The Current U.S. Recession

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Minneapolis

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PLAN OF TALK

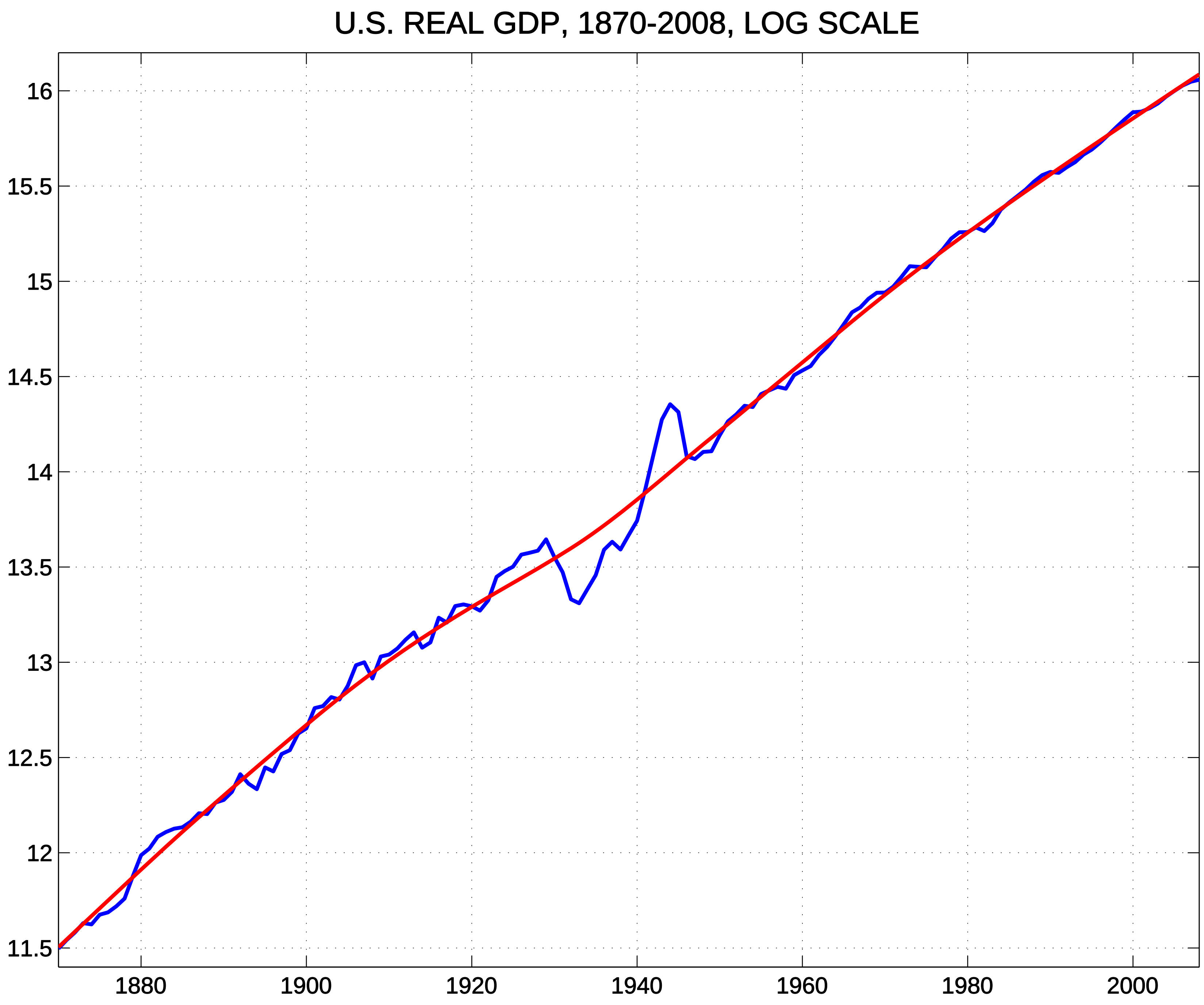
1 Background material: U .S. economy

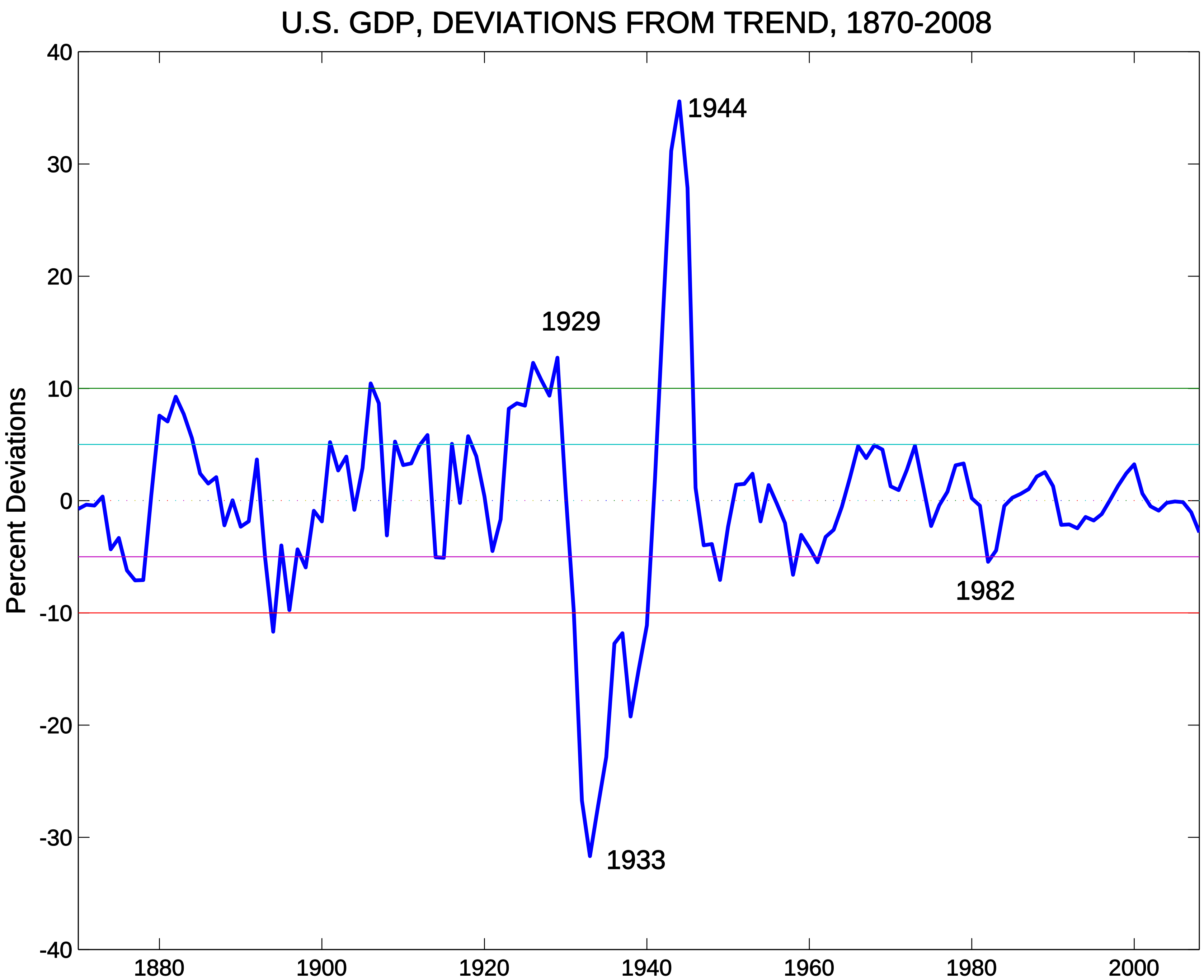
2 A theoretical framework

3 Contraction of 1929-1933: analysis

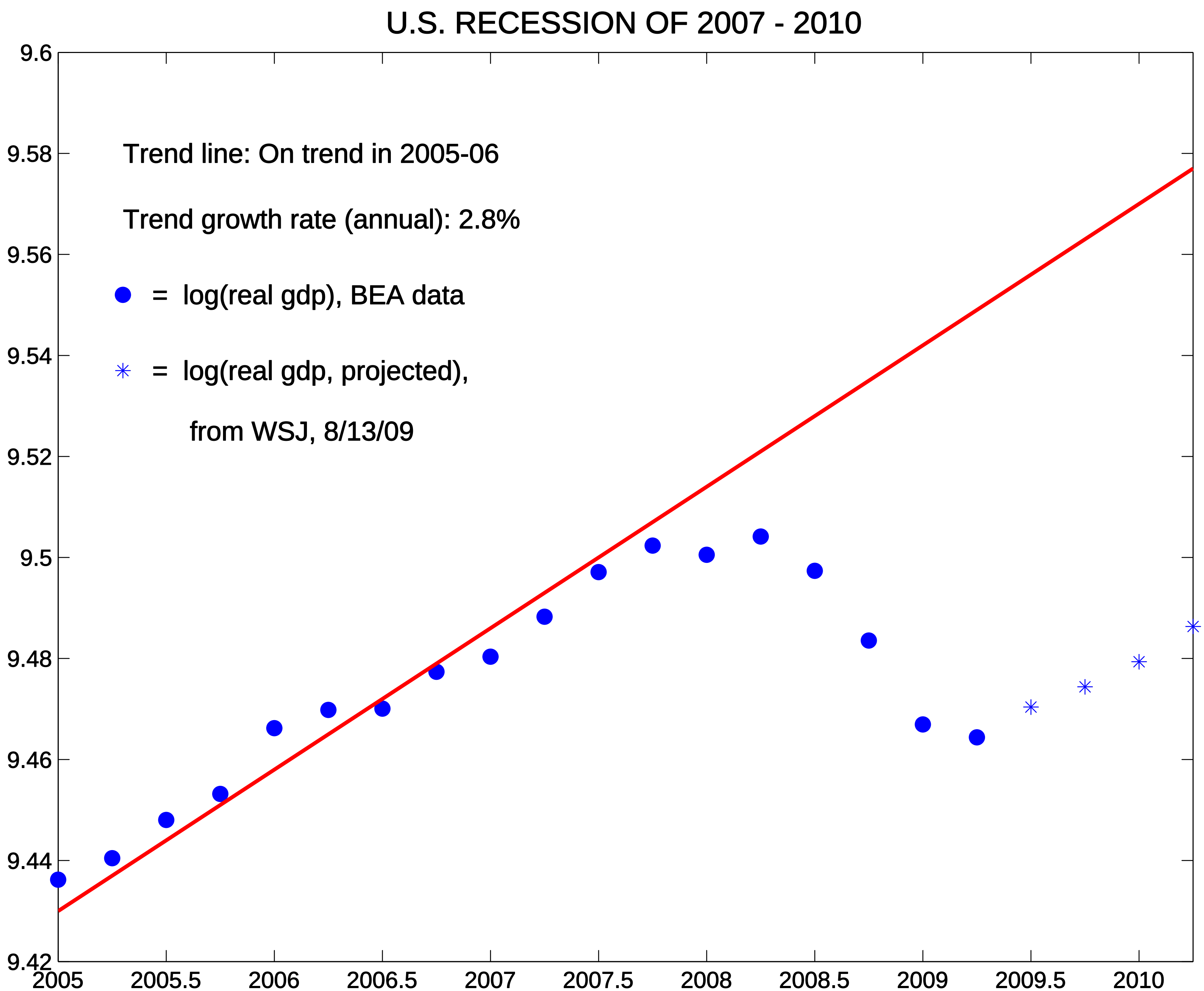
4 Panic of 2008: analysis

1 U.S. Economy: Essential Background


U.S. REAL GDP, 1870-2008, LOG SCALE
16
15.5
15
14.5
14
13.5
13
12.5
12
11.5
1880
1900
1920
1940
1960
1980
2000



U.S. GDP, DEVIATIONS FROM TREND, 1870-2008
Percent Deviations
40
30
20
10
0
-10
-20
-30
-40
1880
1900
1920
1940
1960
1980
2000
1944
1929
1933
1982


U.S. RECESSION OF 2007 - 2010
Trend line: On trend in 2005-06
Trend growth rate (annual): 2.8%
= log(real gdp), BEA data
= log(real gdp, projected),
from WSJ, 8/13/09
9.6
9.58
9.56
9.54
9.52
9.5
9.48
9.46
9.44
9.42
2005
2005.5
2006
2006.5
2007
2007.5
2008
2008.5
2009
2009.5
2010

2 Theoretical framework

- "Normal" recession or liquidity crisis?

- How identify, respond to financial crisis?

$$Mv = Py$$

$$\$ \times \left(\frac{1}{t}\right) = \left(\frac{\$}{\text{apple}}\right) \times \left(\frac{\text{apples}}{t}\right)$$

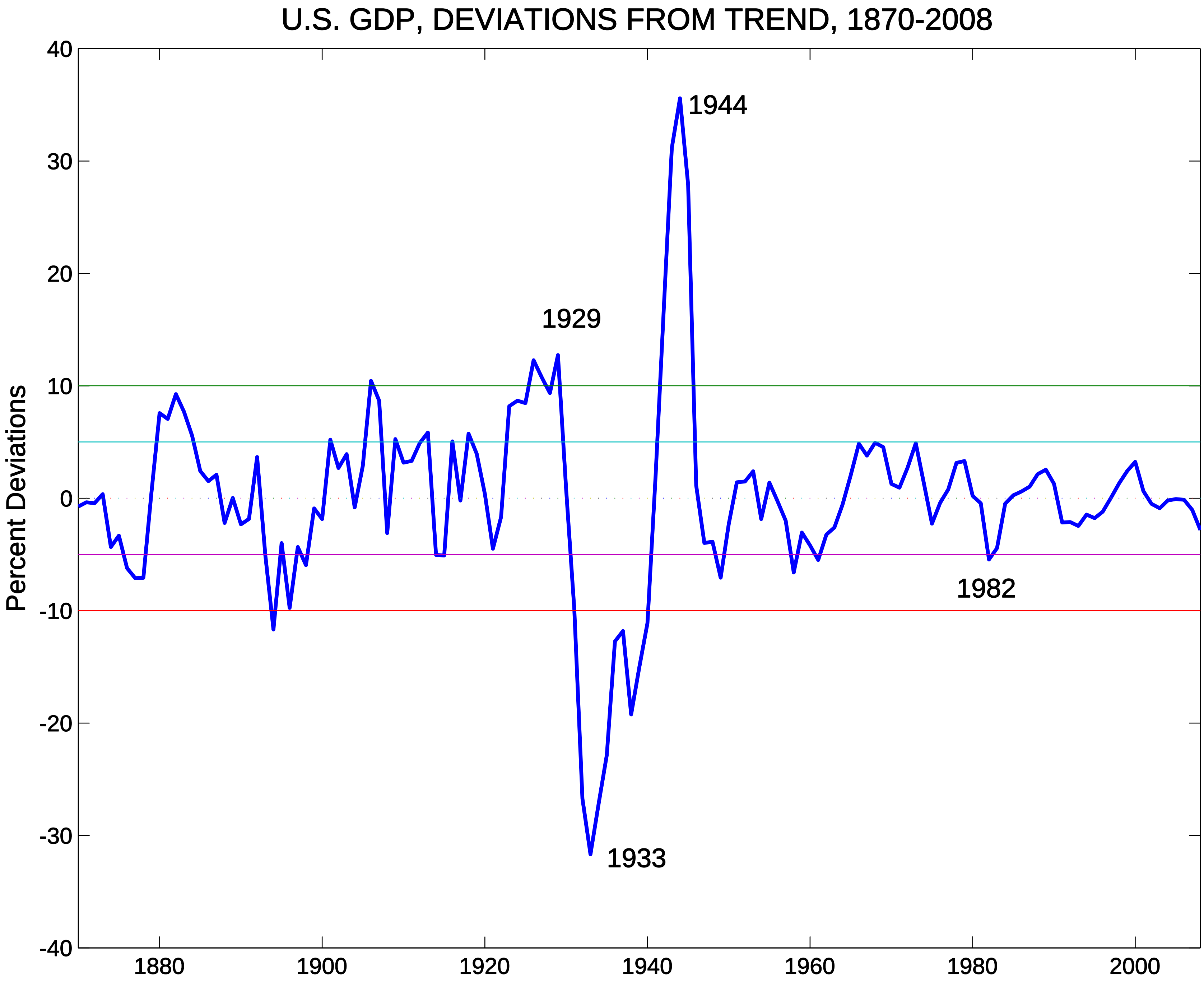
- Liquidity crisis? Sudden fall in Mv; induces fall in Py

- Which one? P or y?

3 Contraction of 1929-1933

Milton Friedman and Anna J. Schwartz,

A Monetary History of the United States



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CONTRACTION OF 1929 - 1933

Year-to-year Percent Changes

Year ending	Real GDP	Price level	Bank deposits	Reserves
1929	5.9	2	-1.4	-3.1
1930	-9.3	-4	-4.7	4.3
1931	-8.0	-8.8	-20.6	-5.9
1932	-14.1	-9	-11.3	2.2
1933	-2.1	-2.6	-11.6	7.8
1934	7.4	7.7	16	35.8

- Cumulating these changes, real output fell 34% from 29 peak to 33 trough

- Price level fell 24%

- Add these to get a 58% decline in spending on goods and services in this 4 year period

....or dollar value of Mv and of Py

- Which: M or v?

- Which: P or y?

$$\text{In 1929:} \qquad \frac{\text{bank deposits}}{\text{GDP}} \cong 0.5$$

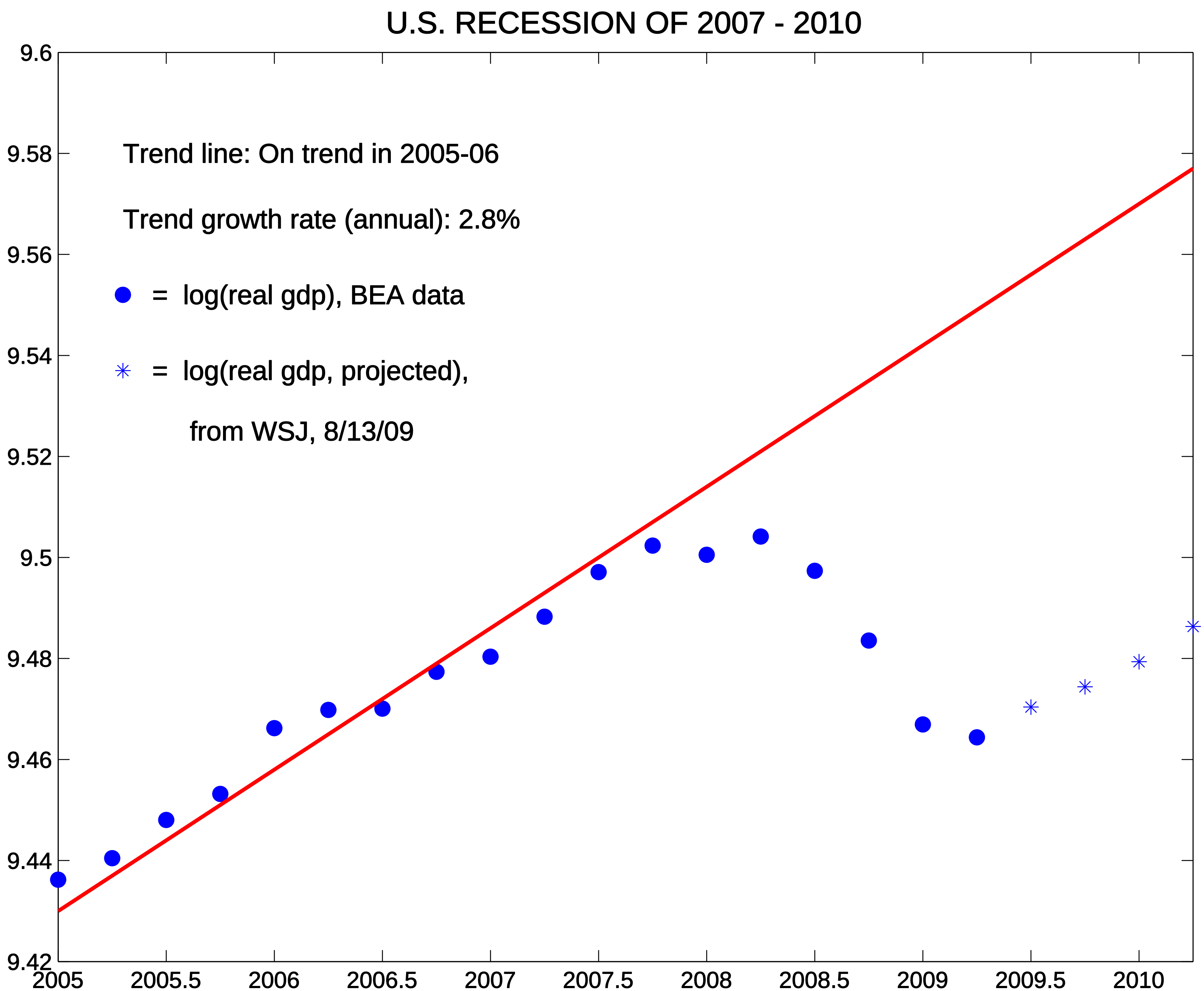
$$\text{In 1933:} \qquad \frac{\text{bank deposits}}{\text{GDP}} \cong 0.5$$

- What could have been done?

- Look at reserves!

4 Panic of 2008

- Repeat of 1930?
- Differences and similarities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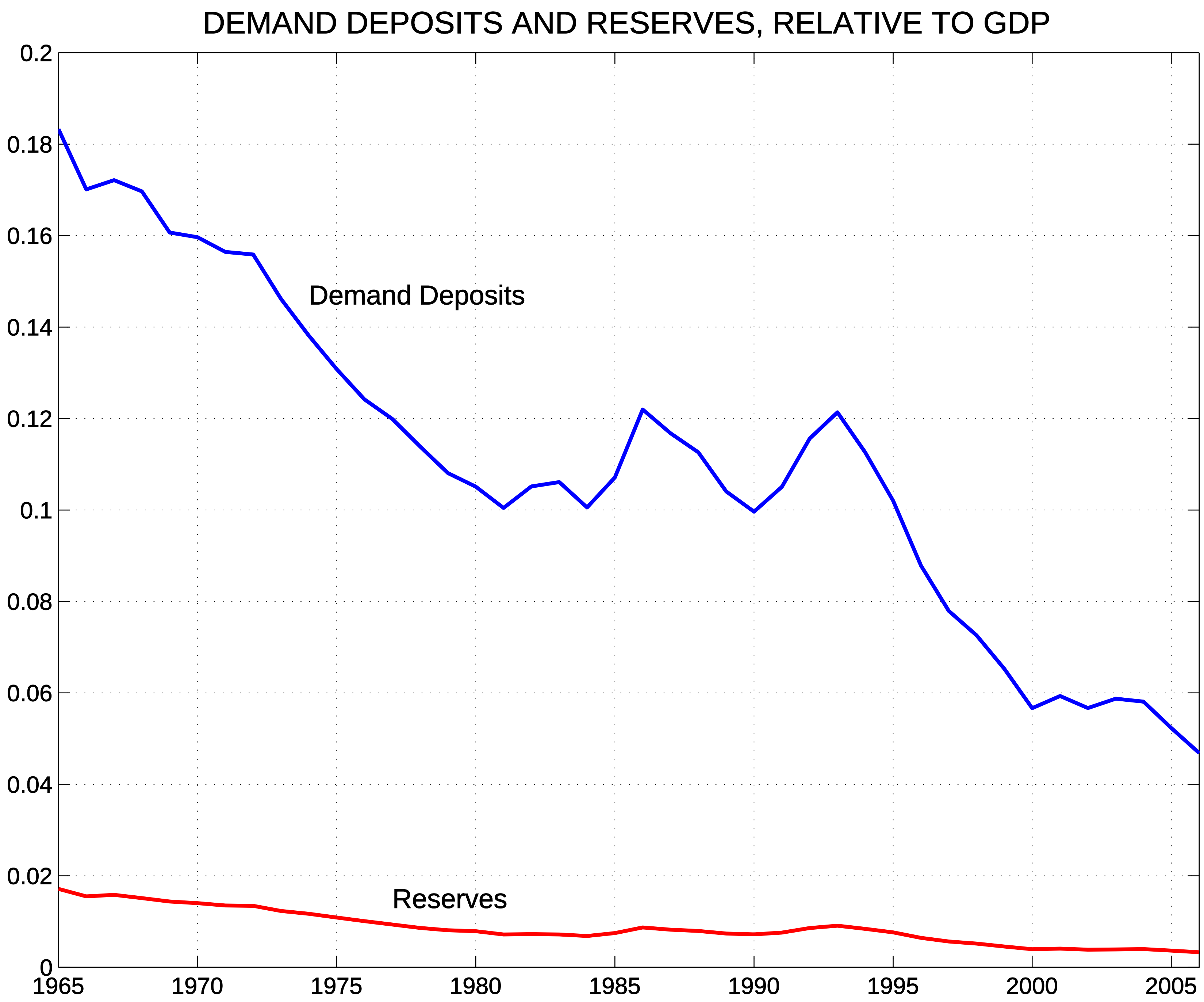

DEMAND DEPOSITS AND RESERVES, RELATIVE TO GDP
0.2
0.18
0.16
0.14
0.12
0.1
0.08
0.06
0.04
0.02
0
1965
1970
1975
1980
1985
1990
1995
2000
2005
Demand Deposits
Reserves

- In 1930, the Federal Reserve stood by and watched as spending and production declined
- In 2008, the Federal Reserve did exactly the opposite
- In August, 2008, there were \$45 billion of reserves in the banking system
- By the end of the year, there were \$821 b.
- By August, 2009 there were \$856 b.