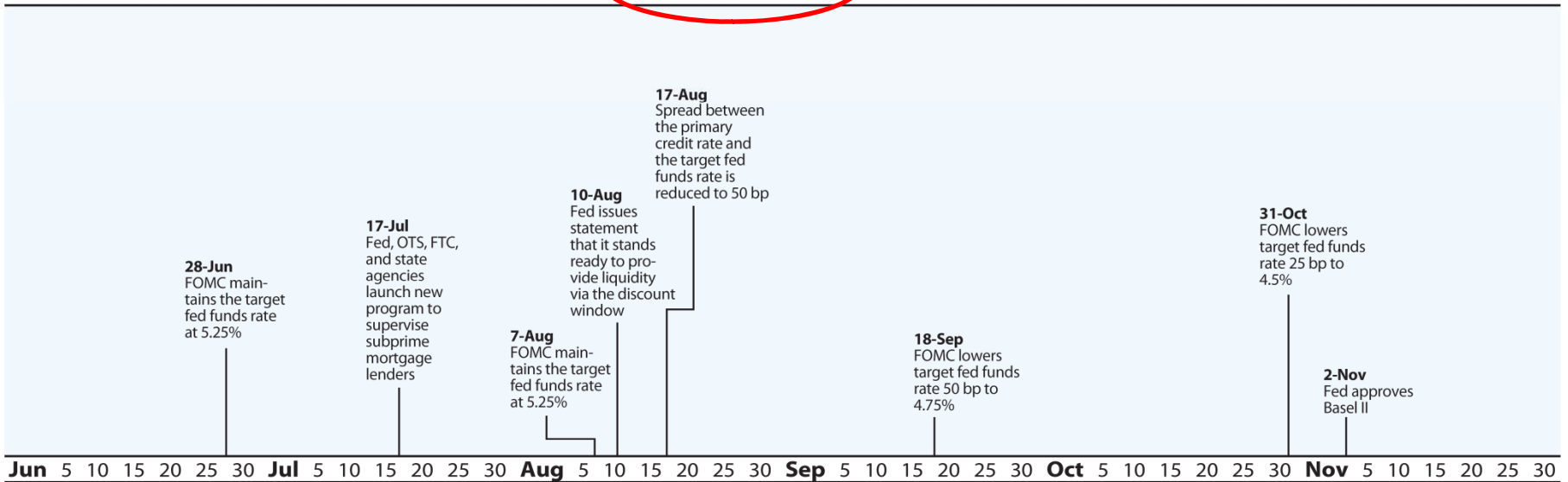


Public Affairs 974-1
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Wake of the Financial Crisis
(12/13/2012)

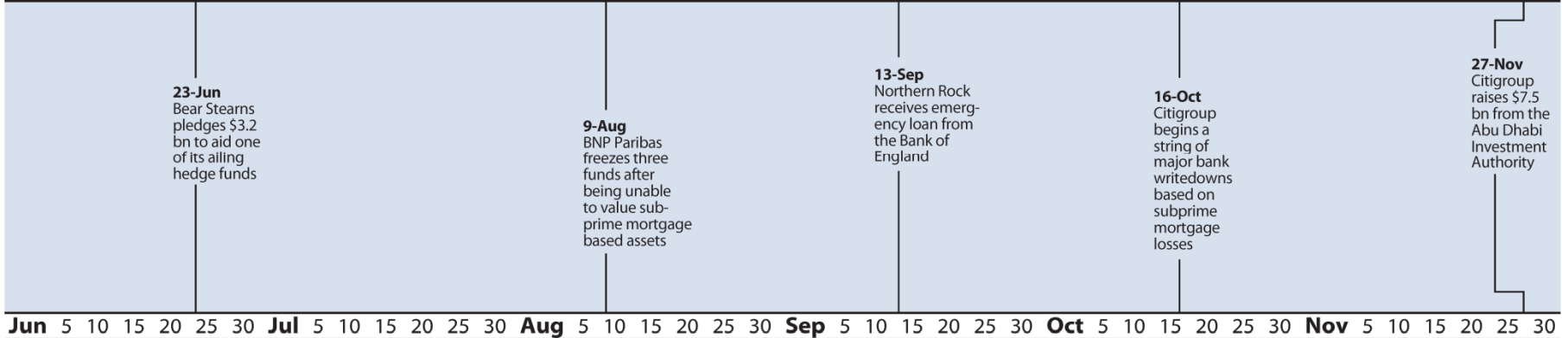
Instructor: Prof. Menzie Chinn
UW Madison
Fall 2012

Financial Turmoil Timeline (June 2007 - November 2007)

Fed Policy Actions



Market Events



Other Policy Actions

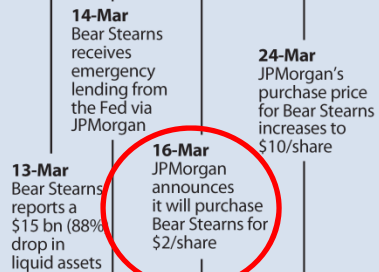


Financial Turmoil Timeline (March 2008-May 2008)

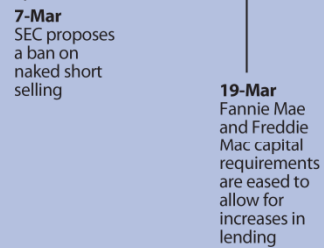
Fed Policy Actions



Market Events

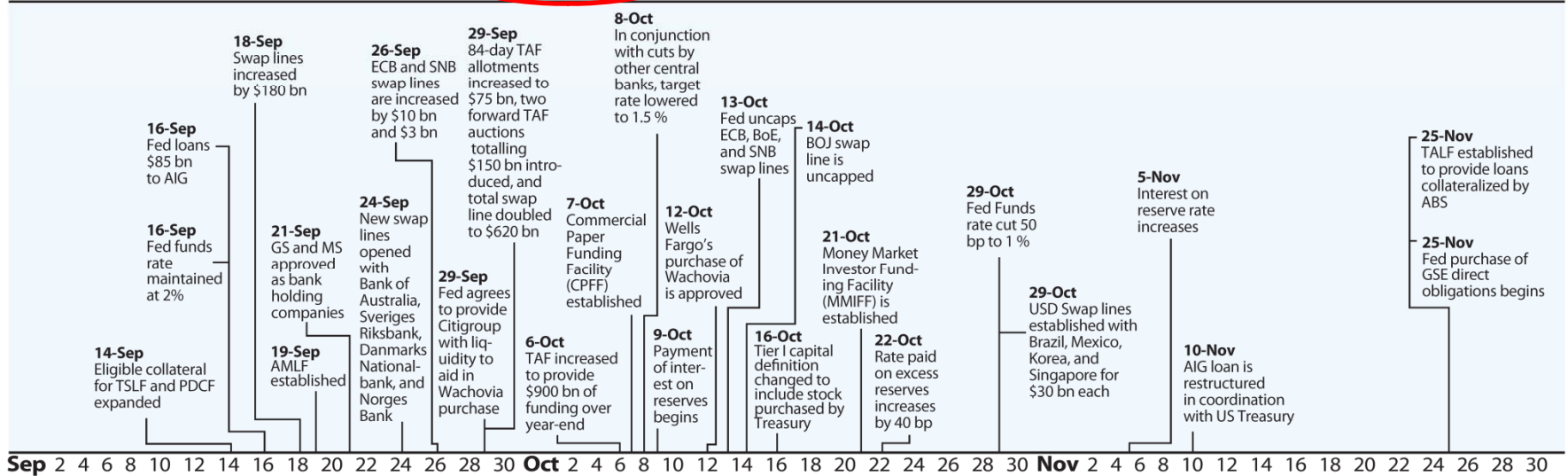


Other Policy Actions

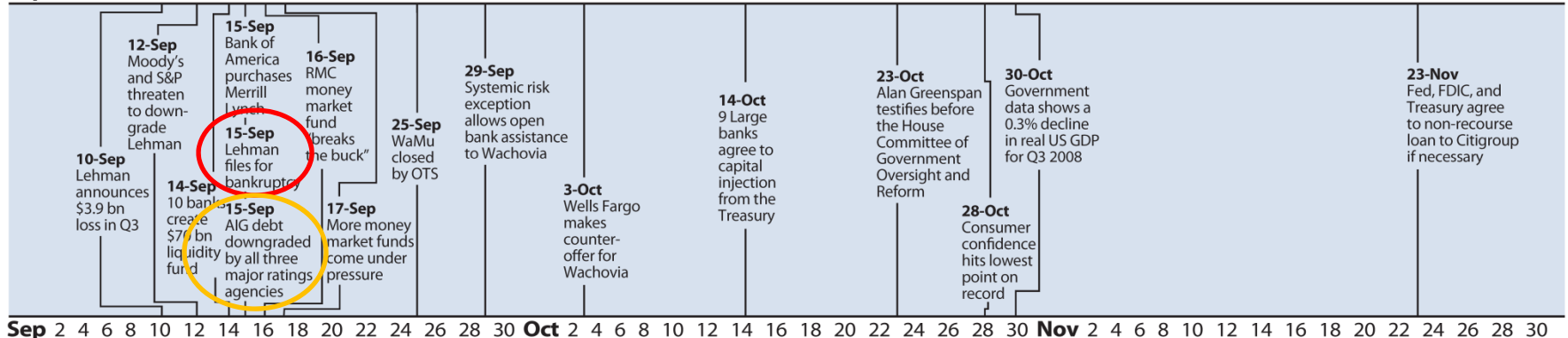


Financial Turmoil Timeline (September 2008 - November 2008)

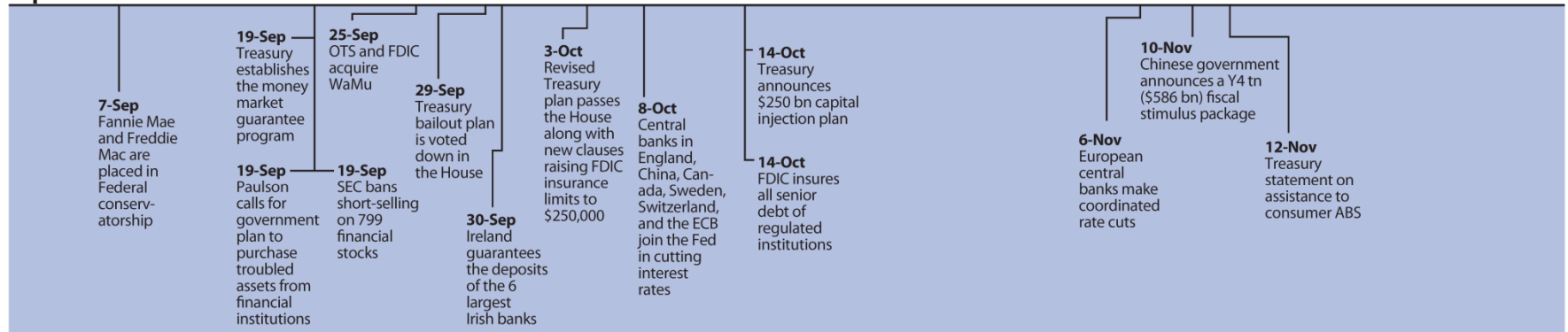
Fed Policy Actions



Market Events

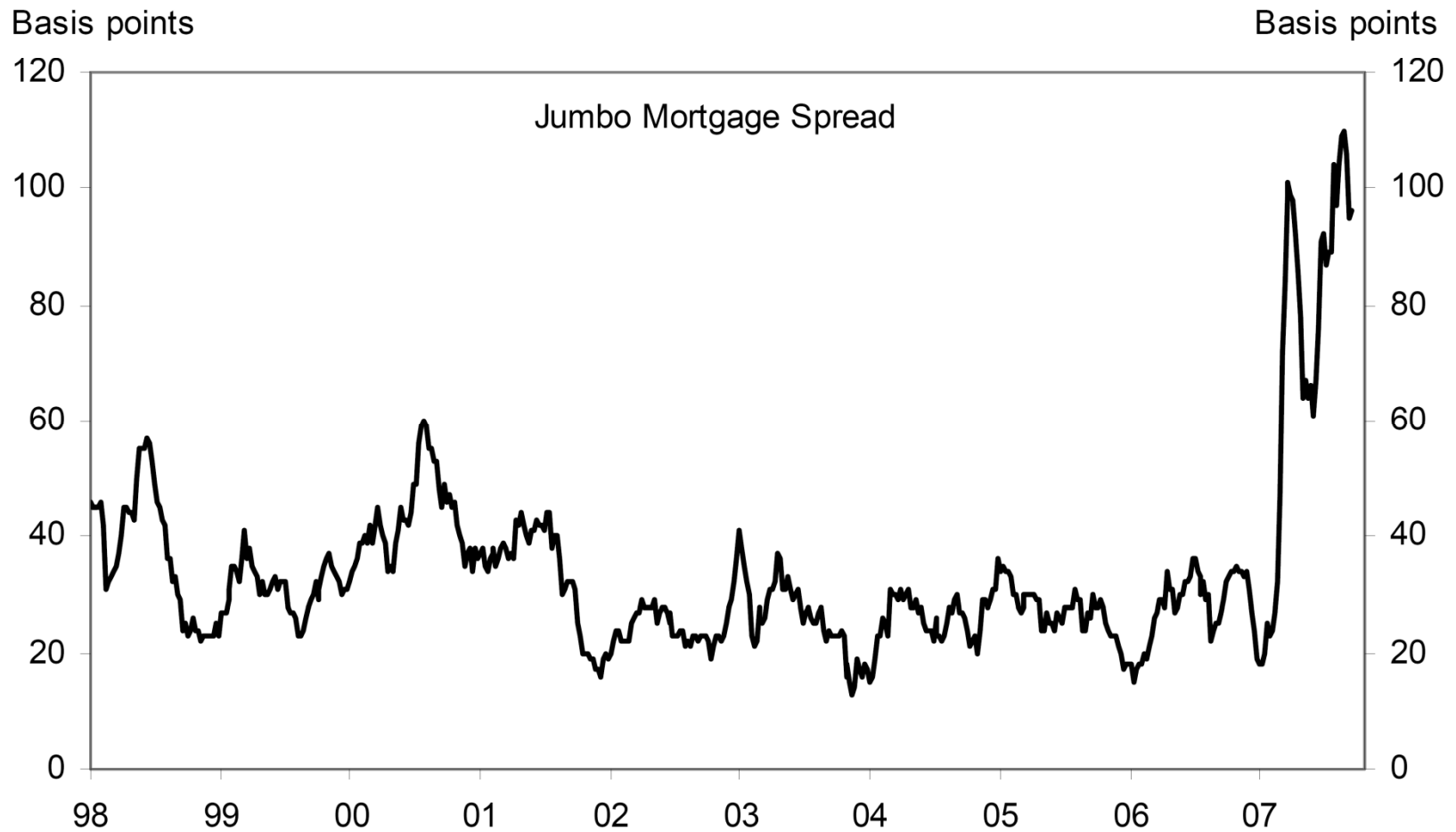


Other Policy Actions



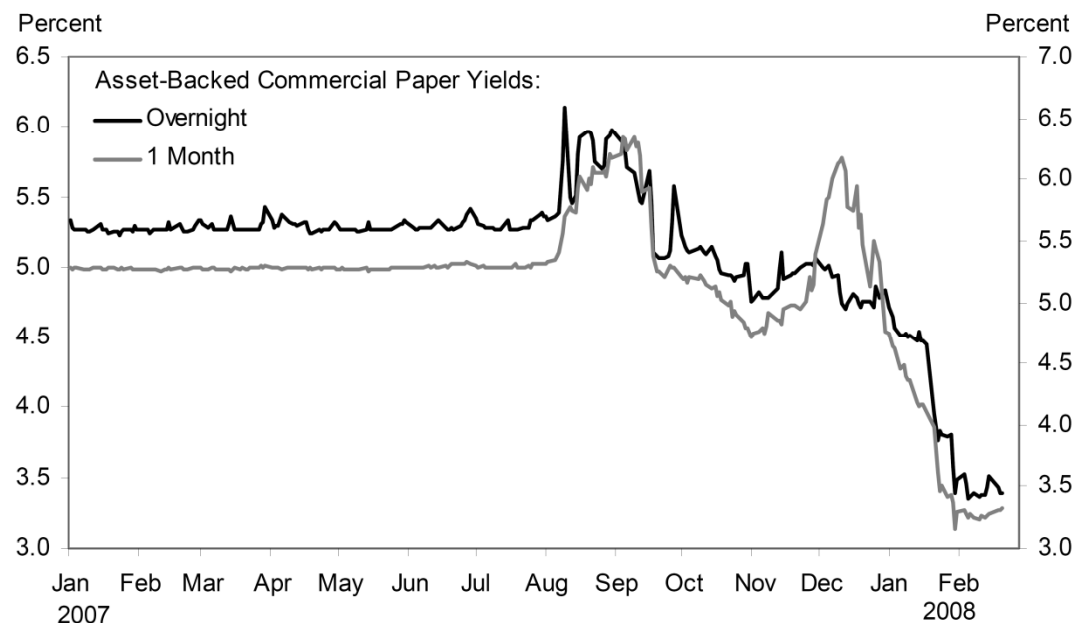
Spreads Rise

Exhibit 2.2 Jumbo Mortgage Spread



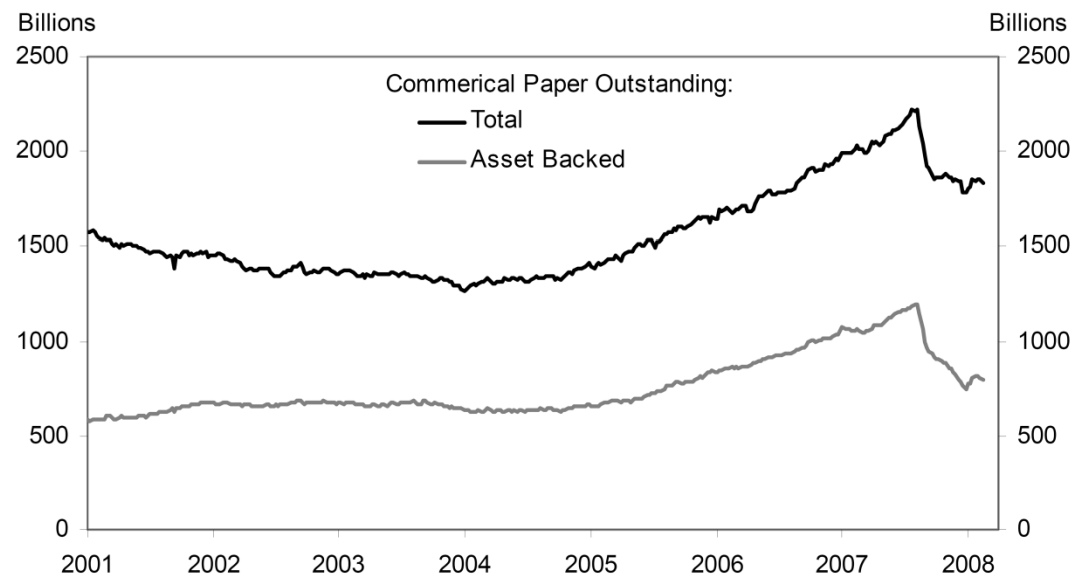
Source: BankRate.com.

Exhibit 2.3 Asset-Backed Commercial Paper (ABCP) Yields



Source: Federal Reserve Board.

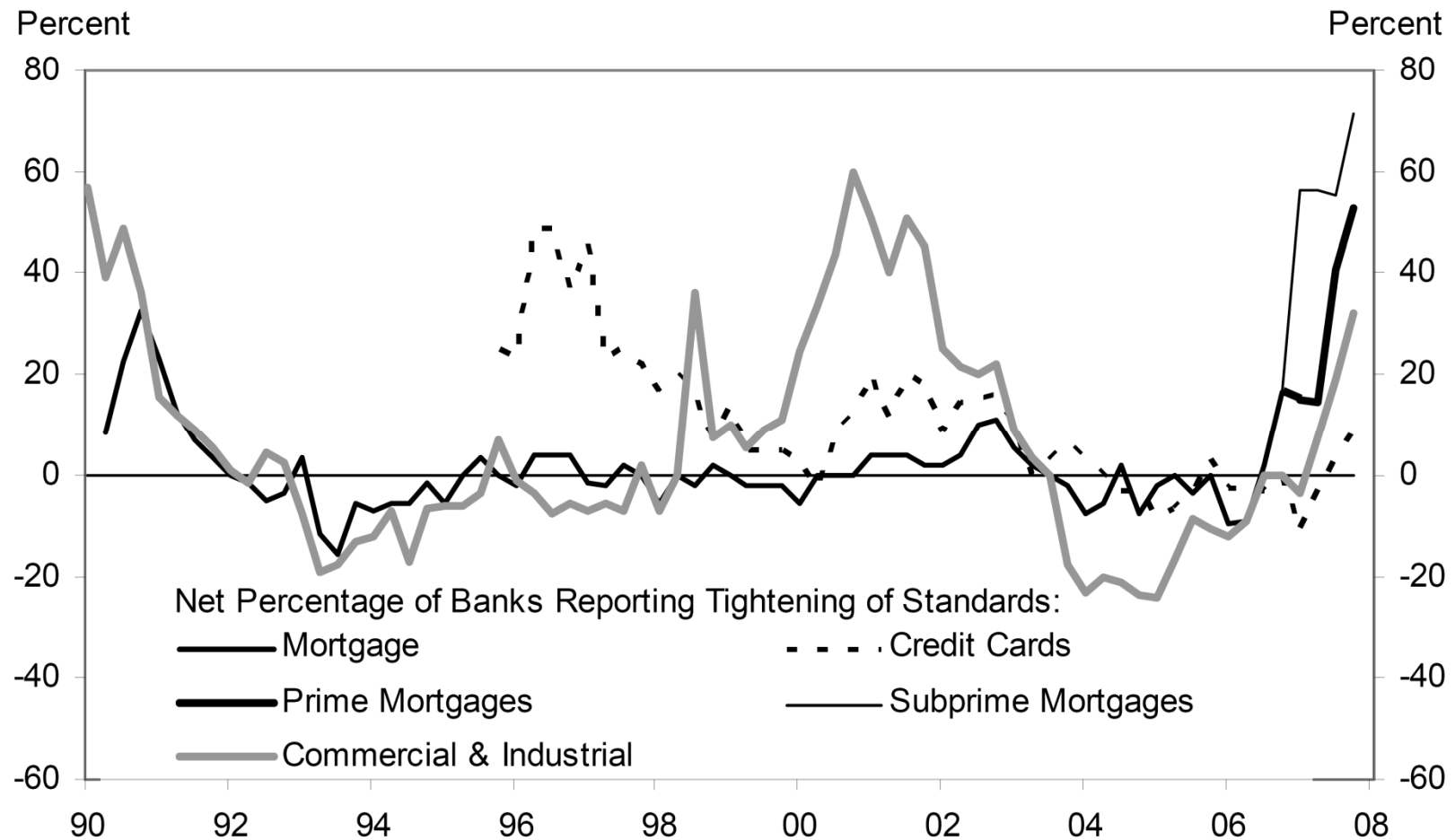
Exhibit 2.4 Commercial Paper Outstanding



Source: Federal Reserve Board.

Credit Tightening

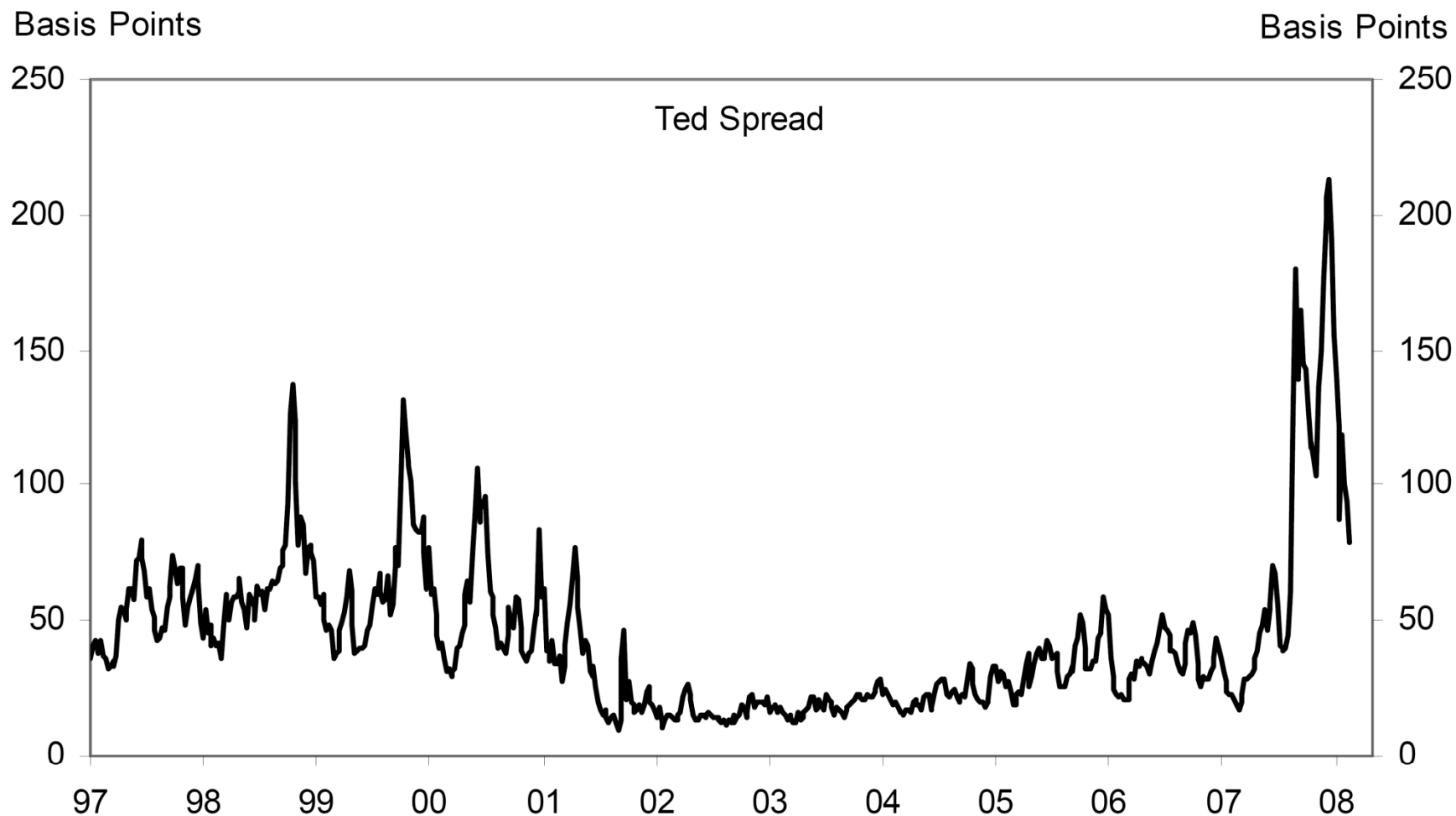
Exhibit 2.5 Senior Loan Officer Survey



Source: Federal Reserve Board.

Trust Disappears

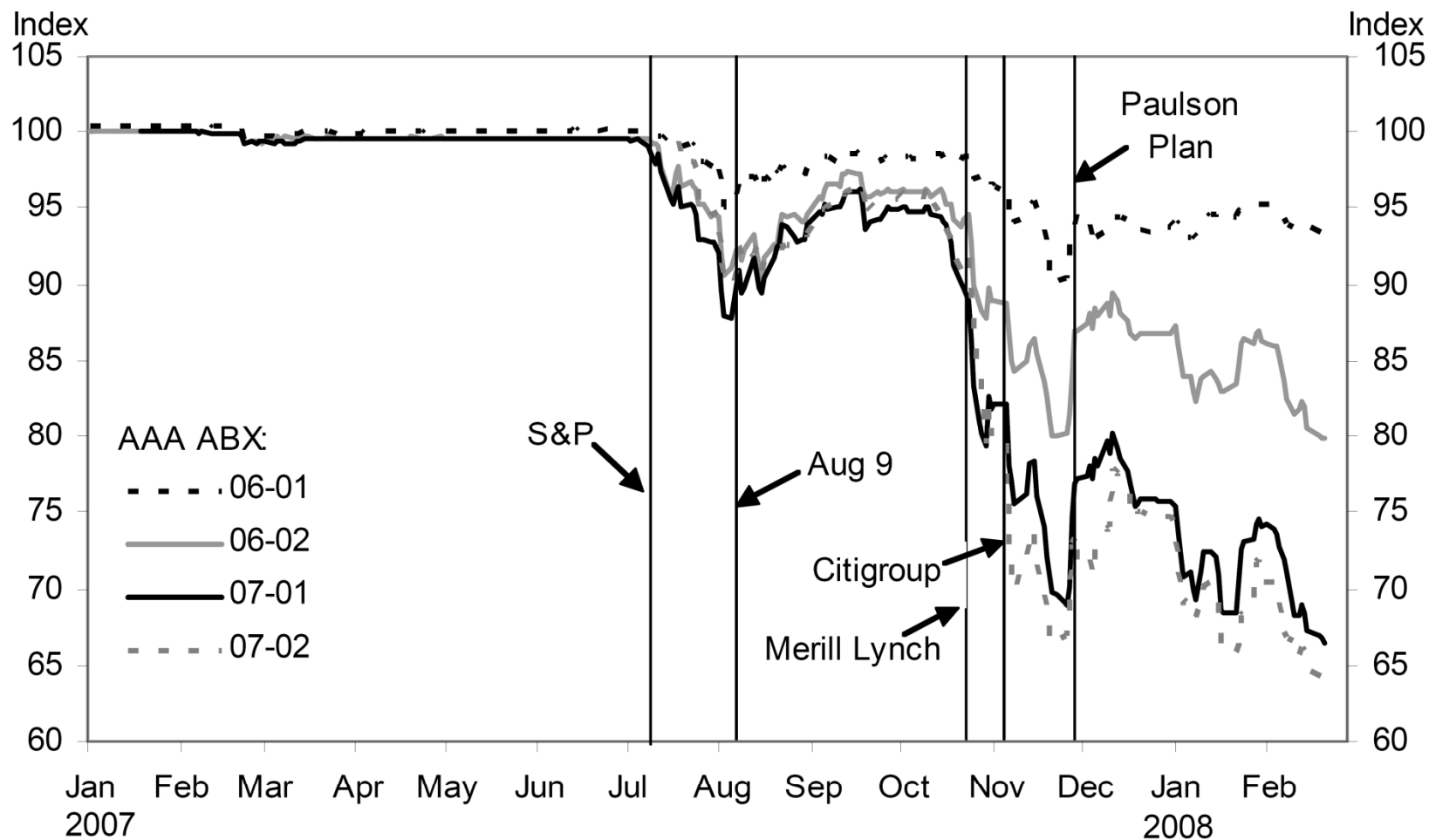
Exhibit 2.8 Treasury-Eurodollar (TED) Spread



Source: Financial Times. Federal Reserve Board.

Derivatives Downgrade

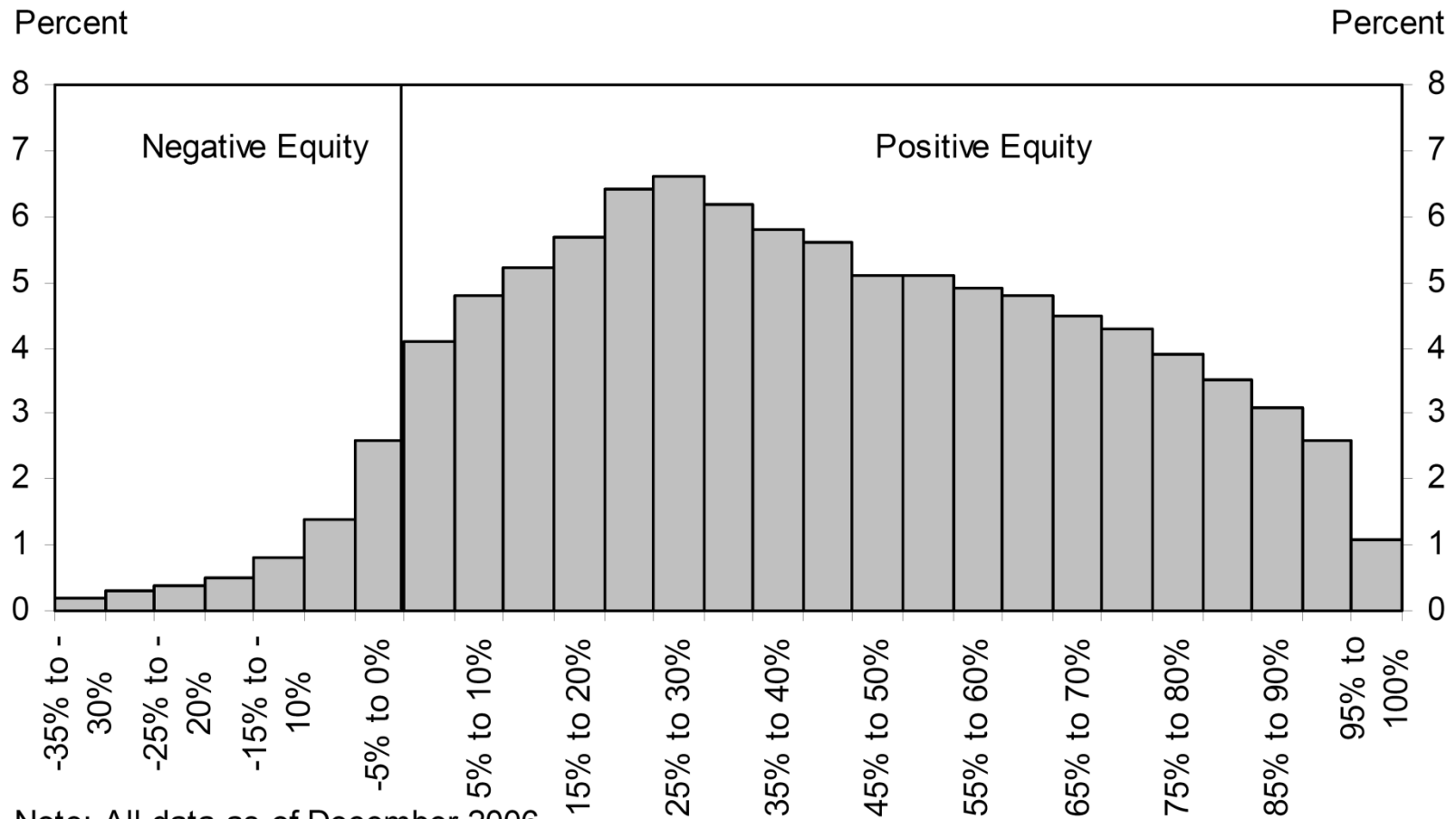
Exhibit 2.12 ABX Indices (AAA rated vintages)



Source: Goldman Sachs.

Arising from Declining House Prices

Exhibit 3.1 Falling Prices Leave Homeowners with Negative Housing Equity

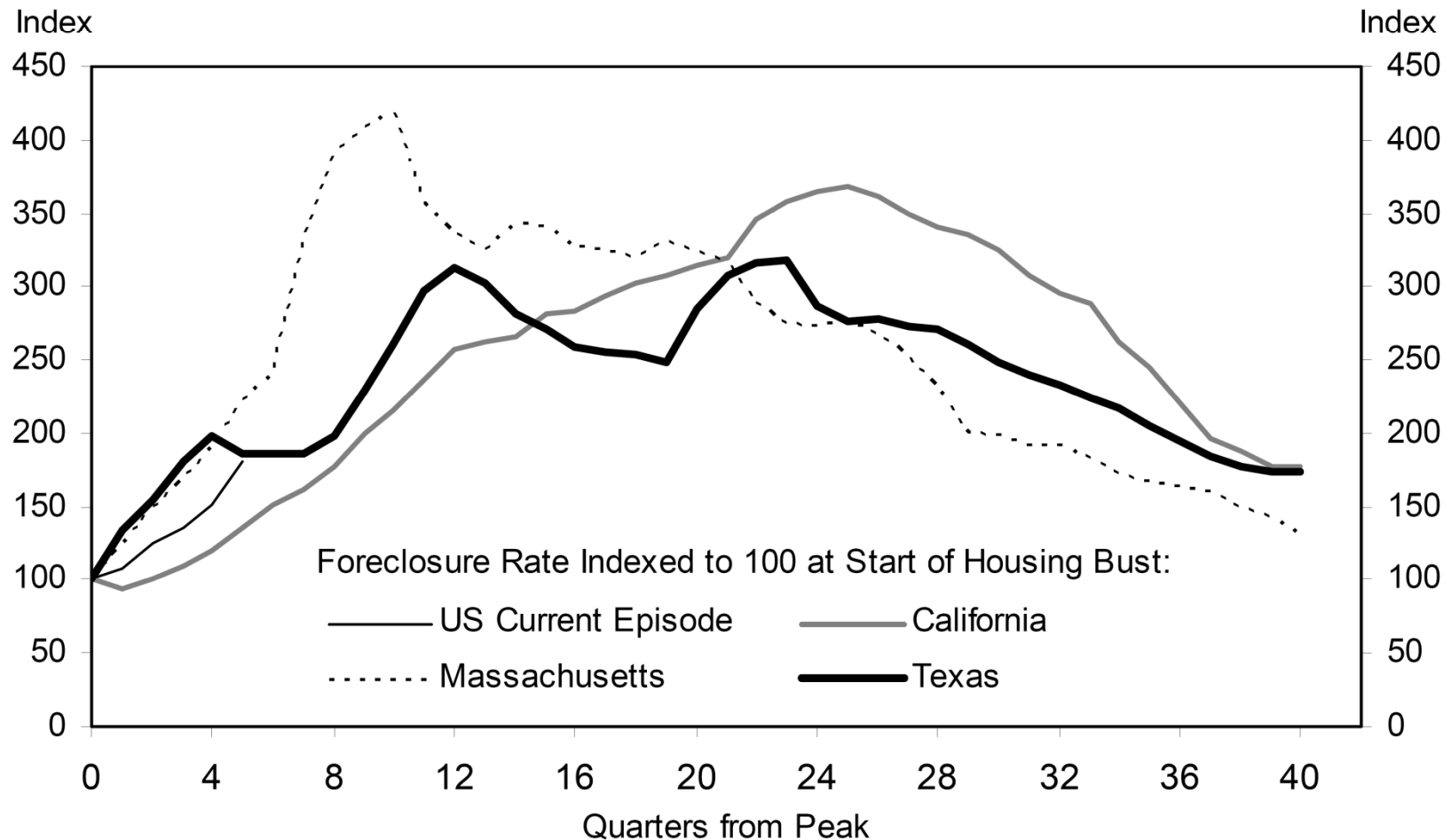


Note: All data as of December 2006.

Source: First American CoreLogic, Inc.

Foreclosures and House Prices

Exhibit 3.6 Foreclosures Triple in the Housing Bust



Source: Mortgage Bankers Association.

Real Estate Debt and Finance

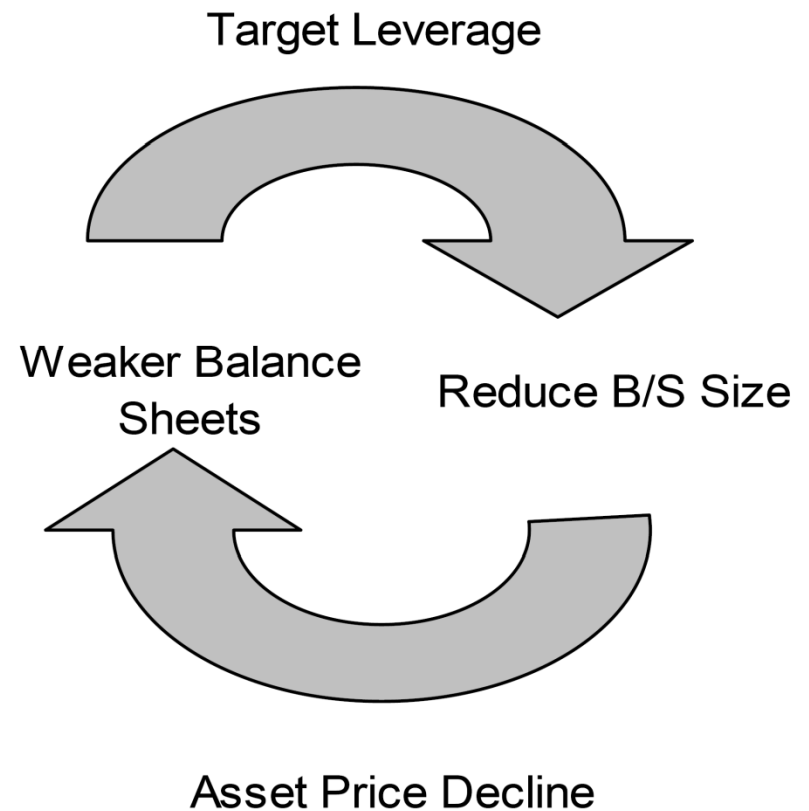
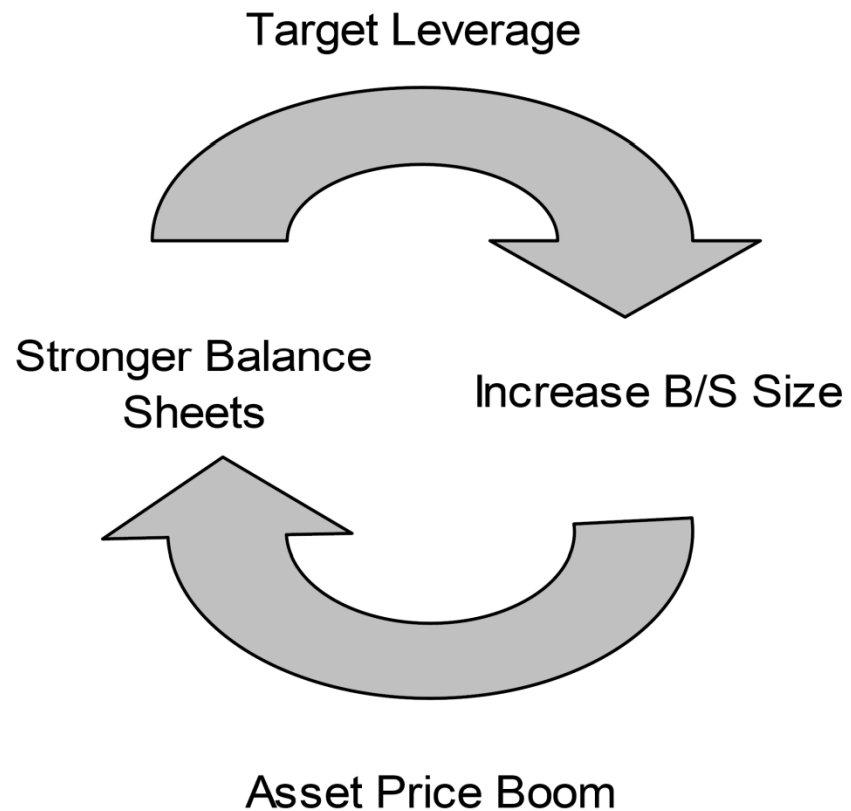
Exhibit 3.7: Home Mortgage Exposures of US Leveraged Institutions

Home Mortgage Debt	Billion (\$)
Total	11,028
US Leveraged Institutions	5,591
Commercial banks	2,881
Direct	1,935
RMBS	946
Savings Institutions	1,148
Direct	895
RMBS	253
Credit Unions	361
Direct	300
RMBS (estimate)	61
Brokers and Dealers	213
Direct	0
RMBS (estimate)	213
Government-Sponsored Enterprises	987
Direct	457
RMBS (estimate)	530

Source: Federal Reserve Board. FDIC. Authors' calculations.

Positive Feedback Loops

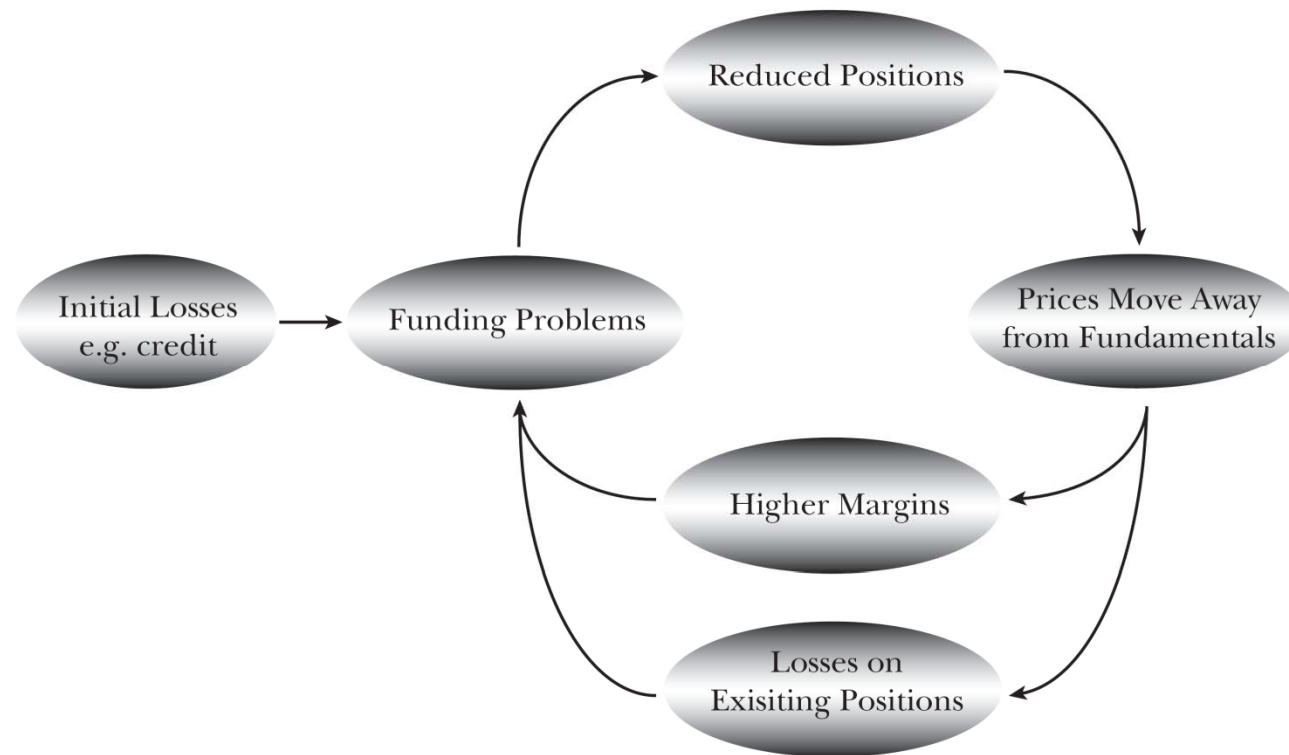
Exhibit 4.3 The Leverage Circle



Additional Channel

Figure 4

The Two Liquidity Spirals: Loss Spiral and Margin Spiral



Source: Brunnermeier and Pedersen (forthcoming).

Note: Funding problems force leveraged investors to unwind their positions causing 1) more losses and 2) higher margins and haircuts, which in turn exacerbate the funding problems and so on.

Leverage

Exhibit 4.5 Leverage of Various Financial Institutions

	Assets (\$bn)	Liabilities (\$bn)	Capital (\$bn)	Leverage
Commercial banks	10793	9693	1100	9.8
Savings Inst	1914	1687	227	8.4
Credit Unions	748	659	89	8.4
Brokers/hedge funds	5397	5226	171	31.6
GSEs	1633	1567	66	24.7
Leveraged Sector	20485	18804	1681	12.2

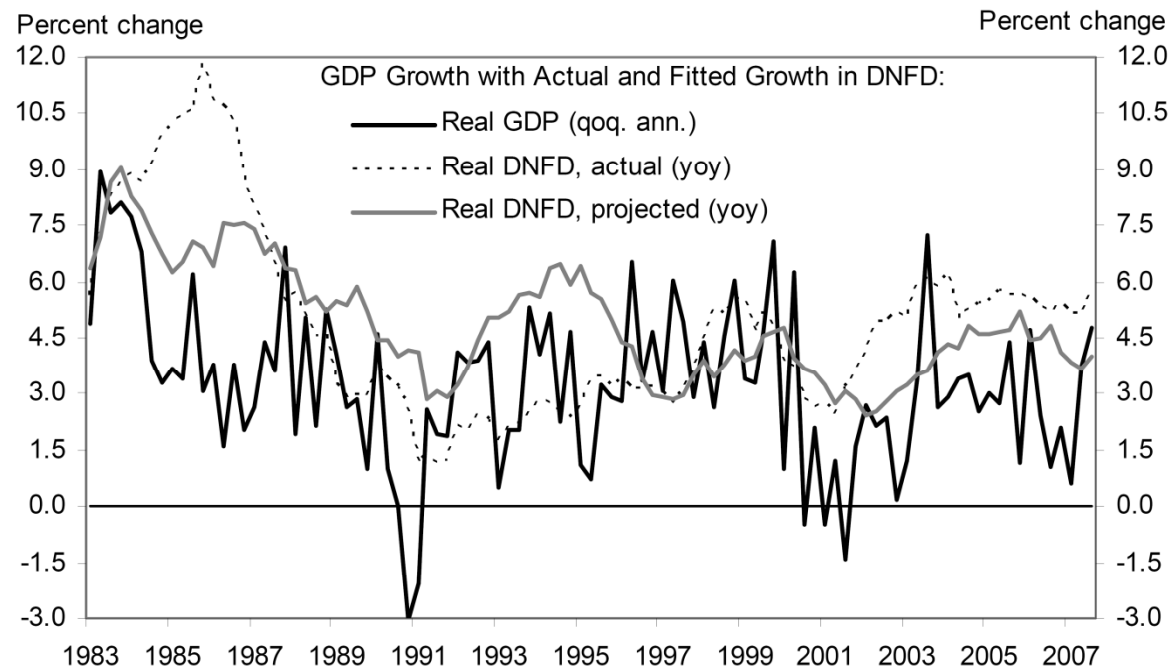
Source: Authors' calculations based on Flow of Funds, FDIC Statistics on Banking, Adrian and Shin (2007), and balance sheet data for Fannie Mae, Freddie Mac, and broker-dealers under Goldman Sachs equity analysts' coverage.

Exhibit 5.2 Instrumental Variable Estimates of GDP Growth and DNFD

Dependent Variable Quarterly GDP Growth (at an annual rate)

Independent Variable	Coefficient	Standard Error	T-Statistic
Constant	0.904	0.590	1.530
GDP Growth _{t-1}	0.247	0.118	2.100
GDP Growth _{t-2}	0.242	0.111	2.190
GDP Growth _{t-3}	-0.264	0.110	-2.410
4 quarter DNFD Growth _{t-1}	0.338	0.176	1.920

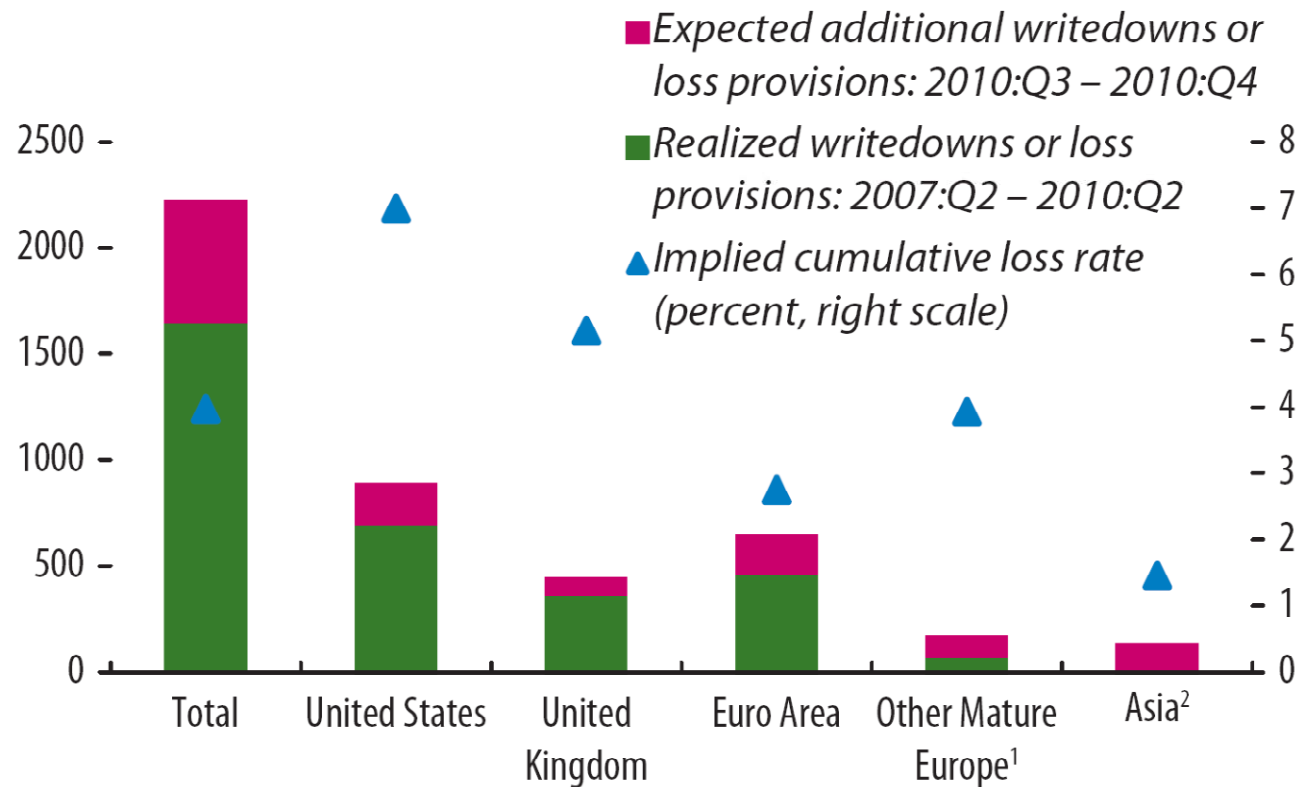
Exhibit 5.3 GDP Growth with Actual and Fitted Growth in DNFD



Source: Department of Commerce. Authors' calculations.

Losses to Financial System

Figure 1.12. Bank Writedowns or Loss Provisions by Region
(In billions of U.S. dollars unless indicated)



Source: IMF staff estimates.

¹Includes Denmark, Iceland, Norway, Sweden, and Switzerland.

²Includes Australia, Hong Kong SAR, Japan, New Zealand, and Singapore.

Four Questions

- Will the new regulatory structure make the financial system more robust to shocks by providing institutions the tools to heal themselves?
- Does the Dodd-Frank Act adequately deal with monitoring and measuring systemic risk?
- Do the provisions of the Act deal adequately with the problem of too-big-to fail institutions?
- To what extent will the Dodd-Frank Act involve the right mix of automatic “stabilizers” (e.g. higher capital requirements), fixed rules (e.g. the Volcker Rule) and discretion (e.g. Federal Reserve’s ability to lend to illiquid, potentially insolvent, institutions at flexible haircuts), to be an effective framework for financial stability?

Robust to Shocks?

- The key issue is whether a financial firm or market participants will have adequate capital and liquidity to withstand adverse events whether they be due to idiosyncratic shocks or aggregate shocks.
- ... regulatory capital requirements, both under Dodd-Frank and under Basel III rules.

Dodd-Frank and Systemic Risk

- Orderly Liquidation Authority (OLA) (FDIC)
- Liquidation versus resolution
- SIFI's versus markets (e.g., repo) or
- “herds of firms” (e.g., money market funds)

Stabilizers vs. Rules vs. Discretion

- Stabilizers (capital requirements)
- Rules - Volcker rule specifically prohibits a bank or institution that owns a bank from engaging in proprietary trading, and from owning or investing in a hedge fund or private equity fund, and also limits the liabilities that the largest banks can hold.
- Discretion: Is liquidation necessarily the right way to go, or resolution.