Economics 435
The Financial System
(1/23/13)

Instructor: Prof. Menzie Chinn
UW Madison
Spring 2013
Administrative Issues

• Course website:  

• OH: MW 3-3:45, W 5:30-6, 7418 Soc Sci

• Textbook: Chinn/Frieden, *Lost Decades*

• Cecchetti/Schoenholtz, or Mishkin

• Additional Readings: from web, Econbrowser, CBO

• *NYT, FT, WSJ, Economist*
Administrative Issues

• Grading: 10% PS, 45% 1×MT, 45% paper
• Dates:
  - MT on 4/17
  - Paper due on Fri, 5/10
• Make-ups: None. Points are re-allocated if you have a legitimate excuse. No late assignments accepted (must be handed in during lecture)
Risk and Crisis

Figure 1. Bank Systemic Risk Indicators
(*In basis points*)

3-Month Libor Minus Overnight Index Swap Spreads
- United States
- Euro Area
- United Kingdom

5-Year Bank Credit Default Swap Spreads
- United States
- Euro Area
- United Kingdom

Sources: Bloomberg L.P.; and Datastream.
Leading to Recession/Depression

Motivating Questions

- Why did the financial crisis occur?
- Was it all financial?
- How did financial problems get transmitted to the real side?
- What are the similarities and differences between the past episodes (e.g., the 1929 crash) and this crisis.
Government and national borrowing

Note: Fed. Budget balance is net lending. Source: BEA
Real interest rates

Source: Federal Reserve Board, Philadelphia Fed SPF
The “Disappearance” of Risk

Figure 3. Advanced and Emerging Markets: Sovereign and Corporate Bond Spreads, 1998–2008

Source: IMF, WEO update, 11/6/08
Household debt (I)

Household debt (II)

Source: BIS, Annual Report (2011)
Housing boom (I)

Note: Rescaled to 2001Q4=1.
Source: BIS, Annual Report (2011)
Housing boom (II)

Note: Rescaled to 2001Q4=1.
Source: BIS, Annual Report (2011)
Leverage (as of 2007)

Source: Greenlaw, Hatzis, Kashyap, and Shin (2008)
Boom and Bust in the Shadow Financial System

Source: Federal Reserve Board
Consortium and Wealth

Source: BEA, 2012Q3 3rd release, Fed Flow of Funds
Policy Uncertainty

Baker, Bloom & Davis policy uncertainty index

www.econbrowser.com
Conventional Monetary Policy
Quantitative Easing, Operation Twist

http://www.clevelandfed.org/research/data/credit_easing/index.cfm
The Other Side of the Fed Balance Sheet

Europe

Figure 1. The Escalating Cycle of Turmoil

Sources: Bloomberg L.P.; and IMF staff estimates.