FROM THE TRADING FLOOR TO THE FORECLOSURE NEXT DOOR:
Financial Markets and Economic Performance

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Moderator
Mark Brickell
Gary Becker (1930-2014)
Some Becker Friedman Institute Initiatives

Macro Financial Modeling
- Fiscal Imbalance
- Price of Policy Uncertainty
Friedman Forums for Undergraduates

REU • Becker Brown Bags
Uncertainty meets Economics

Jacob Bernoulli (left)
Law of Large Numbers

Camille Pissarro (right)
The Old Market at Rouen
Investors Inside an Economic Model

When *constructing* a dynamic economic model, researchers:

- depict economic actors (consumers, enterprises, policy makers) as they cope with uncertainty
- deduce the resulting market responses and consequences for resource allocations

**Outcome:** New sources for fluctuations in *uncertainty prices* emerge in models of financial markets
Even if true scientists should recognize the limits of studying human behaviour, as long as the public has expectations, there will be people who pretend or believe that they can do more to meet popular demand than what is really in their power. (From Hayek’s Nobel address)
Milton Friedman (1965)

“As Josh Billings wrote many years ago, ‘The trouble with most folks isn’t so much their ignorance, as knowing so many things that ain’t so.’ Pertinent as this remark is to economics in general, it is especially so in monetary economics.”
Policy Makers Outside the Model

- Friedman (1961): advocated simple rules because of long and variable lags in the monetary transmission mechanism.

- Current monetary policy: forward guidance with limited knowledge of the impact of monetary policy on labor markets.

- Simple and transparent?
Policy Makers Outside the Model

- **Systemic risk**: A grab bag of scenarios rationalizing interventions in financial markets

- **Challenges**: Limited understanding of systemic risk challenges its value as a guiding principle for financial oversight (Haldane, Bank of England and Tarullo, Board of Governors)

- **Systemic uncertainty**: Complicated problems do not necessarily require complicated solutions
Basel III is Complex

\[ K = 2.33 \cdot \sqrt{h} \cdot \sqrt{\left( \sum_{i} 0.5 \cdot w_i \cdot \left( M \cdot EAD_{i}^{\text{total}} - M_{i}^{\text{hedge}} B_i \right) - \sum_{\text{ind}} w_{\text{ind}} \cdot M_{\text{ind}} \cdot B_{\text{ind}} \right)^2 + \sum_{i} 0.75 \cdot w_i^2 \cdot \left( M_i \cdot EAD_{i}^{\text{total}} - M_{i}^{\text{hedge}} B_i \right)^2} \]