

Economics 134
Spring 2012

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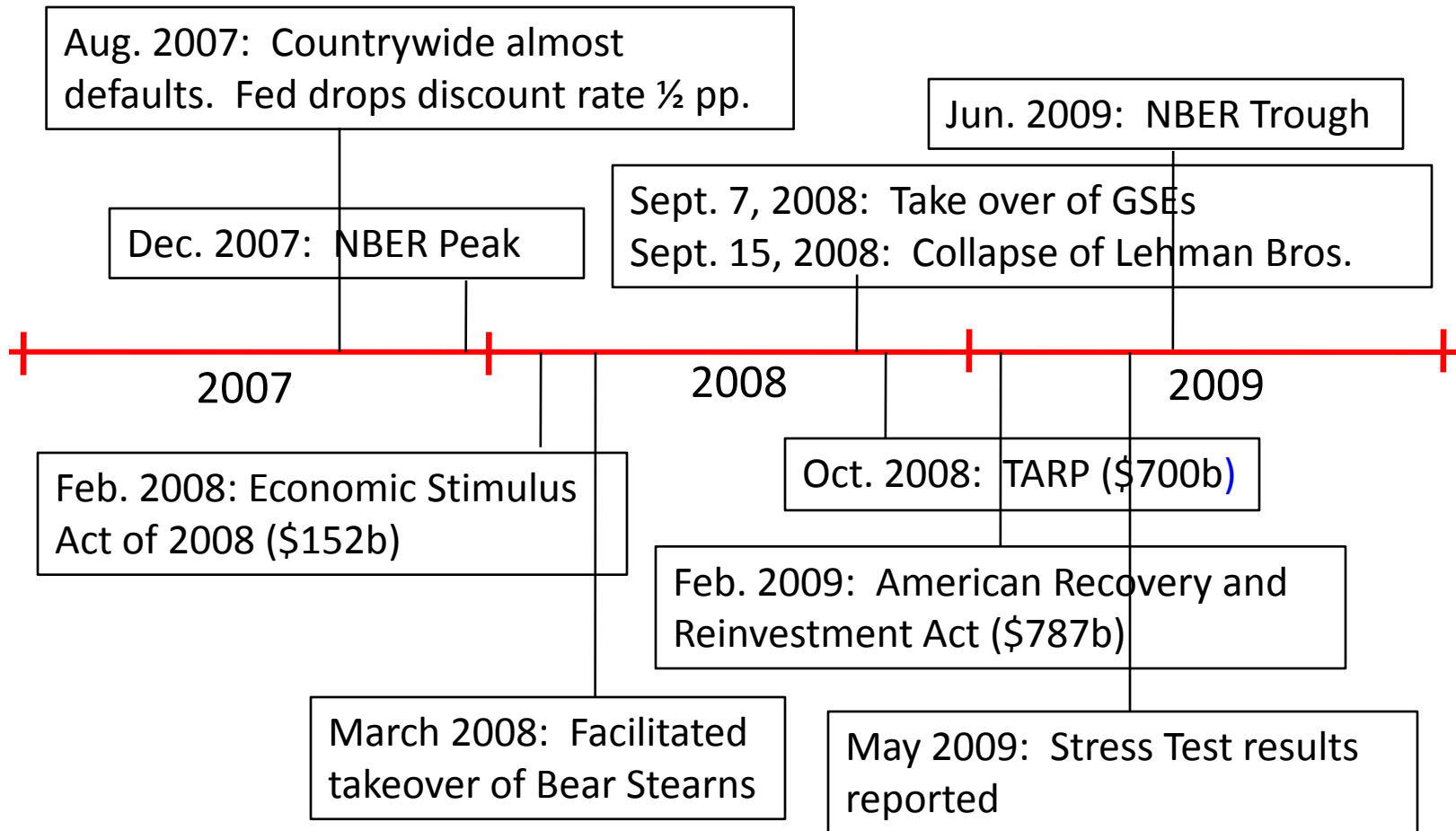
LECTURE 4

The Great Recession



January 26, 2011

Great Recession Time Line



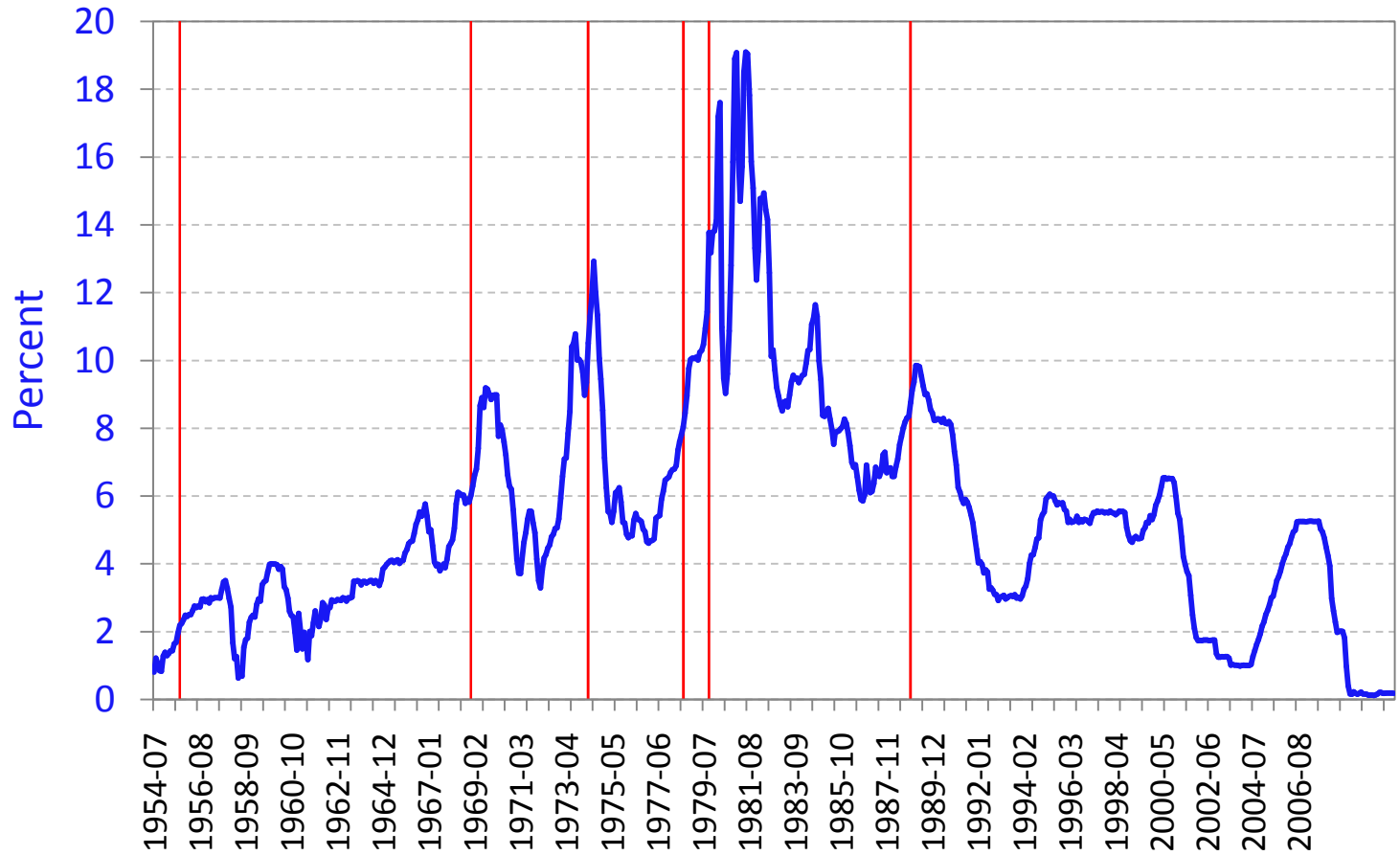
I. RUN-UP TO THE GREAT RECESSION

TABLE 5.1 Recessions in the United States since World War II

Year and quarter of peak in real GDP	Number of quarters until trough in real GDP	Change in real GDP, peak to trough
1948:4	2	-1.7%
1953:2	3	-2.6
1957:3	2	-3.7
1960:1	3	-1.6
1970:3	1	-1.1
1973:4	5	-3.2
1980:1	2	-2.2
1981:3	2	-2.9
1990:2	3	-1.4
2000:4	1	-0.3
2008:2	4	-3.8

The 2001 recession was the smallest since 1947.

Federal Funds Rate



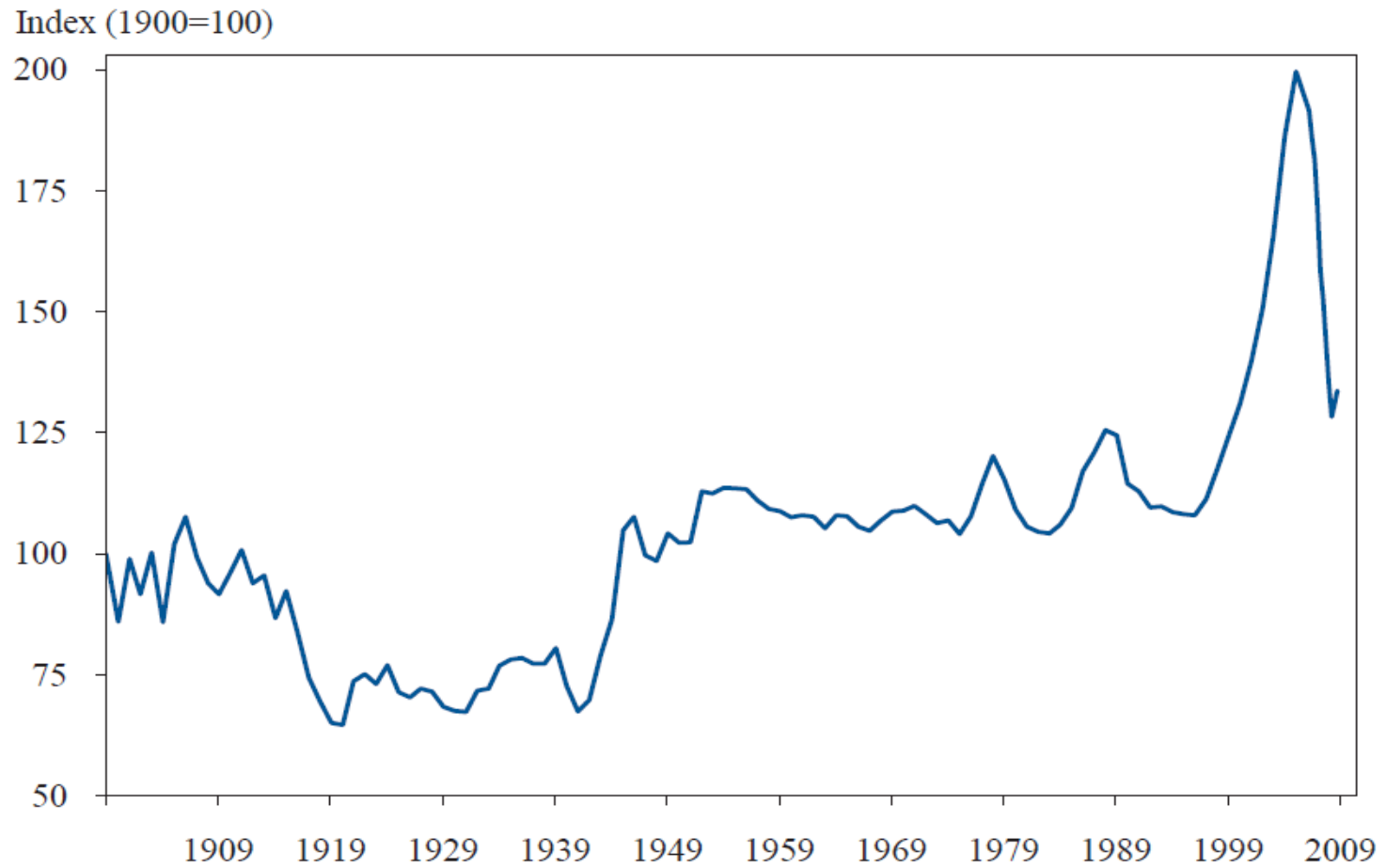
Interest rates didn't rise much before the 2001 recession.

NASDAQ Composite Index 1994-2005



Tech bubble burst in early 2000.

Figure 2-1
House Prices Adjusted for Inflation



House prices rose dramatically in the mid-2000s.

What fueled the housing bubble?

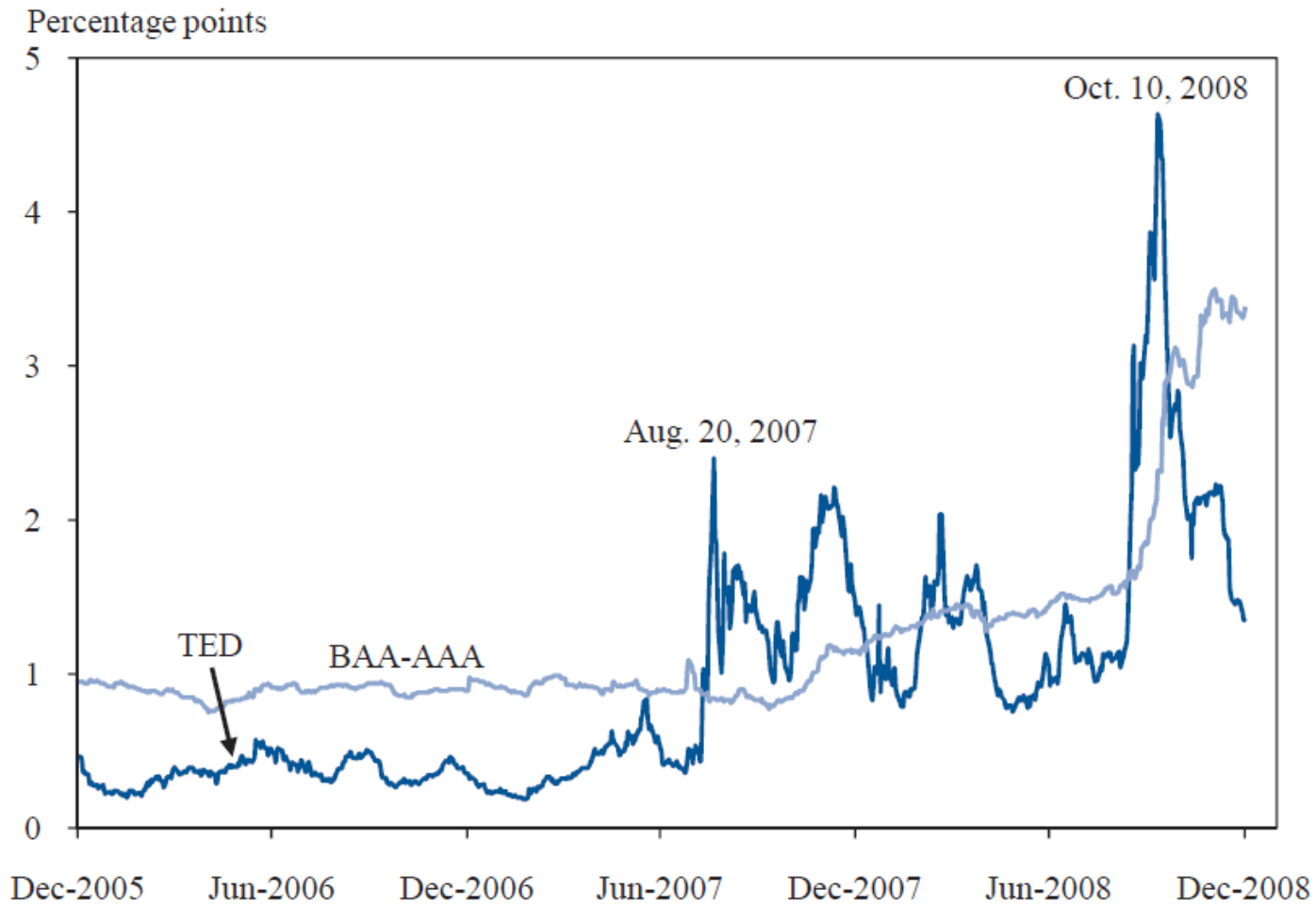
Possible Effects of House Price Decline

TED Spread

Difference between the interest rates on short-term loans between banks (LIBOR) and short-term government debt (T-bills).

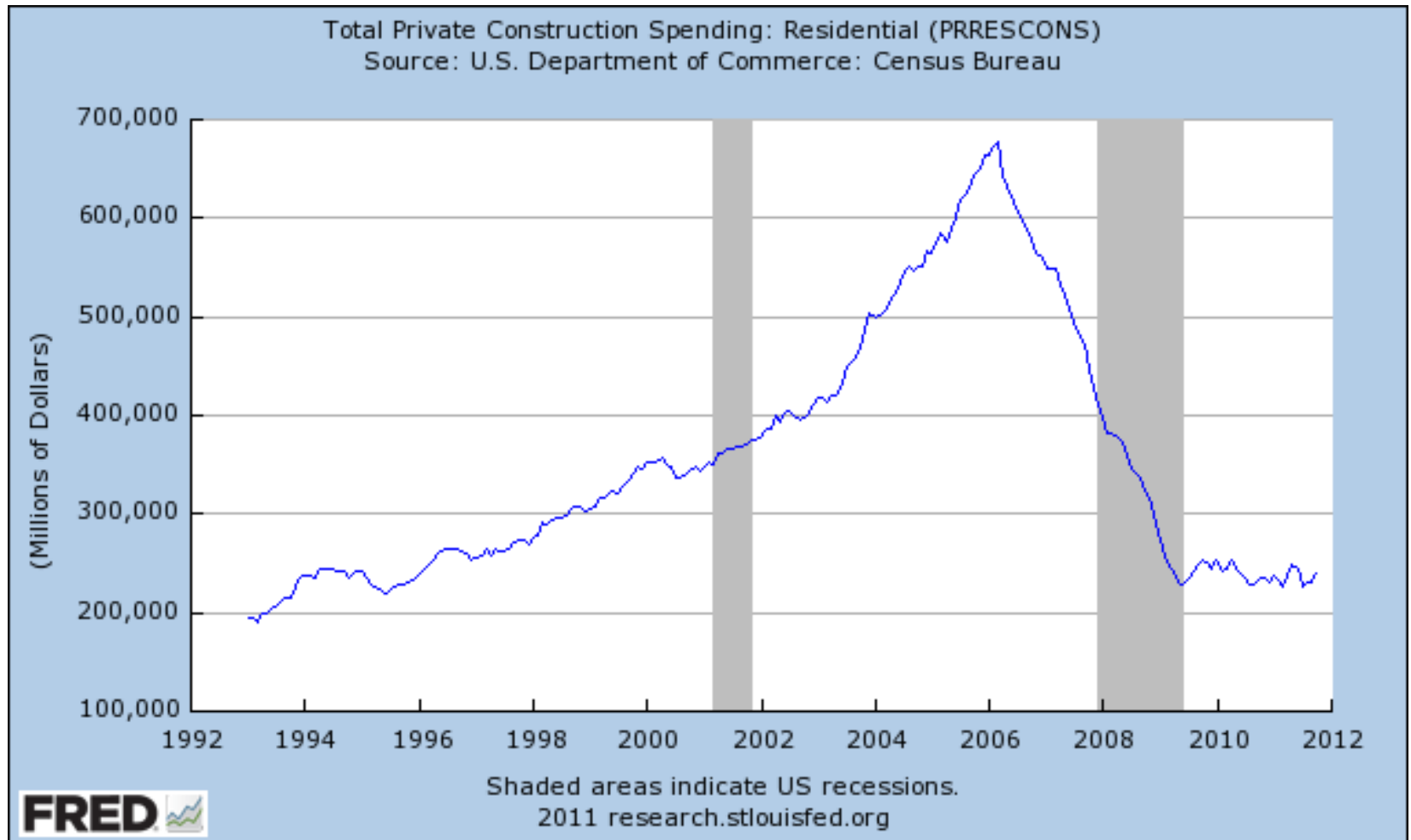
It is a measure of credit risk.

Figure 2-3
TED Spread and Moody's BAA-AAA Spread Through December 2008

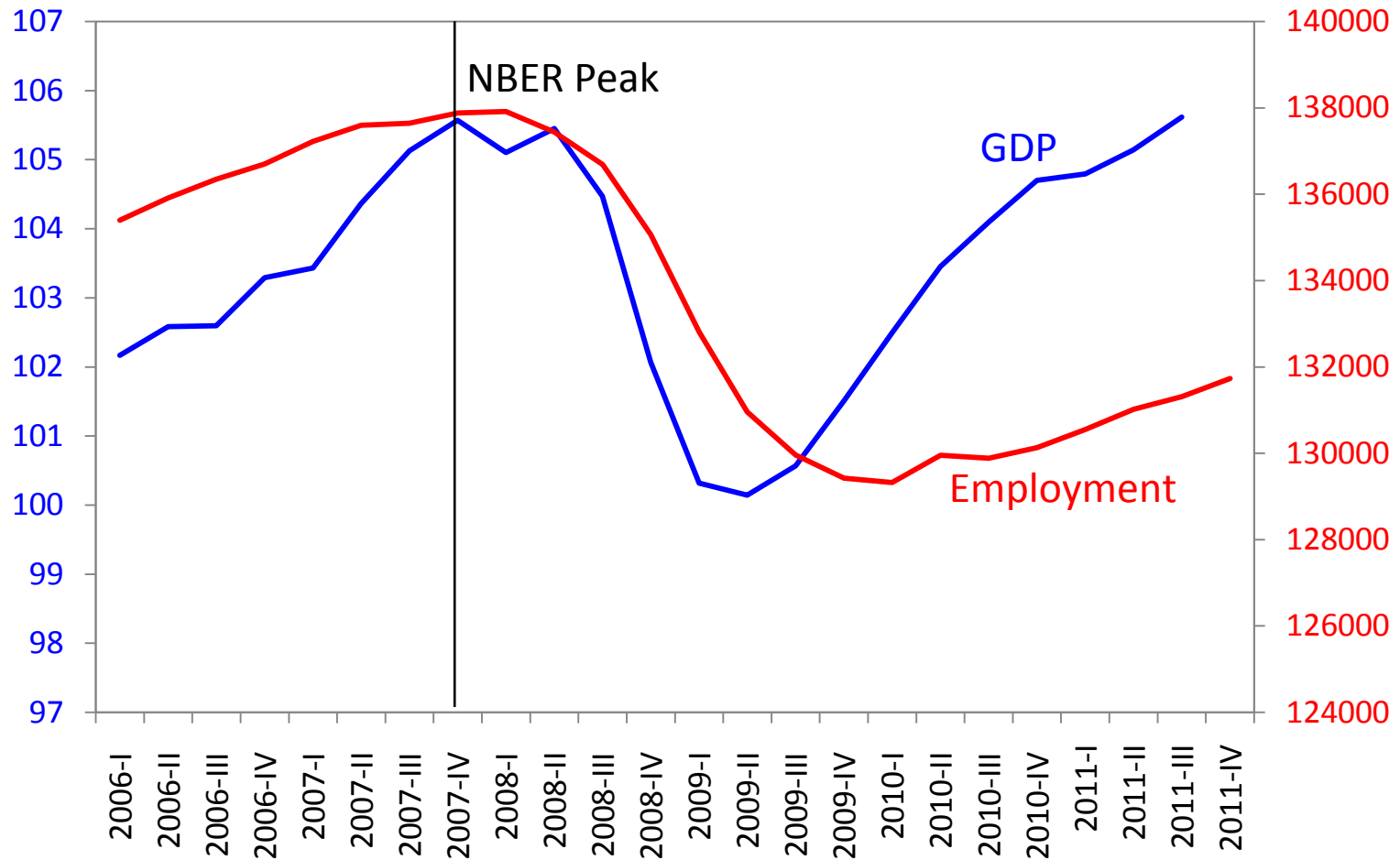


TED spread spiked in August 2007 and again in September and October 2008.

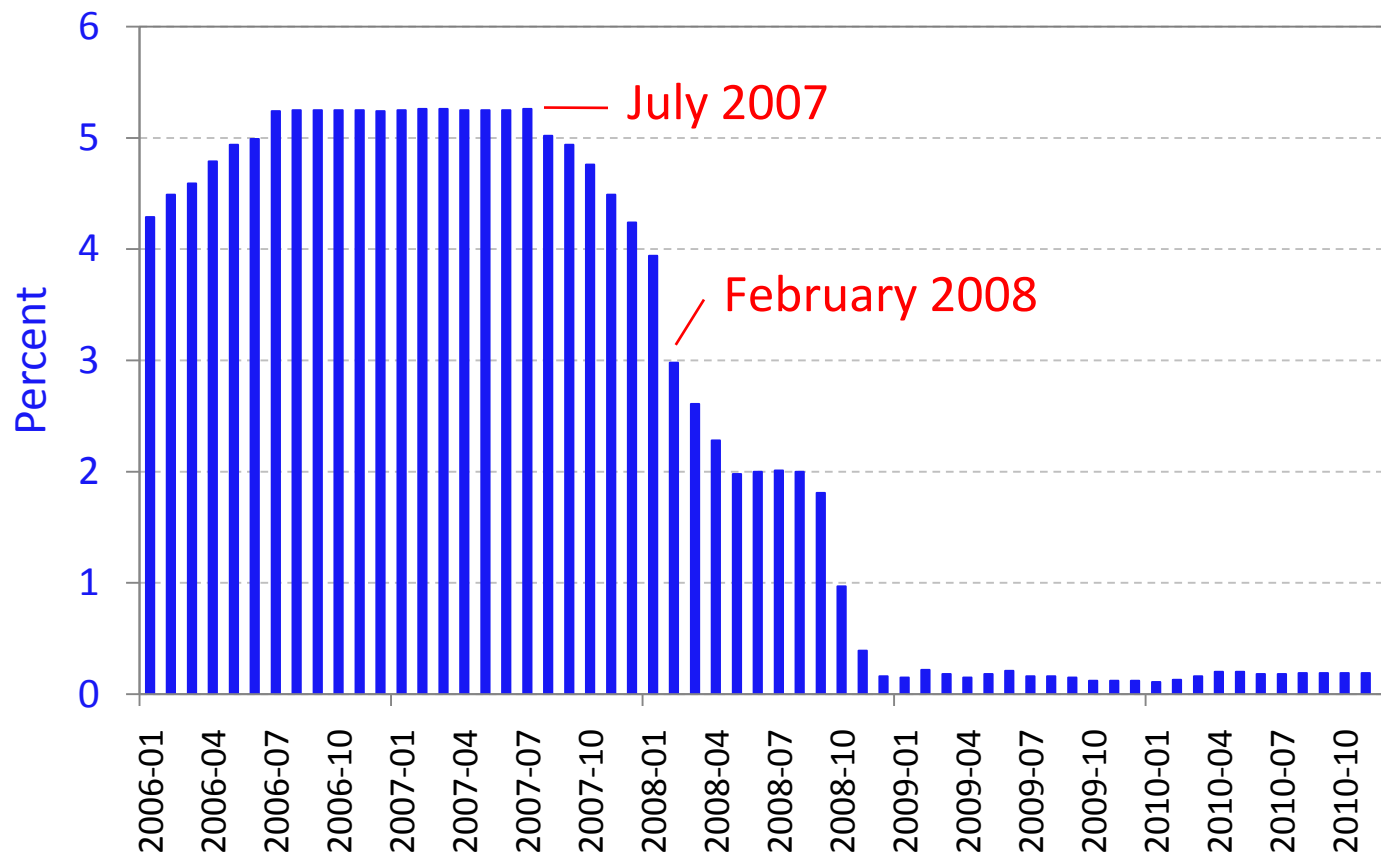
Residential Construction Spending



Real GDP and Employment



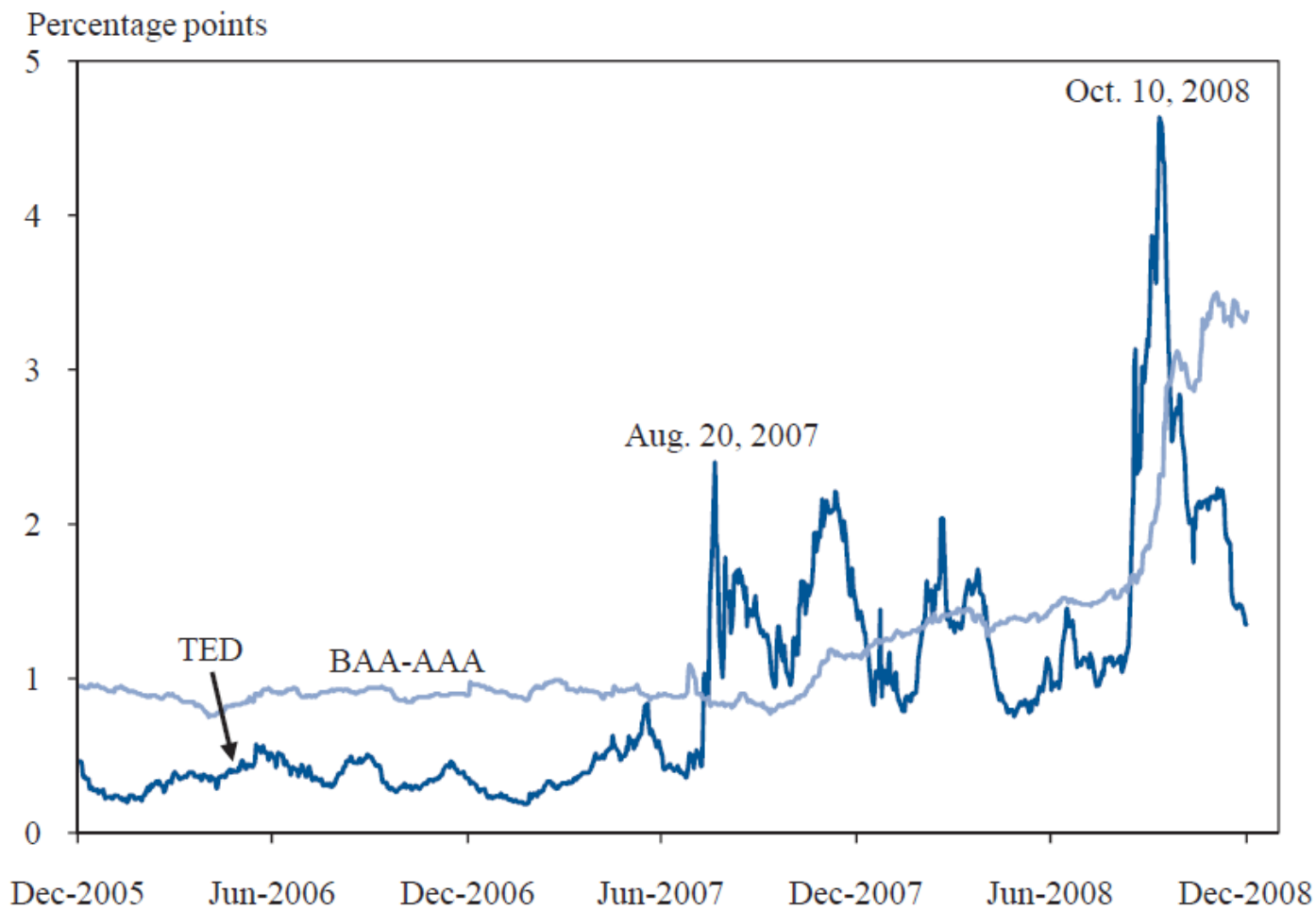
Federal Funds Rate, 2006-2010



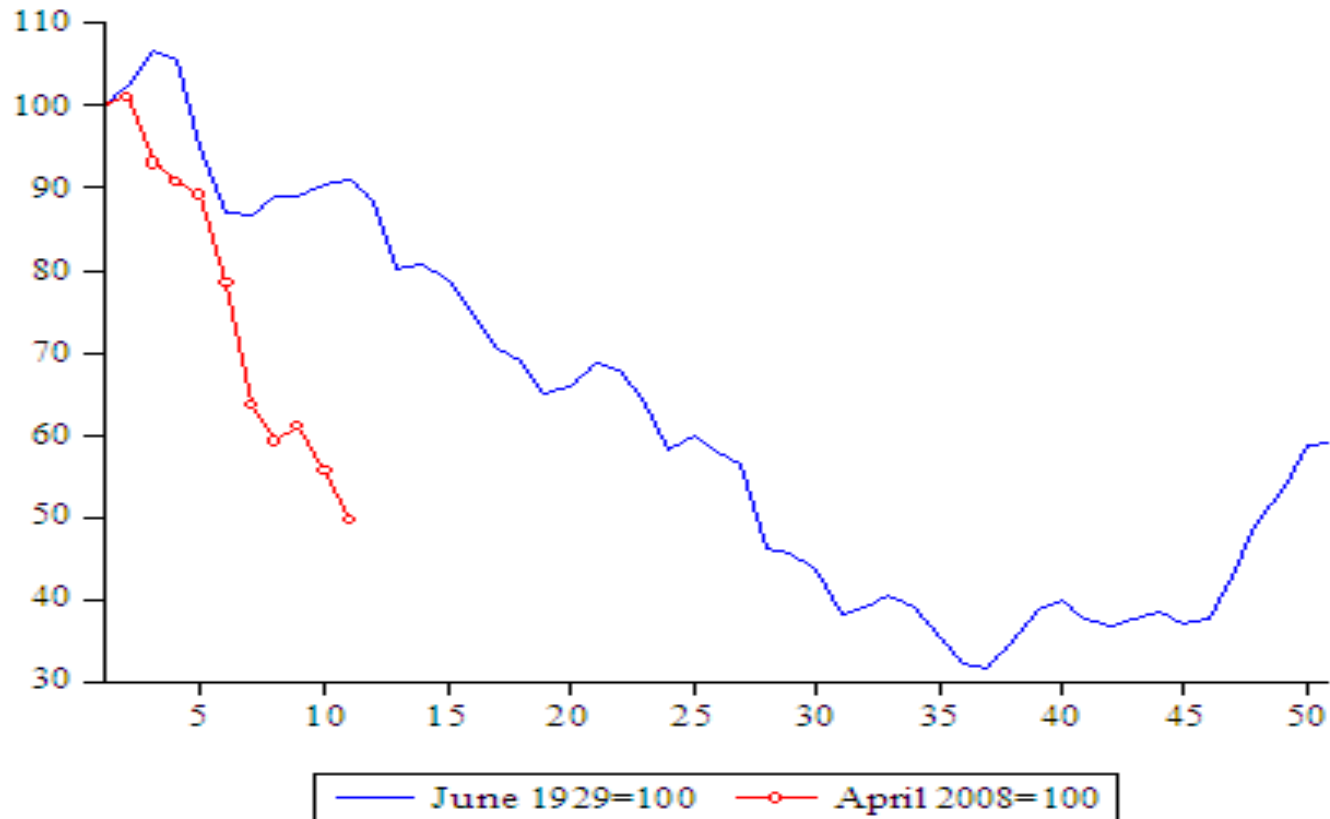
Funds rate dropped from 5.25% to 3% between July 2007 and February 2008.

II. CRISIS IN THE FALL OF 2008

Figure 2-3
TED Spread and Moody's BAA-AAA Spread Through December 2008

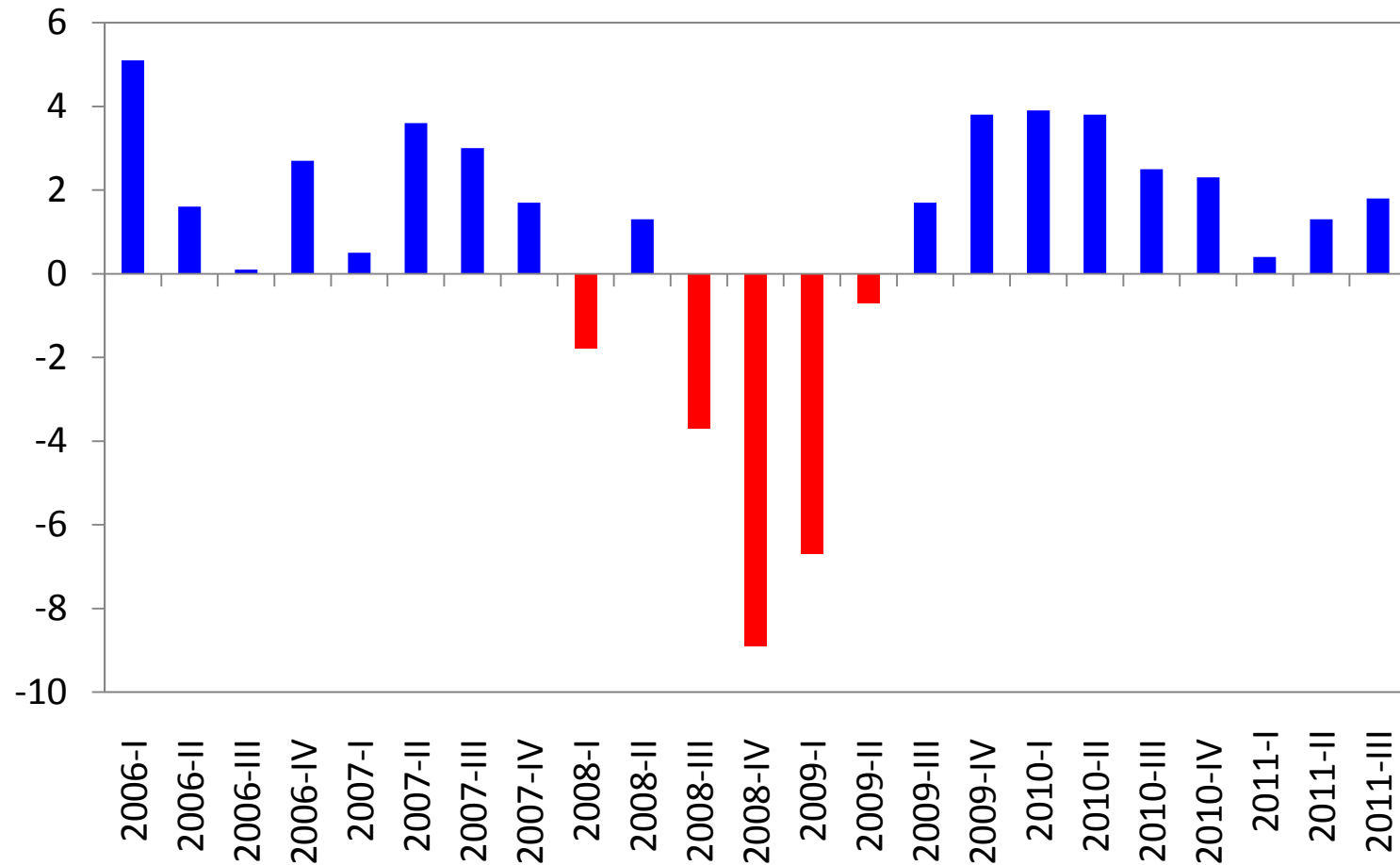


Stock Prices, 1929 and 2008



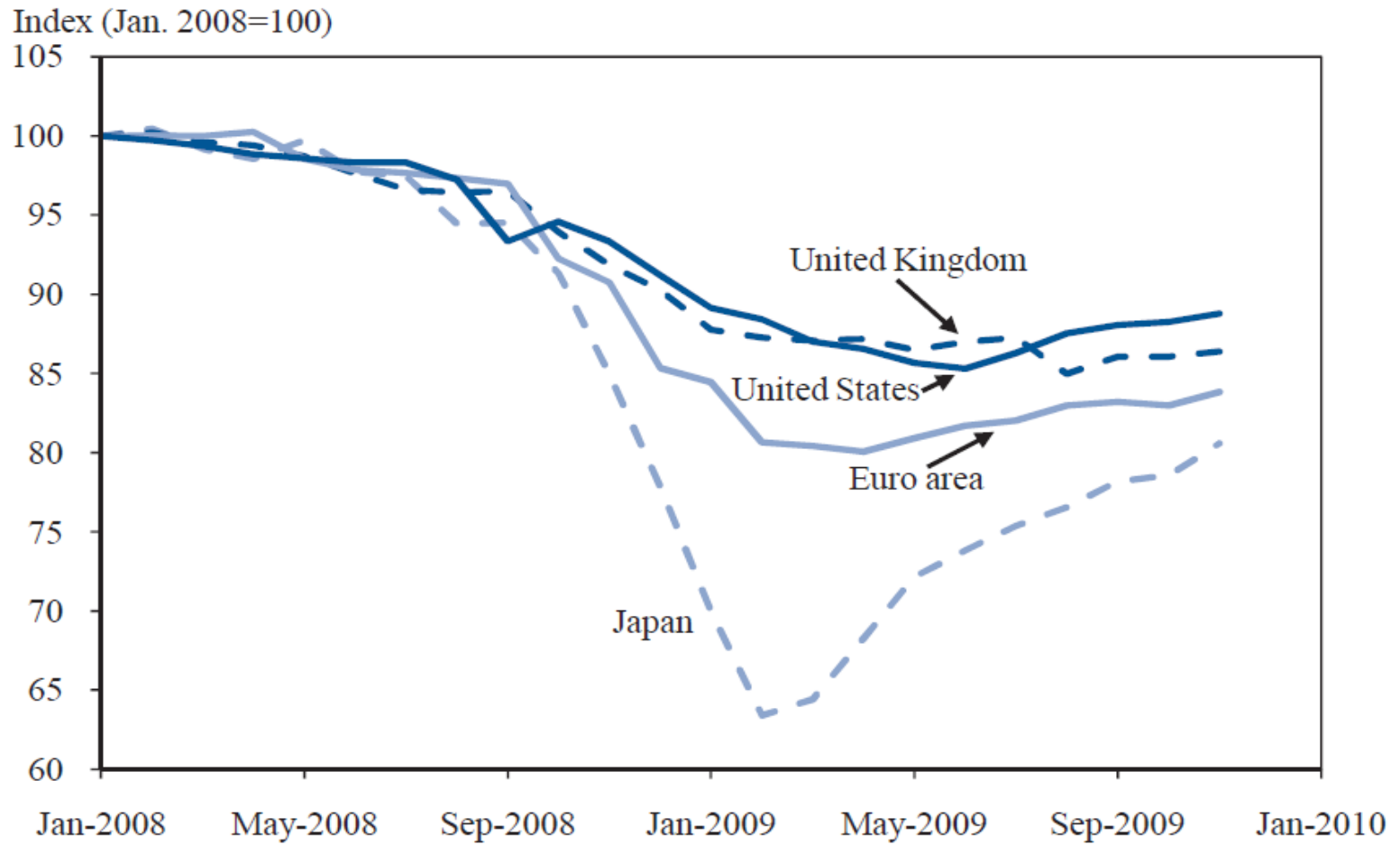
Initial fall in stock prices was larger in 2008-09 than in 1929-30.

GDP Growth



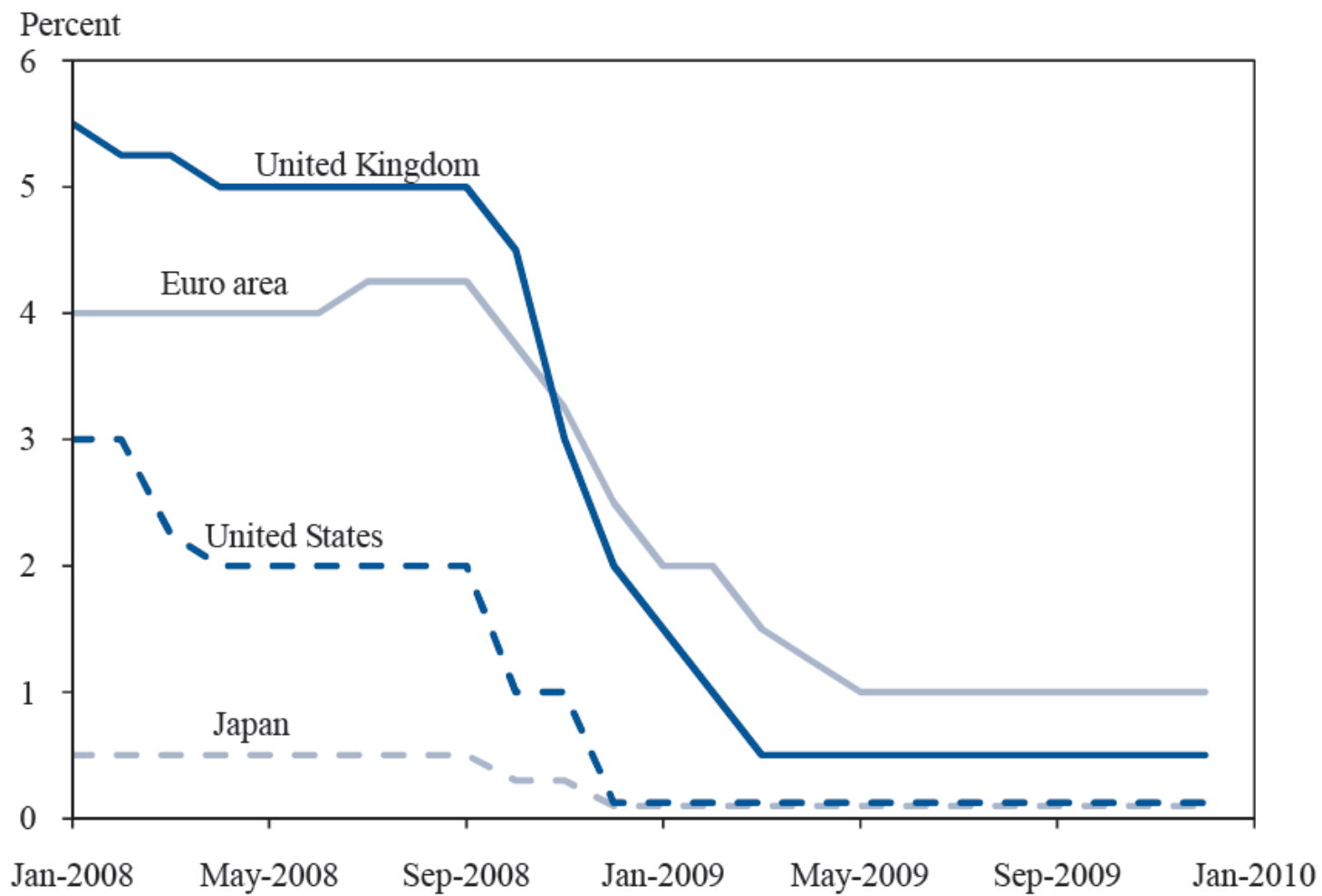
GDP plummeted in the second half of 2008.

Figure 3-6
Industrial Production in Advanced Economies



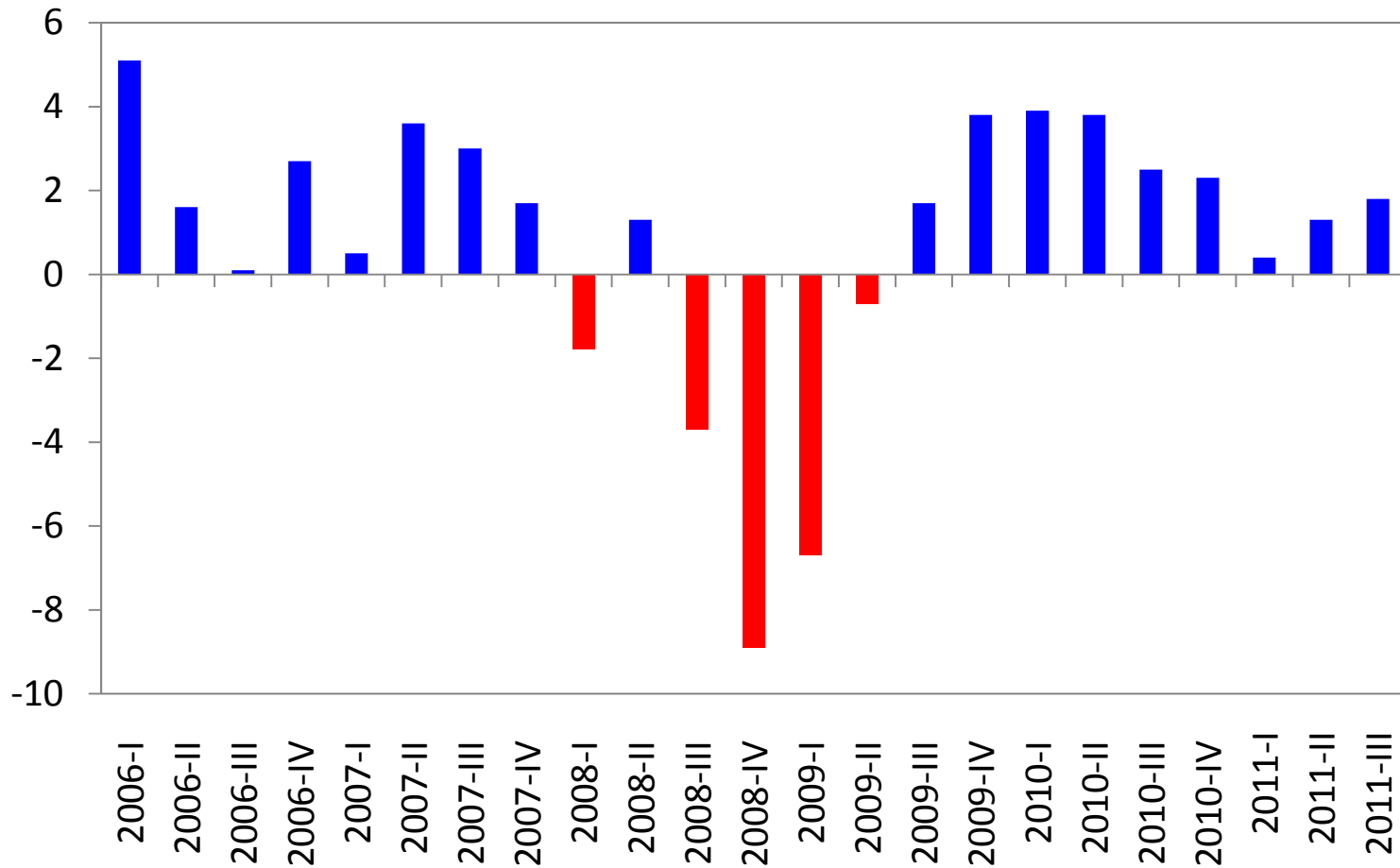
IP fell early in US; rest of the world followed quickly.

Figure 3-9
Policy Rates in Economies with Major Central Banks



III. THE BLEAK WINTER OF 2009

GDP Growth

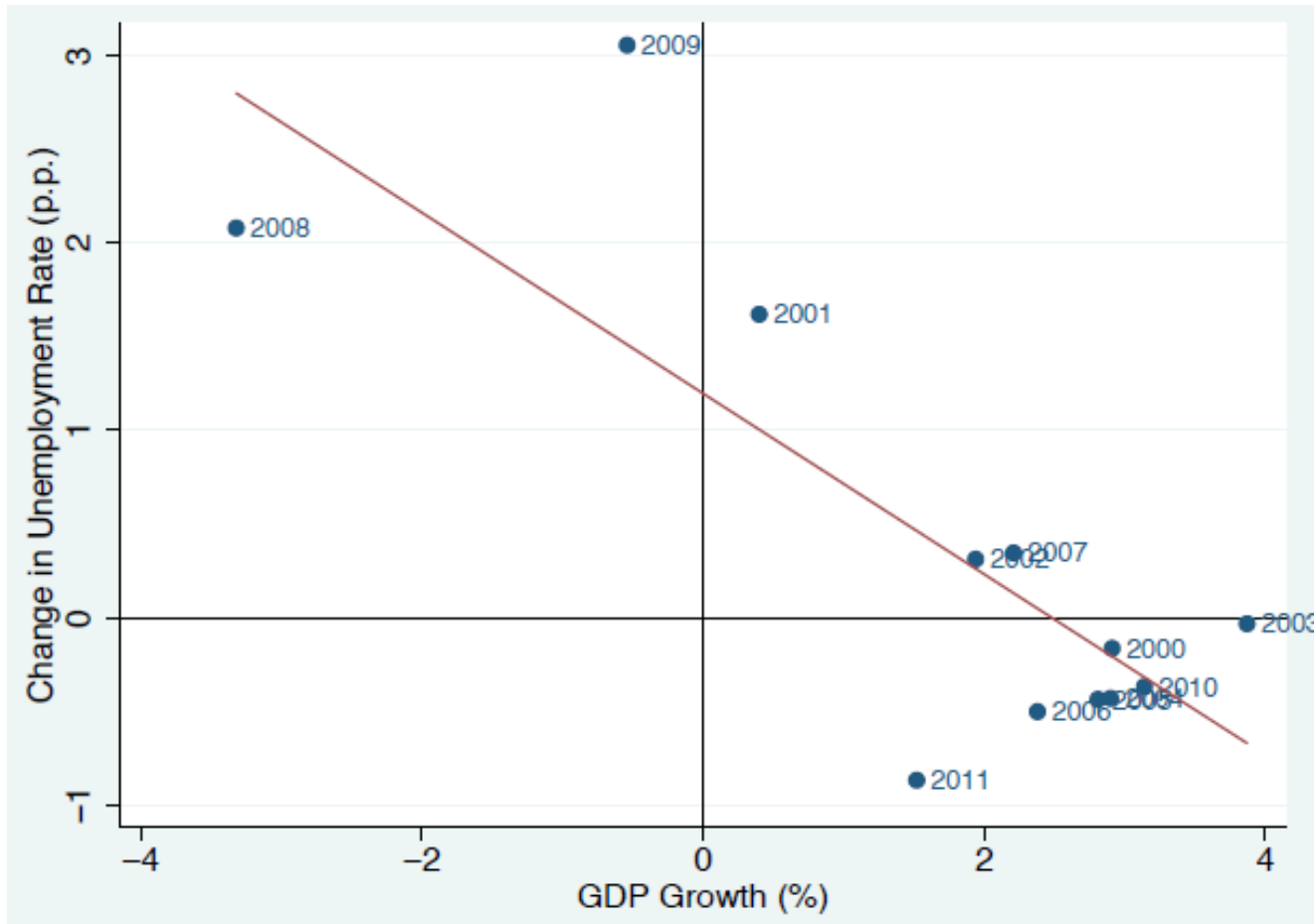


GDP continued to fall in early 2009.

Okun's Law

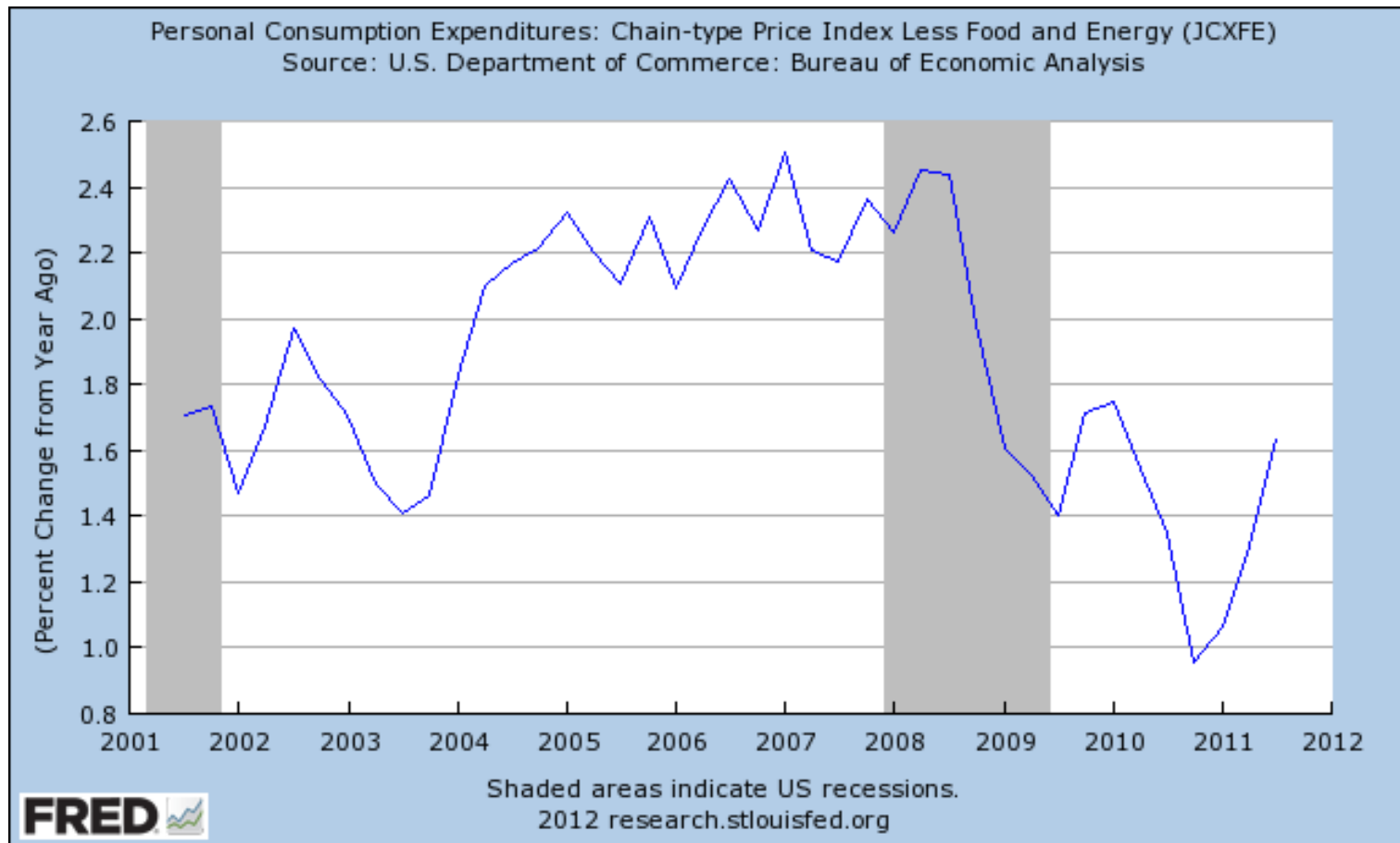
A shortfall of GDP growth from normal of 2 percentage points is usually associated with a rise in the unemployment rate of about 1 percentage point.

Okun's Law, 2000-2011



The rise in unemployment in 2009 and the fall in 2011 were unusually large, given the behavior of real GDP

Core Inflation



Core inflation slowed during the recession, but has not fallen as much as one might have expected, given high unemployment.

More Policy Response

- Fiscal policy: Recovery Act
- Monetary policy: Quantitative easing
- Financial rescue: Stress test

Worldwide Fiscal Stimulus

Table 3-1
2009 Fiscal Stimulus as Share of GDP, G-20 Members

Argentina	1.5%	Japan	2.9%
Australia	2.9%	Mexico	1.6%
Brazil	0.6%	Russia	4.1%
Canada	1.8%	Saudi Arabia	3.3%
China	3.1%	South Africa	3.0%
France	0.6%	South Korea	3.7%
Germany	1.6%	Turkey	2.0%
India	0.6%	United Kingdom	1.6%
Indonesia	1.4%	United States	2.0%
Italy	0.1%	All G-20 Nations	2.0%

Real GDP and Employment

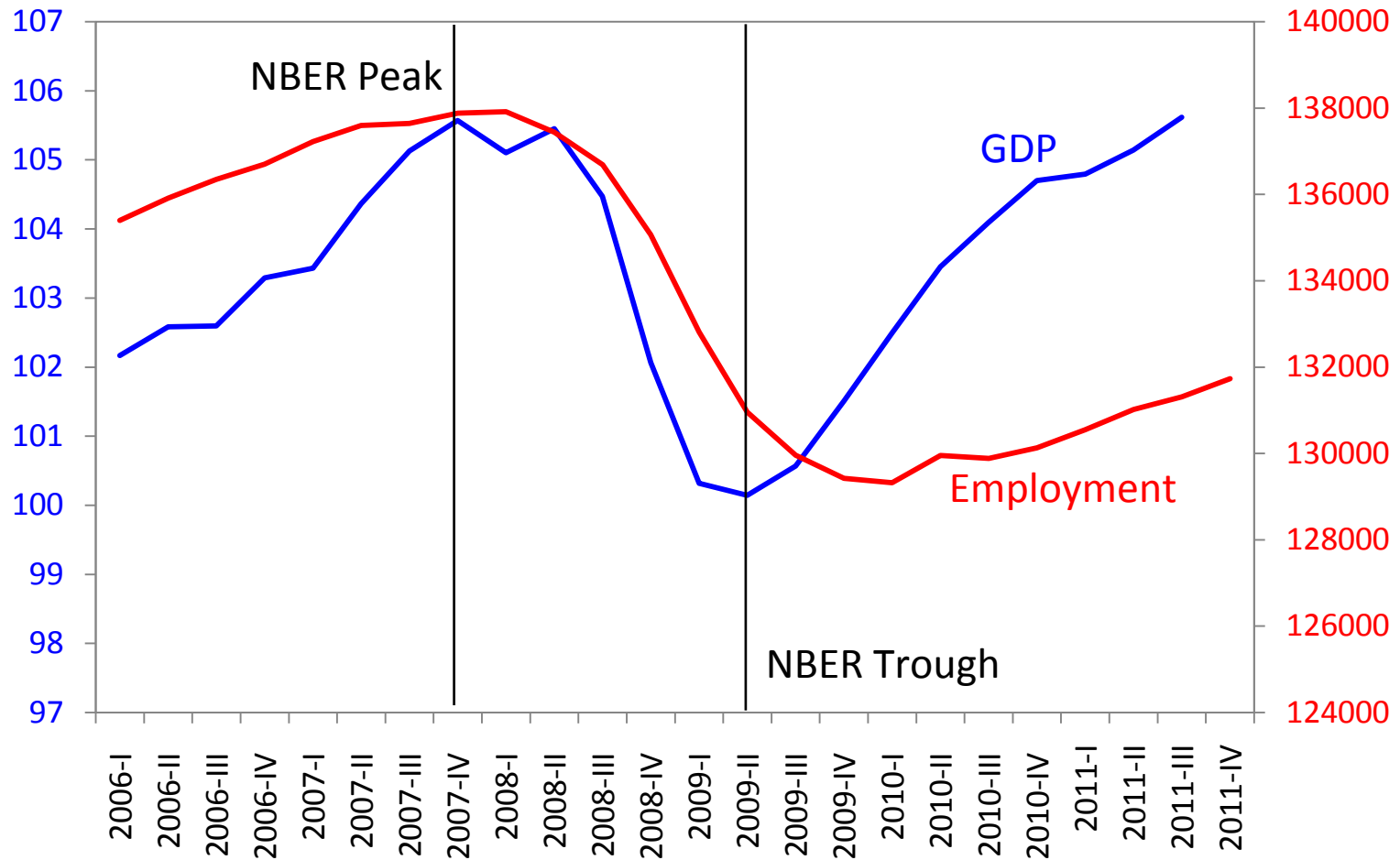
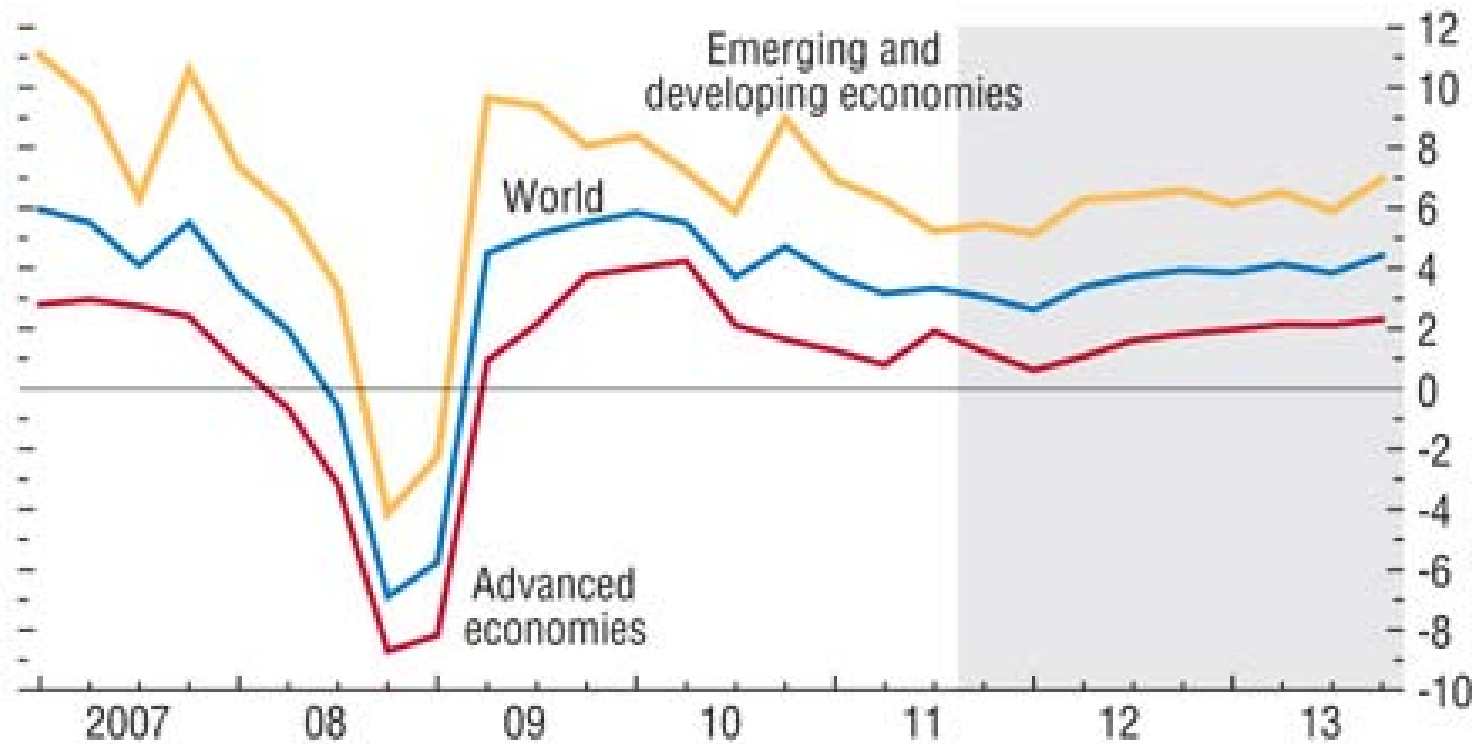


Figure 1. Global GDP Growth

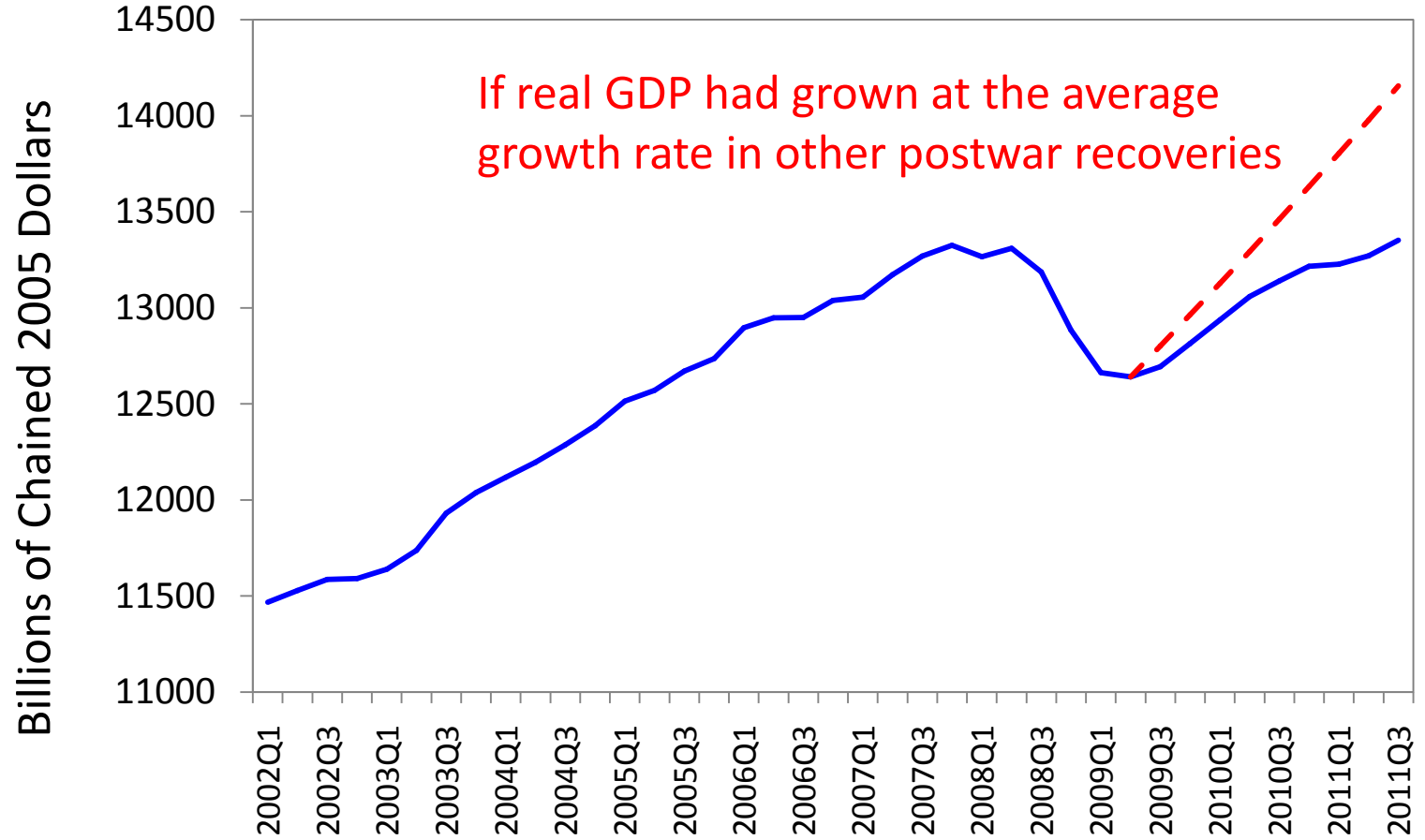
(Percent; quarter over quarter, annualized)



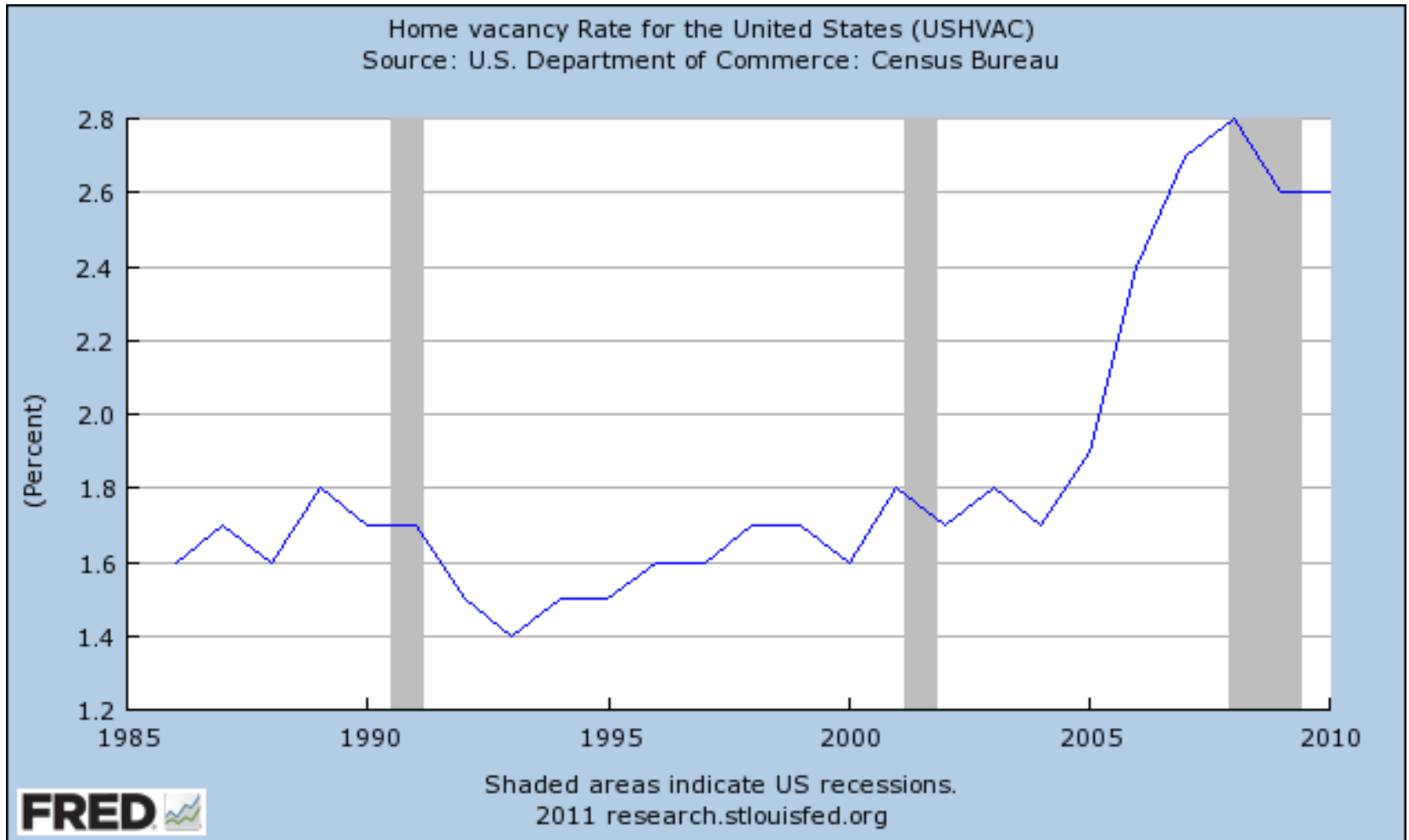
Source: IMF staff estimates.

IV. SLOW RECOVERY IN THE U.S.

Real GDP

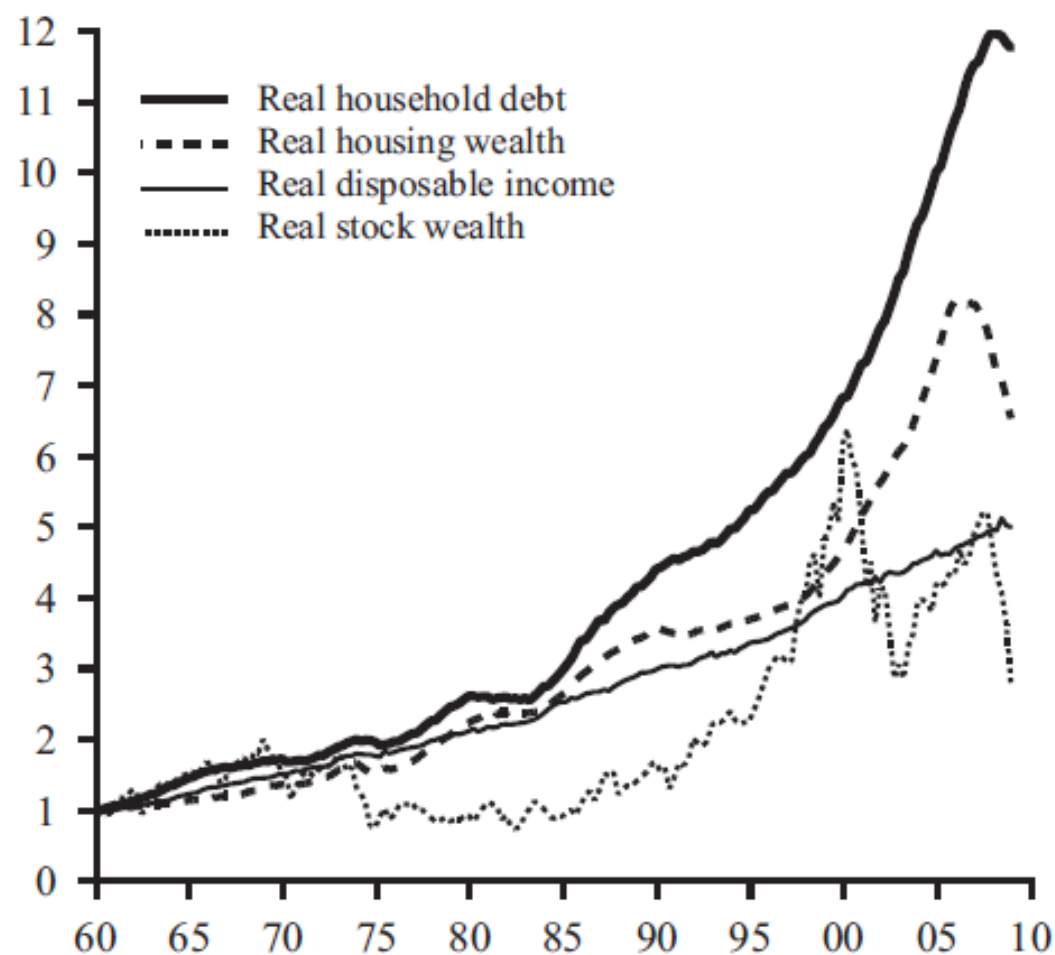


Home Vacancy Rate



Real household debt, wealth, and income

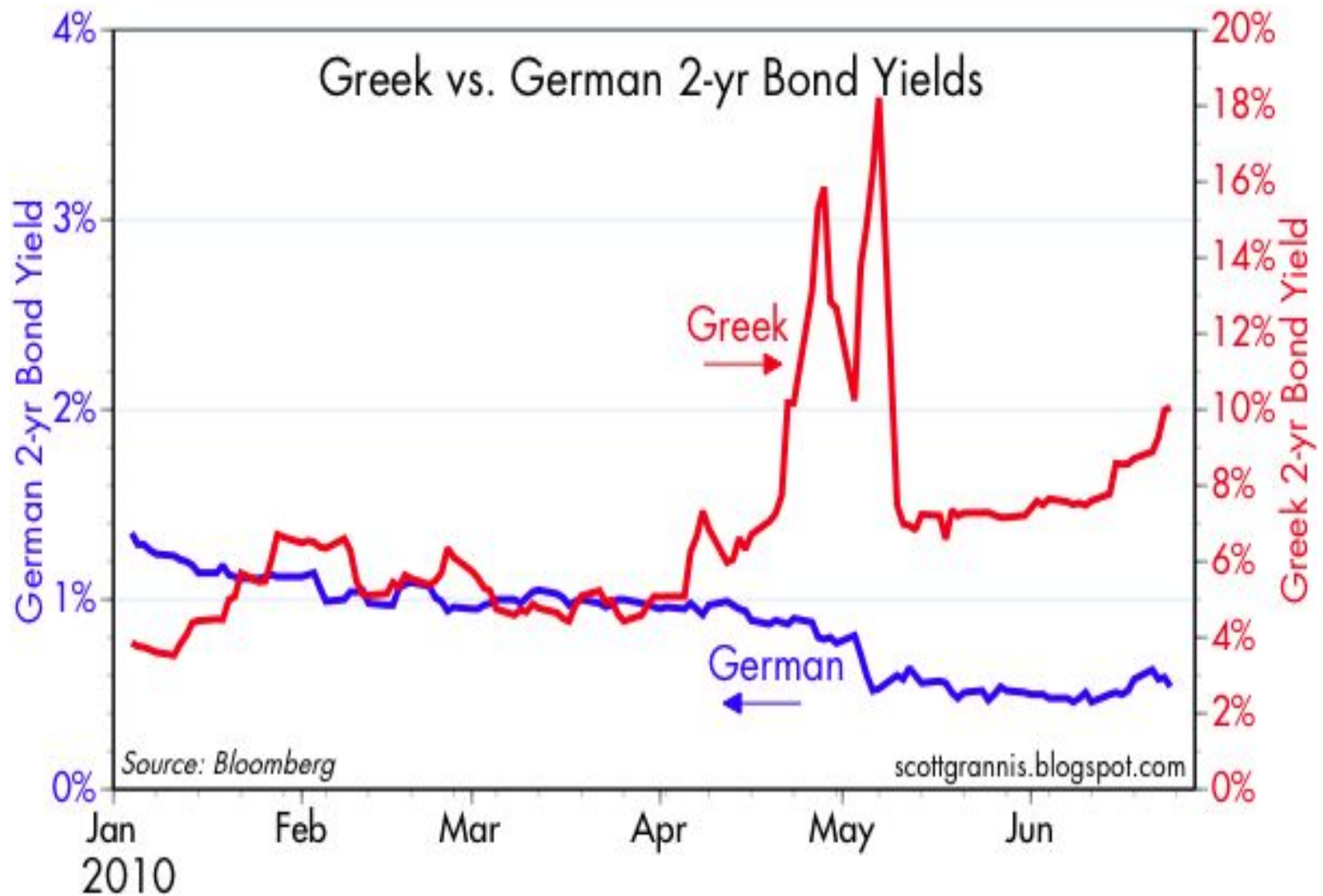
All series normalized to 1 in 1960:Q1



Policy Lull after 2009

- Fiscal policy: Recovery Act gradually runs down; a few pieces are extended.
- Monetary policy: Funds rate kept low, but few additional moves to stimulate the economy.

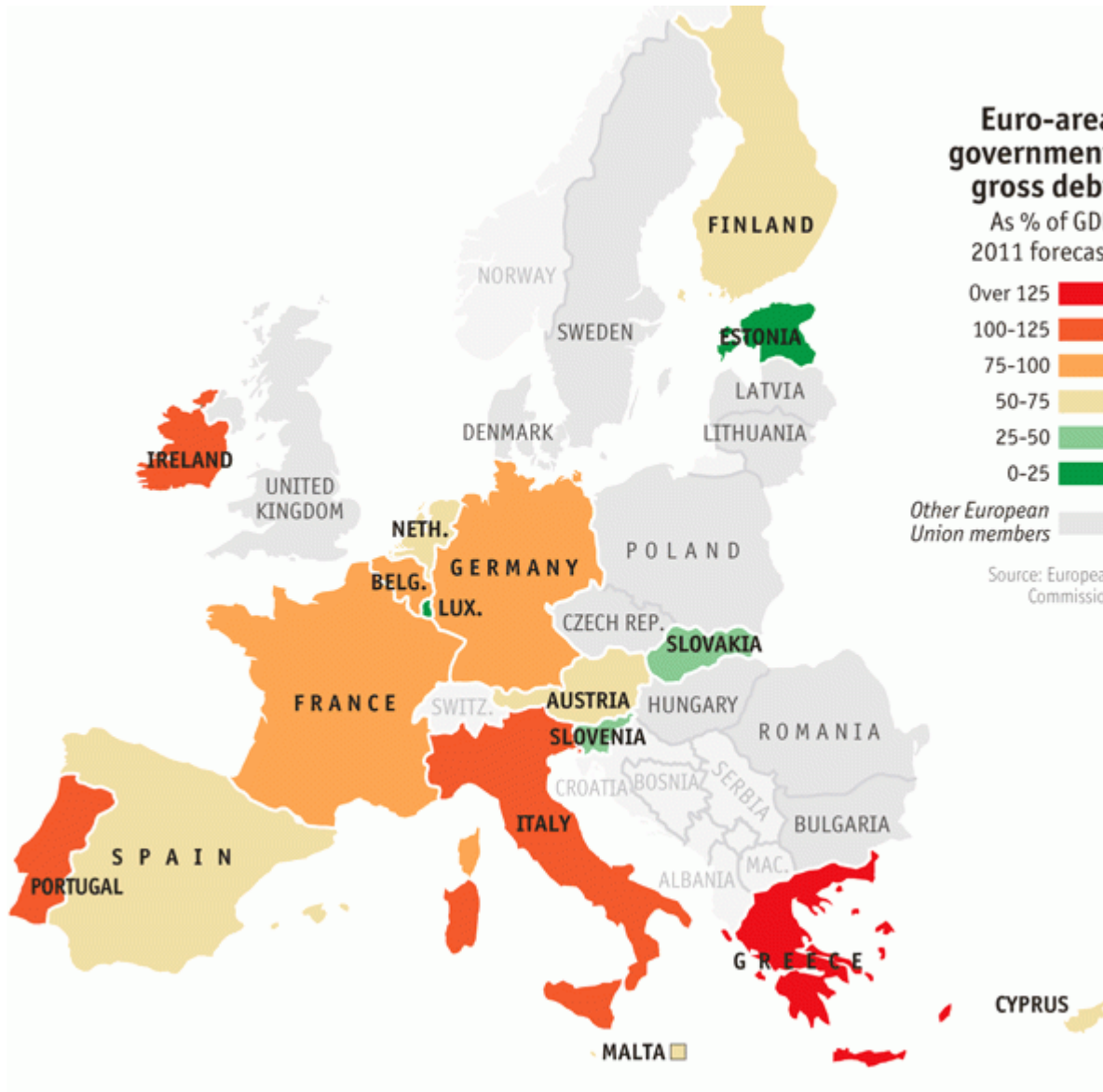
V. EUROPEAN DEBT CRISIS



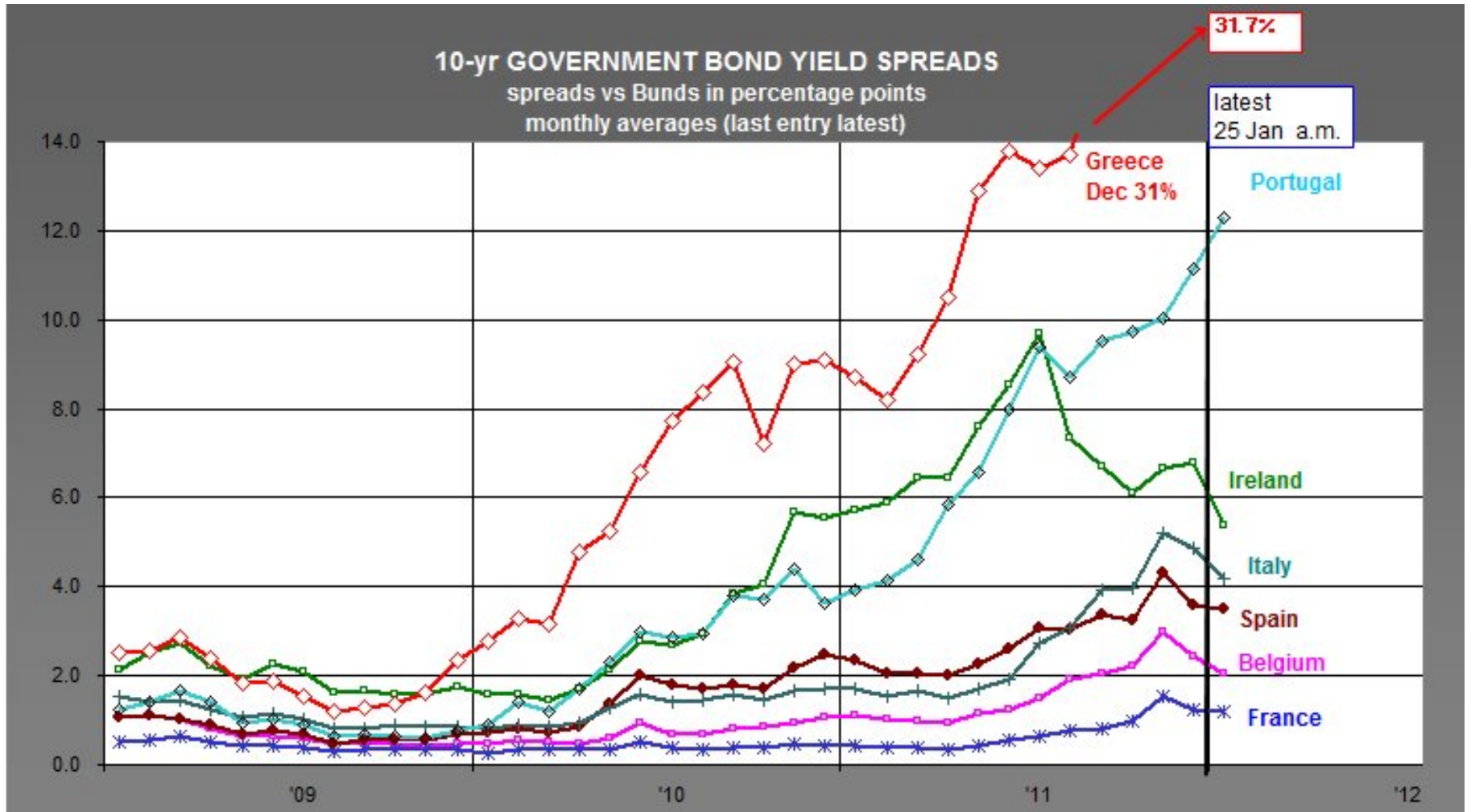
Fiscal crisis in Europe began in April 2010.



Move to a common currency was completed in 2002.



Bond Spreads Relative To Germany



Latest IMF projections

The IMF projects that the world economy will grow 3.3 percent this year, substantially slower than its estimate four months ago.

	2010	2011	Projections		Difference from September 2011 WEO Projections	
			2012	2013	2012	2013
World Output	5.2	3.8	3.3	3.9	-0.7	-0.6
Advanced Economies	3.2	1.6	1.2	1.9	-0.7	-0.5
United States	3.0	1.8	1.8	2.2	0.0	-0.3
Euro Area	1.9	1.6	-0.5	0.8	-1.6	-0.7
Germany	3.6	3.0	0.3	1.5	-1.0	0.0
France	1.4	1.6	0.2	1.0	-1.2	-0.9
Italy	1.5	0.4	-2.2	-0.6	-2.5	-1.1
Spain	-0.1	0.7	-1.7	-0.3	-2.8	-2.1
Japan	4.4	-0.9	1.7	1.6	-0.6	-0.4
United Kingdom	2.1	0.9	0.6	2.0	-1.0	-0.4
Canada	3.2	2.3	1.7	2.0	-0.2	-0.5
Other Advanced Economies	5.8	3.3	2.6	3.4	-1.1	-0.3

Where are we headed?