

Financial Development and Economic Growth. Financial Crises. FIN 204 Lecture 7.1.

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25 Mar. 2010

- 1 Financial Development and Economic Growth
- 2 A Theory of Financial Crises

Financial markets affect the goods and services produced. How?

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Can financial markets cause problems to the production side of the economy?

What is a financial crisis?

Financial Crisis

Financial Crisis: Major disruptions in financial markets that are characterized by sharp declines in asset prices and the failures of many financial and nonfinancial firms

What causes financial crises?

- ① adverse selection, moral hazard
- ② sharp increases in interest rates
- ③ increases in uncertainty
- ④ asset market effects on balance sheets
- ⑤ problems in the banking sector
- ⑥ government fiscal imbalances

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- ➏ **Government fiscal imbalances:** Government deficit $\uparrow$ sharply $\Rightarrow$ foreign investors stop buying G bonds due to $\uparrow$ risk of default $\Rightarrow$ government cannot repay an defaults $\Rightarrow$ currency (exchange rate) crisis

How does a financial crisis develop?

