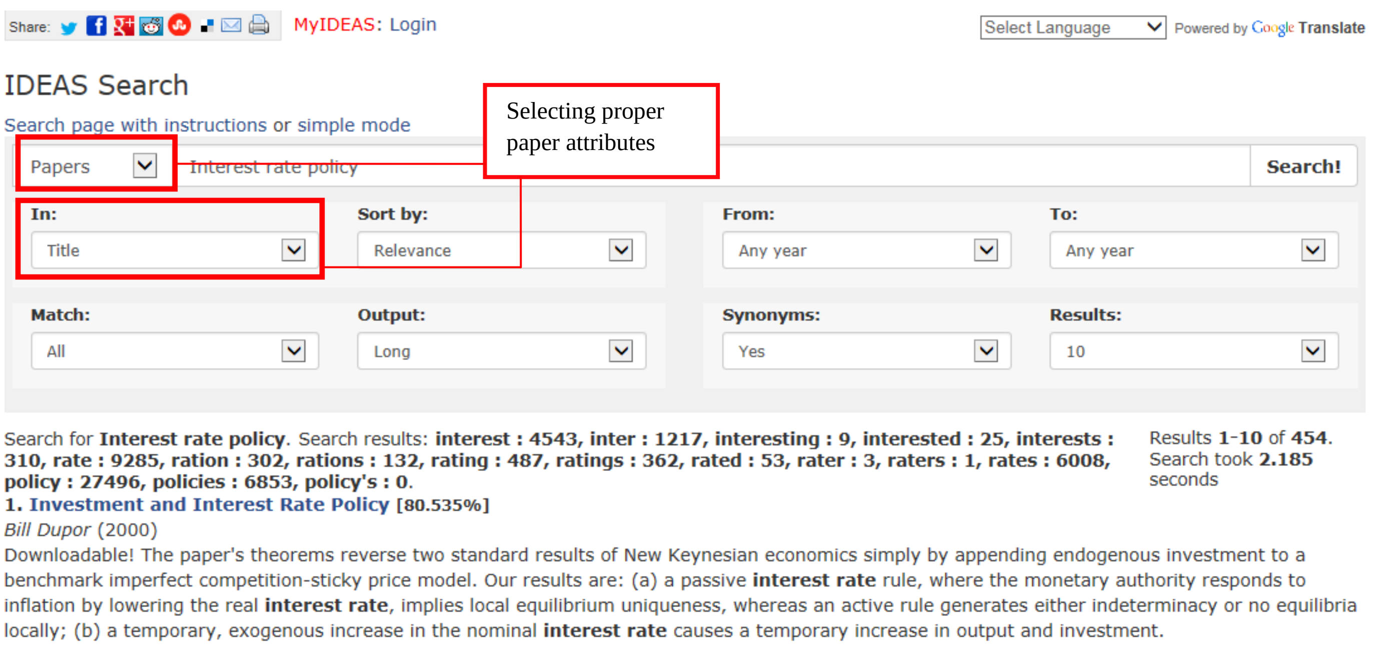
CERGE-EI Library
Search of Sources on a Specific Economic Problem

This guide offers a possible way to proceed when one has a specific economic problem in mind and wants to find available research relevant to this problem.

For instance one might be interested in the following economic problem: projects with excessive risk are started when a cost of capital is low. That is because entrepreneurs will finance projects with low expected returns by borrowing at low interest rates. But, if interest rates unexpectedly increase, entrepreneurs will not continue financing those projects and default on repaying borrowed funds invested in the low-return projects. There might also appear specific questions. How often does such situation happen? And are there economic policy prescriptions to deal with it?

In the case of searching sources related to a specific economic problem, e.g. "low-return projects in low-cost-of-capital environment are subjected to high risk of default", it is reasonable to use specialized databases, like IDEAS. It contains not only published journal papers, but also working papers, discussion paper, conference proceedings, i.e., so-called, "gray literature". So go to the IDEAS web-page: https://ideas.repec.org/

1. Because the problem described above is likely to be of importance for policy-makers and cost of capital is influenced by interest rate policy, it should be discussed in papers on interest rate policy. Thus, enter "Interest rate policy" into the search line. Choose "Papers" on the right and "In: Title" below.



The 3-rd item in the results list entitled "Illiquidity and Interest Rate Policy" is relevant to the considered problem according to the abstract just below. The link to it is:
http://www.nber.org/papers/w15197.pdf

3. Illiquidity and Interest Rate Policy [80.535%]
Douglas W. Diamond & Raghuram G. Rajan (2009)
Downloadable! The cheapest way for banks to finance long term illiquid projects is typically to borrow short term from households. But when household needs for funds are high, **interest rates** will rise sharply, debtors will have to shut down illiquid projects, and in extremis, will face more damaging runs. Authorities may want to push down **interest rates** to maintain economic activity in the face of such illiquidity, but intervention may not always be feasible, and when feasible, could encourage banks to increase leverage or fund even more illiquid projects up front. This could make all parties worse off. Authorities may want to commit to a specific **policy** of **interest rate** intervention to restore appropriate incentives. For instance, to offset incentives for banks to make more illiquid loans, authorities may have to commit to raising **rates** when low, to counter the distortions created by lowering them when high. We draw implications for **interest rate policy** to combat illiquidity.

It could be that sources to which the chosen paper refers might be of interest as well. To see the referred sources click on the "Illiquidity and Interest Rate Policy" in the search results list. You will get to the page: https://ideas.repec.org/p/nbr/nberwo/15197.html. Then click "References" below (seemingly, there are no directly relevant items).

File URL: http://www.nber.org/papers/w15197.pdf
Download Restriction: no
download the selected file

Bibliographic Info

Related research

References — A list of sources referred to in the chosen paper

Citations — A list of sources which refer to the chosen paper

It also could be that the chosen paper is cited by sources relevant to your problem. Click "Citations" and then "on a separate page" below. There appear to be several relevant sources:

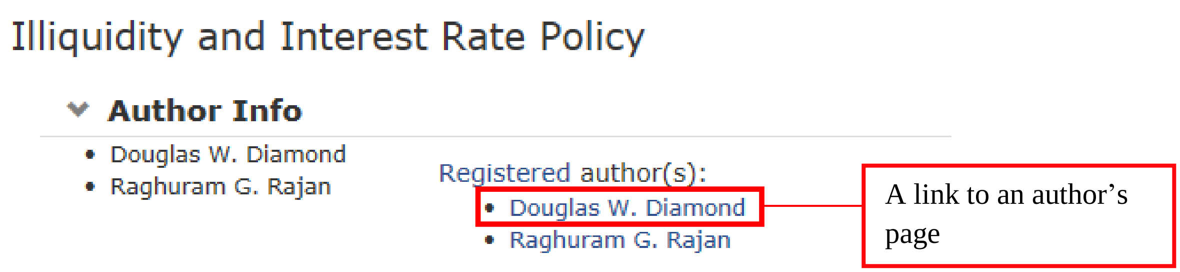
#11 "Does Monetary Policy Affect Bank Risk?" as the abstract below suggests (https://ideas.repec.org/a/ijc/ijcjou/y2014q1a3.html)

Abstract

We investigate the effect of relatively loose monetary policy on bank risk through a large panel including quarterly information from listed banks operating in the European Union and the United States. We find evidence that relatively low levels of interest rates over an extended period of time contributed to an increase in bank risk. This result holds for a wide range of measures of risk, as well as macroeconomic and institutional controls including the intensity of supervision, securitization activity and bank competition. The results also hold when changes in realized bank risk due to the crisis are accounted for. The results suggest that monetary policy is not neutral from a financial stability perspective.

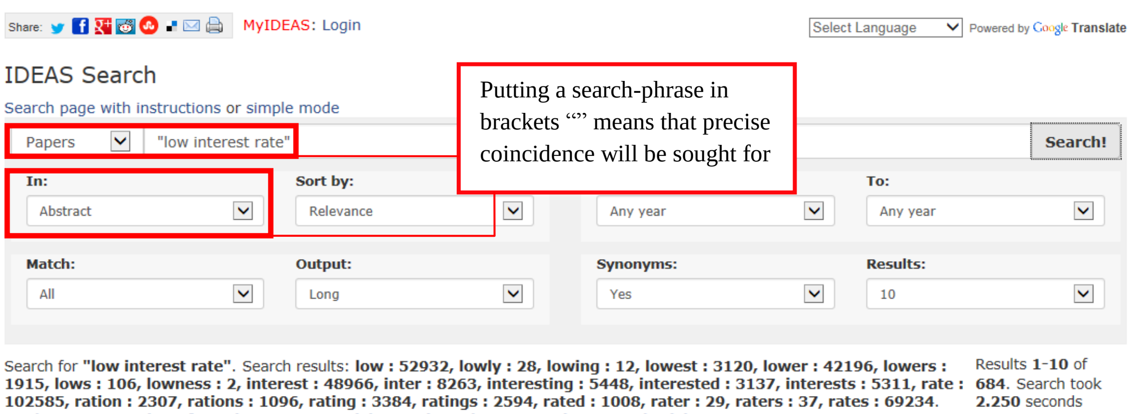
#19 "Do Low Interest Rates Sow the Seeds of Financial Crises?" as the title suggests, (https://ideas.repec.org/p/bca/bocawp/11-31.html), but the previous seems to be more useful

Finally, it could be that some other papers of the same author might be useful. So, click the name "Douglas W. Diamond" at the top of the page corresponding to the paper "Illiquidity and Interest Rate Policy" https://ideas.repec.org/p/nbr/nberwo/15197.html).



It seems that the item #7 in category "Articles" entitled "Banks and liquidity creation: a simple exposition of the Diamond-Dybvig model" is of some use. Its link is: https://ideas.repec.org/a/fip/fedreq/y2007isprp189-200nv.93no.2.html

2. Then, it is worthwhile to try a broader search. Return to IDEAS home (https://ideas.repec.org/). Type "low interest rate" in search line, choose "Papers" to the left, and "In: Abstract" below



Then, within the search results,
the item #24 "Accelerated Investment and Credit Risk under a Low Interest Rate Environment: A Real Options Approach" might be helpful: https://ideas.repec.org/p/ime/imedps/10-e-08.html)

24. Accelerated Investment and Credit Risk under a Low Interest Rate Environment: A Real Options Approach [80.148%]
Tetsuya Yamada (2010)
Downloadable! Empirical studies have found that a **low interest rate** environment accelerates firmsf investment and debt financing, leading to subsequent balance sheet problems in many countries in recent years. We examine the mechanism whereby firmfs debt financing and investment become more accelerated and the credit risk rises under a **low interest rate** environment from the perspective of a real options model. We find that firms tend to increase debt financing and investment not only under strong expectations of continued **low interest rates** but also when there are expectations of future interest rate increases, and such behavior causes higher credit risk. We also find that when future interest rate rises are expected, the investment decisions vary depending on how firms incorporate the possibility of future interest rises. Specifically, myopic firms make glast-minute investmentsh based on concerns over future interest rate hikes and this behavior increases their credit risk. In contrast, economically rational

The item #125 "The low interest rate environment: Causes, effects, and a way out" (especially, a notice on "evergeening")

(https://ideas.repec.org/p/zbw/iwkpps/102014.html)

125. The low interest rate environment: Causes, effects and a way out [79.857%]
Matthes, JÃ¼rgen (2014)
Downloadable! The very expansive and unconventional monetary policy of the ECB reduced the tensions of the Euro debt crisis at the price of persistently very **low interest rates**. While the ECB was right to act at the peak of the crisis, the risks of the **low-interest rate** environment become increasingly obvious. Private savings suffer from very low yields, which is particularly detrimental for long-term retirement savings. Moreover, financial stability risks could arise, as ultra-**low interest rates** can cause a search for yield among investors. Banks and life insurance companies are exposed to reduced interest profits respectively lower yields. While life insurance companies can cope with a shorter period of **low interest rates**, a longer period, however, poses challenges, as contracts with guaranteed interest rates have to be served. Therefore, it is a positive sign that the economic conditions for an interest rate turnaround have improved significantly since 2012 and are expected to improve further. Economic act

The item #115 "Cheap Money and Risk Taking: Opacity versus Underlying Risk" (https://ideas.repec.org/p/ekd/002625/2782.html)

115. Cheap Money and Risk Taking: Opacity versus Underlying Risk [79.876%]
Bernhard Eckwert & Burkhard Drees & Felix Vardy (2011)
Downloadable! In a Bayesian setting, investments can be risky either because they are opaque, i.e., their payoff-relevant signals are noisy, or because they are fundamentally risky, i.e., the variance of the prior is high. When interest rates are low (high), investors favor opaque (transparent) projects that are perceived to be fundamentally safe (risky). Therefore, whether **low interest rates** lead to increased risk taking depends on the sources of risk. Moreover, this analysis helps explain the popularity of senior tranches of CDOs in the pre-crisis years, which were characterized by an unusual combination of high opacity and, supposedly, low fundamental risk. Equilibrium analysis; Modeling information by using the statistical notion of sufficiency; From this concept two different types of risk are derived and their interaction as well as their impact for rational investment and portfolio decisions are analyzed. When interest rates are low (high), investors favor opaque (transparent) projects that are perceiv

Notes:

The numbering of items in the search lists above might change with time once new papers fitting the entered search attributes appear in the database