo Walter is *Seymour Milstein Professor of Finance, Corporate Governance and Ethics*. (iwalter@stern.nyu.edu)

Course Requirements:

The course requires three individually authored 1,000-word “Op-eds” submitted by each student during the semester. No group work is allowed. There can be no use of material from other sources without quotation marks, and with careful footnoting and attribution to avoid questions of plagiarism. The two best grades of the three submissions will be counted toward the final grade.

There are also closed-book, rigorous mid-term and final examinations.

Class Participation:

We like to teach with lots of classroom discussion, and we value initiatives taken by individual students to research things that are of interest to them and bring them up in class. At the instructors’ discretion, a student’s grade may be improved by as much as 10% due to class participation.

Blog:

We have recently launched a blog where we give our views on current topics of interest relating to global banking and financial markets. In many cases the topics will be relevant to this course. So please check out "Banks and Markets: Seasoned perspectives on financial firms and markets" at bank-economics.blogspot.com

Grading:

At NYU Stern, we strive to create courses that challenge students intellectually and that meet the Stern standards of academic excellence. To ensure fairness and clarity of grading, the Stern faculty has agreed that for elective courses the individual instructor or department is responsible for determining reasonable grading guidelines. The grading weights for this course (prior to consideration of class participation) are as follows:

- Op-eds (2) 20%
- Midterm exam 40%
- Final exam 40%

The Stern Finance Department has elected to use the following grading guidelines for this course and all other elective courses. Instructors must award grades of “A” or “A-” to approximately 35% of students in elective courses with

enrollments of more than 25 students.

Textbook & Readings

There is no textbook for this course. The readings will be posted on NYU Classes under “Assignments,” or be available in a course packet to be purchased from the NYU bookstore.

General Conduct and Behavior:

Students are expected to maintain and abide by the highest standards of professional conduct and behavior. Please familiarize yourself with Stern's Policy in Regard to In-Class Behavior & Expectations (<http://www.stern.nyu.edu/portal-partners/current-students/undergraduate/resources-policies/academic-policies/index.htm>) and the NYU Disruptive Behavior Policy (<http://www.nyu.edu/about/policies-guidelines-compliance/policies-and-guidelines/bullying--threatening--and-other-disruptive-behavior-guidelines.html>).

Academic Integrity Above All:

Integrity is critical to the learning process and to all that we do here at NYU Stern. As members of our community, all students agree to abide by the NYU Stern Student Code of Conduct, which includes a commitment to: (a) Exercise integrity in all aspects of one's academic work including, but not limited to, the preparation and completion of exams, papers and all other course requirements by not engaging in any method or means that provides an unfair advantage. (b) Clearly acknowledge the work and efforts of others when submitting written work as one's own. Ideas, data, direct quotations (which should be designated with quotation marks), paraphrasing, creative expression, or any other incorporation of the work of others should be fully referenced. (c) Refrain from behaving in ways that knowingly support, assist, or in any way attempt to enable another person to engage in any violation of the Code of Conduct. Our support also includes reporting any observed violations of this Code of Conduct or other School and University policies that are deemed to adversely affect the NYU Stern community.

The entire Stern Student Code of Conduct applies to all students enrolled in Stern courses and can be found here: www.stern.nyu.edu/uc/codeofconduct

To help ensure the integrity of our learning community, all assignments that you submit via the course's NYU Classes website will be routed through Turnitin, which will compare your submission to a database of prior submissions, current and archived Web pages, periodicals, journals, and publications. Your document will automatically become part of the Turnitin database.

Attendance and Use of Laptops

Students are expected to attend every class and to arrive on time. Failure to follow these instructions can result in a negative class participation grade.

Laptops may be opened in class only for the purpose of taking notes.

Students with Disabilities

If you have a qualified disability and will require academic accommodation of any kind during this course, you must notify the instructors at the beginning of the course and provide a letter from the Moses Center for Students with Disabilities (CSD) at Tel. (212) 998-4980 or www.nyu.edu/csd verifying your registration and outlining the accommodations the Center staff recommends. If you will need to take an exam at the CSD, you must submit a completed Exam Accommodations Form (EAF) to them at least one week prior to the scheduled exam time to be guaranteed the alternative venue.

Course Outline

<u>Session/Date</u>	<u>Topic and Instructor</u>
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| 1. 9/3 | Course Introduction (S&W) <ul style="list-style-type: none">a. Elements of a functional economic and financial systemb. Key political philosophies of Economic Organization |
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Reading:

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| 2. 9/8 | A Short History of the US Economic and Financial System (S) <ul style="list-style-type: none">a. Hamiltonian economic principles (1788)b. Ups and downs of central banking until Fed in 1913c. Globalization in 1914d. Economic Consequences of the Peace (Keynes 1919)e. US emerges as world economic superpower |
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Reading:

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| 3. 9/10 | Banks and the Banking System (W) <ul style="list-style-type: none">a. What is a bank and what does it do?b. How do banks earn money?c. Risk management in banking – market, credit, liquidityd. Asset & liability managemente. Bank failure – liquidity and solvency |
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Reading:

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| 4. 9/15 | What Central Banks Do (W) <ul style="list-style-type: none">a. Policy targeting |
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- b. Policy tools
- c. Matching tools to goals
- d. Banking as a policy transmission belt
- e. Global dimensions of central banking

Reading:

- 5. 9/17 The Crash of 1929 and Great Depression and Global Financial Crisis (S)
 - a. The Banking Act of 1933 and the era of separated banking
 - b. Application of Keynesian economics
 - c. Roosevelt and the beginning of US social welfare programs

Reading:

- 6. 9/22 Wartime Economics (S)
 - a. Effects of WWI on UK economy and repatriation of assets
 - b. Financing WWII: taxation, rationing, direct controls
 - c. Economic consequences of war in Europe and Japan
 - d. Wartime economics create social and political upheavals

Reading:

- 7. 9/24 Postwar Institutions (W)
 - a. Breton Woods (1944)
 - b. World Bank, IMF, GATT / WTO
 - c. Marshall Plan (1945-1948)
 - d. Restarting globalization

Reading:

- 8. 9/29 Remaking of Europe after WWII (W)
 - a. Cold War economics; labor policies and democracy
 - b. The Common Market, EEC, EU
 - c. The 1992 Single Market Act

Reading:

- 9. 10/1 The Euromarket (1965-1990) (S)
 - a. Pressures on the dollar (1968-1970)
 - b. End of Breton Woods and the “Nixon Shock” (1971)
 - c. Free flows, unregulated offshore market
 - d. Swiss funds and secret money

Reading:

- 10.10/6 “Petrodollars” (1973-1979) (W)
 - a. Oil shocks in 1973 and 1978 and OPEC
 - b. Distortion of global financial flows

- c. The great “third world” debt crisis and its impact of banks
- d. Sequential debt restructuring – focus on Latin America
- e. The “Brady Plan” as a successful market solution

Reading:

- 11.10/8 Japan becomes an economic superpower (1970-1990) (S)
- a. Focus on rebuilding after World War II
 - b. Zaibatsu, Keiretsu and “Japan Inc.”
 - c. The Japanese banking and financial system
 - d. Bubbles and busts (1989)
 - e. 25 years of low growth, stagnation disinflation

Reading:

NO CLASSES 10/13

- 12.10/15 The S&L and Banking Crises in the US, Europe and Japan (1980-1995) (W)
- a. Ending US inflation on the 1970s (“Volcker Shock”) (1979)
 - b. Causes and effects – S&L mismatching, banks try to push up share prices
 - c. Lesson from Continental Illinois,
 - d. Problems spread to Europe and Japan
 - e. Deregulating Wall Street (the Fed backs off)

Reading:

13.10/20 Midterm Exam

- 14.10/22 Emerging Markets (W)
- a. Economics of development, risks of default
 - b. Mexico and Washington consensus
 - c. Market access, importance of capital flows (FDI)
 - d. “Asian Tigers”
 - e. Asia Meltdown, role of IMF and US (1997-1998)

Reading:

- 15.10/27 Maastricht Treaty and the Euro (1986-1991) (S)
- a. Politics and economics of the euro and the Eurozone
 - b. The flawed structure of the euro-system
 - c. Duties and powers of the ECB

Reading:

- 16.10/29 German Unification and the Break-up of the Soviet Union (W)
- a. Surveying the wreckage of a failed economic system

- b. Privatization, the Treuhandanstalt and a return to the market
- c. Eastern Europe's transformation
- d. From state banks to private banks

Reading:

17. 11/3 Globalization and Market Integration in 2007 (S)
- a. Market capitalization 3.6 times global GDP
 - b. Markets are integrated, high correlation in difficult times
 - c. FX flows, most for financial transactions
 - d. Derivatives and hedging

Reading:

18. 11/5 The Global Financial Crisis of 2007-2009 (W)
- a. Preceded by tech bubble of 1999-2001
 - b. MBS and excesses, lax regulation – market risk takes over
 - c. Turbocharging bankers
 - d. Consequences – in the financial and real sectors

Reading:

19. 11/10 Consequences of the Crisis (2008-2010) (S)
- a. Basel III
 - b. G20, EU actions
 - c. Dodd-Frank
 - d. Prosecution and litigation
 - e. The banking industry today

Reading:

20. 11/12 Sovereign Debt Crisis in the EU (W)
- a. Greece, Ireland, Portugal, Cyprus
 - b. Spain and Italy
 - c. Sovereign debt spreads face reality
 - d. Flaws in the EU system

Reading:

21. 11/17 The ECB and Resolution of the EU Sovereign problem (S)
- a. Step by step towards federalization
 - b. German politics and pressures on Eurozone guarantees
 - c. The ECB works things out
 - d. But the fundamentals of low growth remain

Reading:

22. 11/19 Impact of the Global Crisis on the World Financial System (S)
- a. Massive (addictive) intervention by central banks

- b. Popularization of economic policy measures and enforcement
- c. Risk transferred to “shadow banks”
- d. Effects on systemically important banks

Reading:

23. 11/24 Retrospective on Democratic Free Market Economic Systems (W)

- a. The omnipresence of politics
- b. Economic history is a journey through one crisis after another
- c. Crises change things
- d. Democracy makes things difficult
- e. Voters respond to economic factors

Reading:

24. 11/26 Alternative Systems: China (S)

- a. Troubled emergence of Red State capitalism (1978)
- b. China’s evolution compared to Taiwan’s
- c. Economic consequences of Tianamen Square
- d. The Chinese system today

Reading:

25. 12/1 Alternative Systems: Russia (S)

- a. Economic development since Soviet breakup (1991)
- b. Privatization, oligarchs, corruption
- c. Authoritarian economics under Putin
- d. Economic consequences of Crimea/Ukraine

Reading:

26. 12/3 The BRICS and N20 (S)

- a. Brazil and India
- b. Mexico, Indonesia, Nigeria
- c. Can high growth be sustained when developed world in low growth, protective mode?

Reading:

27. 12/8 Looking Forward, Betting on Basic Principles (S&W)

- a. Global; economic outlooks, trouble spots and unfinished business
- b. Democracy works better than authoritarianism
- c. Free markets work better than those with too much government intervention
- d. But, more is to be learned from all the future economic crises we will face

Reading:

Final Exam (date to be determined)