Public Affairs 974-1
Monetary and Financial Policy in the Wake of the Financial Crisis (9/6/12)

Instructor: Prof. Menzie Chinn
UW Madison
Fall 2012
Administrative Issues

• Course website:  
  http://www.ssc.wisc.edu/~mchinn/web974_f12.html

• OH: T2:30-3:30, R3-4, 7418 Soc Sci

• Textbook: Chinn/Frieden, *Lost Decades*

• Cecchetti/Schoenholtz

• Additional Readings: from web, Econbrowser, CBO

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

- Grading: 20% PS, 80% paper
- Dates:
  - Paper due on Fri, 12/14
- Make-ups: None. Points are re-allocated if you have a legitimate excuse. No late assignments accepted (must be handed in during lecture)
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

![GDP chart showing potential GDP, actual GDP, and WSJ survey](chart.png)

- **Potential GDP**
  - $1.2 trillion

- **Actual GDP**
  - $3.54 trillion

- **WSJ survey (Aug. 12)**
  - $1.2 trillion
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

Ten year Treasury rate adjusted by expected inflation

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, Hatzius, Kashyap, and Shin (2008)
Boom and Bust in the Shadow Financial System

Source: Federal Reserve Board
Consumption and Wealth

Logs, in bn
Ch.2005$

Consumption, SAAR
[right scale]

Household net worth
[right scale]
Investment

Logs, in bn Ch.05$, SAAR

GDP [right scale]

Fixed Investment [left scale]
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.