Ben S. Bernanke The Federal Reserve and the Financial Crisis Princeton University Press 2013

"In general, a financial panic is sparked by a loss of confidence in an institution" p5

1893 >500 failed

1907 fewer but larger banks went

Congress 23 vol study, Depression almost 10,00

Fed founded in 1914

'29-33 US↓≈1/3 31-2 P↓≈10%

u peak ≈ 25%

~~Bad~~ Lots of causes repercussions of WWI, probs of gold standard, bubble, financial panic

Bad theory "liquidationist"

1920s had been too good

need to squeeze out the excesses

~~Del~~ Depression - unfortunate but necessary

Andrew Mellon Sec'd T

"Liquidate labor, ... stocks ... the farmers ... real estate"

Fed slack of ease stop stock mkt speculation, stay on gold standard

concerned about spec attack on dollar

US abandoned gold standard in 33 and monetary policy became less tight

B2

Things that worked for FDR, deposit insurance in 34, abandon gold standard

B of E was able to maintain gold standard despite low levels of gold because everyone believed in its strong commitment

After WWI stronger labor movement and concern with U

He thinks longer time to recovery after financial crisis is an open issue

"...Unlike the other recessions in the post war period, this one was related to and triggered by a global financial crisis, and that may be why it is already taking longer for the economy to recover" p27

Wm McChesney Martin "Inflation is a thief in the night"

Structural influences on the Great Moderation - better management of inventories - fewer shocks & crises mid 80s to ~~mid~~ 2005

B3

Needed down payments and documentation until early 2000s

The big jump in non prime originations was 04 from 10% to > 20%. 05 > 30%

% of these with little documentation

03 ≈ 40% 07 60%

≈ 20-25% of mortgages under water

≈ 10% in delinquency

Paper wealth lost in Dot com + housing crashes similar

distinction triggers + vulnerability

1) With Great Moderation people became over confident + took on too much debt

2) risk management probs

3 heavy reliance on ST borrowing

4 exotic instruments

Public

1 Structure of regulation didn't keep up with changes in structure of fin sys.

"many important financial firms ... really did not have any serious, comprehensive supervision by any financial regulator" p50

AIG no one looking at CDS.

Investment banks had no statutory oversight - voluntary agreement with SEC

Fed didn't prove hard enough on measuring risks + poor consumer protection
fragmentation of regulators

Admits its controversial but Fed research suggests that low interest rates didn't play a big role
- many bubbles elsewhere
- size of bubble much greater than can explain by Δi
- timing - Shiller argues bubble started in '98, well before 01 i↓
① - middle of Tech boom - could be same psychological optimism
② Foreign demand for dollars after Asian crisis included mortgages
... "probably the strongest correlation across countries that you can find to house price increases is capital inflows, the money coming in to buy mortgages and other assets that were perceived to be safe" p 54
Jane ~~Dok~~ Dokko et al "Monetary Policy and the Housing Bubble" Economic Policy, April 2011
C + V Reinhart "Pride Goes Before a Fall" NBER WP 16815 Feb 2011

St ~~Lous~~ Louis Fed Financial
Stress Index
S&P dropped a little more than in...
the tech bubble
home construction fell before the recession
in 1970s "inflation expectations were
not at all tied down" p 56
u 92 00 03 06 09-10
7½ 4 ↑ to 6+ ↓ 4½ ↑ ≈ 10
"I think there is some effect of low interest
rates on risk taking" p 60 need balance
"be humble"
"... the decline in house prices by itself
was not obviously a major threat" 61
When Ch of CEA did a study on this
expected a recession from too big house
price fall, but not a big one
most of the time transparency makes
monetary policy work better "communication
.. reduces uncertainty and helps increase
the impact of monetary policy in financial
markets
refers to off-balance-sheet vehicles
as accounting fictions

"The crisis of 2008-2009 was a classic financial panic ... not in a bank setting but in a broader financial market setting" p 71

Total ~~past~~ potential losses from sub-prime ~~mortgages~~ mortgages were roughly equivalent to one bad day in the stock market

The problem was nobody knew where they were distributed so lending dried up "a whole series of runs" 72

Sept 15 Lehman, ML sold to B of A
16 AIG attack
26 Washington Mutual
Oct 3 Wachovia (one of top 5) to Wells Fargo

The global aspect "does not receive enough attention" 74

G-7 Oct 10

"big, high profile international meetings are generally a terrible bore" 74

07 ~~mid~~ July Libor spiked to 100 late 08
late summer briefly ↑ 350

MMF run led to dumping commercial paper i's ↑

commercial paper rates also jumped up in late summer 07 hit greater 500 with Lehman back ~~to~~ below 100 in spring 09 back to almost normal (< 25 bp) end of 09

"In our estimation, the failure of AIG would have been basically the end" 85
US ↓↓ 5%

For 1st 15-16 mo behavior of stock markets in Great Depression & 08 were very similar both ↓ ≈ 50%
but in GD kept going ↓ > 80%
"A contagion, just as in an illness context, is the spreading of panic, the spreading of fear from one market or institution to another" 91
range of fed funds rate 03-13
5.75 to ~0 ~ Dec '08
03 1 06.7 peak
QE LSAP effects on housing weaker than had hoped
late 2010 ~~fed~~ concern of possible deflation
communications as a tool
Why recovery sluggish? lack of housing rebound ES but hard to get loans
lots of structural problems banks credit
Thinks reasonable chance we'll return to ≈ 3% real growth
Dodd-Frank Fed legally bail out any more. ~~Must~~
Must go to FDIC for resolution