Progress report

This term I undertook the coursework requirements for the CPGS in Economics. These included 1 exam on which I achieved a distinction, F400 Asset Pricing with Prof. Christopher Harris and 3 PhD modules which I successfully passed. As part of this I produced one project on self-fulfilling sovereign debt crises and one survey paper on debt sustainability taking into consideration the importance of investor expectations.

The remainder of the term has been spent on my first chapter entitled, “Self fulfilling crises and country solidarity”. The paper features a continuous time, dynamic model of government saving and contributes to the literature in two ways. Firstly, I make a methodological contribution by refining the notion of debt sustainability, taking into account the possibility of endogenous coordination failures by investors and a generalised maturity structure. I construct a sophisticated model for the off-equilibrium beliefs held by investors with perfect foresight to determine what level of debt is sustainable in the short term and long term. The main result is that the level of debt below which self-fulfilling crisis are not possible depends on a behavioural parameter which characterizes the duration of a contemporaneous coordination crisis amongst investors. Moreover, I show that both the incidence and the magnitude of such crises depends on the maturity of debt. The paper also features an application to the notion of solidarity and country bailouts. I consider a symmetric two-country, continuous time, dynamic model where there is an incentive for transfers (on and off-equilibrium) between sovereigns because default of one inflicts spill-over costs on the other. Both countries borrow from international markets and investors internalise the possibility of bailouts. I allow investors to hold heterogeneous expectations of default for each country. I show that this presents another explanation why countries choose to borrow into high spreads. This application further demonstrates the possibility of self-fulfilling crises of different magnitudes. The paper will be completed by the end of October but I attach work in progress.

I have recently embarked on a project with Prof. Panicos Demetriades regarding a presentation to the Financial Stability Board in their October meeting on the subject of market based financing of the real economy. The discussion is on the viability of market based finance as a compliment and a substitute to regulated banking and the objectives of prudential policy. I aspire to contrast current shadow banking contracts to the Diamond-Dybvig optimal contract for traditional banks in order to further our understanding of the potential fragilities in the system. This relates to my own research since confidence runs on the shadow banking sector are particularly worrisome for policymakers.