

Principles of Economics
Macroeconomics
Financial Paralysis

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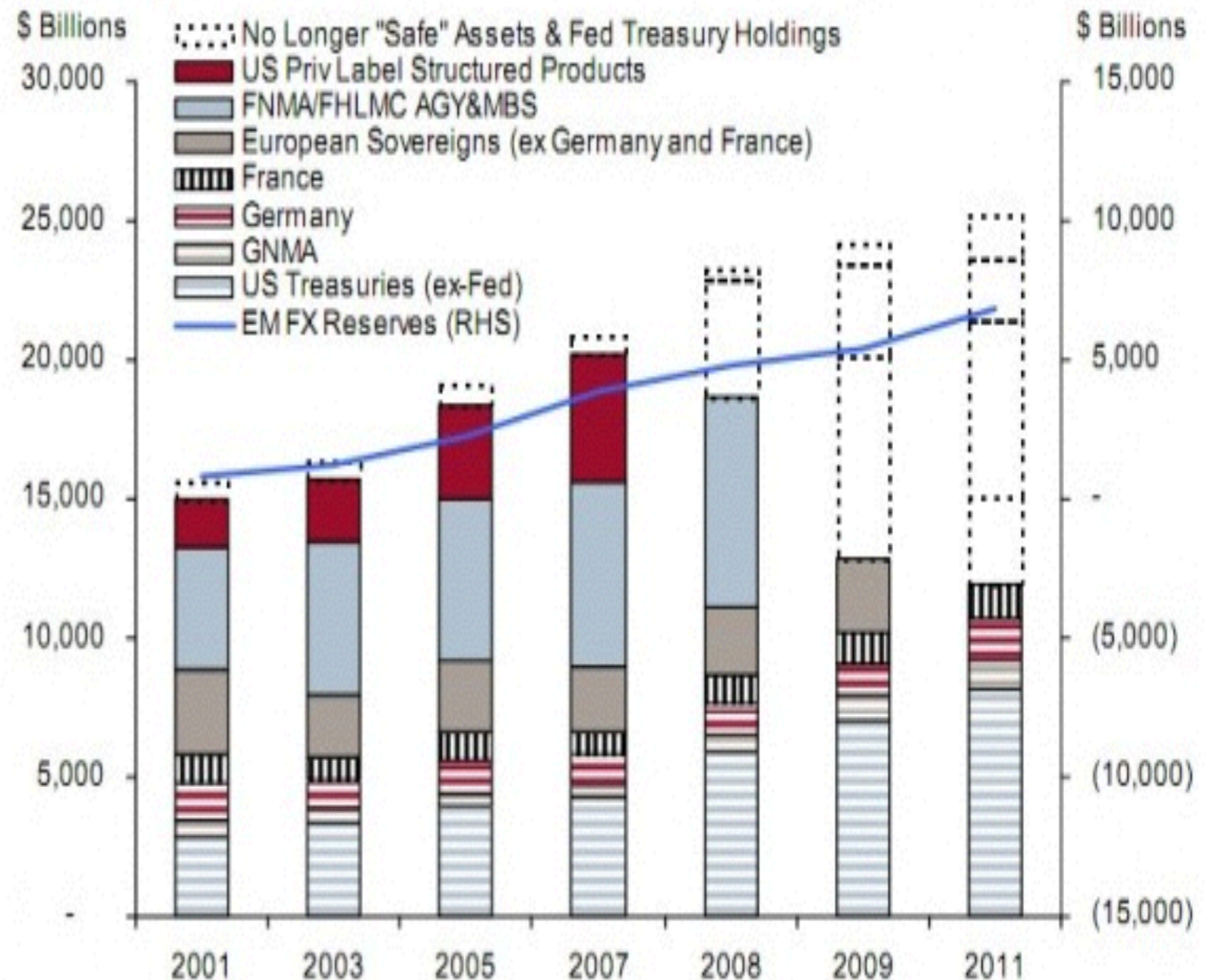
Wall Street and Main Street

- 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...

Exhibit 174: Shrinking universe of “safe” assets in the primary reserve currencies (USD and EUR)



Wall Street

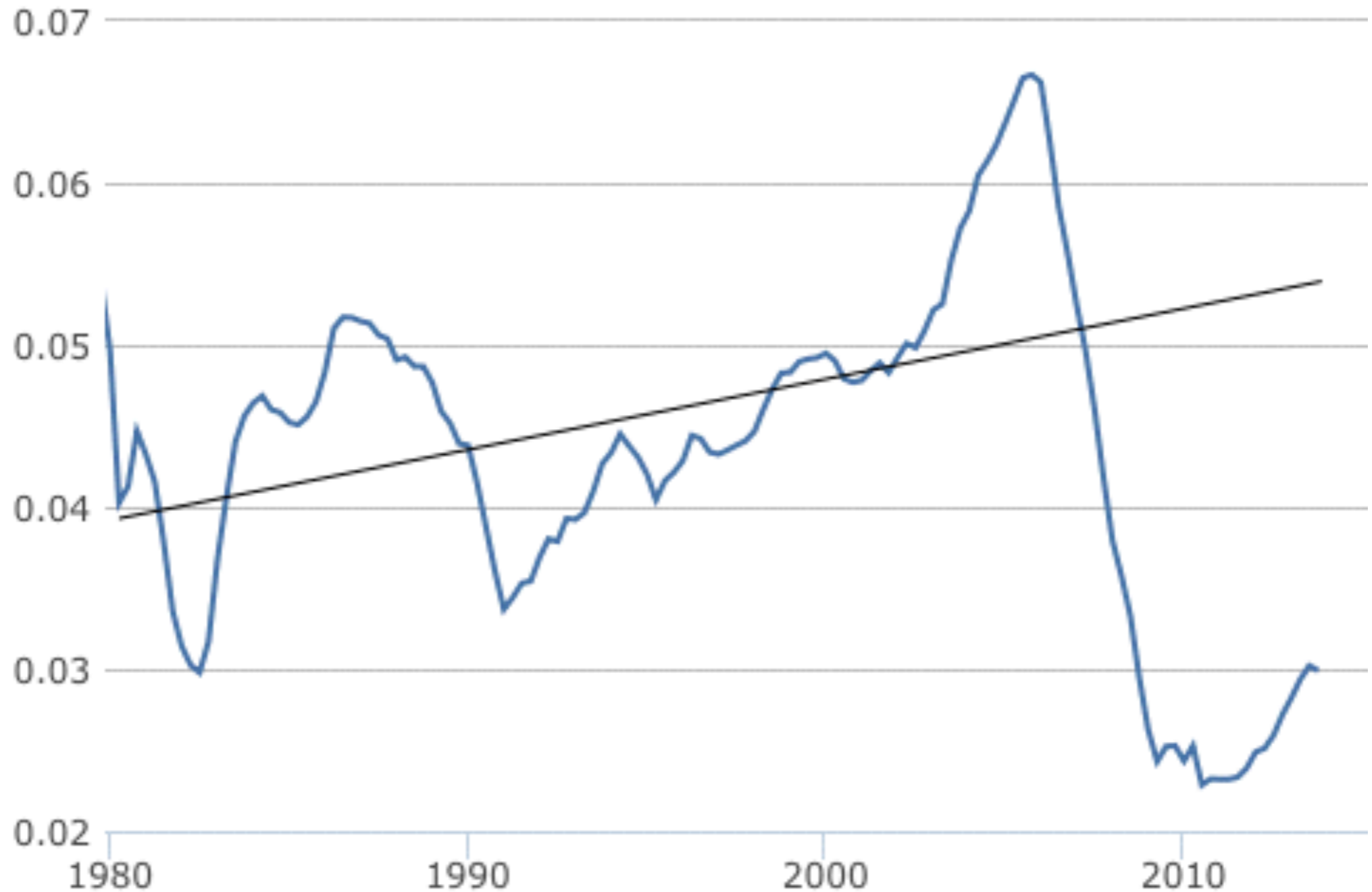
- Dodd-Frank
 - How will it work?
- The Bagehot Rule
 - Lend freely...
 - At a penalty rate...
 - Rule broken in 2008-9
- Is there still a lender of last resort there?

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...