

Economics 435  
The Financial System

Lecture 1

9/4/2019

Instructor: Prof. Menzie Chinn

UW Madison

Fall 2019

# Administrative Issues

- Course website:  
[http://www.ssc.wisc.edu/~mchinn/web435\\_f19.html](http://www.ssc.wisc.edu/~mchinn/web435_f19.html)
- OH: MW 2:30-3:30 7418 Soc Sci
- Textbook: Chinn/Frieden, *Lost Decades*
- Cecchetti/Schoenholtz, or Mishkin
- Additional Readings: from web,  
Econbrowser
- *NYT, FT, WSJ, Economist*

# Administrative Issues

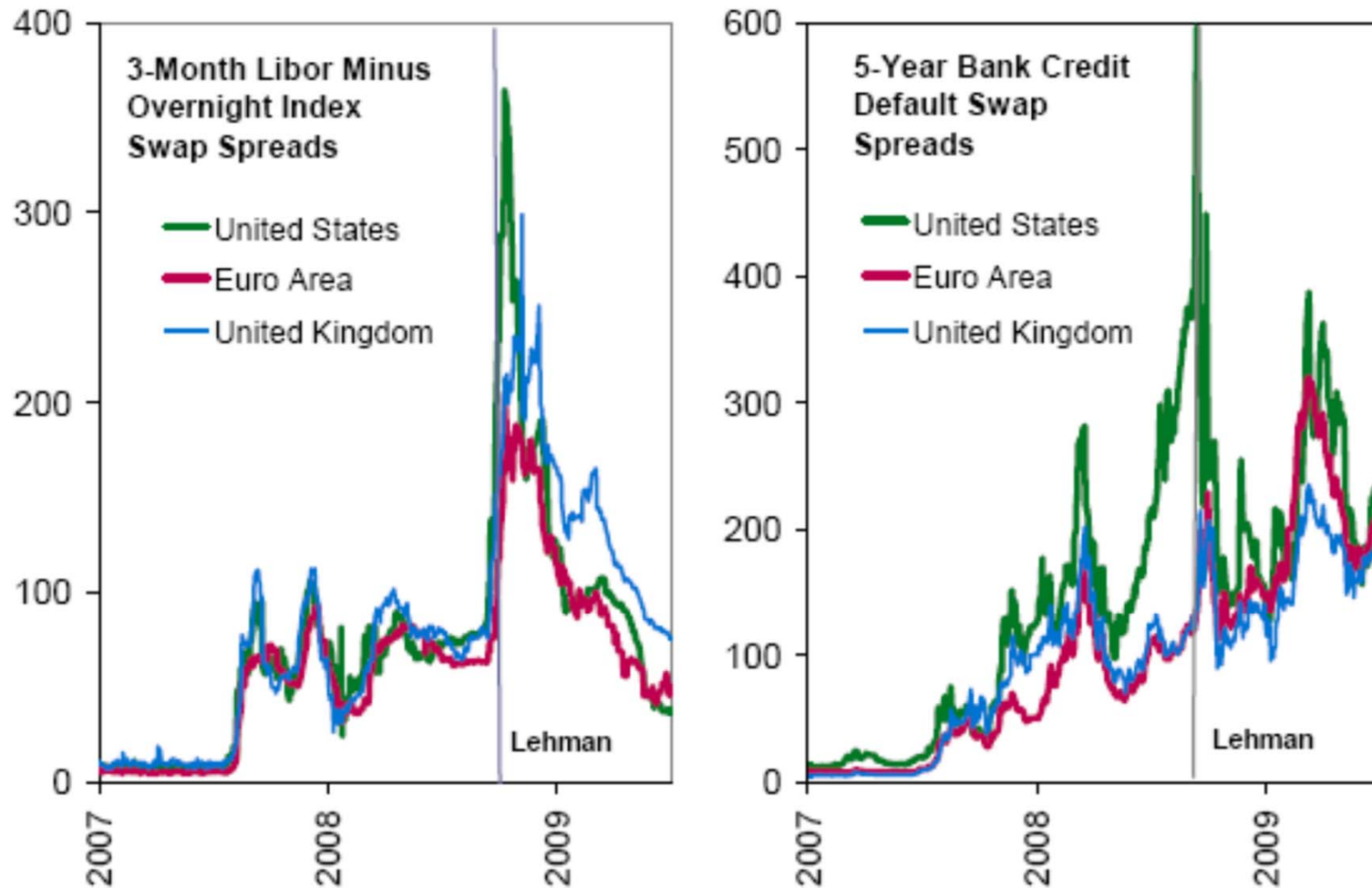
- Grading: 10% PS, 50% 2×MT, 40% paper
- Dates:
  - MT on 10/26, 11/20
  - Paper due on **Wednesday, 12/12**
- Make-ups: **None**. Points are re-allocated *if* you have a legitimate excuse. **No** late assignments accepted (must be handed in during lecture)

# Outline

- The Financial Crisis of 2008-09
- The Great Recession of 2007-09 and the slow recovery
- Extraordinary monetary policies, and their end
- On the cusp of recession?

# Risk and Crisis

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

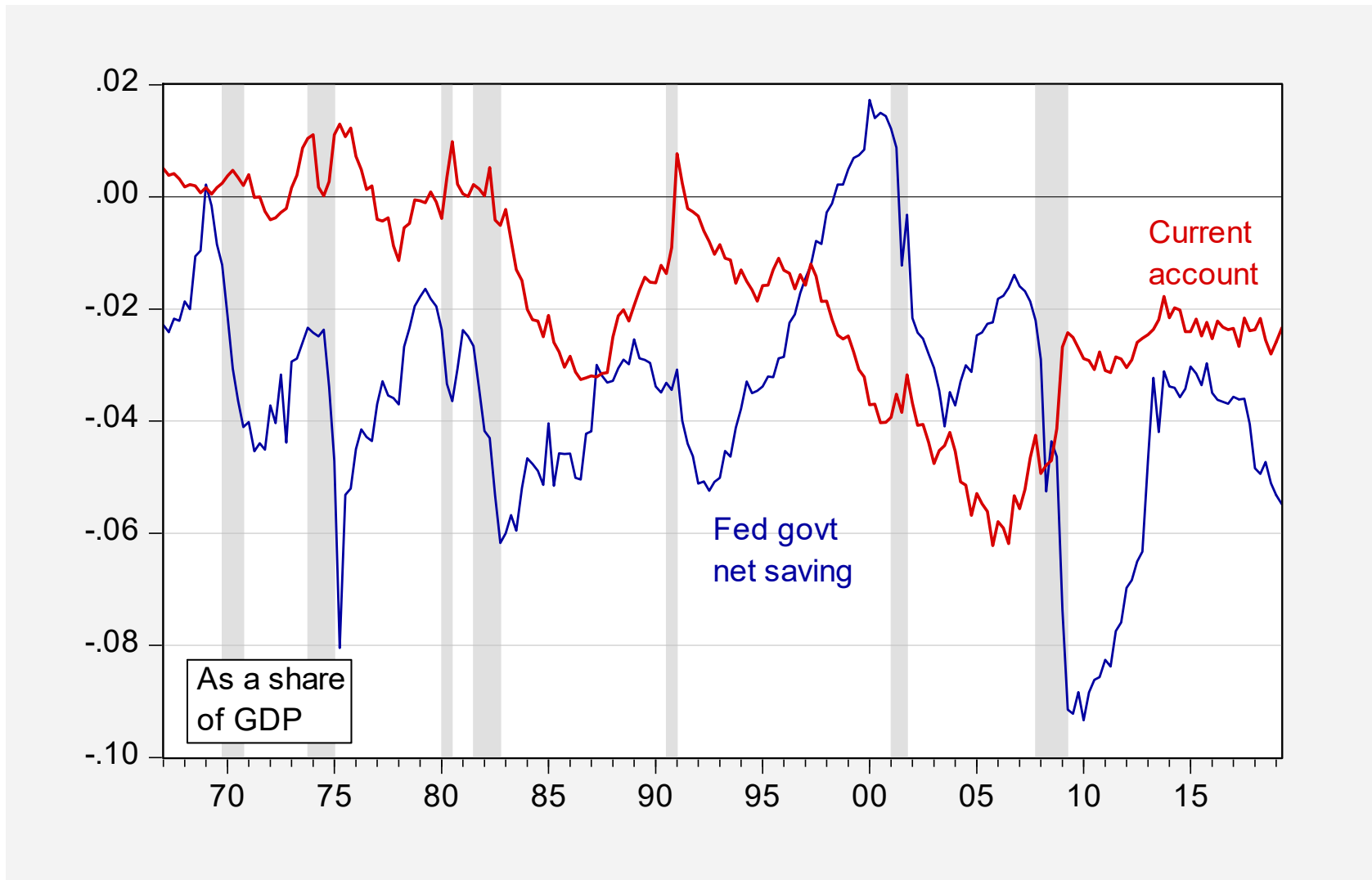


Sources: Bloomberg L.P.; and Datastream.

# Motivating Questions

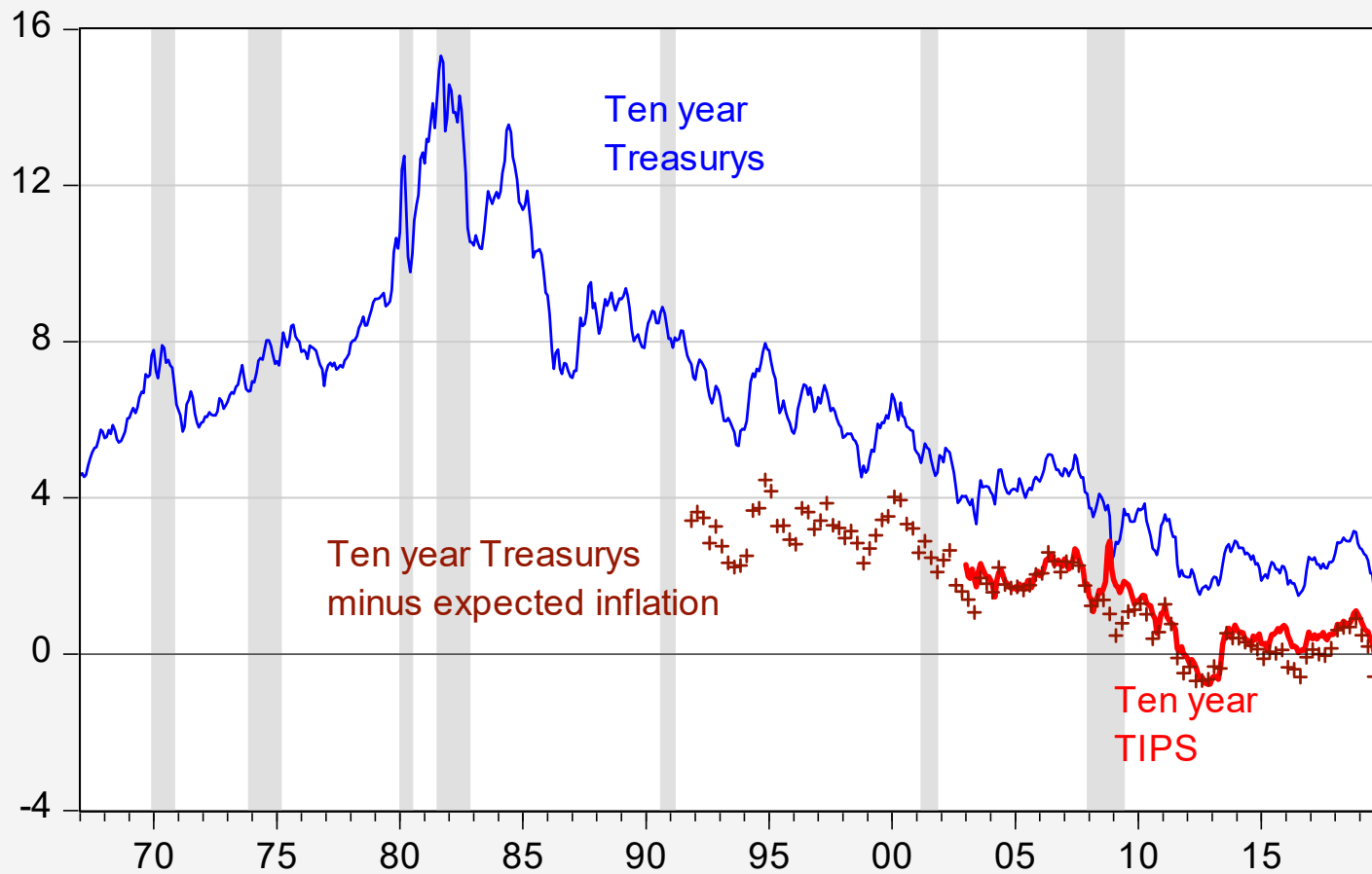
- Why did the financial crisis occur?
- Was it all financial?
- How did financial problems get transmitted to the real side?
- What are the similarities and differences between the past episodes (e.g., the 1929 crash) and this crisis.

# Government and national borrowing



Source: BEA, 2019Q2 2<sup>nd</sup> release.

# Real interest rates



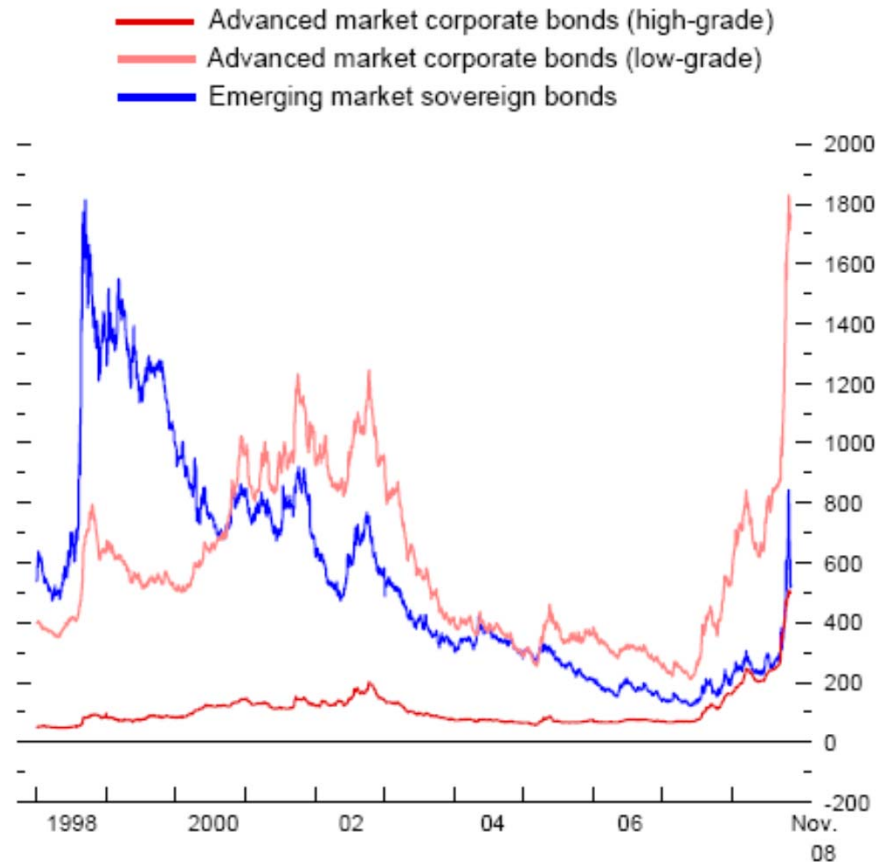
Source: Federal Reserve Board, Philadelphia Fed *Survey of Professional Forecasters* (median)



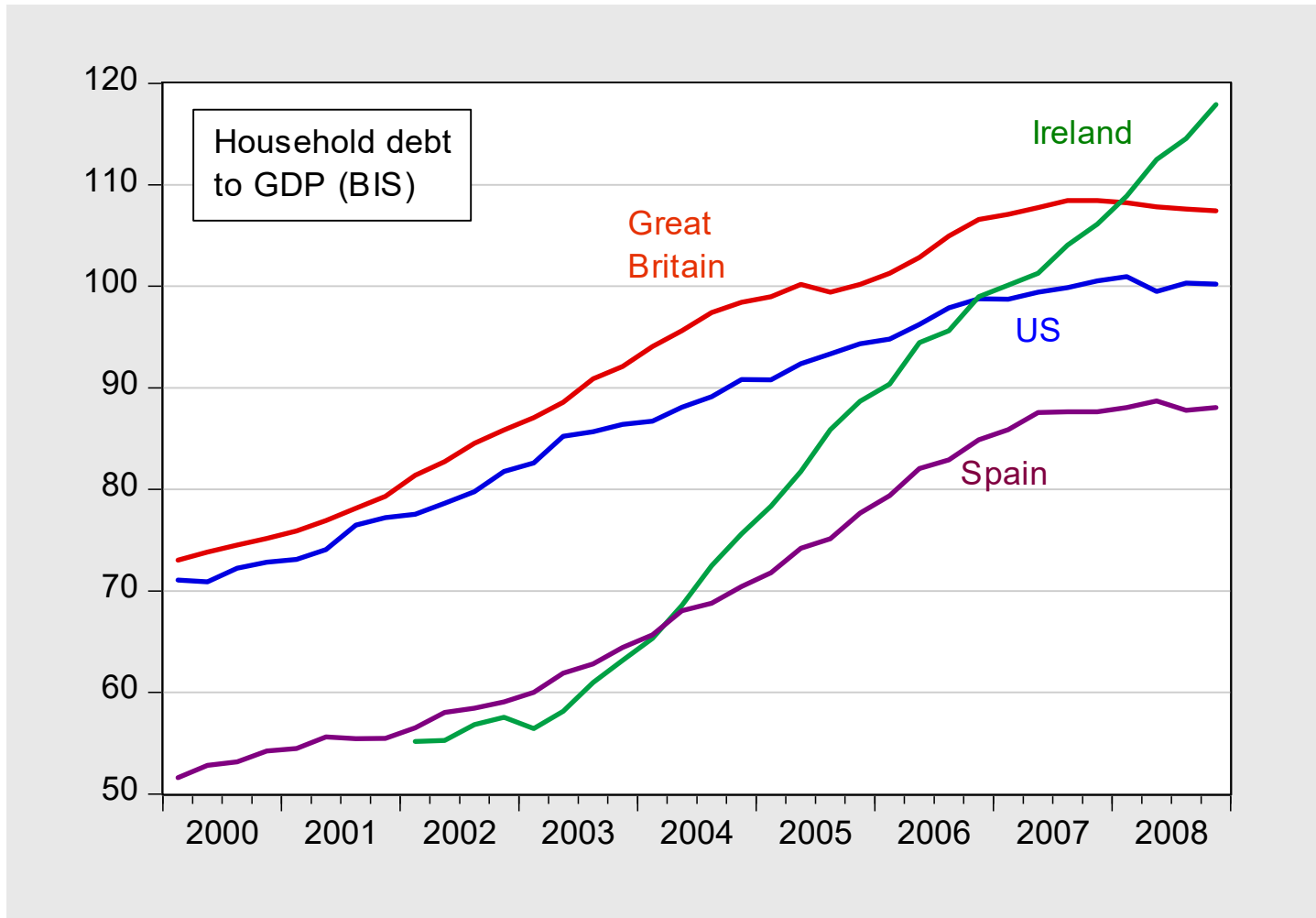
# The “Disappearance” of Risk

**Figure 3. Advanced and Emerging Markets: Sovereign and Corporate Bond Spreads, 1998–2008 <sup>1</sup>**  
(In basis points)

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

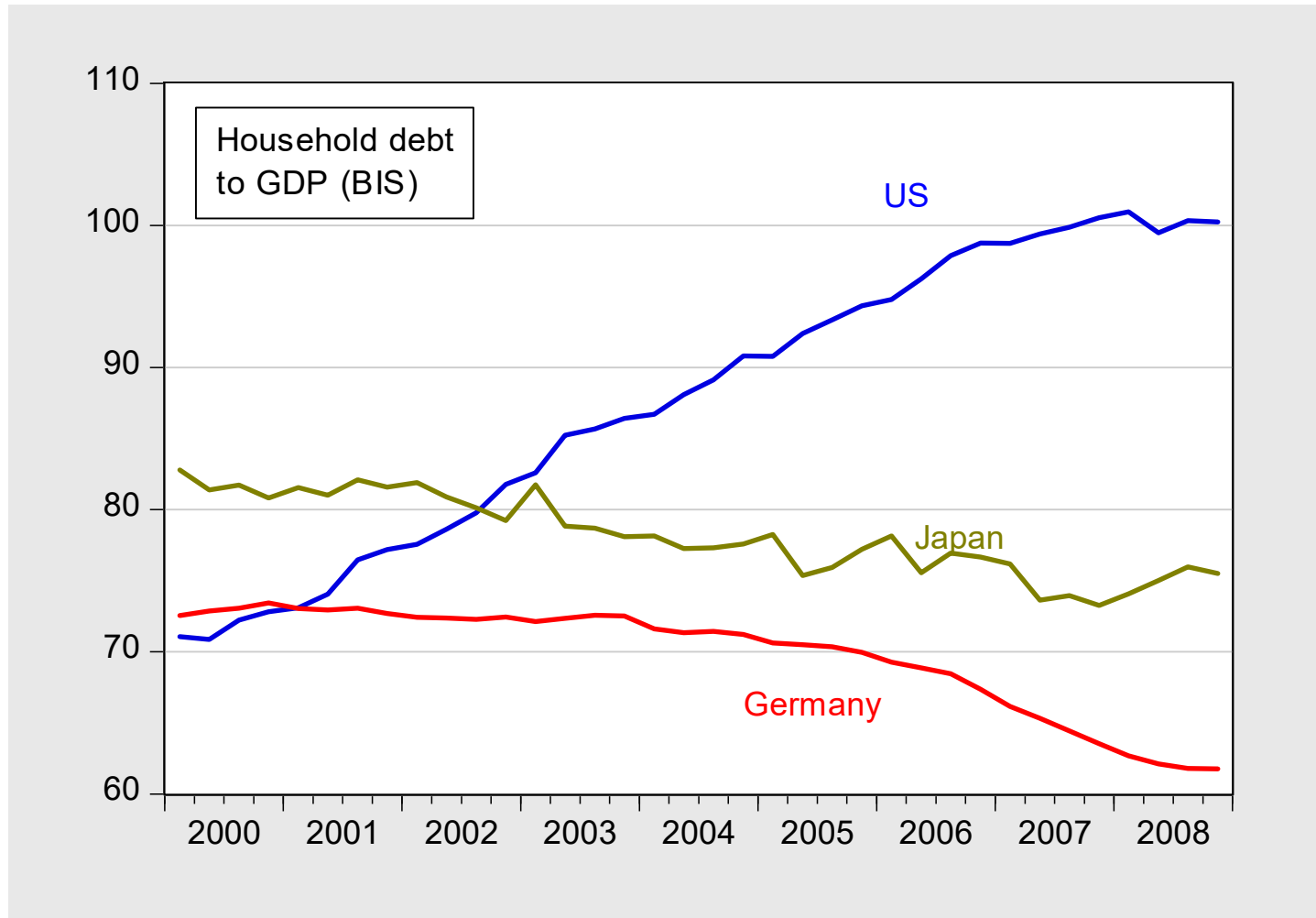


# Household debt (I)



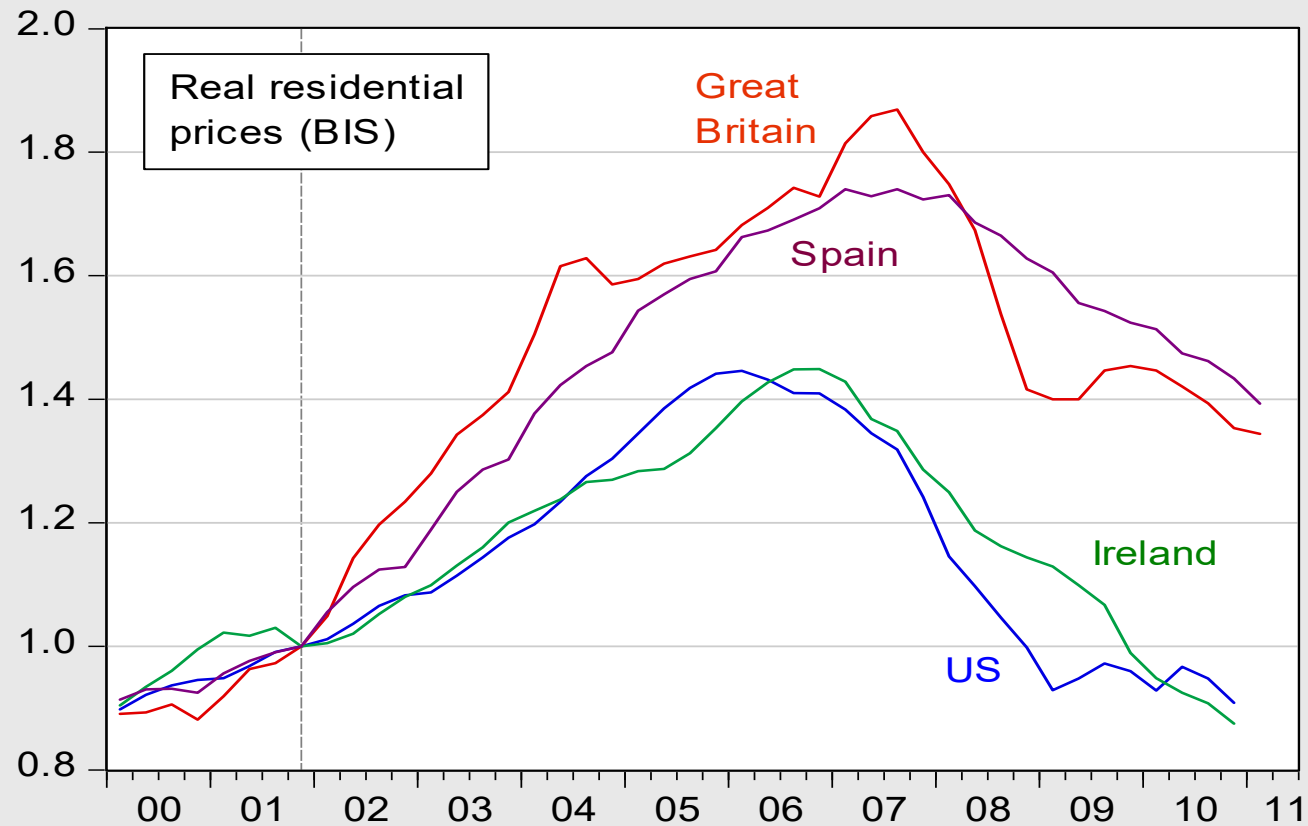
Source: BIS, *Annual Report* (2011)

# Household debt (II)



Source: BIS, *Annual Report* (2011)

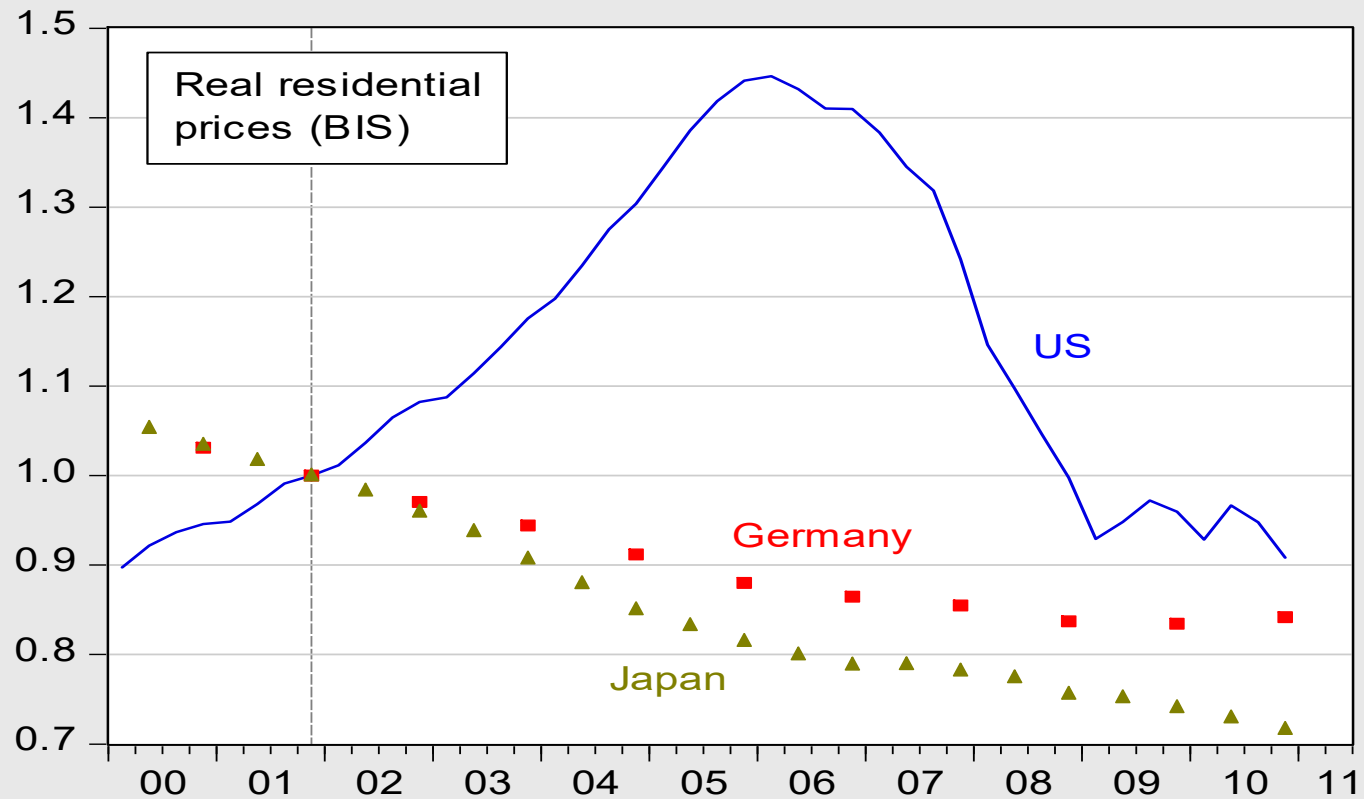
# Housing boom (I)



Note: Rescaled to 2001Q4=1.

Source: BIS, Annual Report (2011)

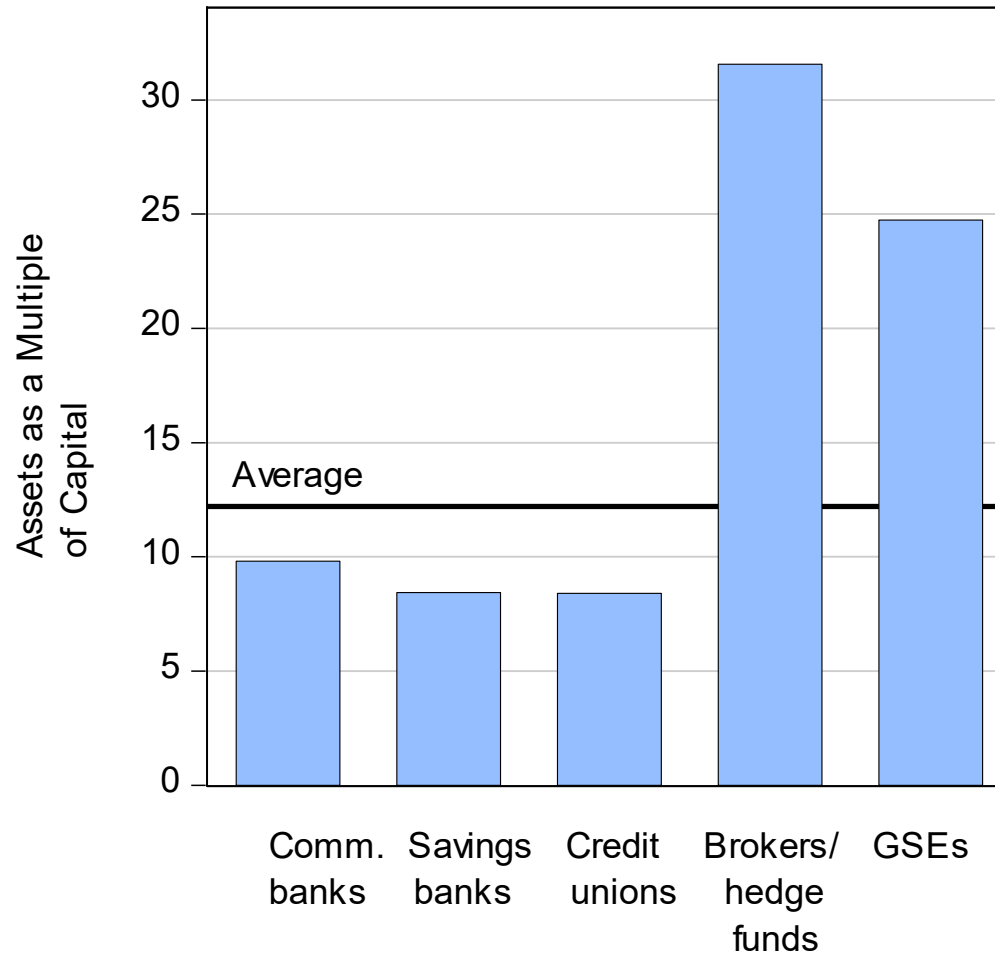
# Housing boom (II)



Note: Rescaled to 2001Q4=1.

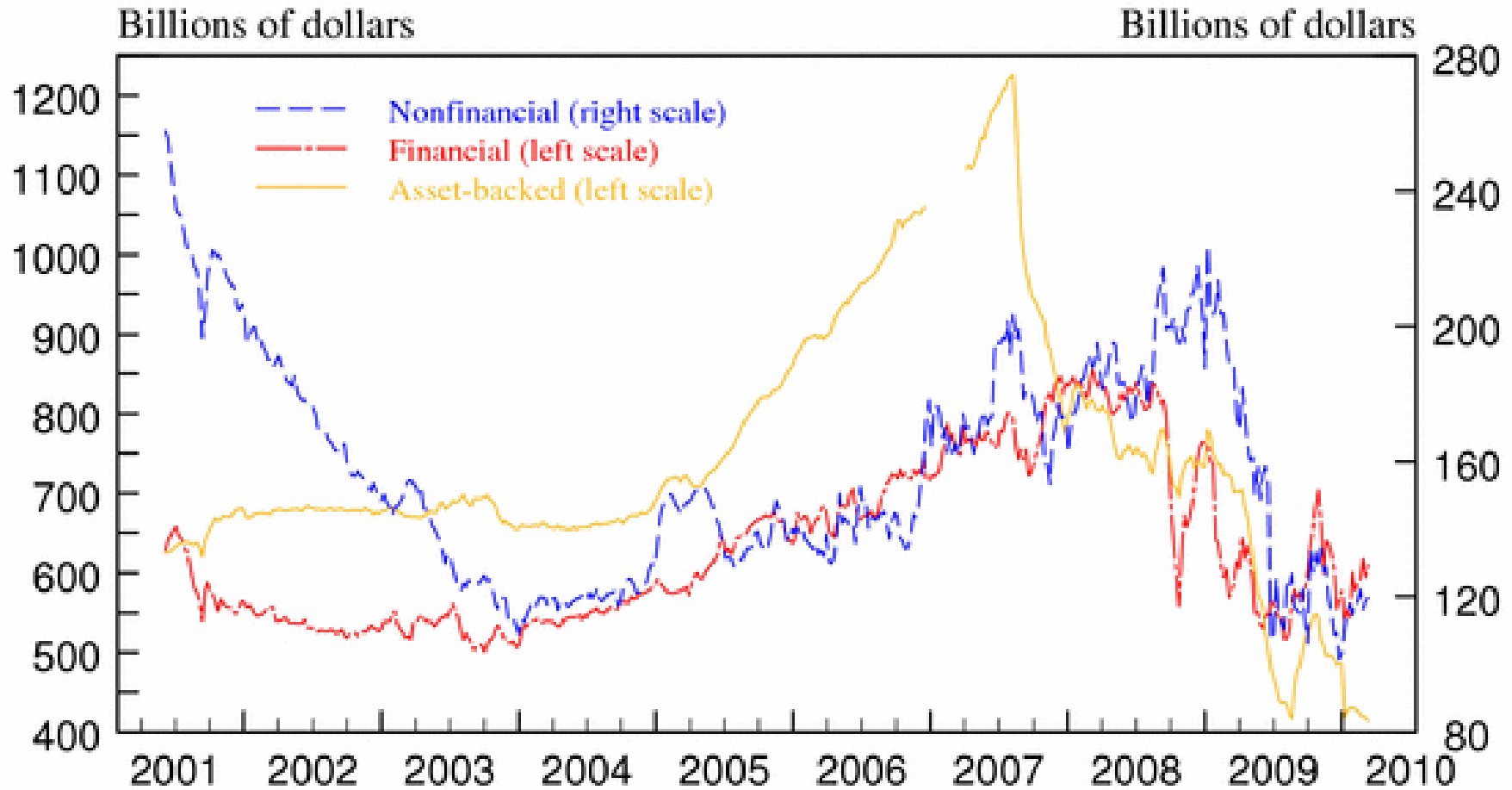
Source: BIS, Annual Report (2011)

# Leverage (as of 2007)



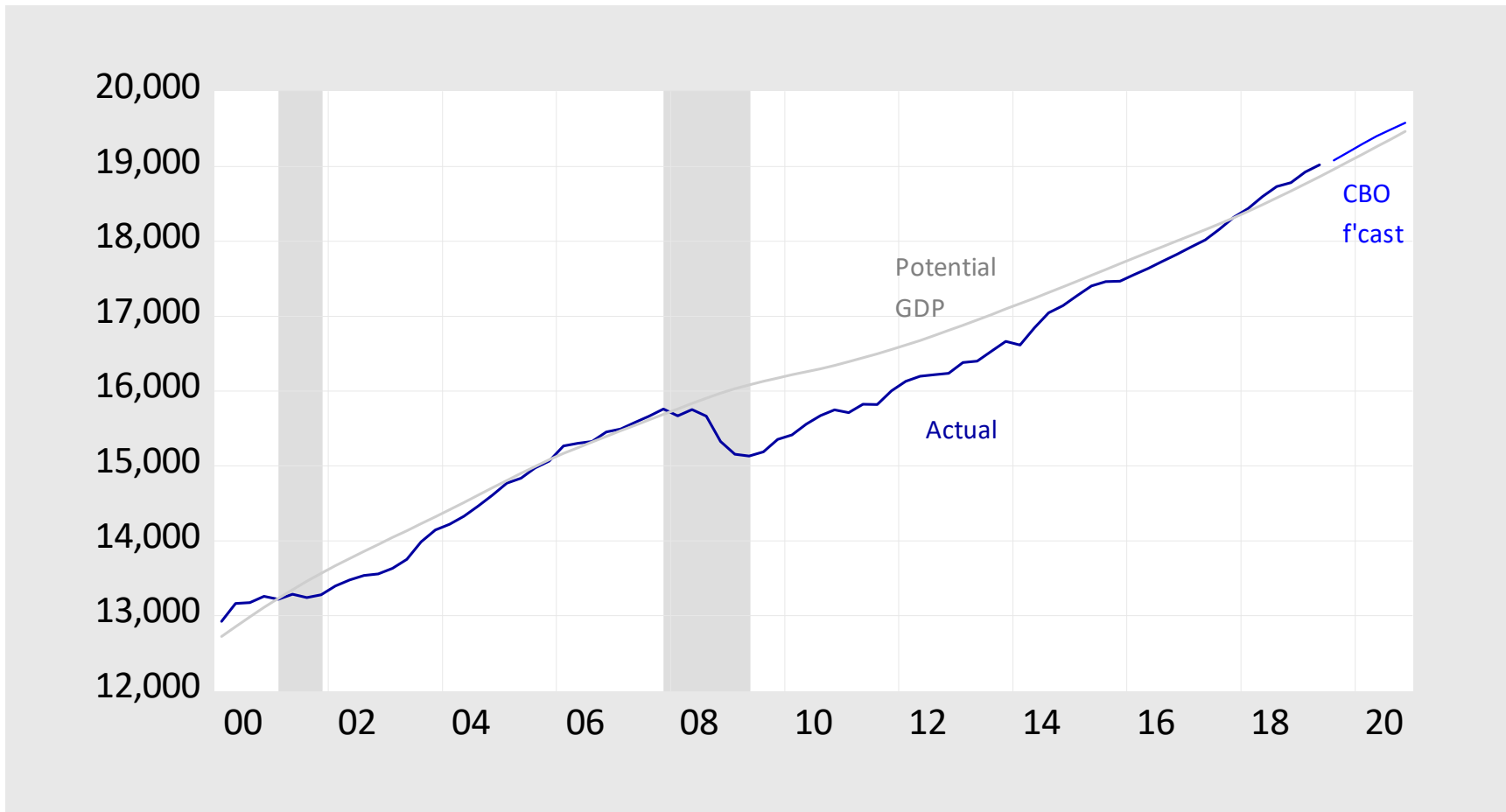
Source: Greenlaw, Hatzius, Kashyap, and Shin (2008)

# Boom and Bust in the Shadow Financial System



Source: Federal Reserve Board

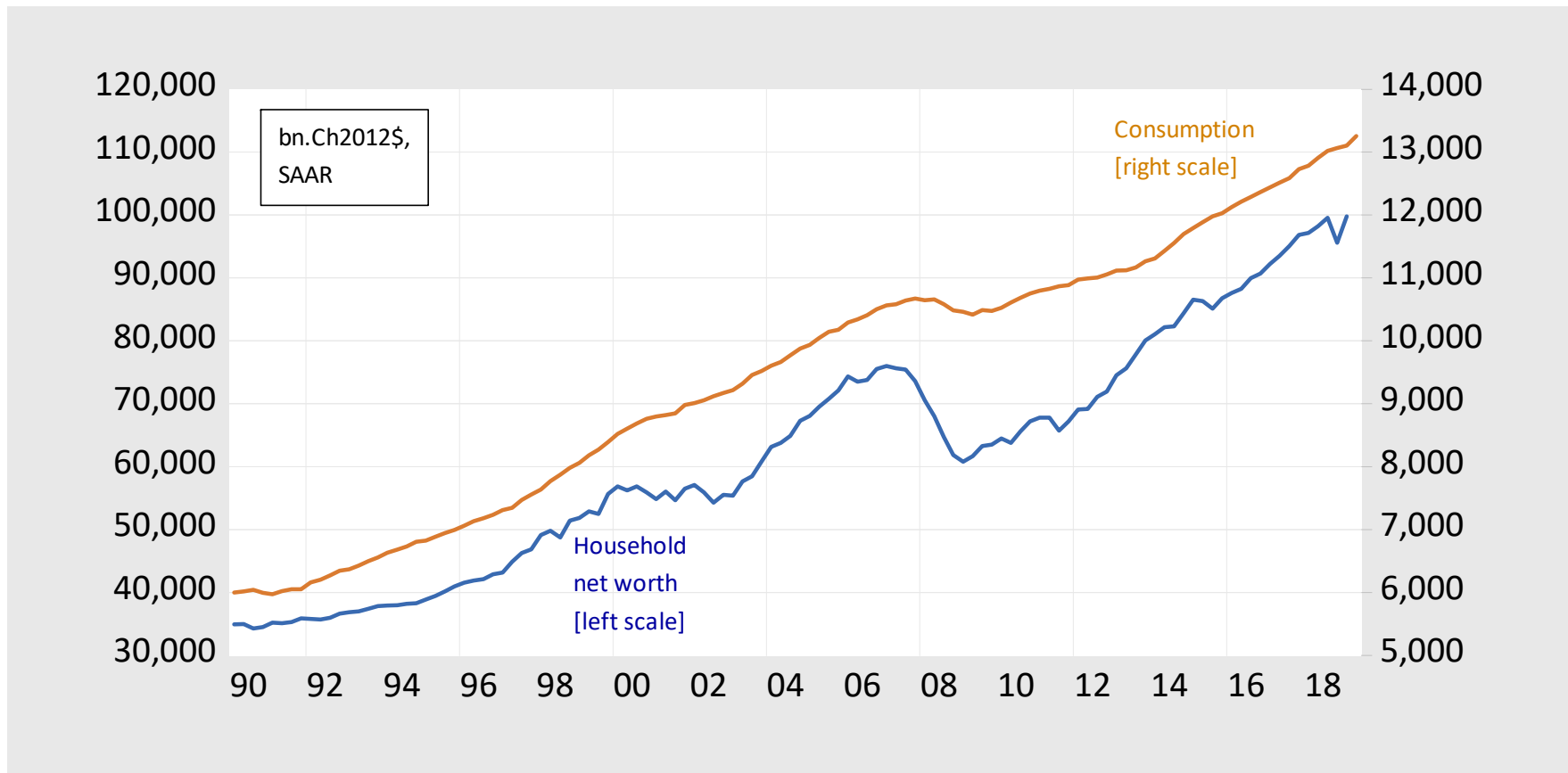
# Leading to Recession/Depression



Source: BEA, 2019Q2 2nd release, CBO, August 2019

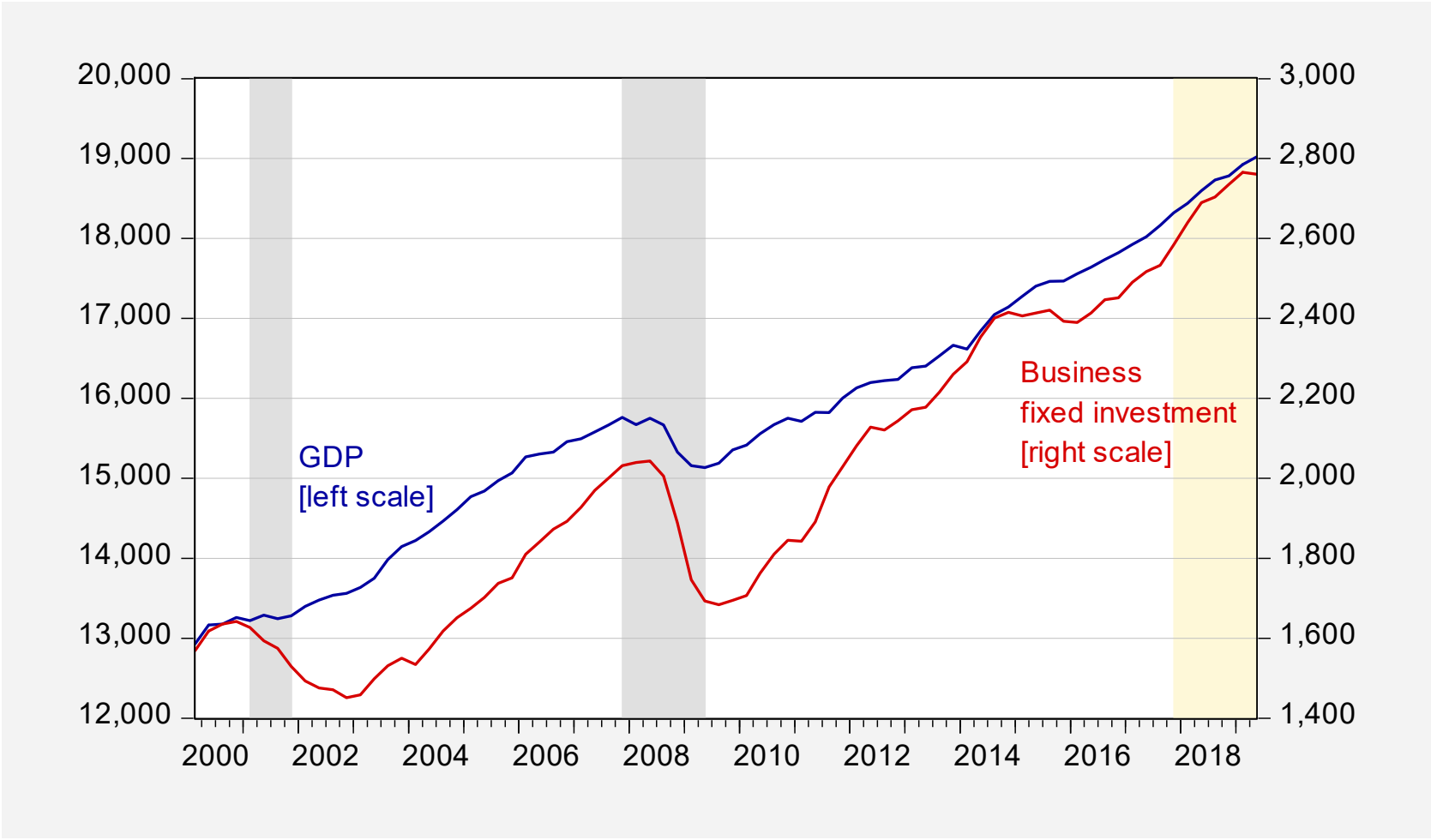


# Consumption and Wealth



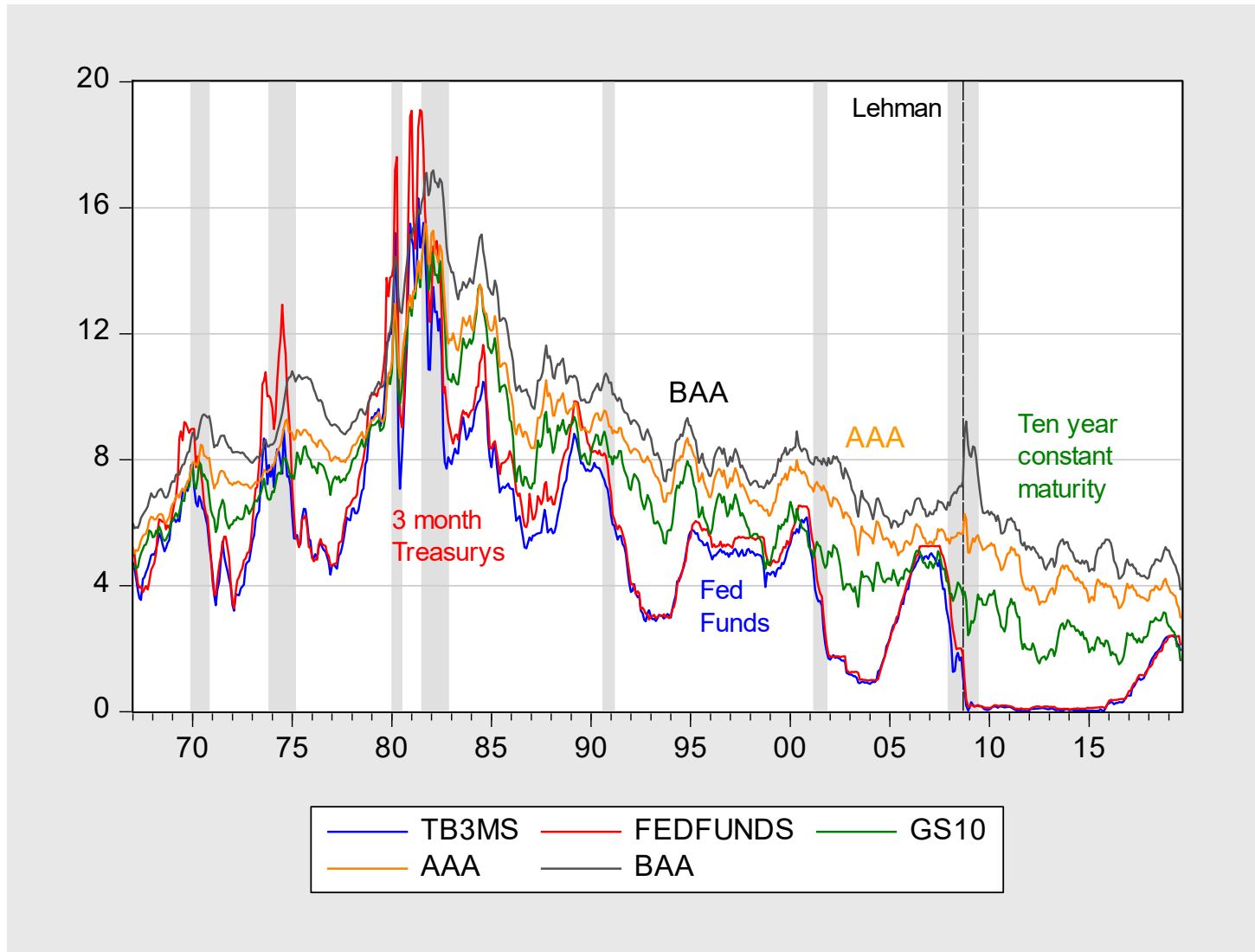
Source: BEA, 2019Q2 2nd release, Fed Flow of Funds

# Investment



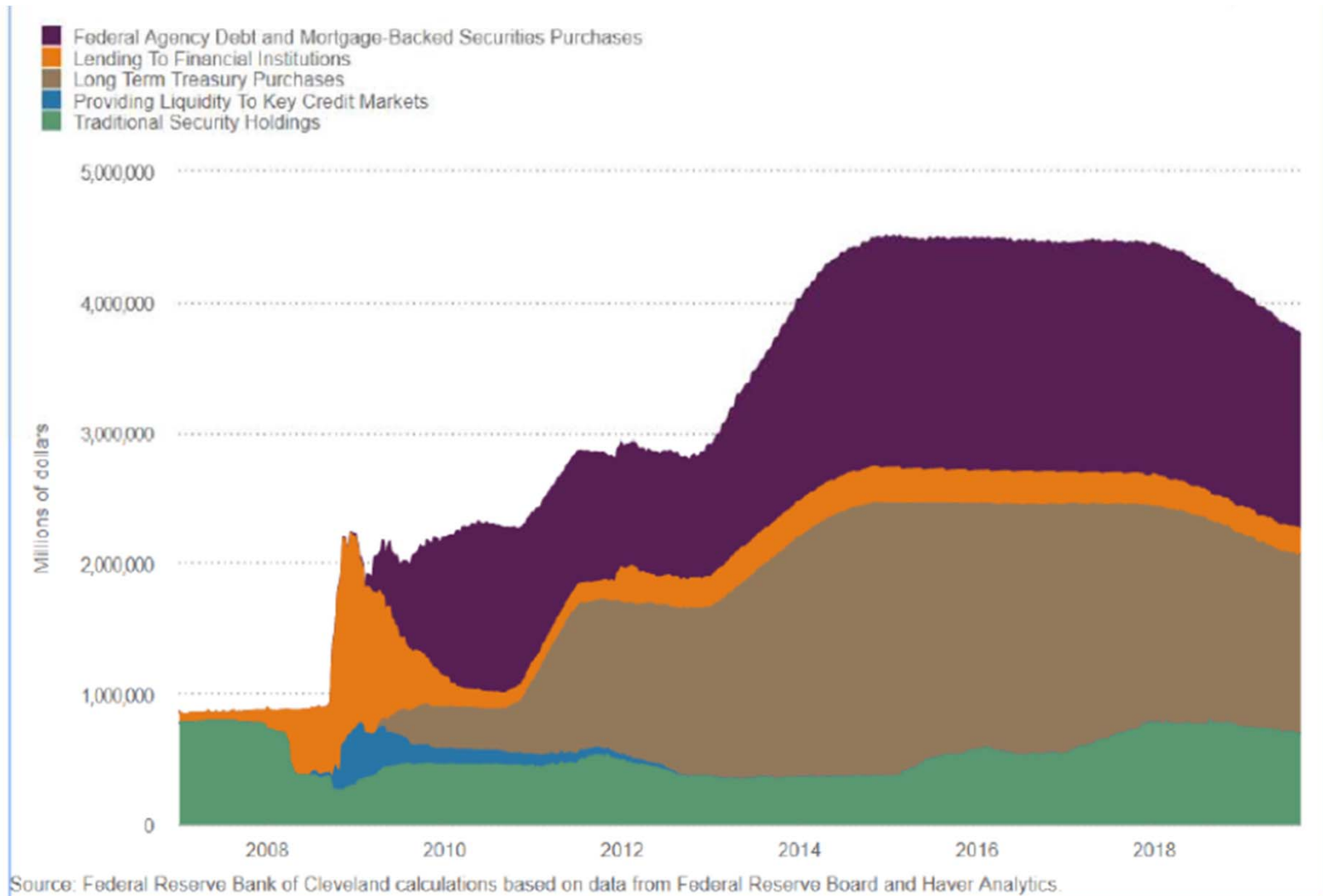
Source: BEA, 2019Q2 2nd release

# Conventional Monetary Policy



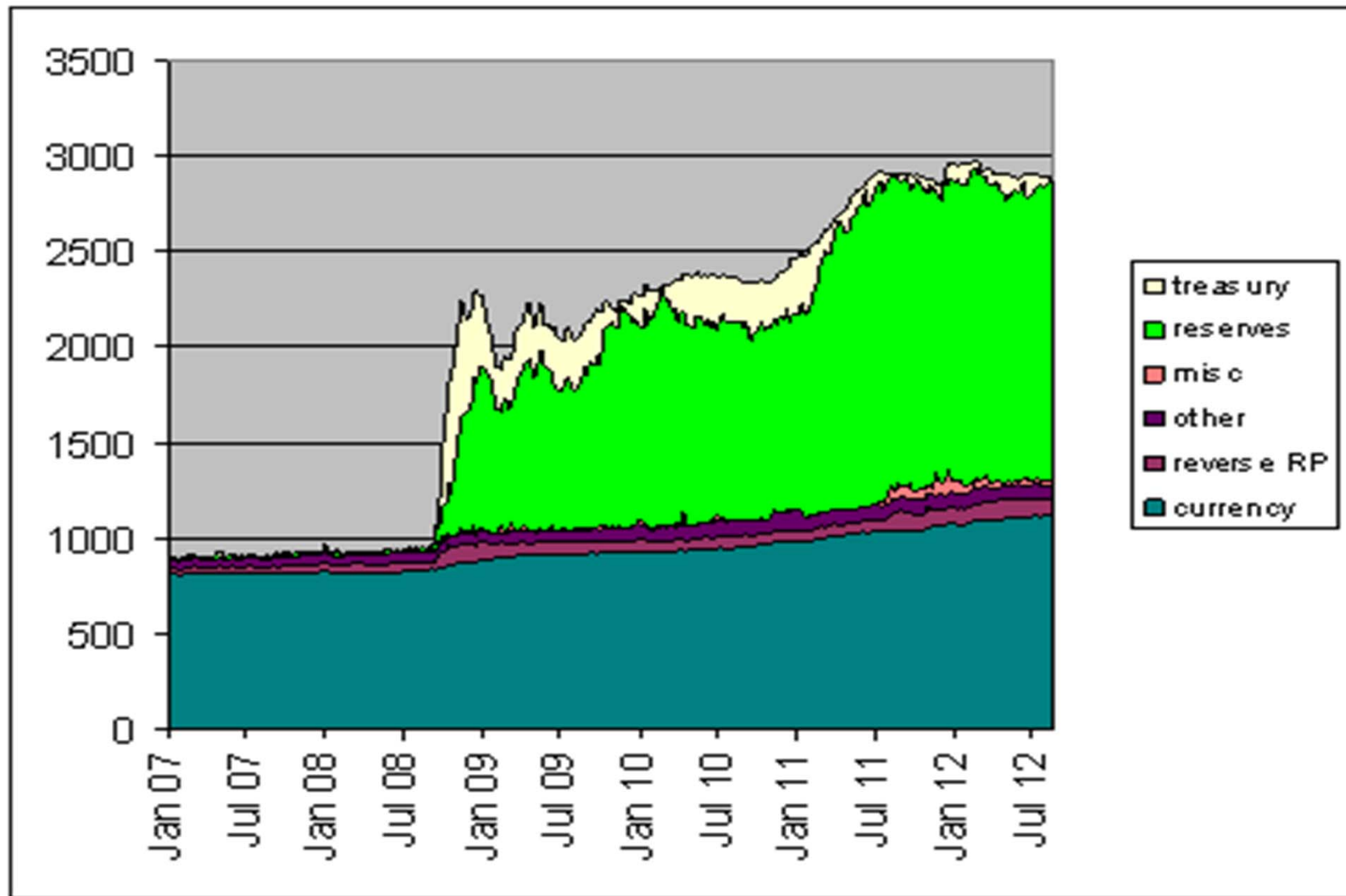
Source: Federal Reserve Board via St. Louis Fed FRED system

# Quantitative Easing

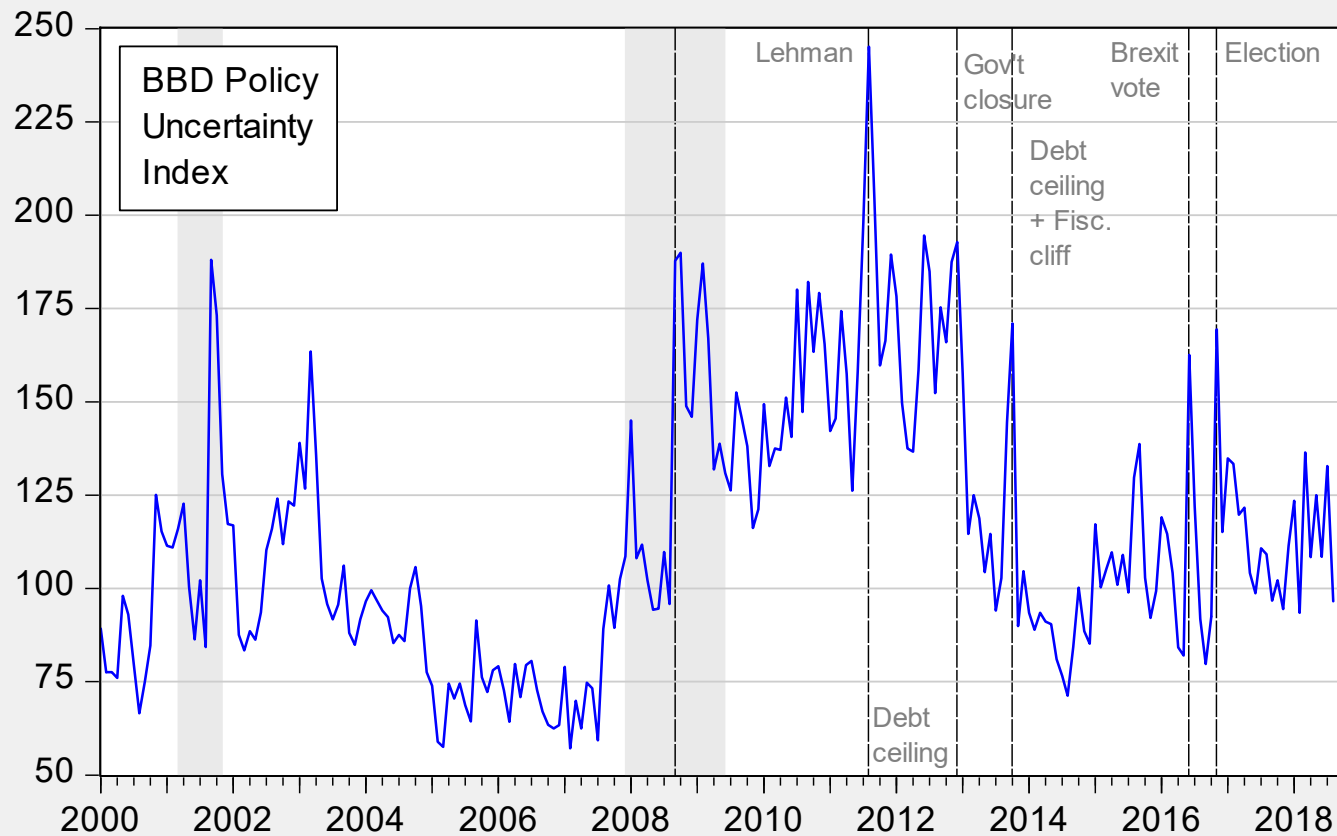


<https://www.clevelandfed.org/en/Our%20Research/Indicators%20and%20Data/Credit%20Easing.aspx>

# The Other Side of the Fed Balance Sheet

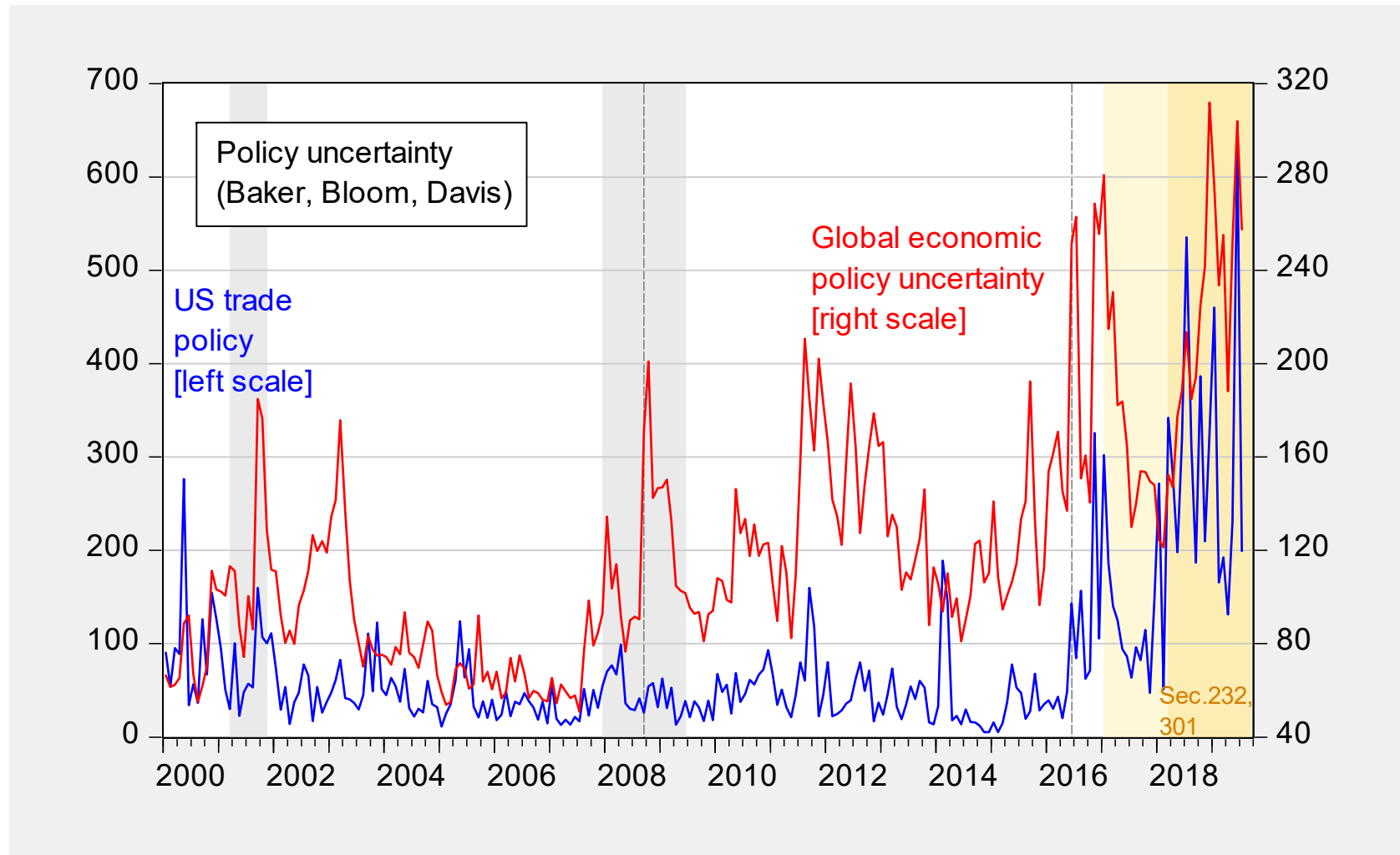


# Policy Uncertainty



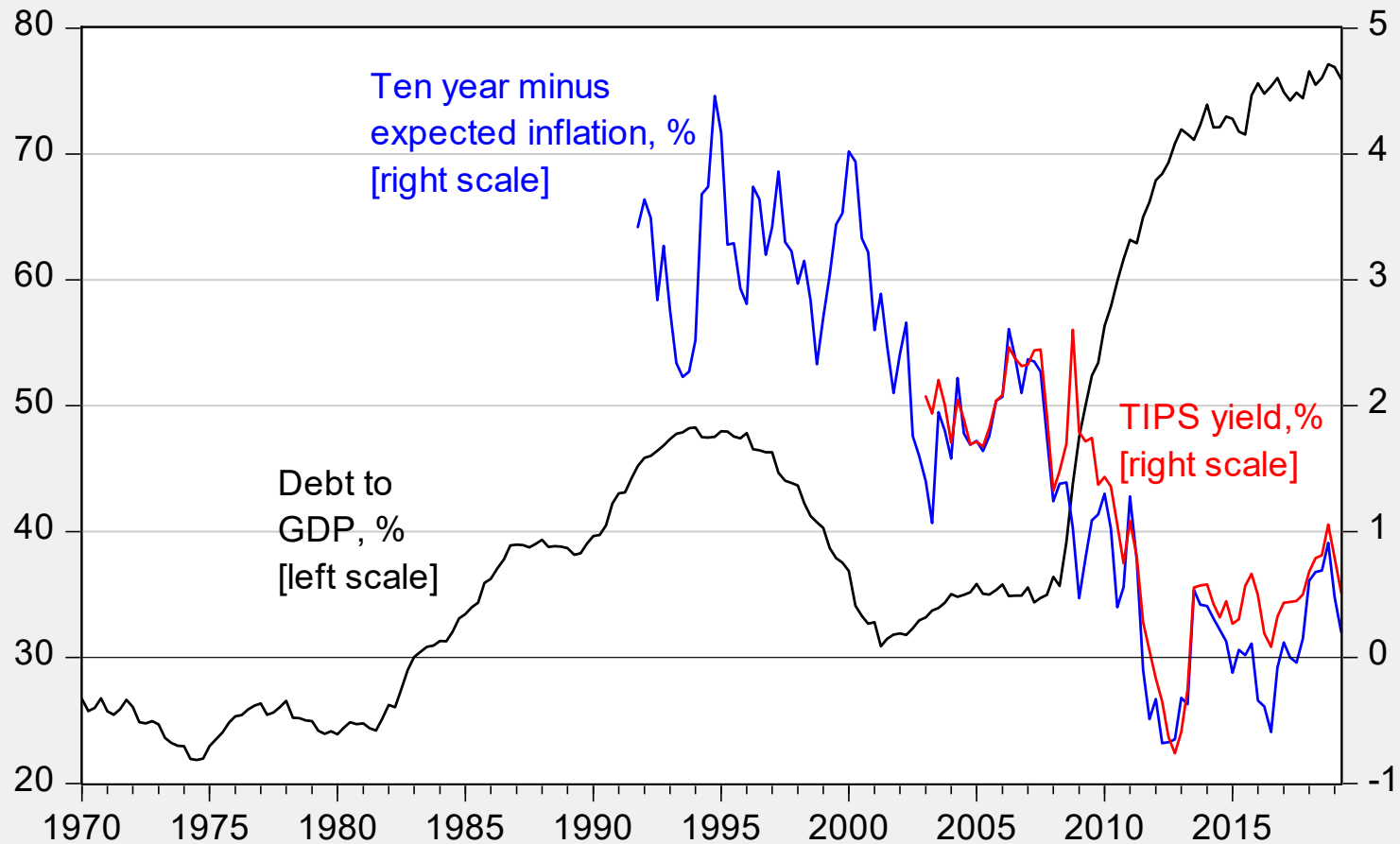
Source: Policy Uncertainty, <http://www.policyuncertainty.com>, accessed 9/3/2018

# Policy Uncertainty



Source: Policy Uncertainty, <http://www.policyuncertainty.com>, accessed 9/1/2019

# The Current Puzzle



Source: Federal Reserve Board, Philadelphia Fed Survey of Professional Forecasters



# Yield Curve Inversion Imminent? And recession to follow?

