

BOSTON COLLEGE  
DEPARTMENT OF ECONOMICS

EC 360  
Fall 1998  
TTh 9 a.m.  
Carney 009

Joe Peek  
Office: Carney 141, 2-3686  
Office Hours: Tu 1-2:30 pm,  
Th 10:30 am- 12 noon, and  
by appointment

## **Economics of Financial Intermediation**

Text: Frederic S. Mishkin and Stanley G. Eakins, *Financial Markets and Institutions*, 2nd edition, Addison-Wesley, 1998 (available at bookstore).

In addition to the set of articles included in the course outline, I will hand out in class numerous short articles from current newspapers and magazines that are particularly relevant to the topic being discussed. All assignments are to be read before the class during which they will be discussed.

This course applies the standard tools of financial analysis and economics to issues in the operation and regulation of financial intermediaries. The primary focus will be on commercial banks, although other intermediaries will be discussed. Emphasis will be placed on the continuing innovation and evolution of financial markets and financial institutions and on their interaction both with the changing regulatory environment and the conduct of monetary policy. We will cover chapters 1-20 in Mishkin. Because the economics of financial intermediation is a rapidly changing field, a number of supplementary readings will be assigned.

Method of Evaluation: The course has three major components. The first is based on course lectures and assigned readings. The second is based on an individual case study of a banking organization. The third is based on a group term project. The lecture component will have two exams. The first exam will be on Thursday, October 15, and the second exam will occur at the end of the lecture portion of the course. The case study will be due on Tuesday, November 10. The term project component will continue throughout the semester, culminating in a presentation to the class. The presentations will occur during the meetings at the end of the course, following the second exam. Course grades will be calculated using the following weights: first exam 25%; second exam 25%; case study 20%; project 20%; class participation/presentation 10%.

## **OUTLINE**

- I. Introduction  
Mishkin, Chs. 1-2.
- II. Principles of Financial Markets  
Mishkin, Chs. 3-7.

III. Financial Markets  
Mishkin, Chs. 8-11.

Michael W. Klein, "European Monetary Union," *New England Economic Review*, March/April 1998, pp. 3-12.

IV. Financial Institutions Industry  
Mishkin, Chs. 12-19.

Simon Kwan, "Bank Charters vs. Thrift Charters," *FRBSF Economic Letter*, April 24, 1998.

John S. Jordan, "Problem Loans at New England Banks, 1989 to 1992: Evidence of Aggressive Loan Policies," *New England Economic Review*, Jan/Feb 1998, pp. 23-38.

Fred Furlong, "New View of Bank Consolidation," *FRBSF Weekly Letter*, July 24, 1998.

Katerina Simons and Joanna Stavins, "Has Antitrust Policy in Banking Become Obsolete?," *New England Economic Review*, March/April 1998, pp. 13-26.

Joe Peek and Eric Rosengren, "Have Borrower Concentration Limits Encouraged Bank Consolidation?," *New England Economic Review*, Jan/Feb 1997, pp. 37-47.

George J. Benston and George G. Kaufman, "FDICIA After Five Years," *Journal of Economic Perspectives*, Vol. 11, No. 3, Summer 1997, pp. 139-58.

Joe Peek and Eric Rosengren, "How Well Capitalized Are Well-Capitalized Banks?," *New England Economic Review*, Sept/Oct 1997.

Edward S. Prescott, "Group Lending and Financial Intermediation: An Example," *FRB Richmond Economic Quarterly*, Fall 1997, pp. 23-48.

John P. Caskey and Brian J. Zikmund, "Pawnshops: The Consumer's Lender of Last Resort," *FRB Kansas City Economic Review*, March/April 1990, pp. 5-18.

John P. Caskey, "Check-Cashing Outlets in the U.S. Financial System," *FRB Kansas City Economic Review*, Nov./Dec. 1991, pp. 53-67.

Joseph J. Doyle, Jose A. Lopez, and Marc R. Saldenberg, "How Effective Is Lifeline Banking in Assisting the 'Unbanked'?" *Current Issues in Economics and Finance*, FRB-New York, June 1998.

V. Risk Management in Financial Institutions  
Mishkin, Ch. 20.

VI. Trends and Issues in Banking

Bharat Trehan, "Bank Lending and the Transmission of Monetary Policy," *FRBSF Weekly Letter*, September 3, 1993.

Mark E. Levonian, "Why Banking Isn't Declining," *FRBSF Weekly Letter*, January 20, 1995.

Simon Kwan, "Cracking the Glass-Steagall Barriers," *FRBSF Weekly Letter*, March 21, 1997.

Joao Cabral dos Santos, "Glass-Steagall and the Regulatory Dialectic," *FRB-Cleveland Economic Commentary*, February 15, 1996.

John Krainer, "The Separation of Banking and Commerce," *FRBSF Weekly Letter*, July 3, 1998.

Elizabeth Laderman, "The Rhyme and Reason of Bank Mergers," *FRBSF Weekly Letter*, November 17, 1995.

- Jerry L. Jordan, "The Future of Banking Supervision," FRB-Cleveland *Economic Commentary*, April 1, 1996.
- Simon Kwan, "Efficiency of U.S. Banking Firms--An Overview," *FRBSF Weekly Letter*, February 28, 1997.
- Jerry L. Jordan, "The Functions and Future of Retail Banking," FRB-Cleveland *Economic Commentary*, September 15, 1996.
- James J. McAndrews, "Making Payments on the Internet," FRB Philadelphia *Business Review*, Jan/Feb 1997, pp. 3-14.
- James J. McAndrews, "ATM Surcharges," *Current Issues in Economics and Finance*, FRB-New York, April 1998.

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### Project/Paper Guidelines

Project groups will consist of 3 or 4 students. I am willing to let you select your groups, but am also willing to randomly assign students into groups. The method of group formation will be decided at the first class meeting.

This semester's topic will be **Banking Crises Around the World**. Each group will be responsible for selecting a country, but I must approve your selection. Each group will make a presentation of their research to the class and respond to questions. The presentations will be in the second half of the course.

The schedule for the project is as follows:

Sept. 10 (Th)	Submit country selection and list of group members
Oct. 6 (Tu)	Submit detailed outline and data sources/availability
Nov. 17 (Tu)	Submit first draft of paper
Nov. 24-Dec. 8	Presentations (dates approximate)
Dec. 8 (Tu)	Submit final draft of paper

All due dates should be read as "No later than...." You can, of course, complete any and all tasks (other than the presentation) prior to the recorded due date.

The key word for the paper/project is analyze. A literature review (summary) or historical description alone is not sufficient. I expect a research paper that makes use of economic and finance arguments and analysis, makes use of data, and includes a bibliography.

You can approach this project as a consulting firm asked by the country, the IMF, or The World Bank to analyze what went wrong and to recommend regulatory and policy changes that could help prevent future crises. You should discuss the causes of the crisis and the response of markets, bank regulators, and outside agencies such as the IMF or The World Bank. You should evaluate the response by the country's bank regulators: did it help or hurt; was it timely, etc. Similarly, if The World Bank or the IMF was involved, what role did they play and did they give good advice? Finally, you should discuss how the banking structure and/or regulations of the country could be changed to prevent (or limit) future crises.

#### Possible countries

You may choose any country (other than the United States) that has had a major banking crisis in the past that has now been resolved (for example, Finland, Norway, Sweden, Argentina, several Eastern European transitional economies), a country with a recent banking crisis that has not yet been fully resolved (for example Japan, Mexico--still some fall-out from resolution), a country with a banking crisis that may still be evolving (for example, Thailand, Indonesia, Korea), or even a country that is just now being hit (Russia) or likely will soon be hit (China) by a major banking crisis. However, if the crisis has not yet been resolved (or not yet happened), the approach to the paper will necessarily differ somewhat.

### Information Sources

There are many sources that will provide useful information for your project. Certainly, *The Wall Street Journal*, the *Financial Times*, and *The Economist* have had numerous articles on recent and past banking crises. The Bank for International Settlements (BIS), The World Bank, and The International Monetary Fund (IMF) have publications and working papers that will be quite relevant. The BC library subscribes to numerous economic and finance journals and trade publications. The economic reviews of the various regional Federal Reserve Banks often have relevant articles, as do the proceedings of the annual FRB Chicago bank structure conference. Additional bibliographic sources include the *Business Periodicals Index*, the American Bankers Association *Banking Literature Index*, the *American Banker Index*, the *Wall Street Journal Index*, and the *Journal of Economic Literature*. *The Fed in Print*, distributed by the FRB of Philadelphia and available on the WEB, lists articles and working papers produced within the Federal Reserve System.

Finally, once you select your topic, I may be able to help get you started with a few relevant articles or data sources.

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### Case Study

Each student will select a U.S. bank holding company; no duplications, first come, first served. The assignment involves doing a case study on the selected bank holding company (BHC), with an emphasis on its lead bank. The study should provide a brief history of the bank holding company. You should discuss the BHC's current structure (number and types of subsidiaries), recent merger and acquisition activity, primary lines of business, and its business strategy. You should then provide a more detailed case study on the BHC's lead bank that includes a review of its balance sheet and income statements over the past five years, branch information, and other information you believe to be important. In addition, you should make an assessment of the bank holding company's competitive future.

### Suggested Outline

Name of bank holding company  
Address  
Home page on WWW  
BHC structure, including recent mergers and acquisitions  
Primary lines and business and importance of each to BHC  
BHC Business strategy  
Evaluation of business strategy

#### BHC's lead bank

FDIC certificate number  
Bank type  
History--including  
    Bank environment  
    Merger/acquisitions  
    Assets and Liabilities (5 years)  
Performance  
    Income and Expenses (5 years)  
Assessment of competitive position today and in the future. (This will involve a comparison with peer institutions.)

### Useful Sources

Mishkin, Chs. 13, 14, and 20.  
bank's home page and annual report  
[www.fdic.gov](http://www.fdic.gov)  
[www.ots.treas.gov](http://www.ots.treas.gov)  
<http://lamar.colostate.edu/~rphillip> has a lot of useful internet links  
[http://www.frbchi.org/rcr/rcr\\_database.html](http://www.frbchi.org/rcr/rcr_database.html)  
Moody's, Standard and Poor's, Value Line, and other analysts' reports

### **Due date and page limit**

The assignment is due (on or before) Tuesday, **November 10**.  
The page limit is **8 pages**, double spaced with 12 point font and 1 inch margins.