Principles of Economics
Macroeconomics
Financial Paralysis

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Wall Street and Main Street

- Wall Street: finance and safe assets…
  - Reducing risk premia…
  - Getting banks and others to spend their cash…
  - Preventing the overleverage that would lead to the next financial crisis…
- Main Street: housing…
  - Restoring consumption to normal levels…
  - Providing a proper regulatory framework…
Safe Assets

• From Credit Suisse

• The disappearance of $12 trillion of assets where “credit risk” had not been a concern

• And the investors are desperate to replace those assets…
Wall Street

- Dodd-Frank
  - How will it work?
- The Bagehot Rule
  - Lend freely…
  - At a penalty rate…
  - Rule broken in 2008-9
- Is there still a lender of last resort there?
It’s Not Fixed…

• We are still substantially in excess of what we used to think of as normal…

• No plans for further reform…

• Great worry about whether Dodd-Frank resolution procedures will in fact work…
The Housing Market: Residential Investment as a Share of Potential GDP
Housing

• Housing as a share of GDP rises over time
  • Especially as the country becomes more congested…

• Approximately $1T of excess houses built—that’s 1.3 million or so—during the boom…

• Approximately $4T of houses missing—that’s 5.2 million or so—since…

• What are the 3.9 million households doing?
Housing Finance

• How housing finance used to work: the GSEs…

• For a bank, financing a mortgage is a thirty-year investment…

• But the government has declared that it is going to change the regulatory framework…

• How new mortgages are made will affect how old mortgages are priced…