Economics 435
The Financial System
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Output Gap

In logs, bn. Ch.09 SAAR

Potential GDP

CBO fcast

GDP
Advanced Country Output Gaps
Big Banking Crises & Slow Recoveries

Figure 1. Basic concepts: An Illustration with the US Banking Crisis of 1893

Percent

Note: The severity index for this episode is 20.2

Sources: Reinhart and Rogoff (2014) and sources cited therein.

Reinhart and Rogoff, “Recovery from Financial Crises: Evidence from 100 Episodes” (2014)
Credit Booms and Crashes

Real GDP per capita (% deviation by year)

Normal recessions (unconditional):
+ Excess credit =
+ 1,2,3 %GDP/year

Financial recessions (unconditional):
+ Excess credit =
+ 1,2,3 %GDP/year

Jorda, Schularick, and Taylor (2012)
The ongoing housing recovery is healing household and banking sector balance sheets

- Household sector balance sheet: Rising home prices
- Banking sector balance sheet: Fiscal drag shrinking in 2014
- Government sector balance sheet: Moving away from bank loans toward credit market loans
- Corporate sector balance sheet:
HH Balance Sheets

Consumption [left scale]

Household net worth [right scale]
Bank Balance Sheets

Banking sector quarterly net income currently at the same level as in 2005 and 2006

All FDIC institutions
- Net operating income
- Securities gains/losses

Source: FDIC, Haver Analytics, DB Global Markets Research
Bank Balance Sheets (II)

Balance sheet repair almost complete in small banks...

Total non-performing loans as % of total loans

- BHCs>$500bn
- All institutions
- BHCs $50bn-500bn
- Banks and BHCs<$50bn

Note: Non-performing loans include loans that are (1) 90 days or more past due and still accruing or (2) non-accrual.

Source: FRBNY, DB Global Markets Research
Back to IS-LM

Figure 6. Monetary Policy in the Liquidity Trap
Ten-Year Real Interest Rate Comparison

2. United States

3. United Kingdom


Note: CF = Consensus Forecasts; FRB = Federal Reserve Bank; IPS = inflation-protected securities.
But the Government is Retrenching

![Graph showingGov't cons. & inv. and transfers ratio to GDP and potential GDP](#)