Contents

Introduction					
Part I. Money, Bonds and Economic Activity					
1	Moi	ney, Bonds and Interest Rates	9		
	1.1	Introduction	9		
	1.2	Some Basics	9		
	1.3	Macroeconomic Theories of the Interest Rate	10		
	1.4	Monetary Policy and Interest Rates	13		
	1.5	Monetary Policy and Asset Prices	14		
	1.6	Conclusions	15		
2	Term Structure of Interest Rates		17		
	2.1	Introduction	17		
	2.2	Definitions and Theories	17		
	2.3	Empirical Tests on the Term Structure	19		
	2.4	Conclusions	24		
Pa	rt II. '	The Credit Market and Economic Activity			
3	The	ories on Credit Market, Credit Risk and Economic Activity	27		
	3.1	Introduction	27		
	3.2	Perfect Capital Markets: Infinite Horizon and Two Period Models	27		
		3.2.1 Infinite Horizon Model	29		
		3.2.2 A Two Period Model	31		
	3.3	Imperfect Capital Markets: Some Basics	35		
	3.4	Imperfect Capital Markets: Microtheory	37		
	3.5	Imperfect Capital Markets: Macrotheory	40		
	3.6	Imperfect Capital Markets: The Micro-Macro Link	42		
	3.7	Conclusions	48		

VIII	Contents

4	Em	pirical Tests on Credit Market and Economic Activity	49
	4.1	Introduction	49
	4.2	Bankruptcy Risk and Economic Activity	49
		4.2.1 Introduction: Measurement Problems	49
		4.2.2 Some Empirical Results	52
		4.2.3 Conclusions	53
	4.3	Liquidity and Economic Activity in a Threshold Model	55
		4.3.1 Introduction	55
		4.3.2 A Simple Model	58
		4.3.3 Conclusions.	62
	4.4	Estimations of Credit Risk and Sustainable Debt	63
		4.4.1 Introduction	63
		4.4.2 The Dynamic Model	65
		4.4.3 Estimating the Parameters	68
		4.4.4 Testing Sustainability of Debt	71
	4.5	Conclusions	75
Pa	rt III.	The Stock Market and Economic Activity	
-		The Stock Harket and Deconomic Neutro	
5	App	oroaches to Stock Market and Economic Activity	79
	5.1	Introduction	79
	5.2	The Intertemporal Approach	80
	5.3	The Excess Volatility Theory	82
	5.4	Heterogenous Agents Models	84
	5.5	The VAR Methodology	85
	5.6	Regime Change Models	87
	5.7	Conclusions	88
6		cro Factors and the Stock Market	89
	6.1	Introduction	89
	6.2	A Dynamic Macro Model	90
	6.3	Empirical Results	93
	6.4	Conclusions	95
7	Morr	Toohnology and the Ctarle Manhat	07
,	7.1	Technology and the Stock Market	97 97
	7.1	Some Facts	97 97
	7.2		97
	7.3 7.4	The Model	99

Part IV. Asset Pricing and Economic Activity					
8	Port	tfolio Theory: CAPM and Extensions	105		
	8.1	Introduction			
	8.2	Portfolio Theory and CAPM: Simple Form	105		
	8.3				
	8.4	Conclusions			
9	Con	sumption Based Asset Pricing Models	113		
	9.1	Introduction	113		
	9.2	Present Value Approach	113		
	9.3	Asset Pricing with a Stochastic Discount Factor	114		
	9.4	Derivation of some Euler Equations	117		
		9.4.1 Continuous Time Euler Equation	117		
		9.4.2 Discrete Time Euler Equation: 2-Period Model	119		
		9.4.3 Discrete Time Euler Equation: n-Period Model	119		
	9.5	Consumption, Risky Assets and the Euler Equation	120		
	9.6	Conclusions	124		
10	Production Based Asset Pricing Models				
	10.1	Introduction	125		
	10.2	Stylized Facts	127		
	10.3	The Baseline RBC Model	128		
	10.4	Asset Market Restrictions	129		
	10.5	Conclusions	131		
— Par	t V. F	oreign Exchange Market, Financial Instability and Economic Acti	vity		
11	Bala	nce Sheets and Financial Instability	135		
		Introduction	135		
		The Economy-wide Balance Sheets	136		
		Households' Holding of Financial Assets	137		
		Shocks and Financial Market Reactions	139		
		Conclusions	140		
12	Exchange Rate Volatility and Financial Crisis				
	12.1	Introduction	141		
		Stylized Facts	142		
		The Standard Exchange Rate Overshooting Model	143		
	12.4	Exchange Rates, Balance Sheets and Multiple Equilibria	147		
		Imperfect Capital Markets, Exchange Rates and Multiple Equilibria	149		
		Exchange Rates, Endogenous Credit Cost and Multiple Equilibria	153		
		Conclusions	156		

<u>X</u>	Contents	
13	Some Policy Conclusions	157
Ref	rences	163
Ind	· · · · · · · · · · · · · · · · · · ·	173