

# The Great Slump.

## Some facts

Dany Rodrik: Blame the economists, not economics.

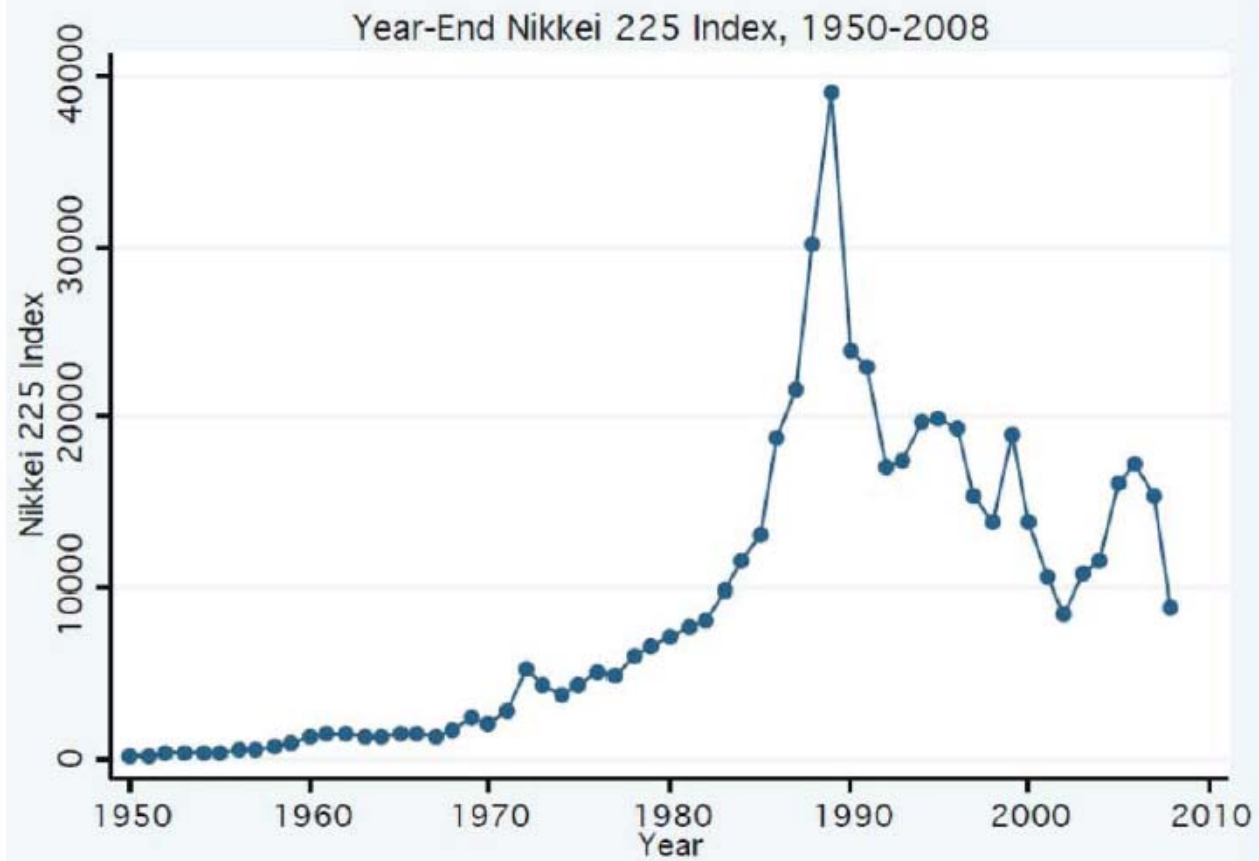
Eric Maskin: Contrary to popular perception, economic theory did a good job of foreseeing the financial crisis, it's just that no one was paying any attention.

NN: Serious economic downturns often begin with a financial crisis and a credit crunch.

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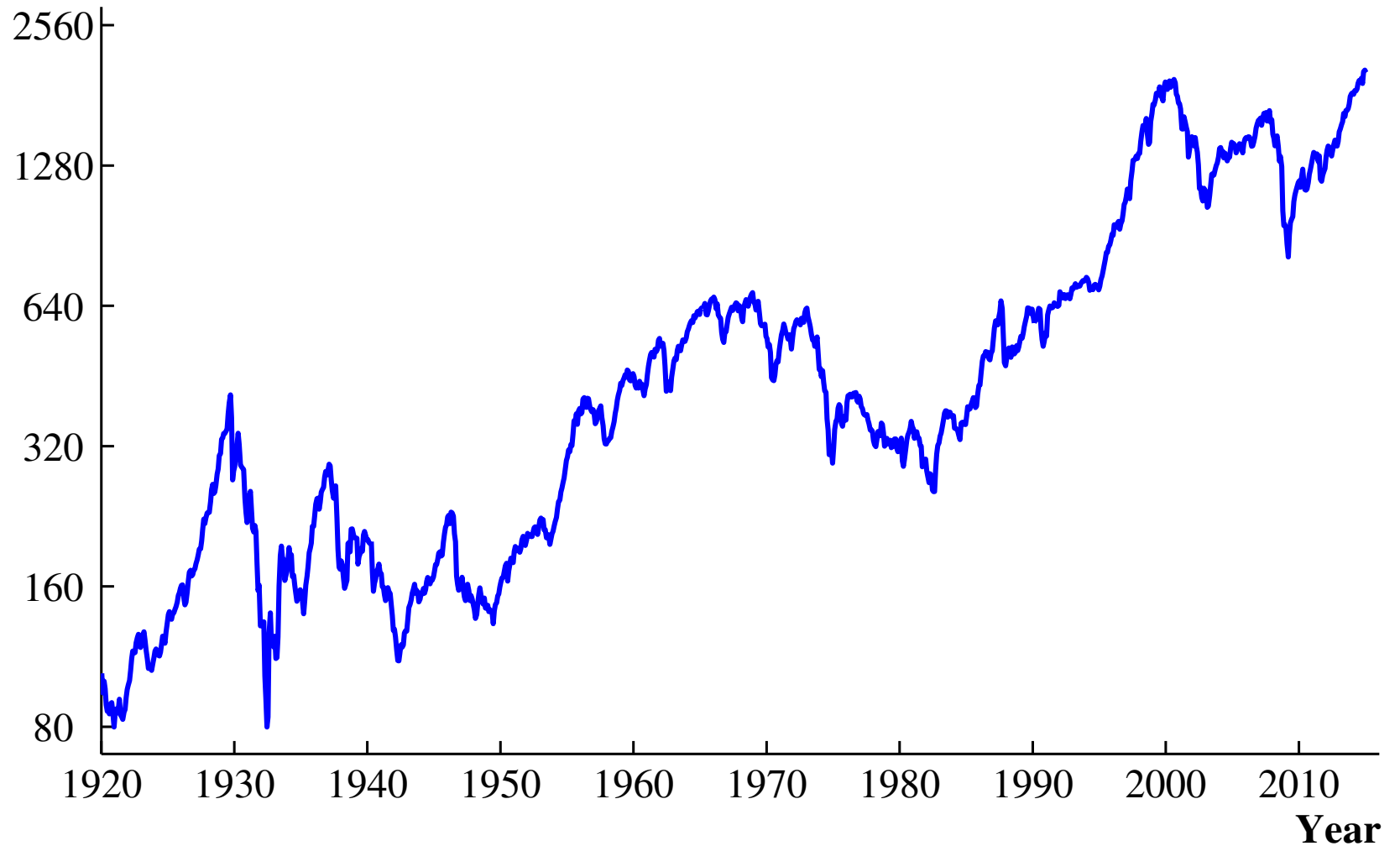
Christian Groth, University of Copenhagen, Sept. 2016 (with a lot of borrowing from Chad Jones' "Updated graphs", Stanford University).

# The Japanese Bubble



# The S&P 500 Stock Price Index (real)

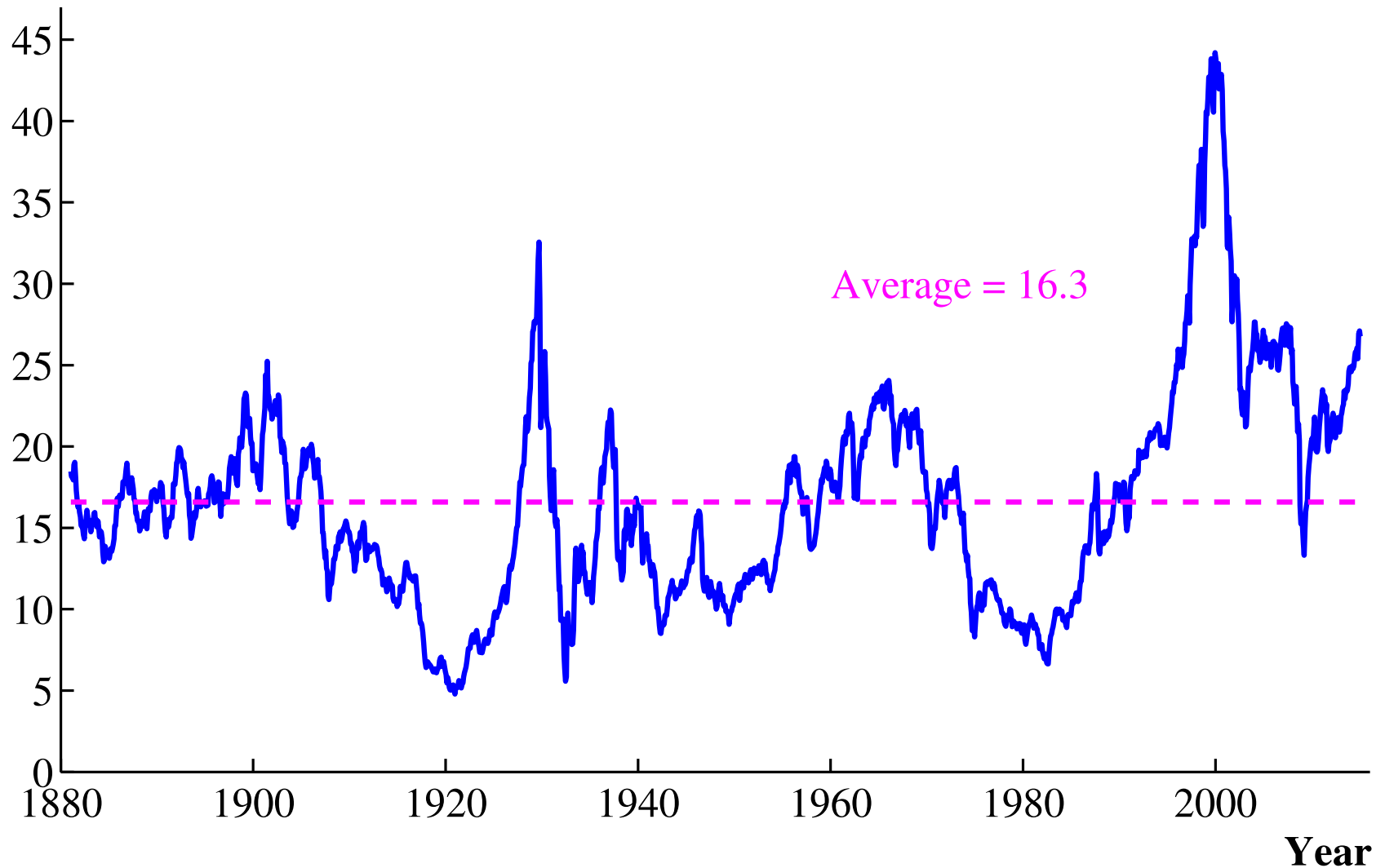
**Real Stock Price Index (ratio scale)**



Source: Robert Shiller, <http://www.econ.yale.edu/~shiller/data.htm>

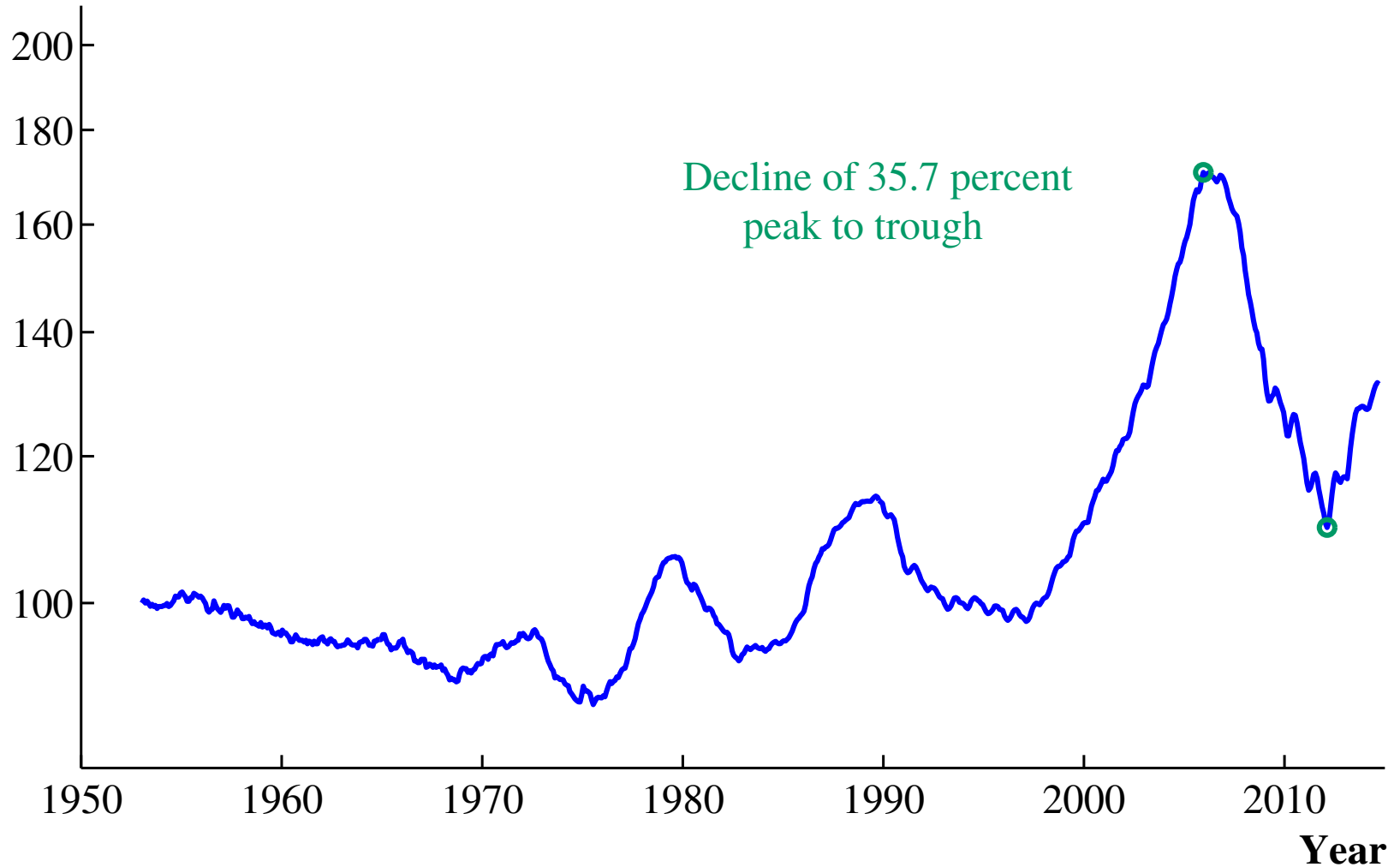
# Bubbles in the stock market?

## P/E Ratio



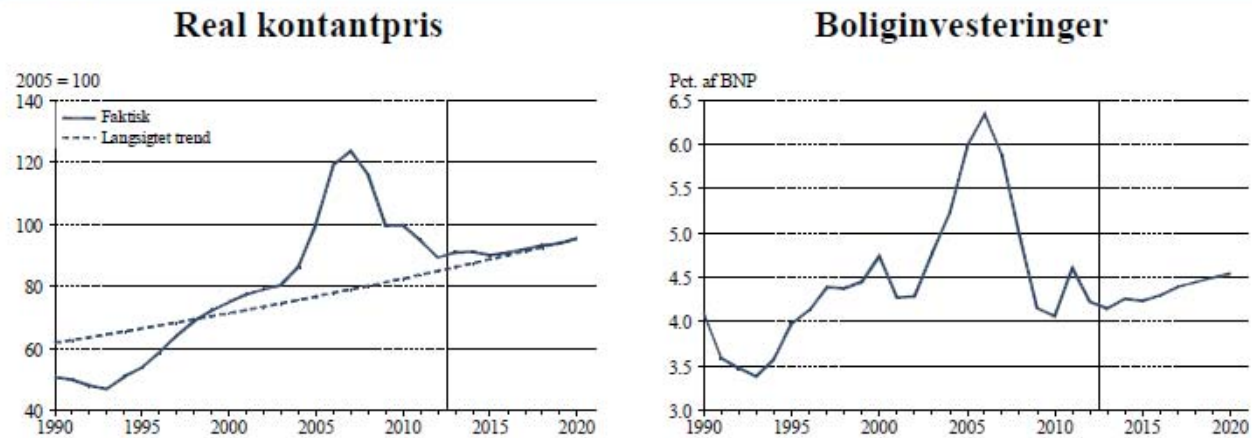
# Bubbles in housing prices?

**Real Home Price Index (1953=100, ratio scale)**



Source: Robert Shiller, <http://www.econ.yale.edu/~shiller/data.htm>

Figur I.8 Boligmarkedet



Anm.: Boliginvesteringerne er opgjort i faste priser.

Kilde: Danmarks Statistik, ADAM's databank og egne beregninger.

G.B. Eggertsson and Paul Krugman: Debt, Deleveraging, and the Liquidity Trap, WP, Feb. 14, 2011.

Table 1: Household debt as % of disposable personal income

	2000	2008
US	96	128
UK	105	160
Spain	69	130

Source: McKinsey Global Institute (2010)

Table 3: A Hypothetical Bank's Balance Sheet (billions of dollars)

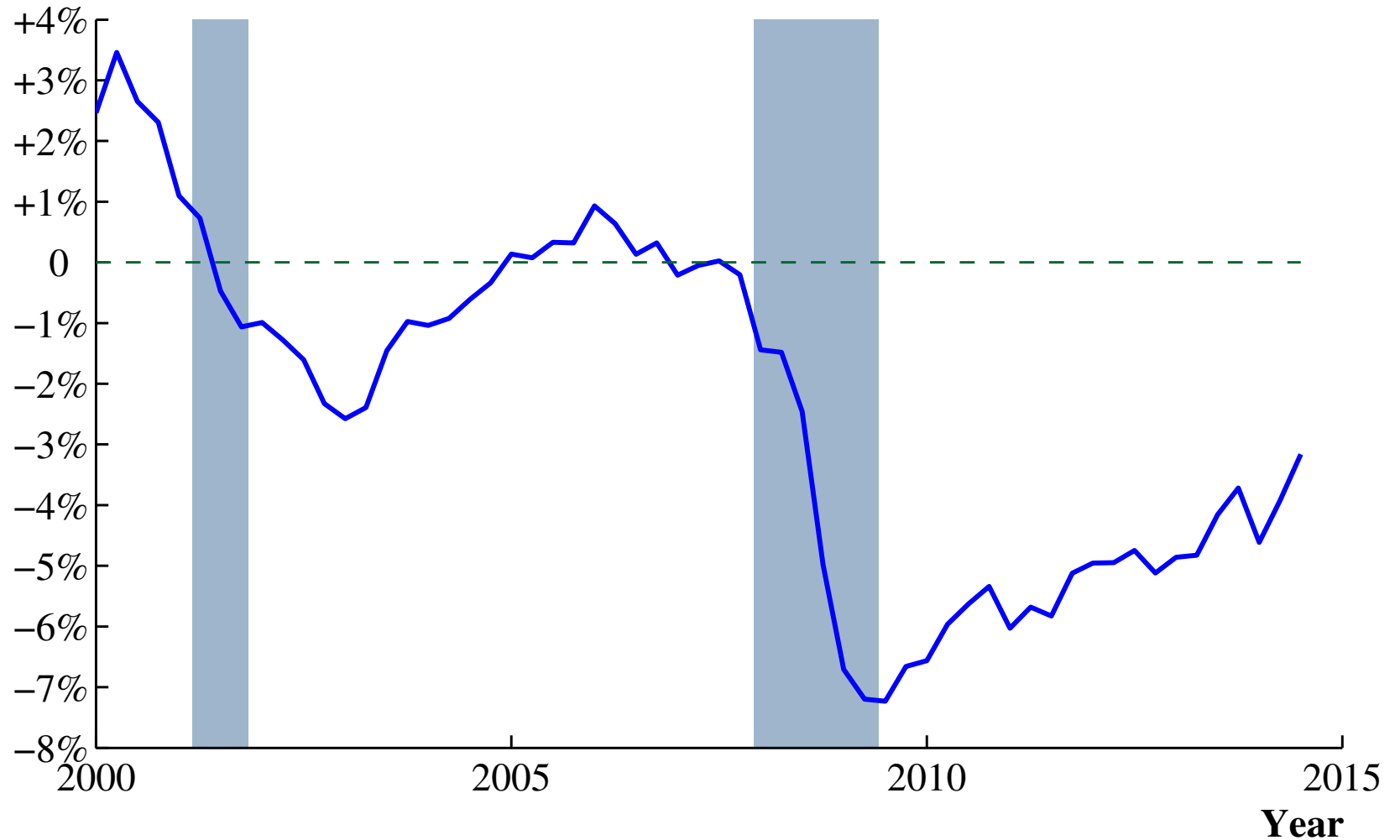
<b>Assets</b>		<b>Liabilities</b>	
Loans	1000	Deposits	1000
Investments	900	Short-Term Debt	400
Cash and reserves	100	Long-Term Debt	400
<i>Total Assets:</i>	2000	<i>Total Liabilities:</i>	1800
		<i>Equity (net worth)</i>	200

Note: The net worth of a company is the difference between its total assets and its total liabilities. Because net worth is usually small relative to assets, a modest decline in the value of assets can render a company bankrupt.



# Fig 10.7: U.S. Economic Fluctuations since 2000

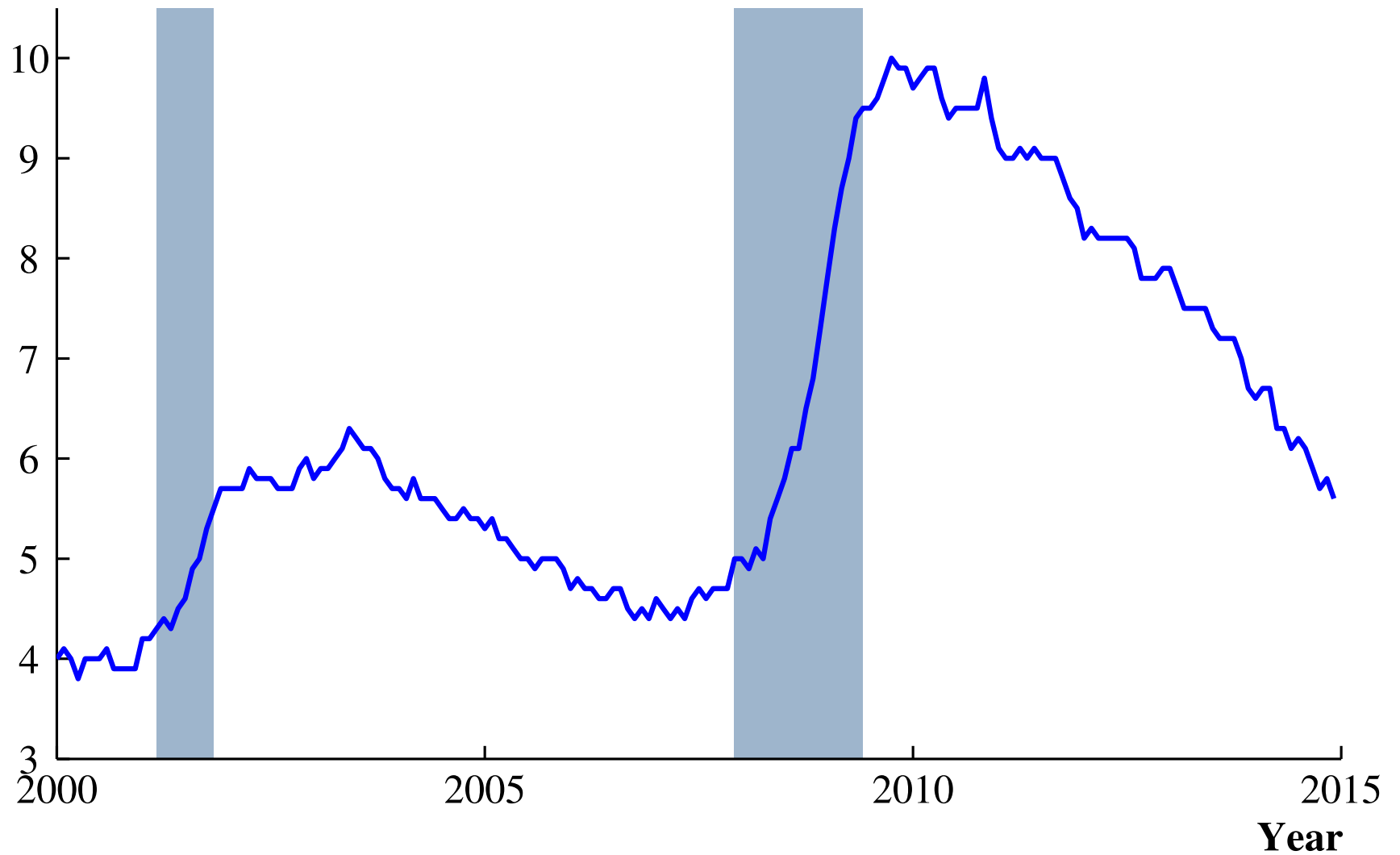
## Short-run output, $Y_{t|d}$



Source: Federal Reserve Economic Data

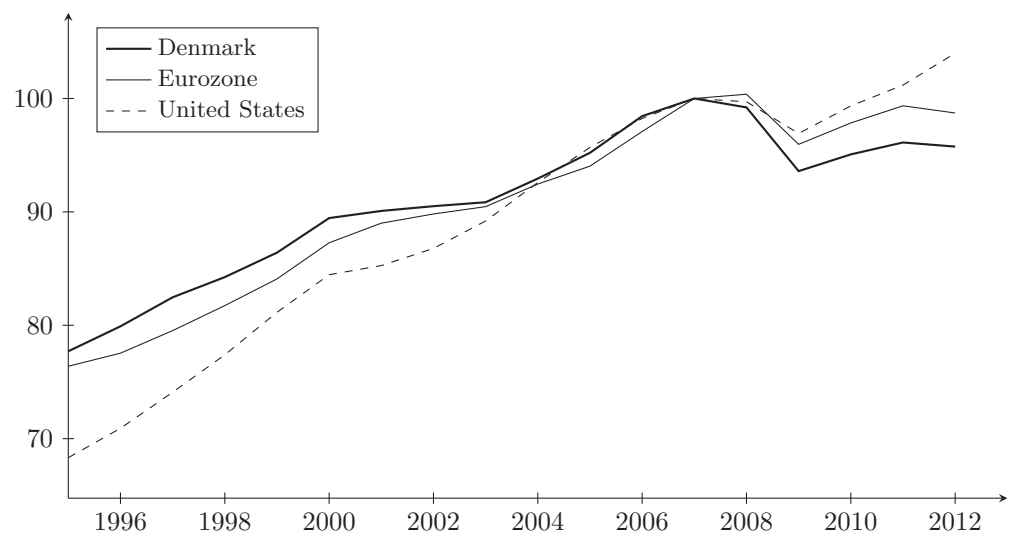
# Fig 10.8: U.S. Unemployment Rate

Percent

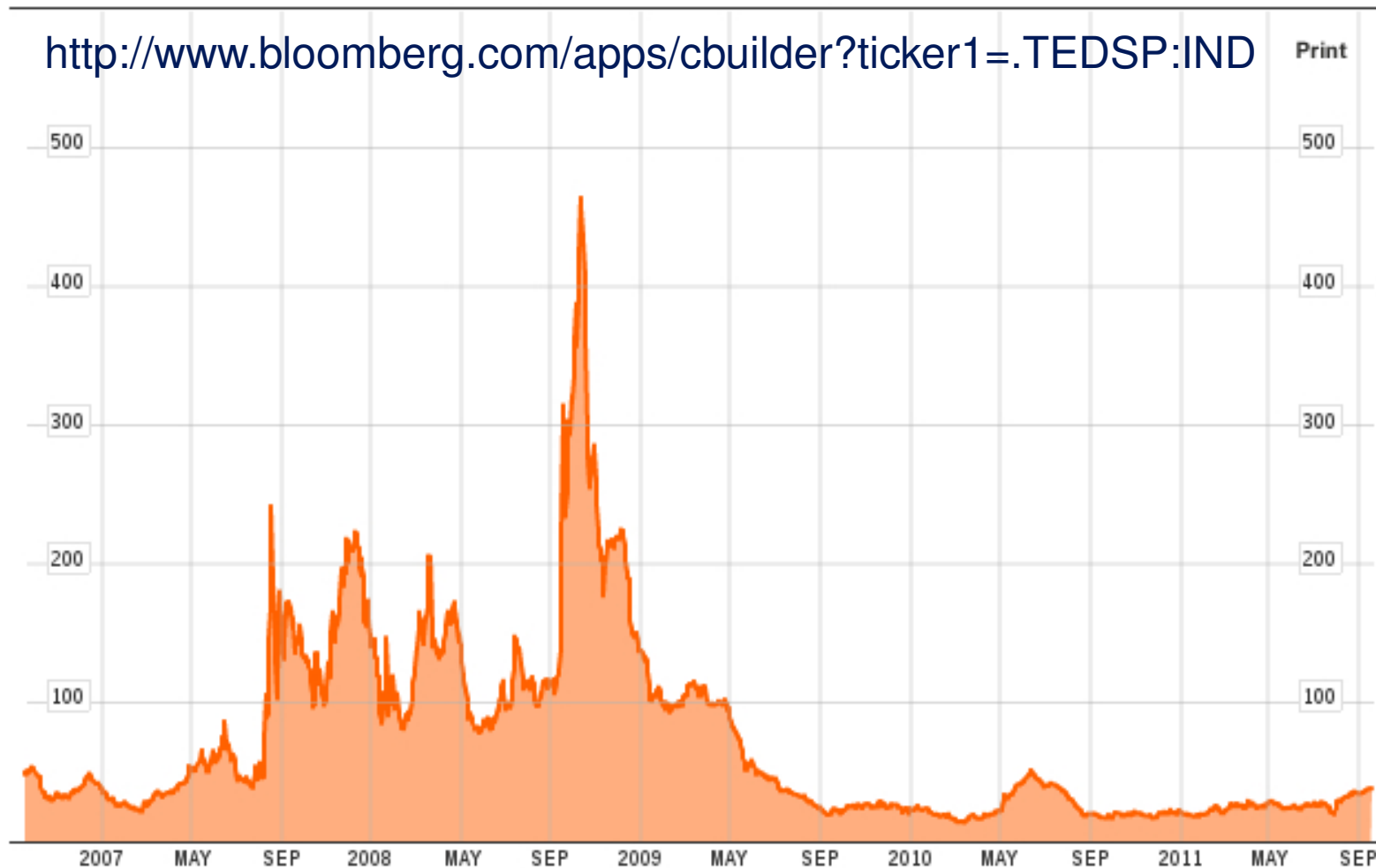


Source: Federal Reserve Economic Data

GDP. Denmark, Eurozone, and the US.

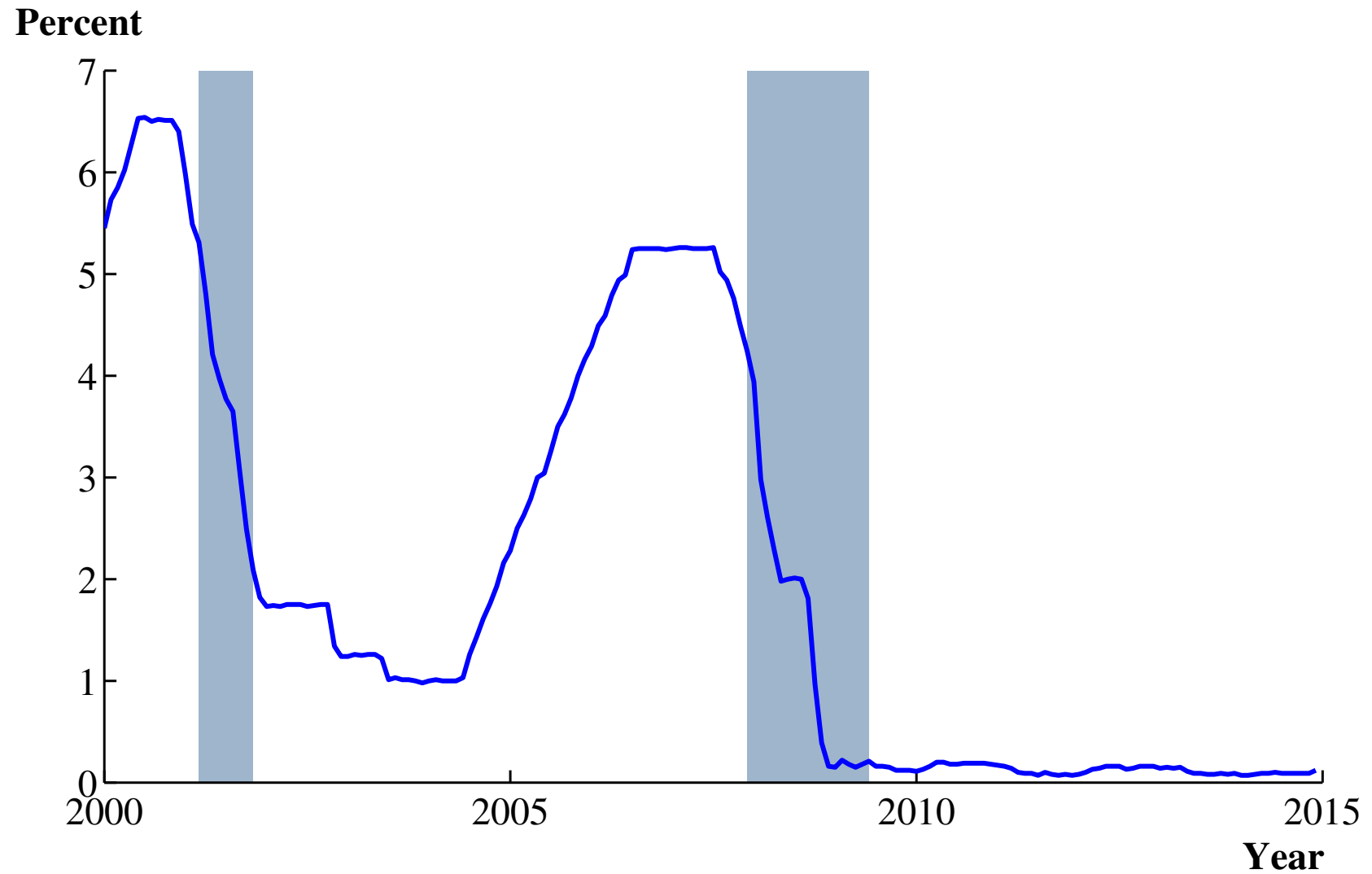


# Risk spreads in interbank lending

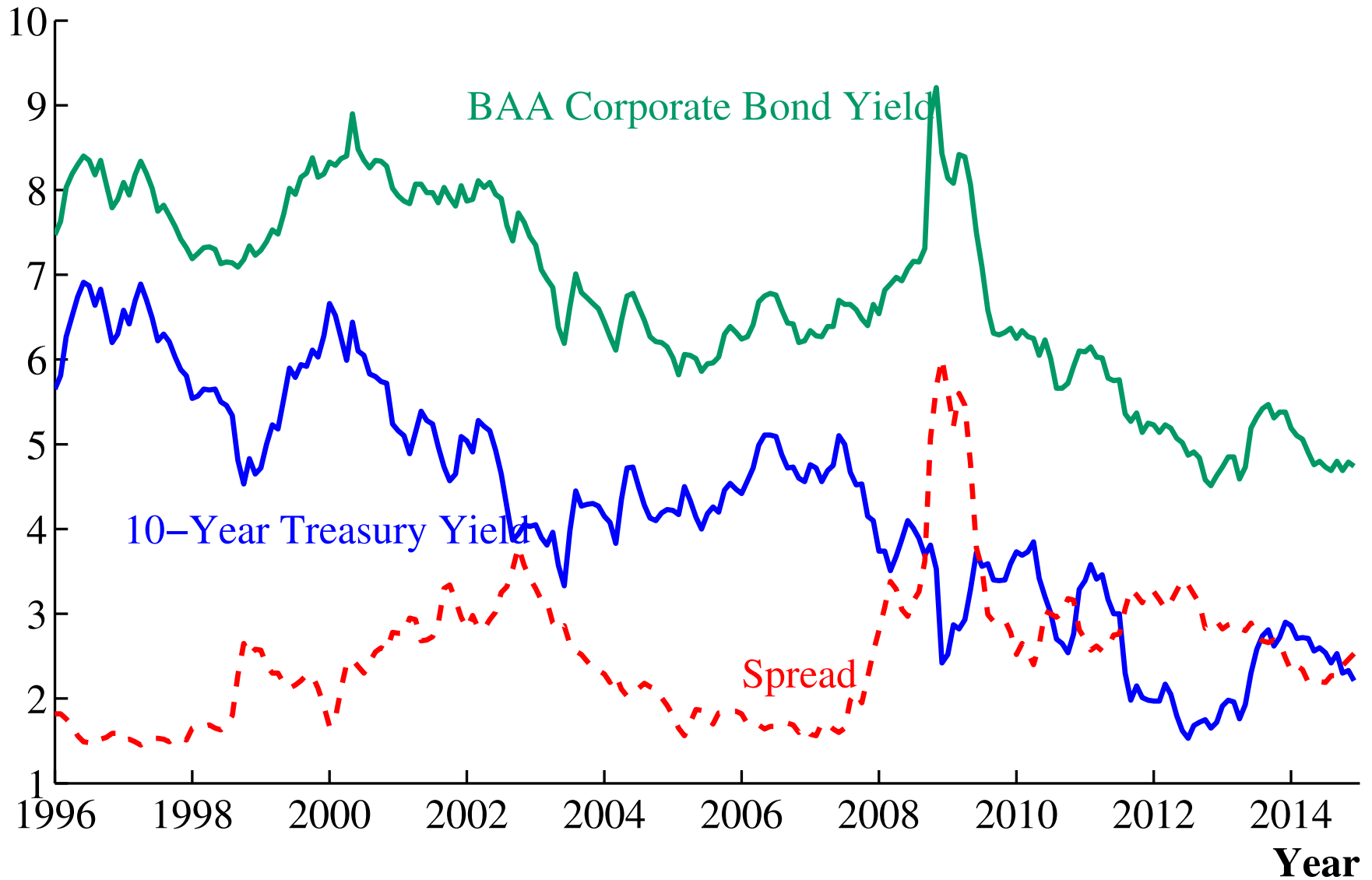


TED Spread: difference between the 3-month LIBOR rate and the 3-month U.S. treasury yield

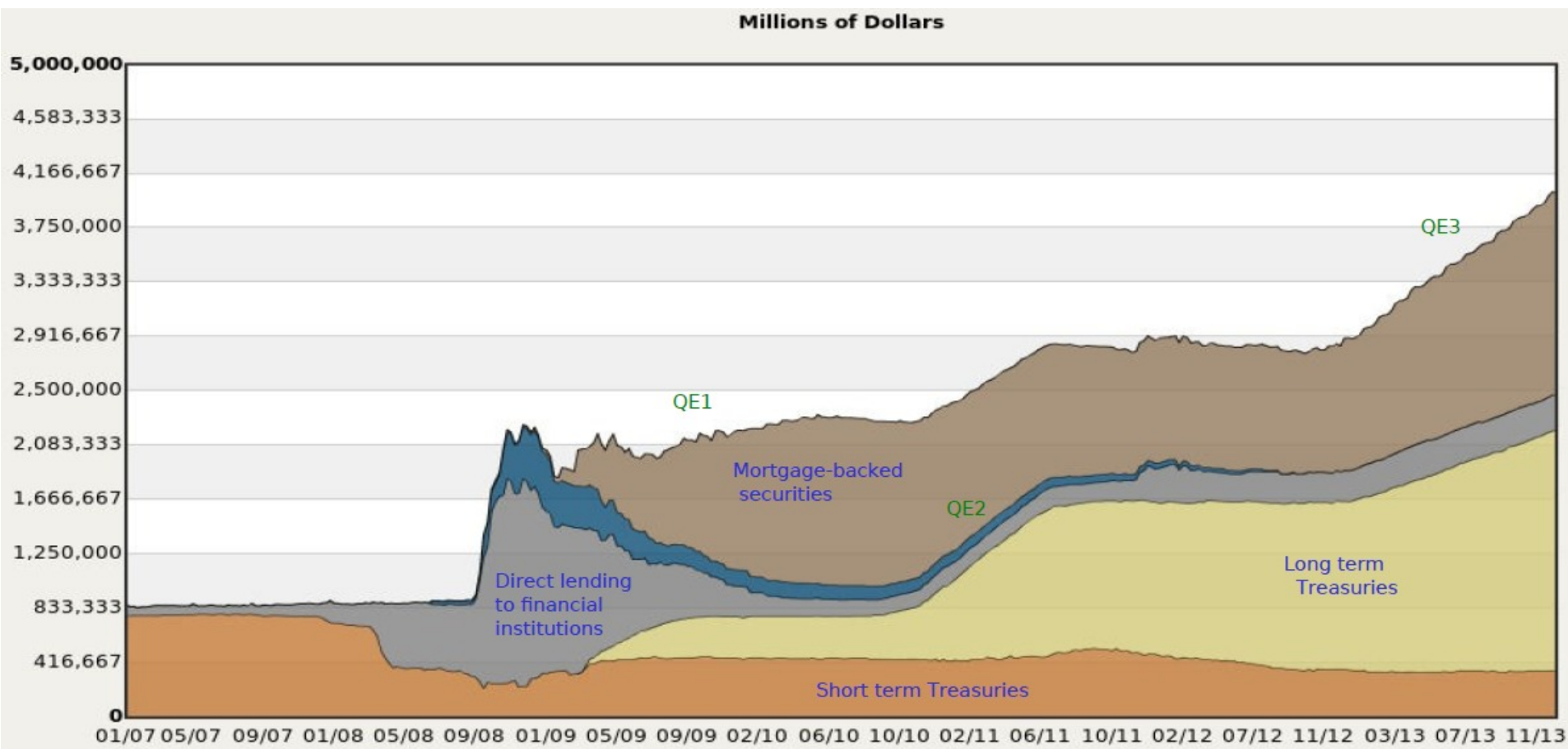
# Dropping the Fed Funds rate to zero



# Fig 14.1: Ten Year Bond Spreads



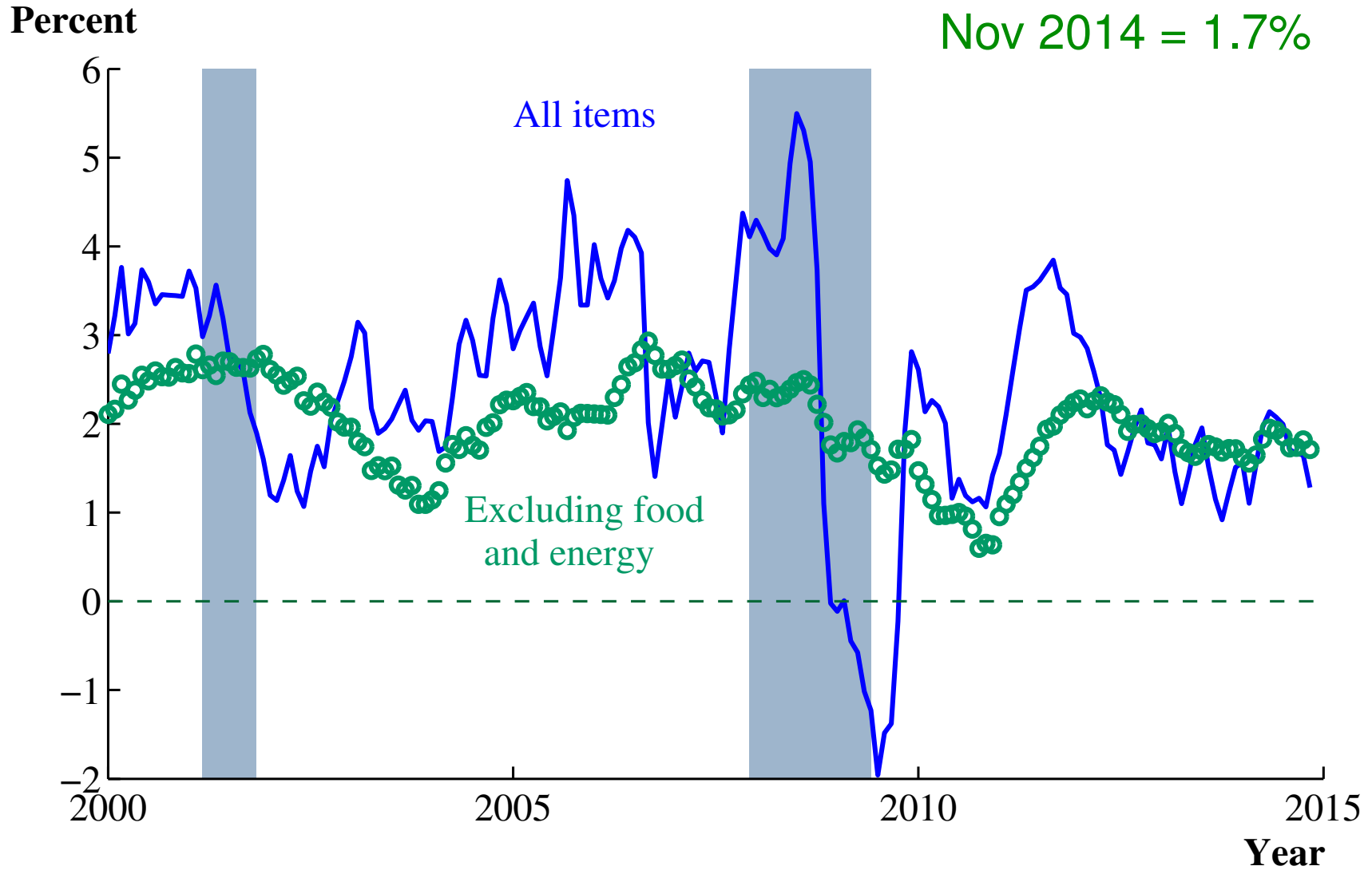
# Fig 14.8: The Fed's Use of Unconventional Policies



Source: [http://www.clevelandfed.org/research/data/credit\\_easing/index.cfm](http://www.clevelandfed.org/research/data/credit_easing/index.cfm)

Fig 10.10: Inflation in the U.S.

Dec 2007 = 2.4%  
Dec 2010 = 0.6%  
Nov 2014 = 1.7%



Source: Federal Reserve Economic Data



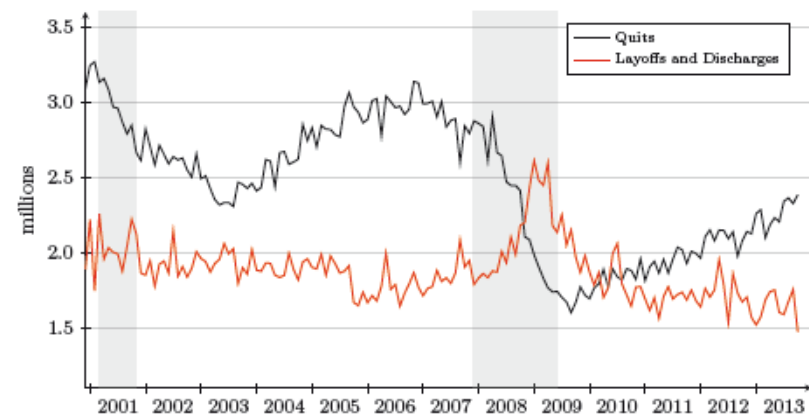


Figure 28.3: Quits and layoffs and discharges (seasonally adjusted). USA December 2000 - October 2013. Recessions according to NBER in gray. Source: Bureau of Labor Statistics.

# Economic policy in the Great Recession

**Laissez-faire** implies risk of long duration of the slump, hence:

1. high *youth unemployment*,
2. high *long-term unemployment*.

Both have adverse effects not only for people directly harmed, but also for the effective labor supply in the future (dequalification, demotivation).

## Monetary policy

*Conventional monetary policy* ineffective due to the lower bound on  $i$ . Alternatives:

- *Quantitative easing*.
- Adopting a *higher inflation target* in the Taylor rule until return to boom? Makes sense, but: credibility problem because CBs are known for their distaste of inflation.

## Expansionary fiscal policy

Is powerful in a liquidity trap, spending multipliers high, both  $C_p$  and  $I_p$  likely to be raised because:

- a. no financial crowding out,
- b. helps to reduce precautionary saving,
- c. less risk of a Fisher-Tobin-style deflationary spiral.

**Adverse effect on the long-run situation,  $B_g/Y^*$  ?** Not necessarily, we have  $B_g \uparrow$ , but also  $Y^* \uparrow$  because of:

- (i) the problems 1 and 2 from previous page mitigated,
- (ii) public investment in infrastructure and education may contribute to overall productivity.