Economics 435 The Financial System (1/22/13)

Instructor: Prof. Menzie Chinn UW Madison Spring 2014

Administrative Issues

- Course website: http://www.ssc.wisc.edu/~mchinn/web435_s14.html
- OH: MW 2-3, 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 4/16
 - Paper due on Fri, 5/9
- Make-ups: None. Points are re-allocated *if* you have a legitimate excuse. No late assignments accepted (must be handed in during lecture)

Outline

- The Financial Crisis of 2008-09
- The Great Recession of 2007-09 and the slow recovery
- Extraordinary monetary policies
- Europe
- IS-LM

Risk and Crisis

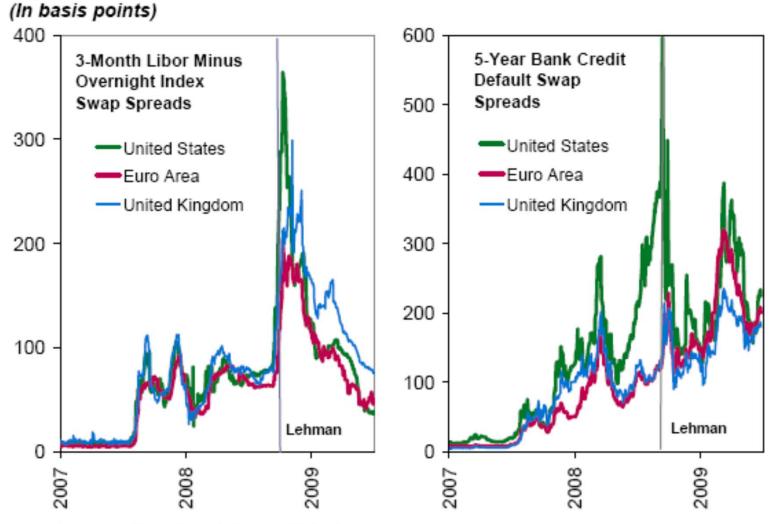


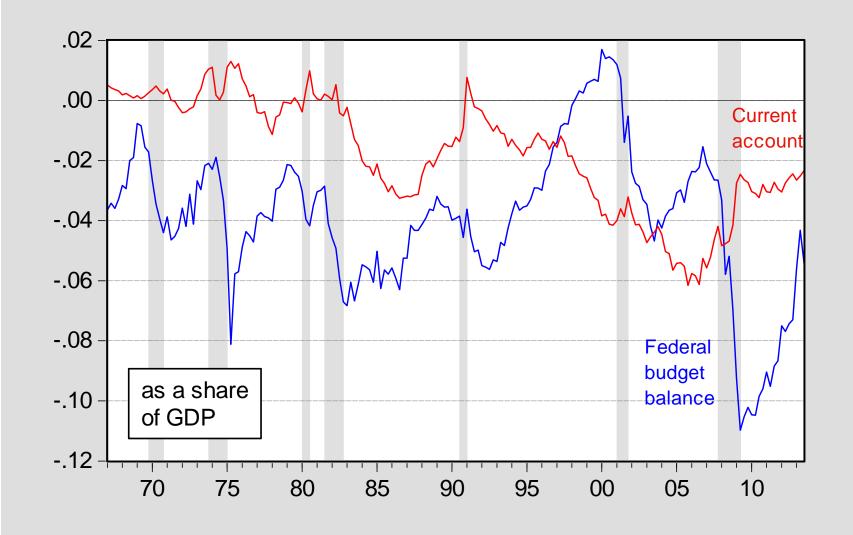
Figure 1. Bank Systemic Risk Indicators

Sources: Bloomberg L.P.; and Datastream.

Motivating Questions

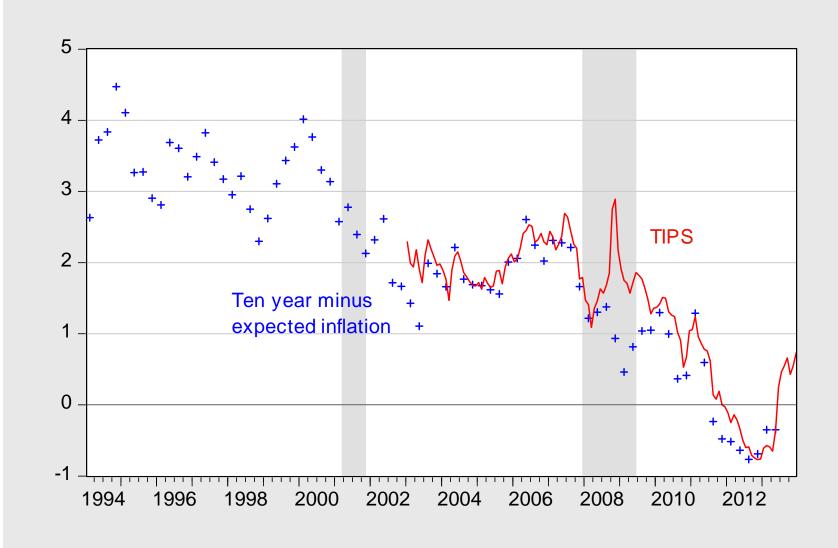
- Why did the financial crisis occur?
- Was it all financial?
- How did financial problems get transmitted to the real side?
- What are the similarities and differences between the past episodes (e.g., the 1929 crash) and this crisis.

Government and national borrowing



Note: Fed. Budget balance is net lending. Source: BEA

Real interest rates



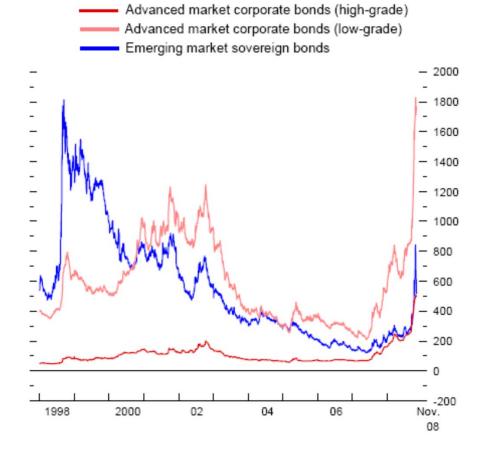
Source: Federal Reserve Board, Philadelphia Fed SPF

The "Disappearance" of Risk

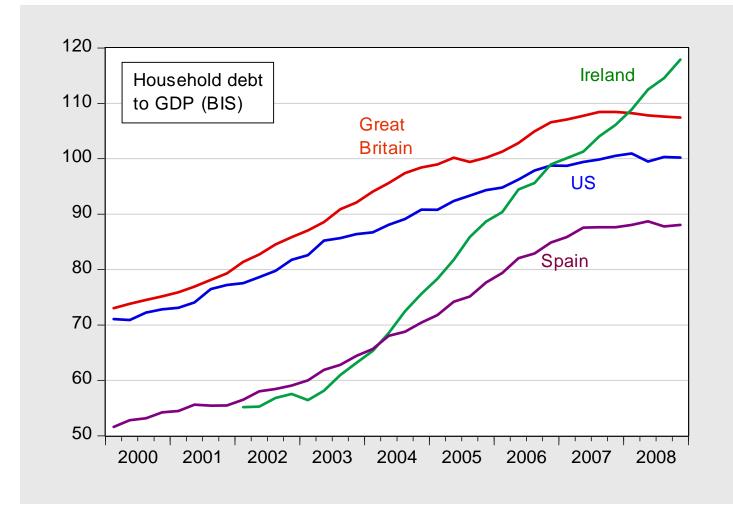
Figure 3. Advanced and Emerging Markets: Sovereign and Corporate Bond Spreads, 1998–2008

(In basis points)

Source: IMF, *WEO* update, 11/6/08

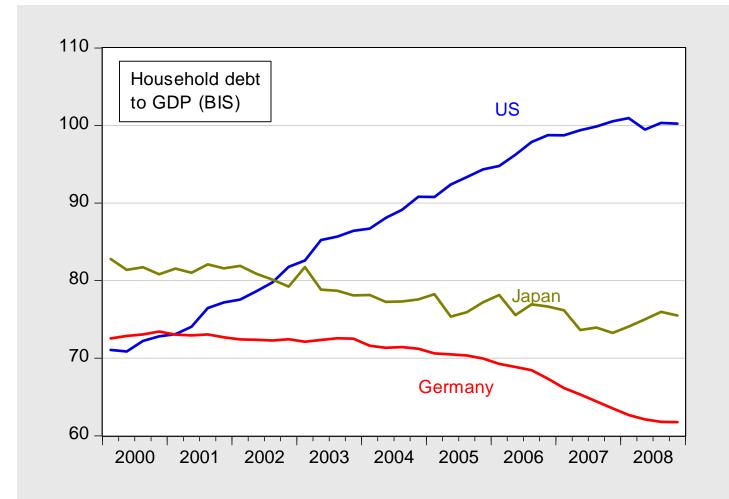


Household debt (I)



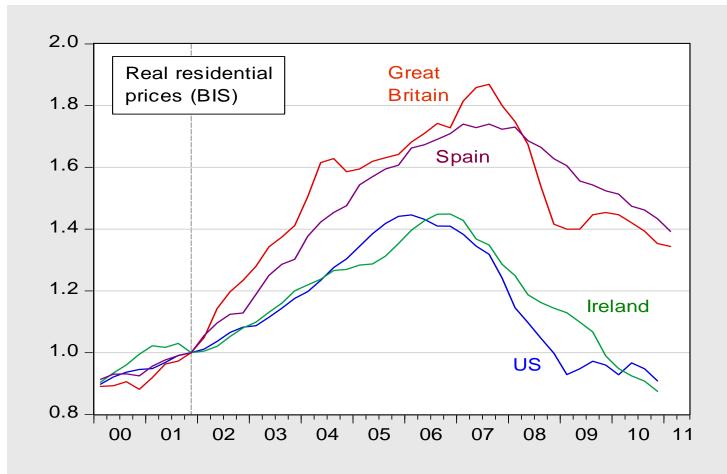
Source: BIS, Annual Report (2011)

Household debt (II)



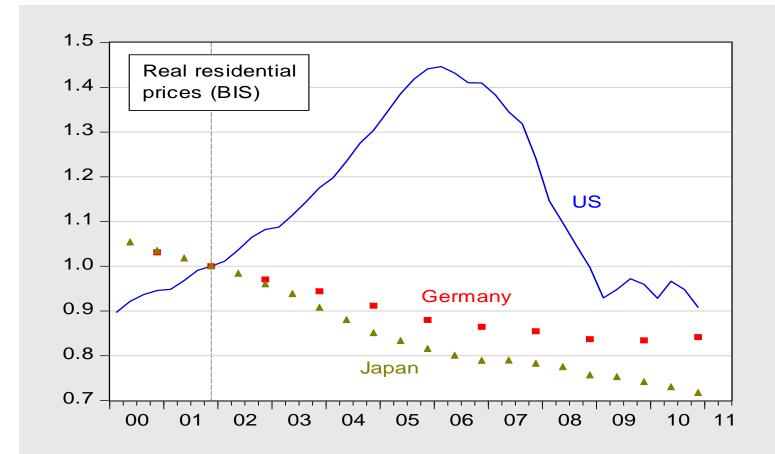
Source: BIS, Annual Report (2011)

Housing boom (I)

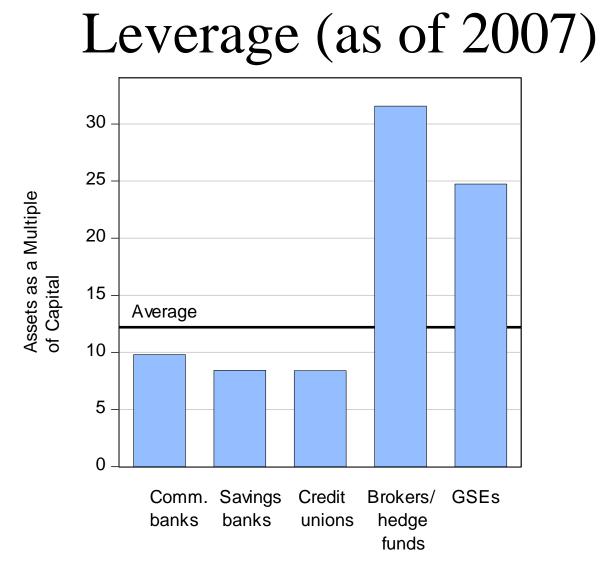


Note: Rescaled to 2001Q4=1. Source: BIS, Annual Report (2011)

Housing boom (II)

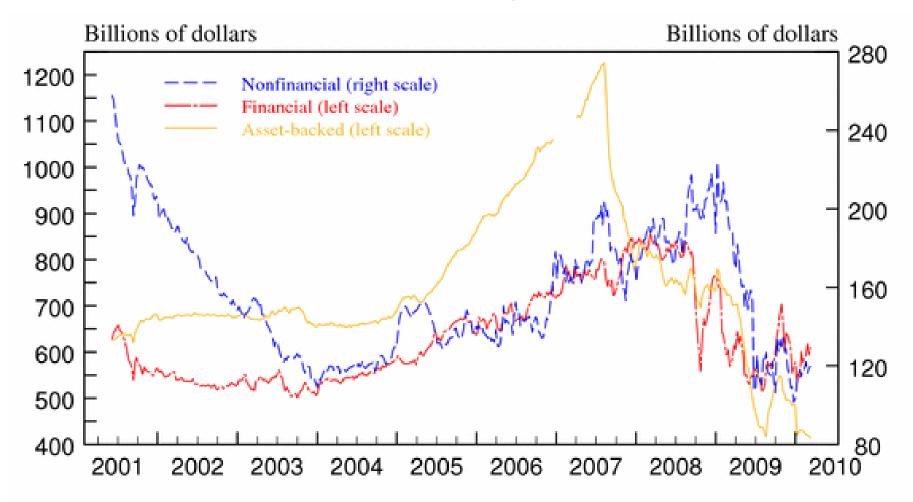


Note: Rescaled to 2001Q4=1. Source: BIS, Annual Report (2011)



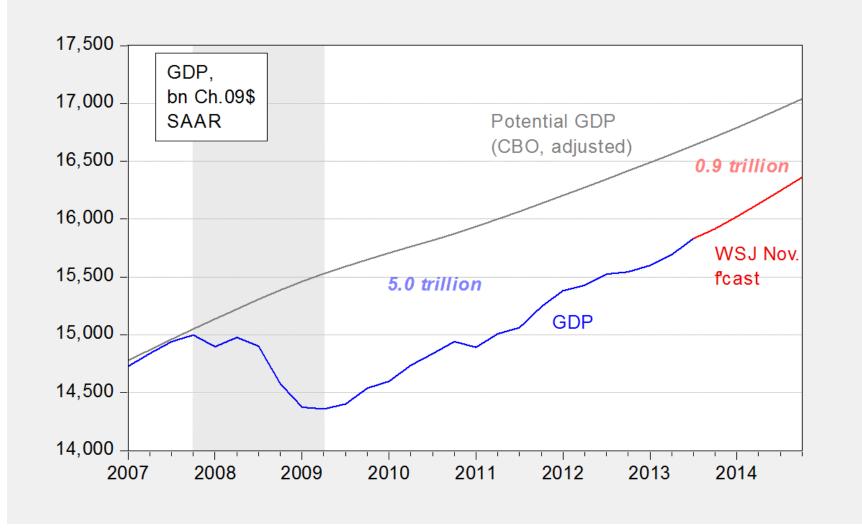
Source: Greenlaw, Hatzius, Kashyap, and Shin (2008)

Boom and Bust in the Shadow Financial System



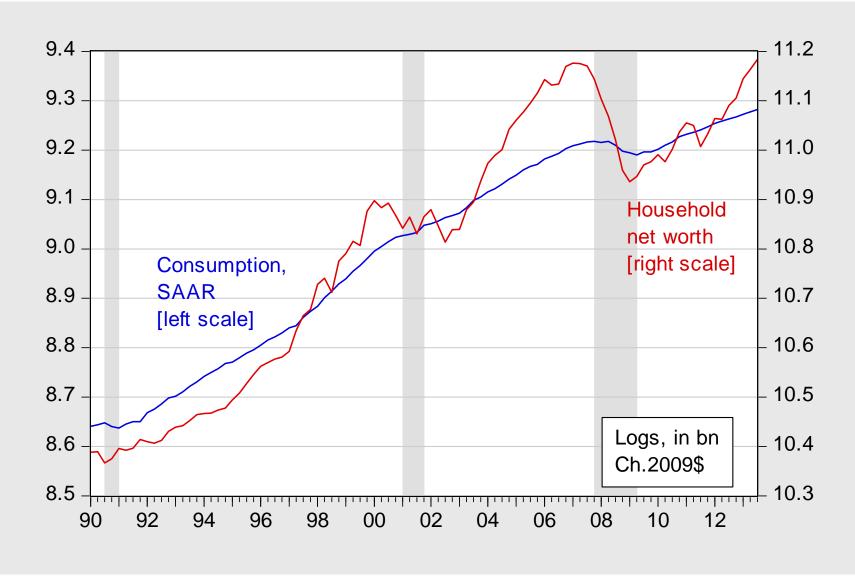
Source: Federal Reserve Board

Leading to Recession/Depression



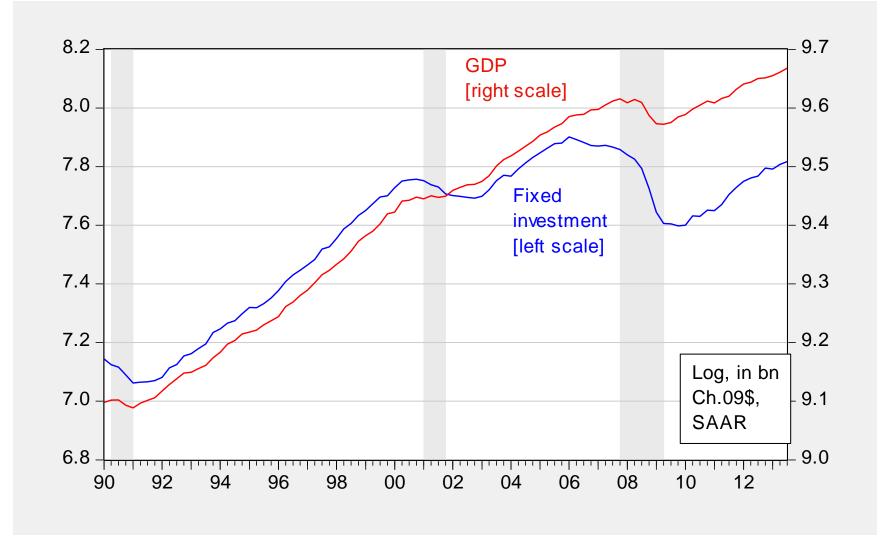
Source: BEA, 2012Q3 3rd release, CBO (Aug. 2012), WSJ

Consumption and Wealth



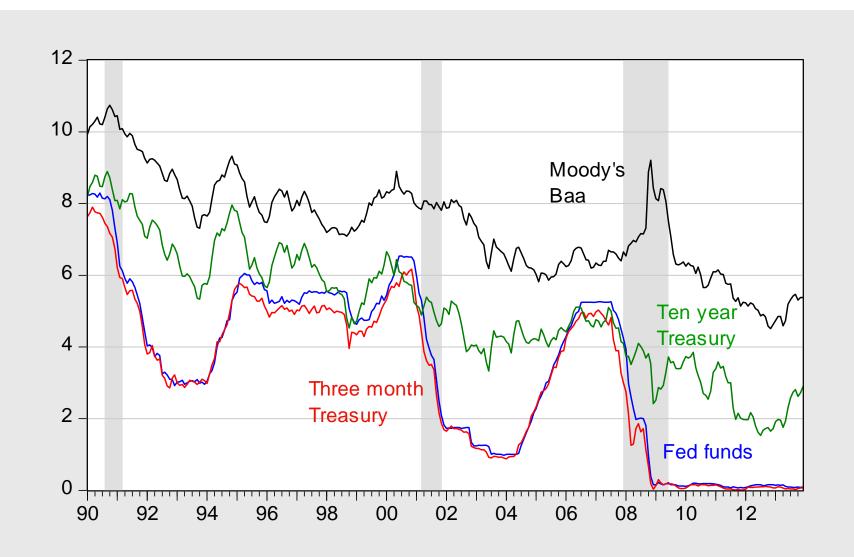
Source: BEA, 2013Q3 3rd release, Fed Flow of Funds

Investment



Source: BEA, 2013Q3 3rd release

Conventional Monetary Policy



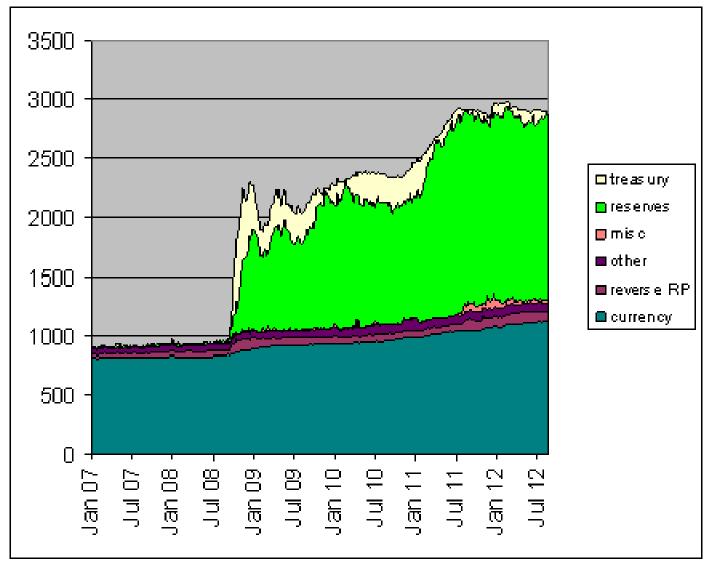
Source: St. Louis Fed FRED system

Quantitative Easing, Operation Twist

| Www.clevelandfed.org/researcherel | d.org/research/data/credit_easing/index.cfm | | | | | | | ☆▼ | CE | Vafmusic2 Customized Web Search | 1 | | 3- 1 | ŀ | | |
|--------------------------------------------------------------------|---------------------------------------------|--------------------------|--------------------|----------|-----------|--------|--------------|------------|----------|---------------------------------|------|----------------------------|------------------------------------------|---|--|--|
| Detailed View | Show dates f | from: 01 • / 2007 • | to: 11 - / 201 | 3 • Go | [reset da | lates] | | | | | | | | | | |
| Lending to Financial Institutions | May 3, 2013: | : The data have been upd | ated and are curre | ent. | | | | | | | | | | | | |
| • Repurchase Agreements | Chart D | ata | | | | | | | | | | | | | | |
| • Term Auction Credit | | | | | | | CUMMA | RY VIEW | | | | | | | | |
| Credit to Depository Institutions | | | | | | | | of Dollars | | | | | | | | |
| o Primary | 4,000,00 | 00 | | | | | | | | | | | | | | |
| o Secondary | 3,666,6 | 67 | | | | | | | | | | | | | | |
| o Seasonal | 3,333,3 | 33 | | | | | | | | | | | 1 | | | |
| • Credit Extensions | | | | | | | | | | | | | 5 | | | |
| • Primary Dealer & Other | 3,000,0 | 00 | | | | | | | | ~ | | min | | | | |
| Broker-Dealer Credit | 2,666,6 | 67 | | | | | | | | / | | ~~~~ | | | | |
| O Credit Extended to Alg Other Credit Extensions | 2,333,3 | 22 | | | | | | | / | | | | | | | |
| Other Federal Reserve | 2,333,3 | 33 | | M | | ~~ | ~~~ | | | | | | / | | | |
| Assets | 2,000,0 | 00 | | | 500 | ~ | | | | | | man | | 1 | | |
| Currency Swaps | 1,666,6 | 67 | | prom | 124 | | | | | E | | | | | | |
| · Securities Lent to | | | | | har | 2 | | | | // | | | | | | |
| Dealers (including TSLF) | 1,333,3 | 33 | | | | 1 | - | | 1 | / | | | | | | |
| Providing Liquidity to Key Credit Markets | 1,000,0 | 00 | | | | | - | - | 2/ | | | | | | | |
| Asset-Backed Commercial | 666,6 | 67 | ~ | | | | - | | _ | | | | | | | |
| Paper Money Market | | | | | | | | | | ~~~~ | - | | | | | |
| Mutual Fund Liquidity Facility | 333,3 | 33 | | m | \sim | | | | | | | | | | | |
| • Term Asset-Backed | | 0 | 01/08 05/08 | 09/08 01 | 1/09 05/0 | 00/00 | 02/10 0 | 06/10 10 | /10 02/1 | 1 06/11 | 10/1 | 1 02/12 07/12 11/12 03/ | 13 07/13 | | | |
| Securities Loan Facility | | | | | | | | | | | | rkets Fed Agency Debt Mort | | | | |
| Net Portfolio Holdings of Commercial Paper | Charleses. | | CONTRACTOR | | | | curities Pur | | | | | | a an | | | |

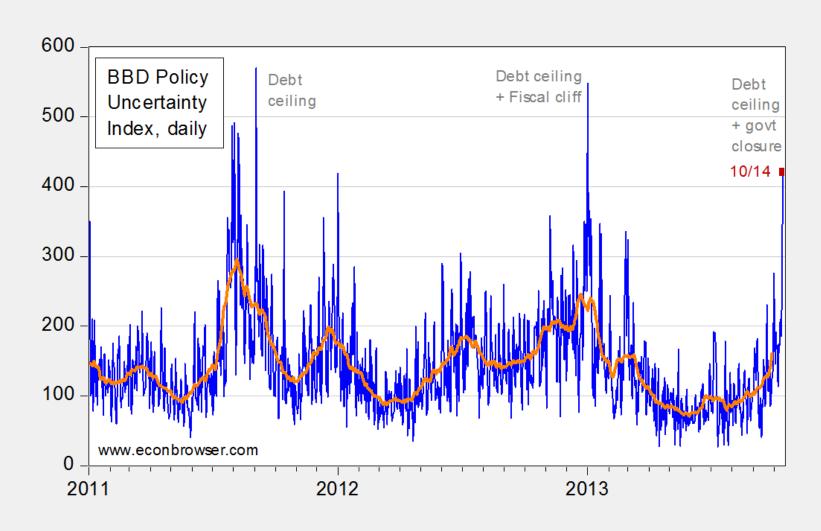
http://www.clevelandfed.org/research/data/credit_easing/index.cfm

The Other Side of the Fed Balance Sheet



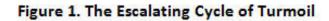
http://www.econbrowser.com/archives/2012/08/us_monetary_pol.html

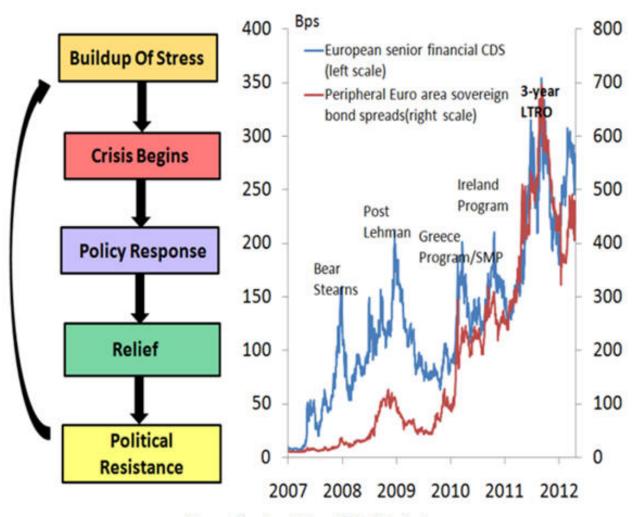
Policy Uncertainty



Source: Policy Uncertainty, http://www.policyuncertainty.com

Europe





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