

Crisis retrospect

Causes and response

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All views expressed are those of the author only and not necessarily those of the Federal Reserve Bank of New York or the Federal Reserve System.



Overview

- The Crisis
 - Markets disrupted
 - Severe recession
- The Response
 - Diversity of Fed lending
 - Cutting interest rates to zero
 - Asset purchases



The crisis

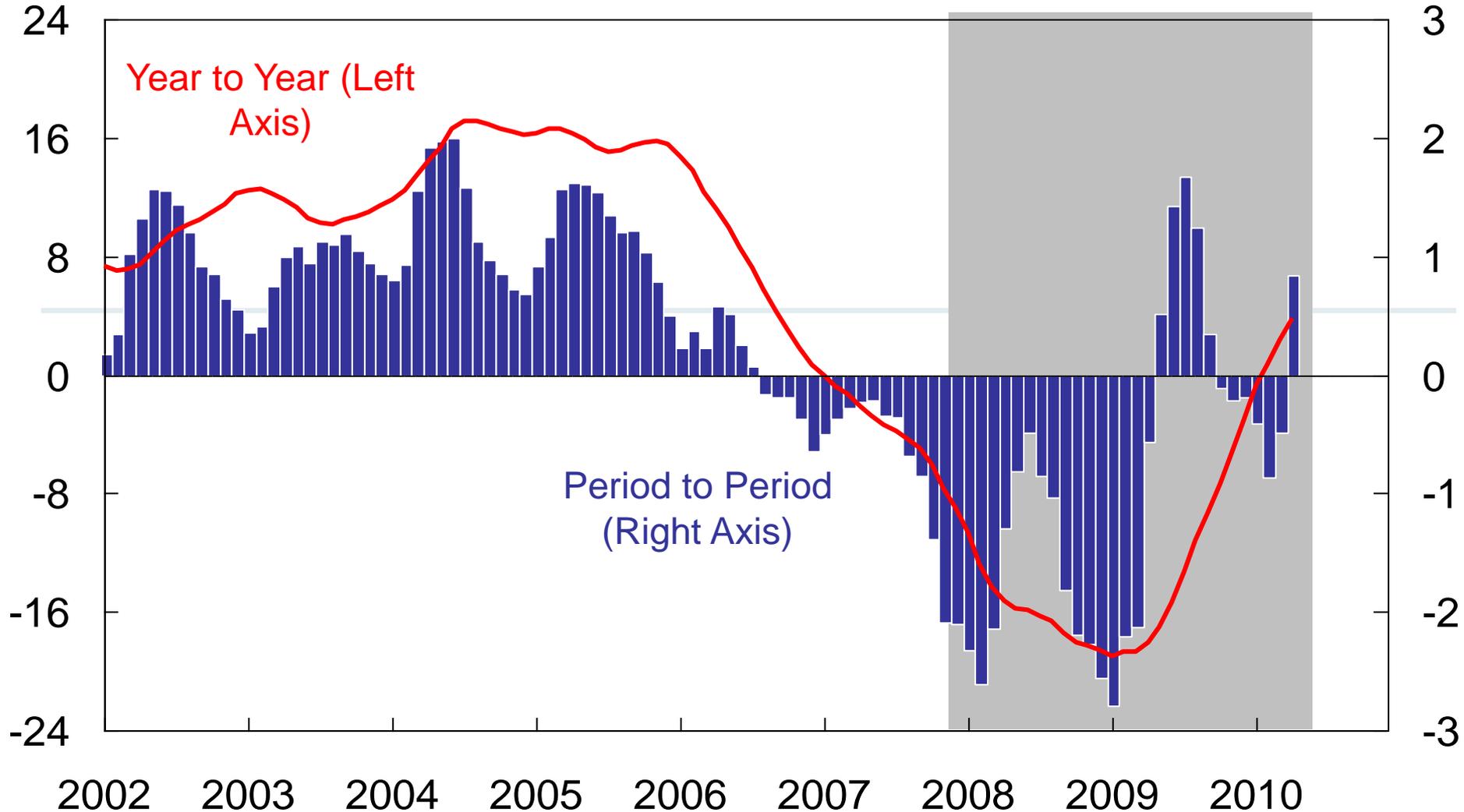


Case-Shiller Home Price Index

Composite 20-NSA

% Change

% Change

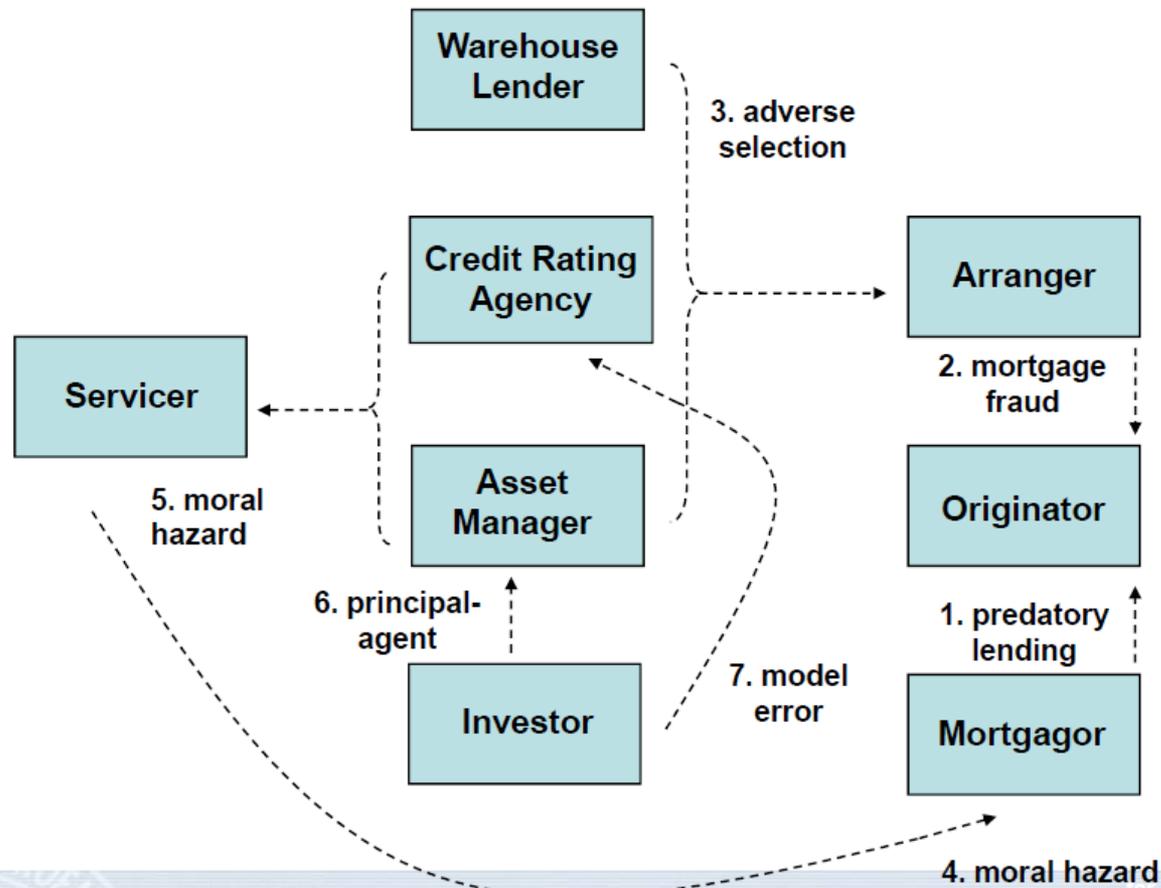


Source: S&P, Fiserv, and MacroMarkets LLC

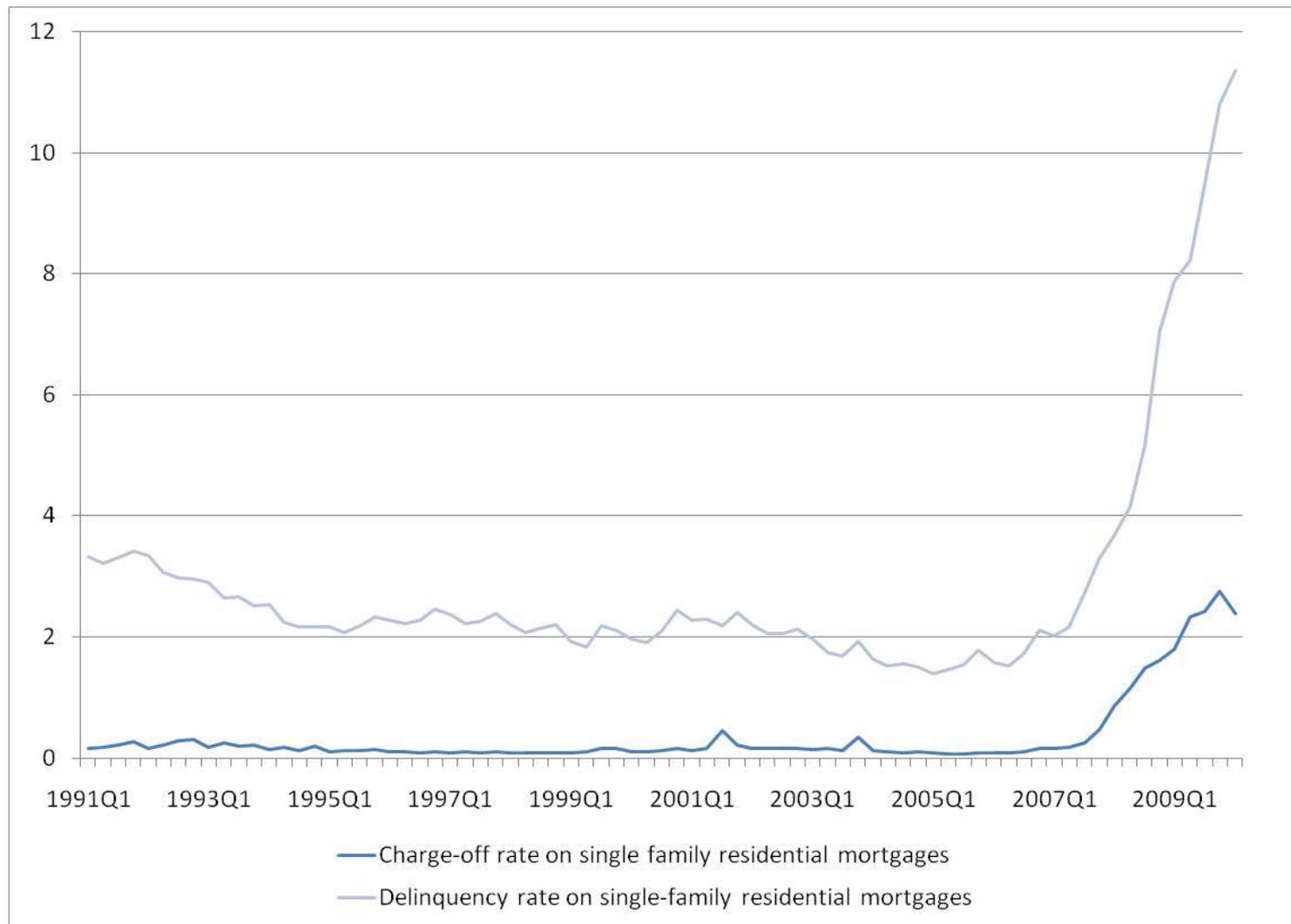
Note: Monthly Data

Potential problems in securitization process

The seven deadly frictions



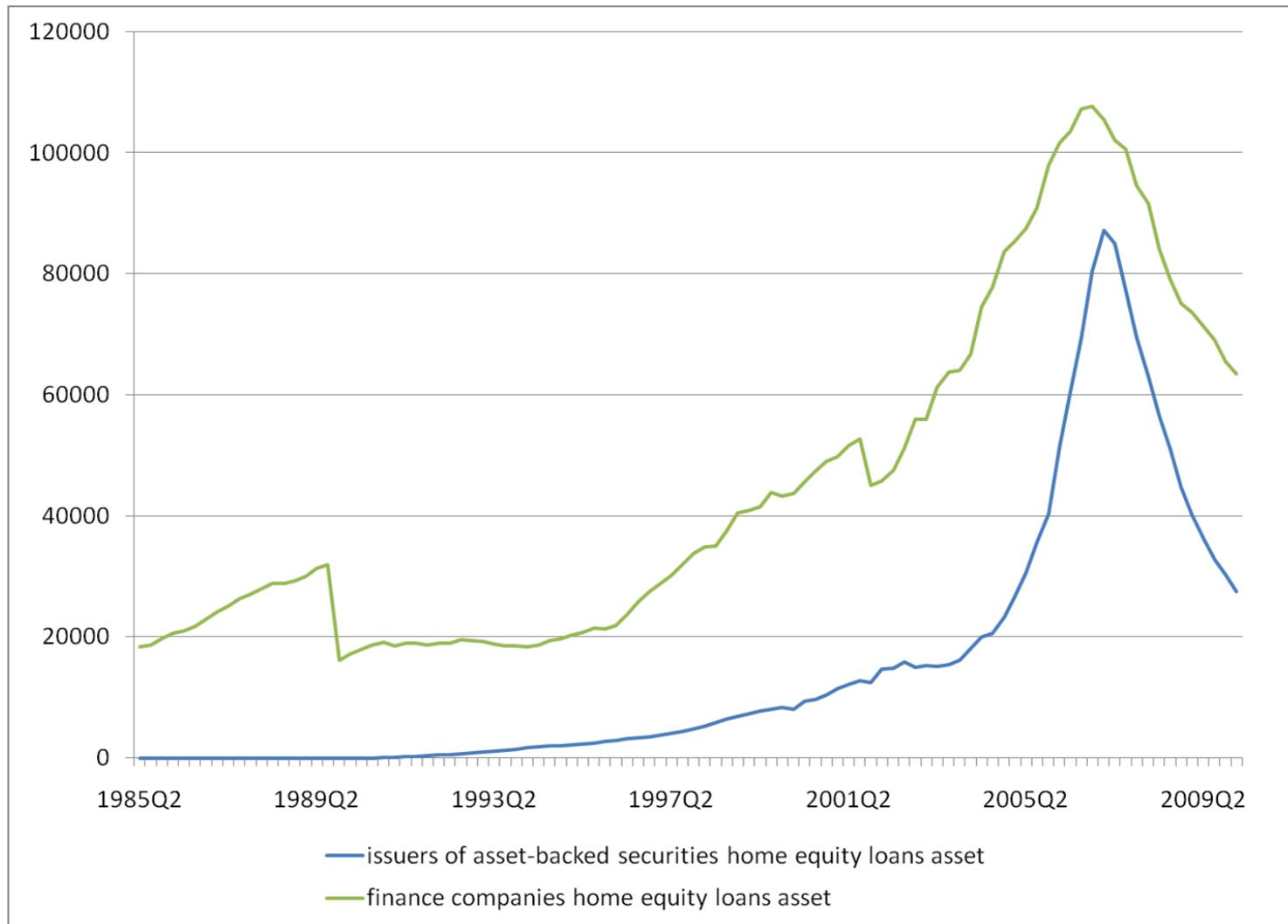
Trouble in the housing market



<http://www.federalreserve.gov/datadownload/default.htm>



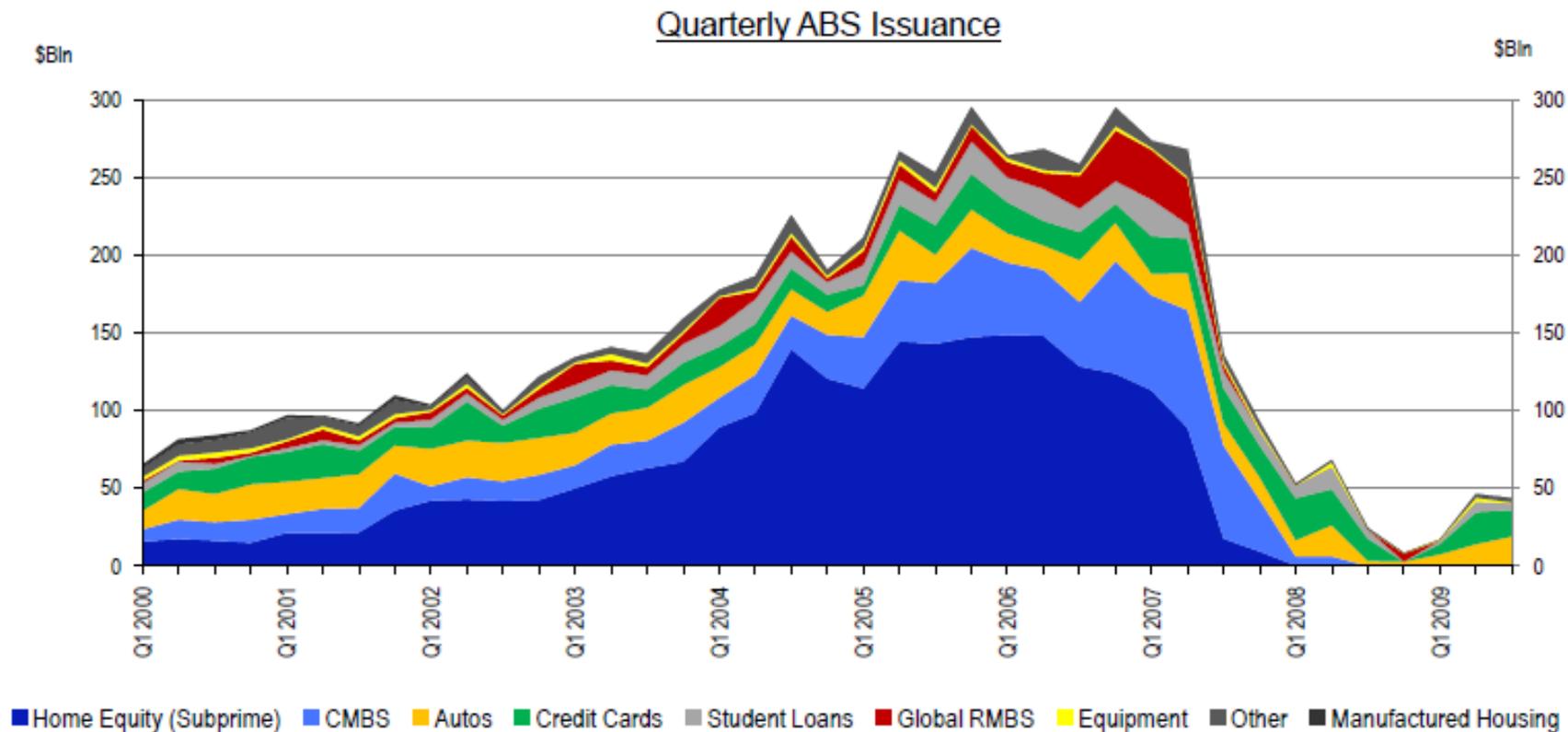
Collapse of securitization



<http://www.federalreserve.gov/datadownload/default.htm>



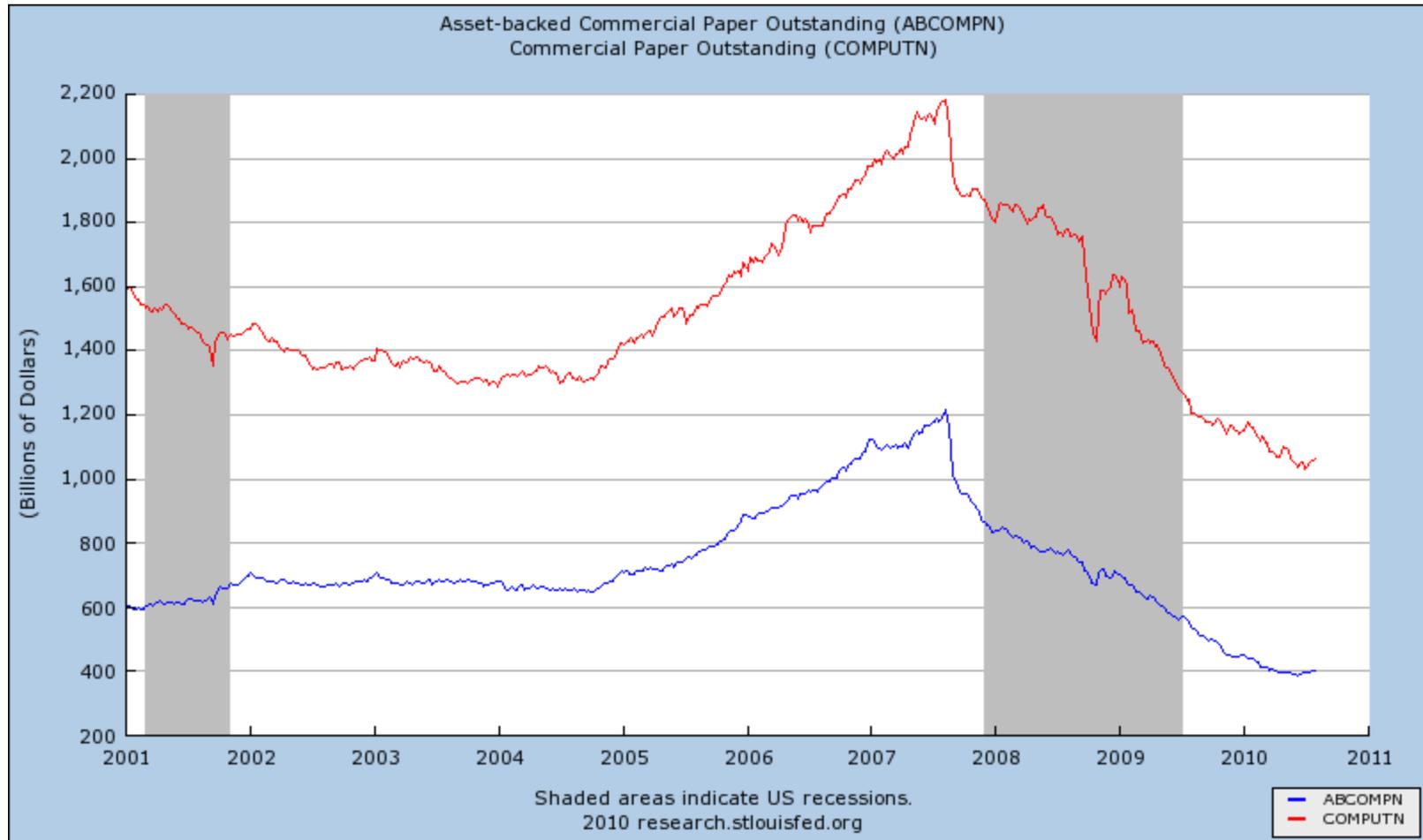
ABS markets: rise and fall



Source: Morgan Markets



Other markets freeze up

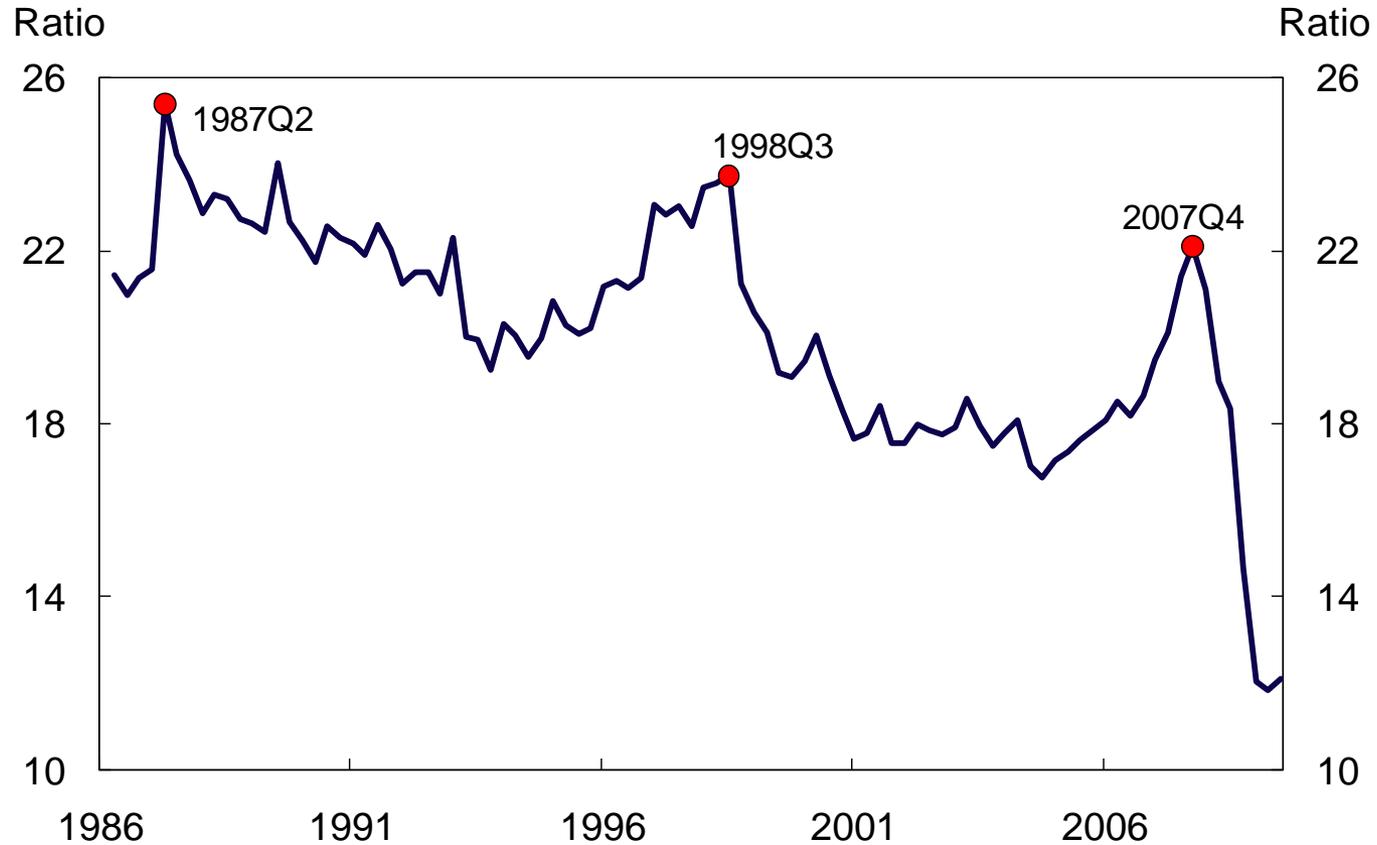


<http://research.stlouisfed.org/fred2/>



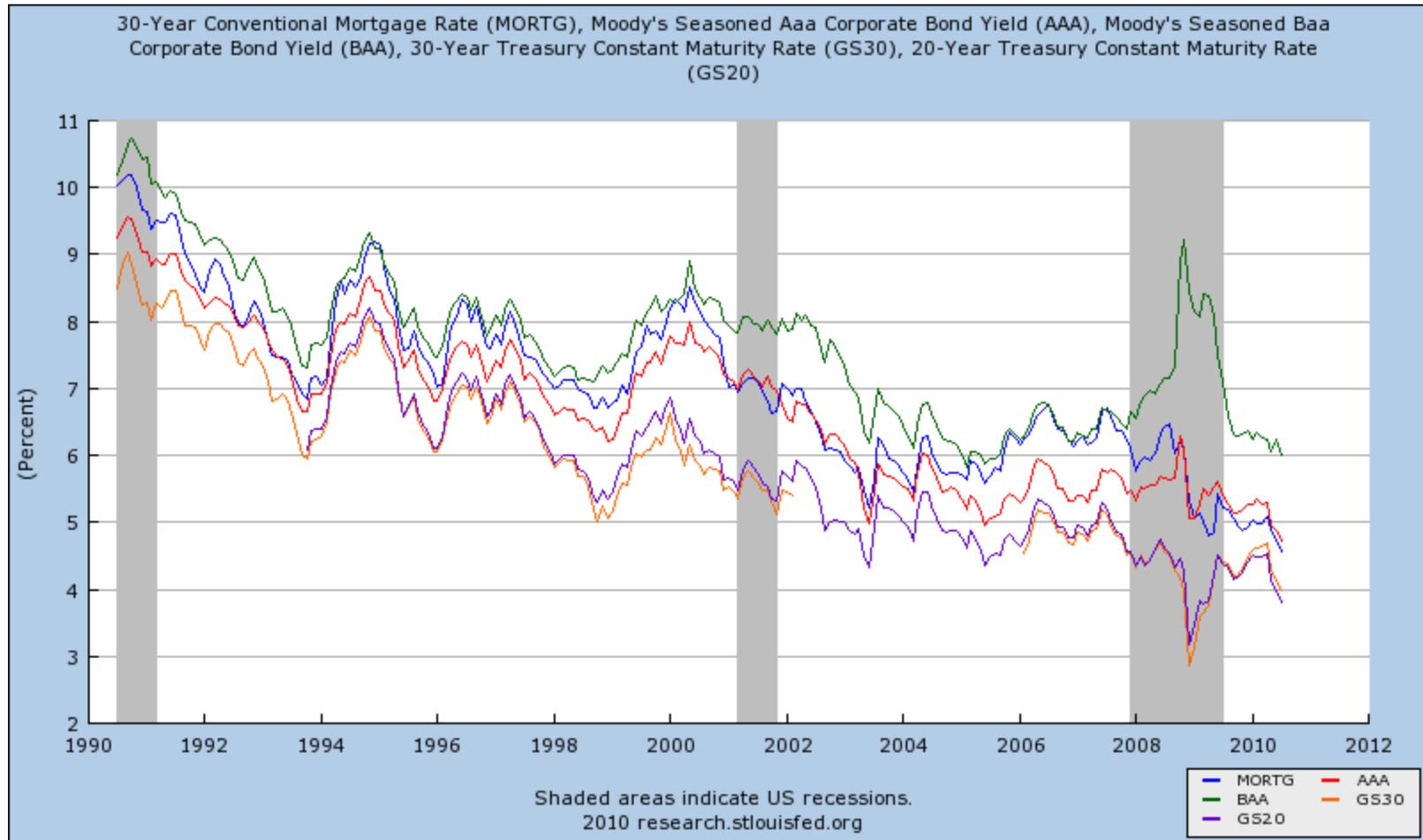
Domestic Dealer Leverage

Domestic Primary Dealers

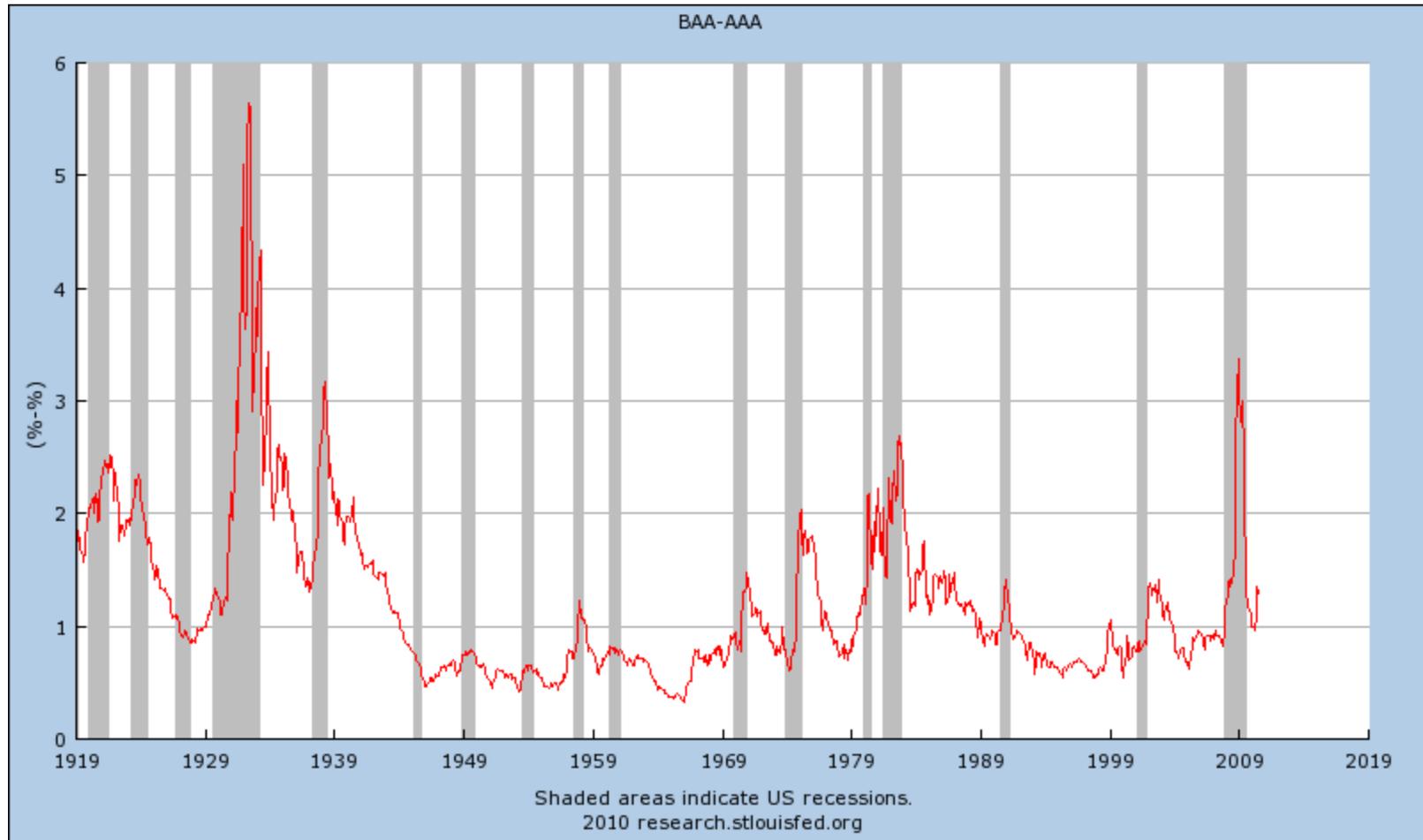


Source: SEC

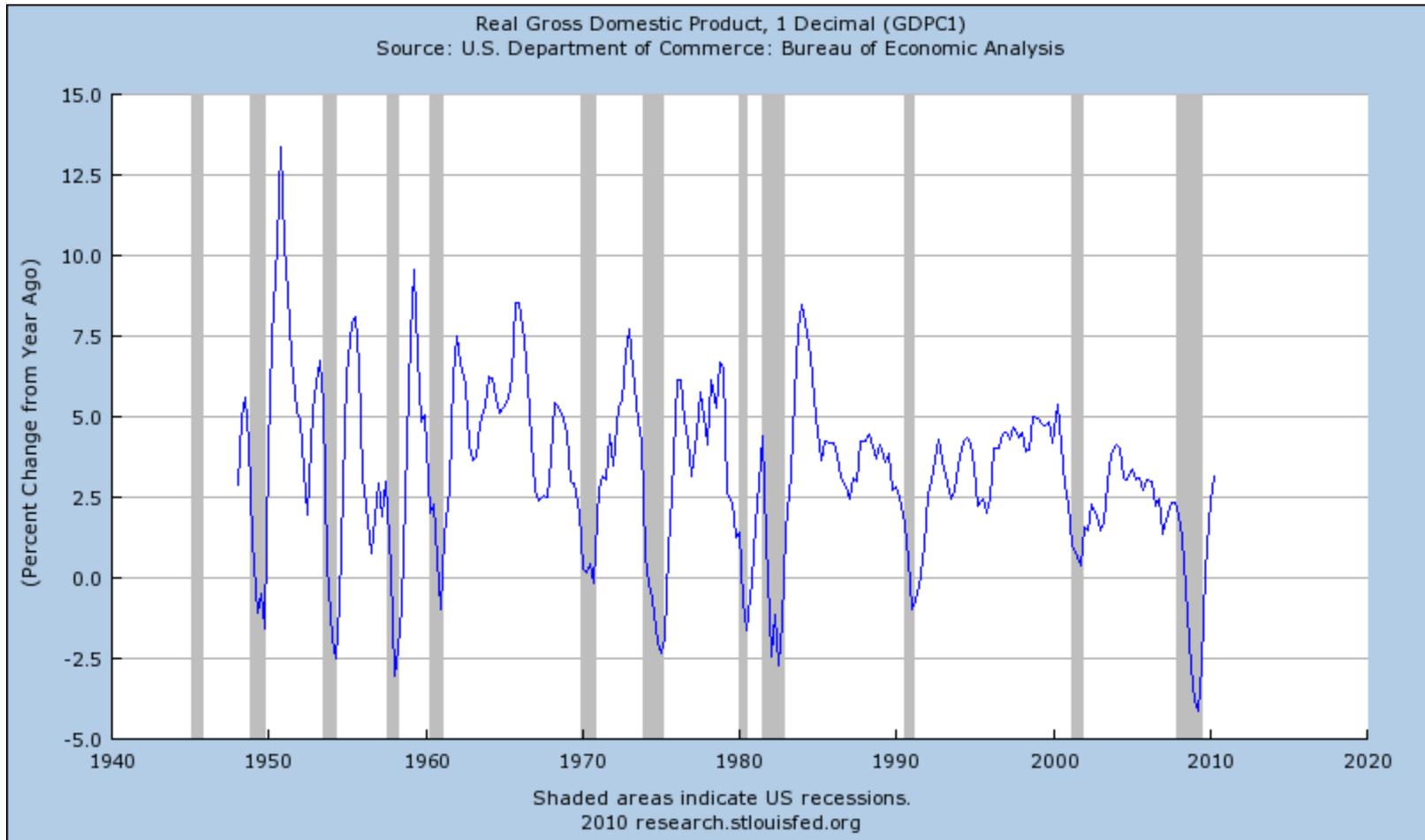
Interest rates across risk categories



Long term credit spread



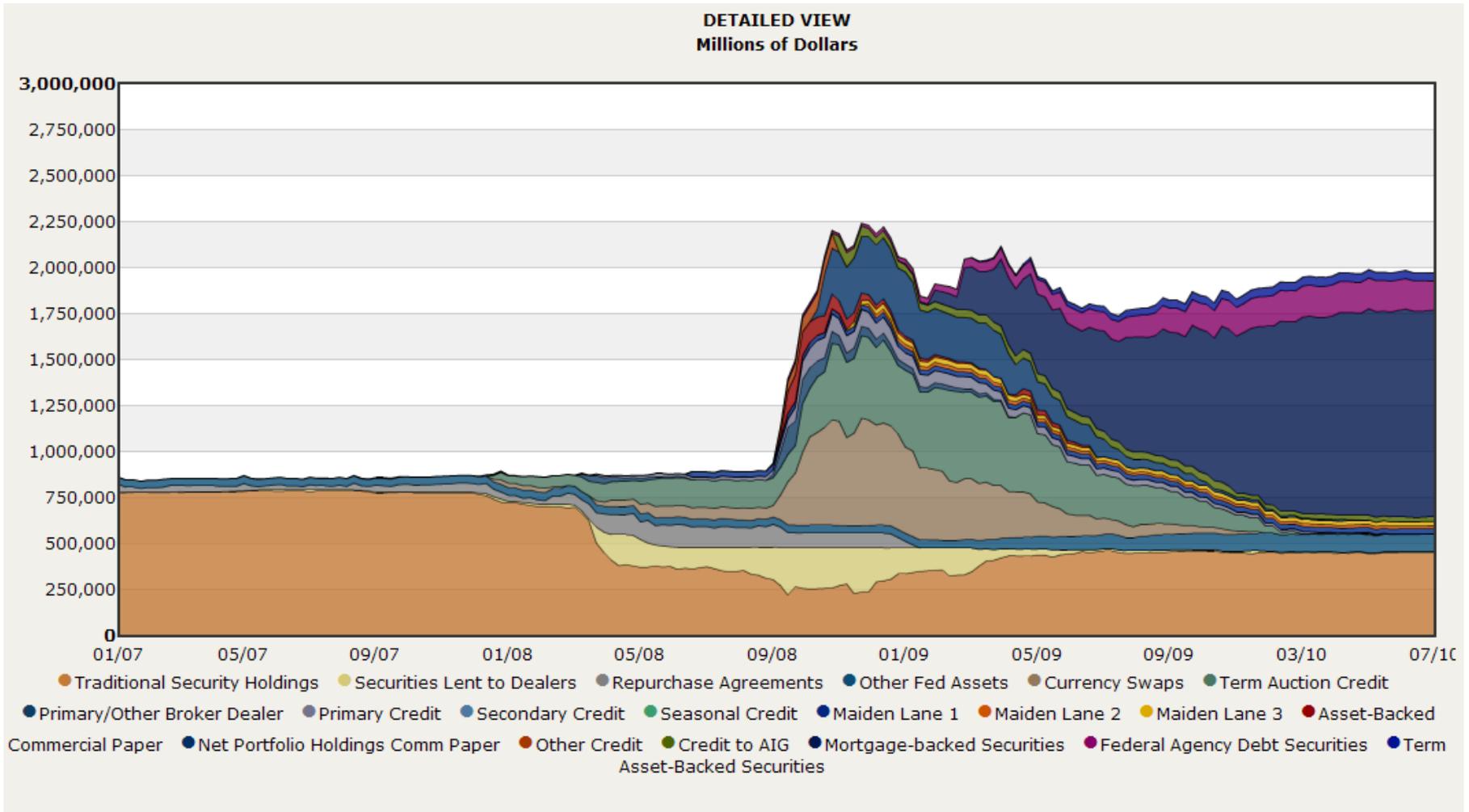
Severe recession



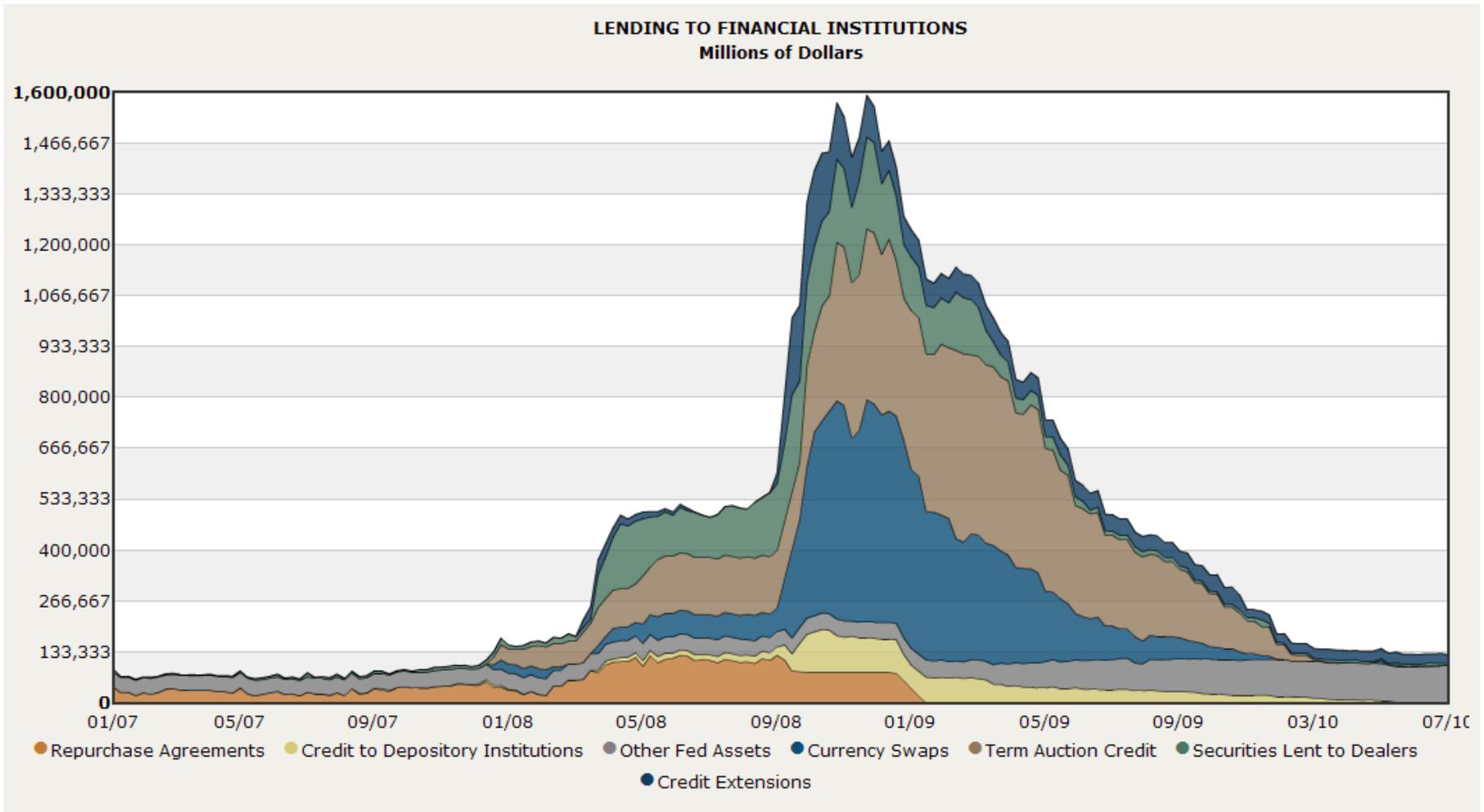
<http://research.stlouisfed.org/fred2/>

The Fed Response

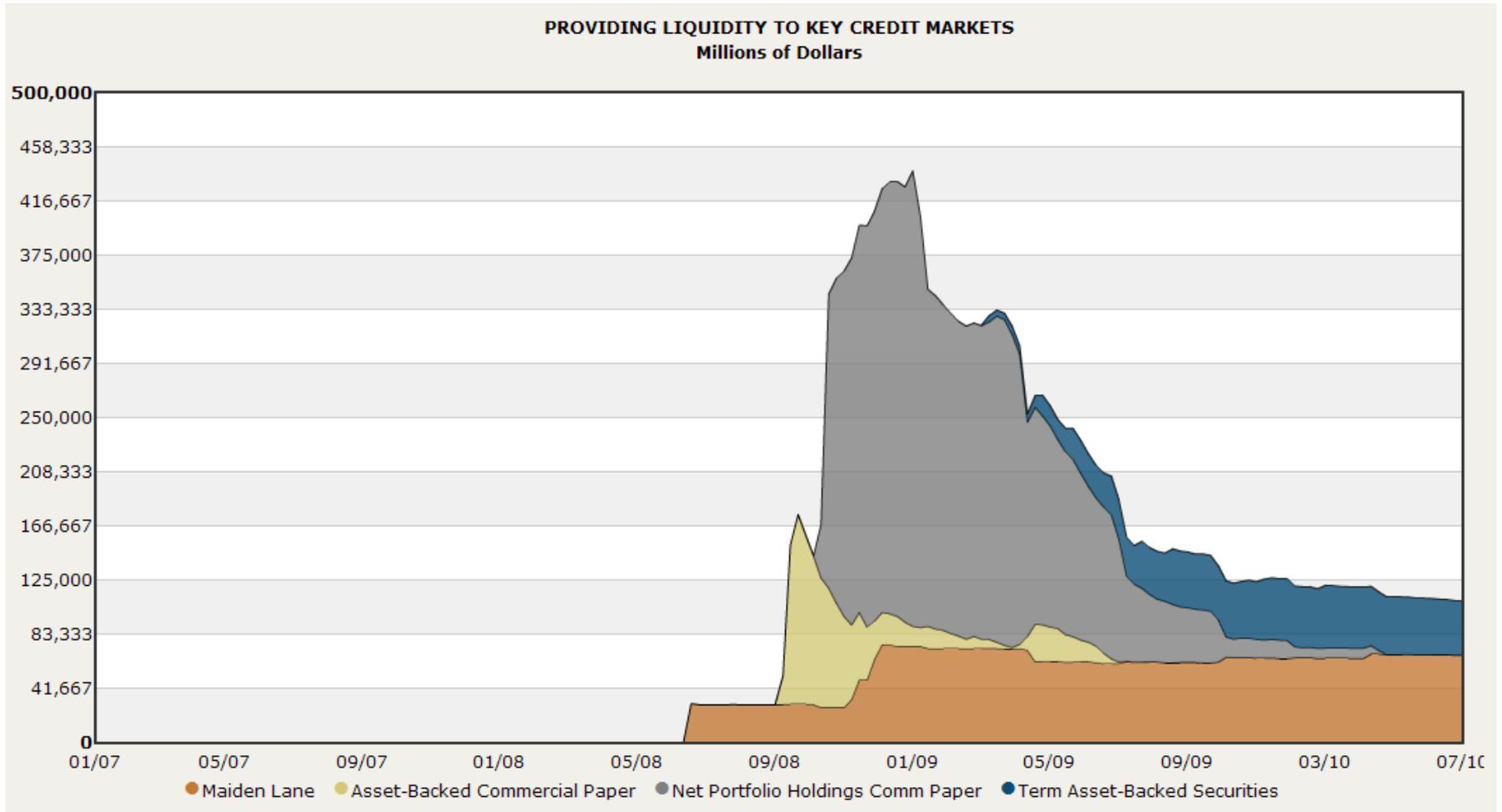
Fed lending to support financial system & economy



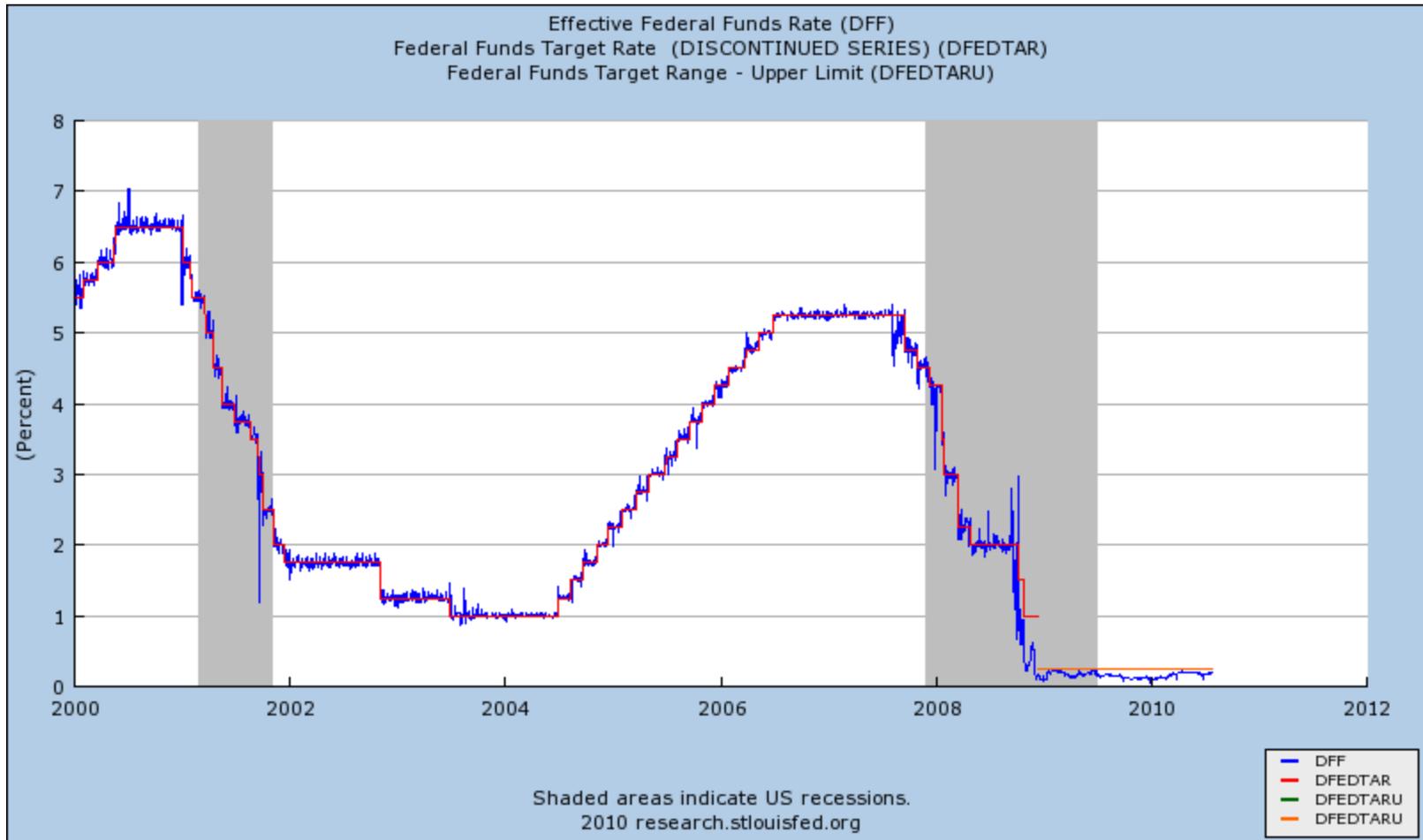
Lending to banks and other financial institutions



Lending to key credit markets & institutions

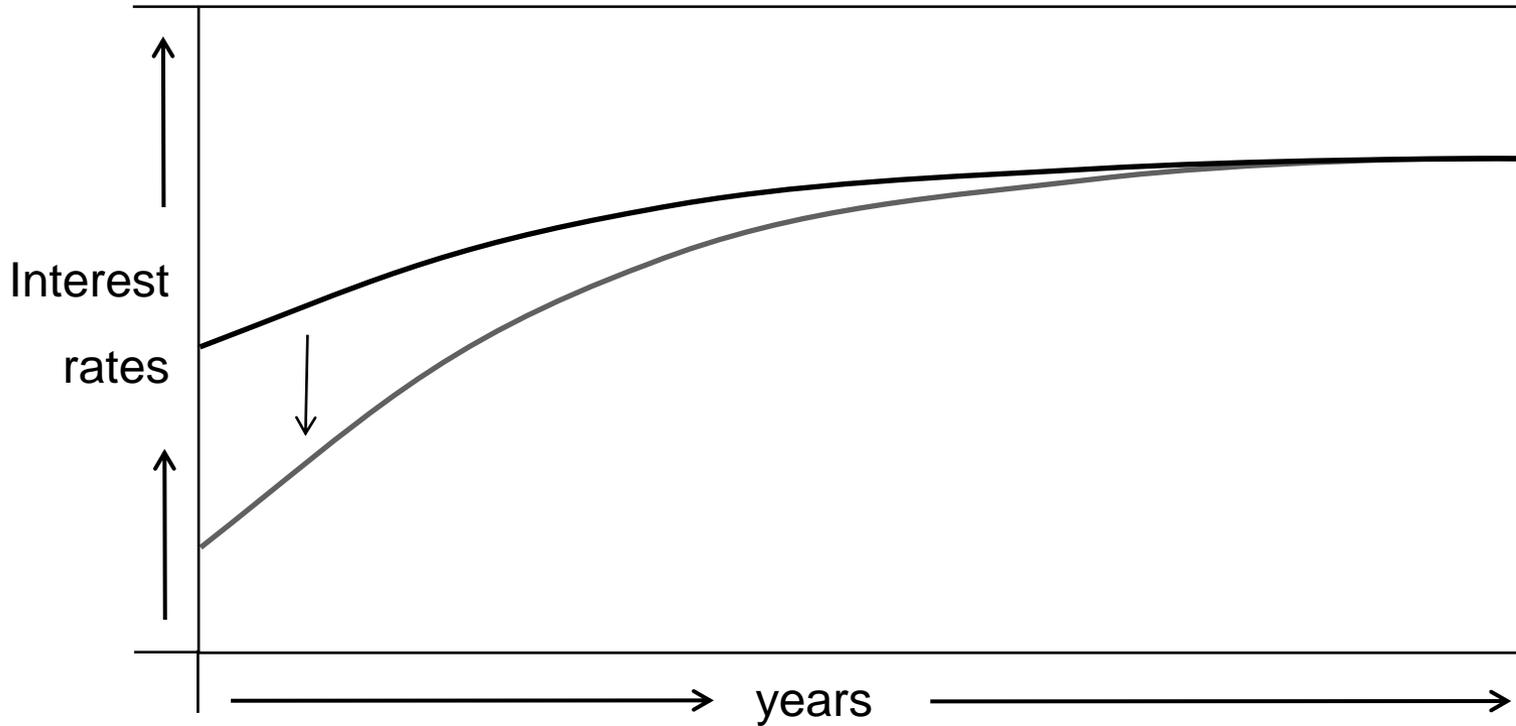


Cutting rates to the bone

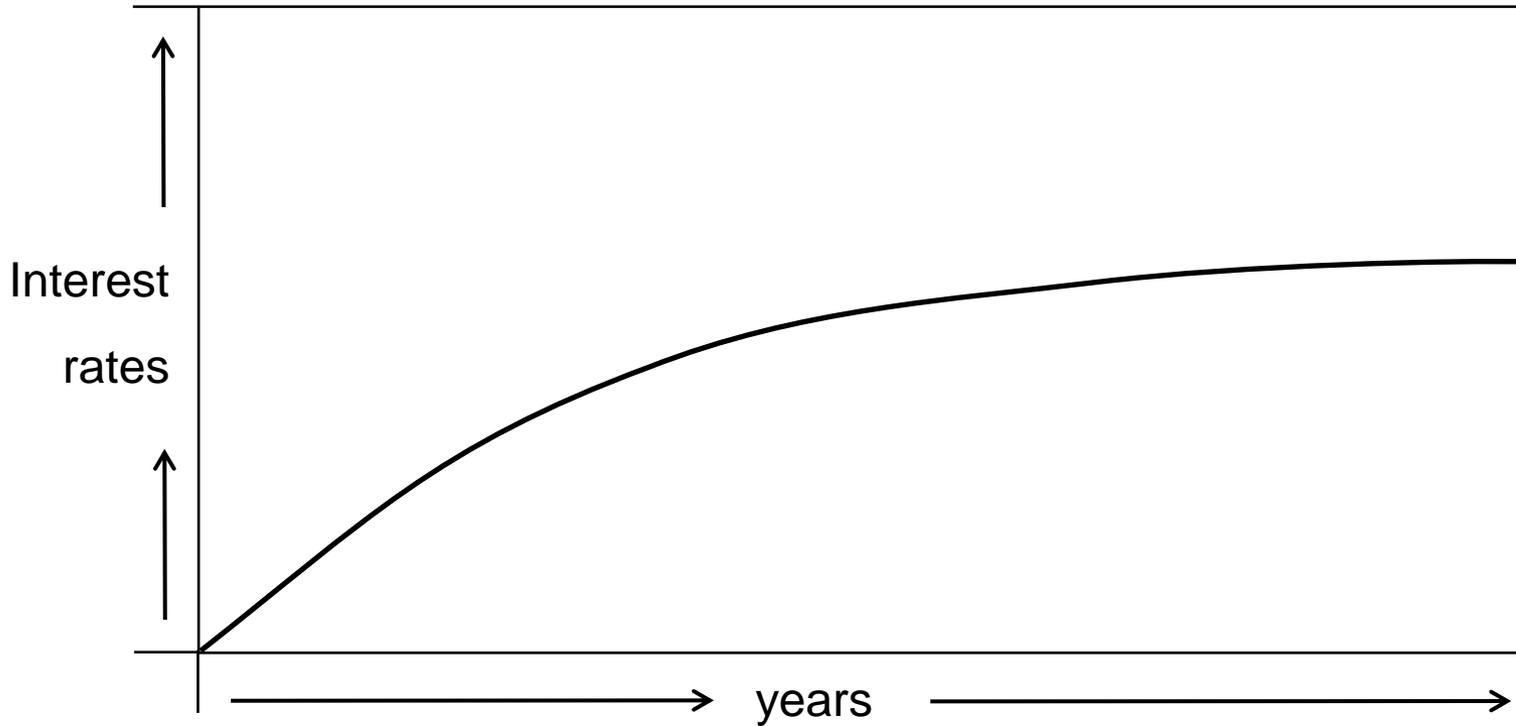


<http://research.stlouisfed.org/fred2/>

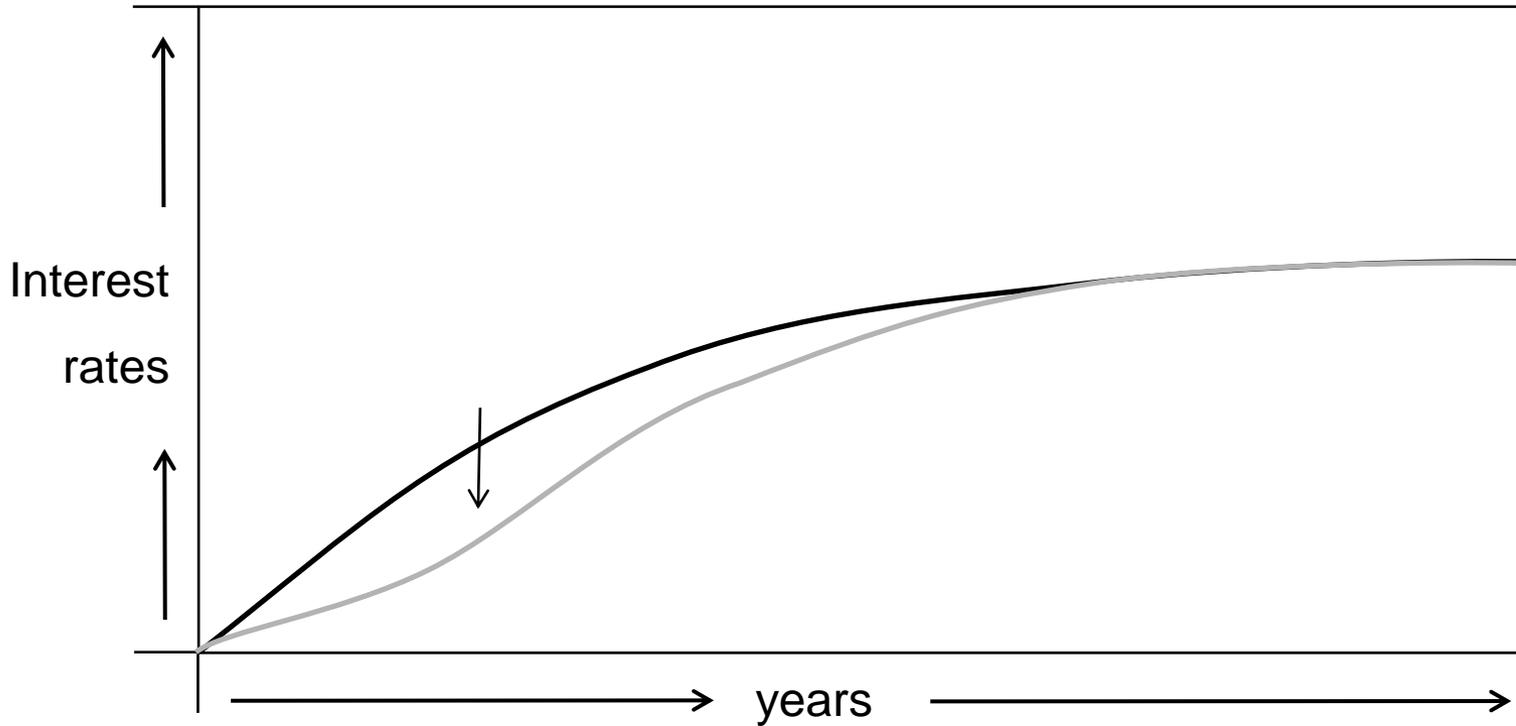
Fed funds rate cuts influence longer term rates



What to do when the Fed funds rate is already zero?



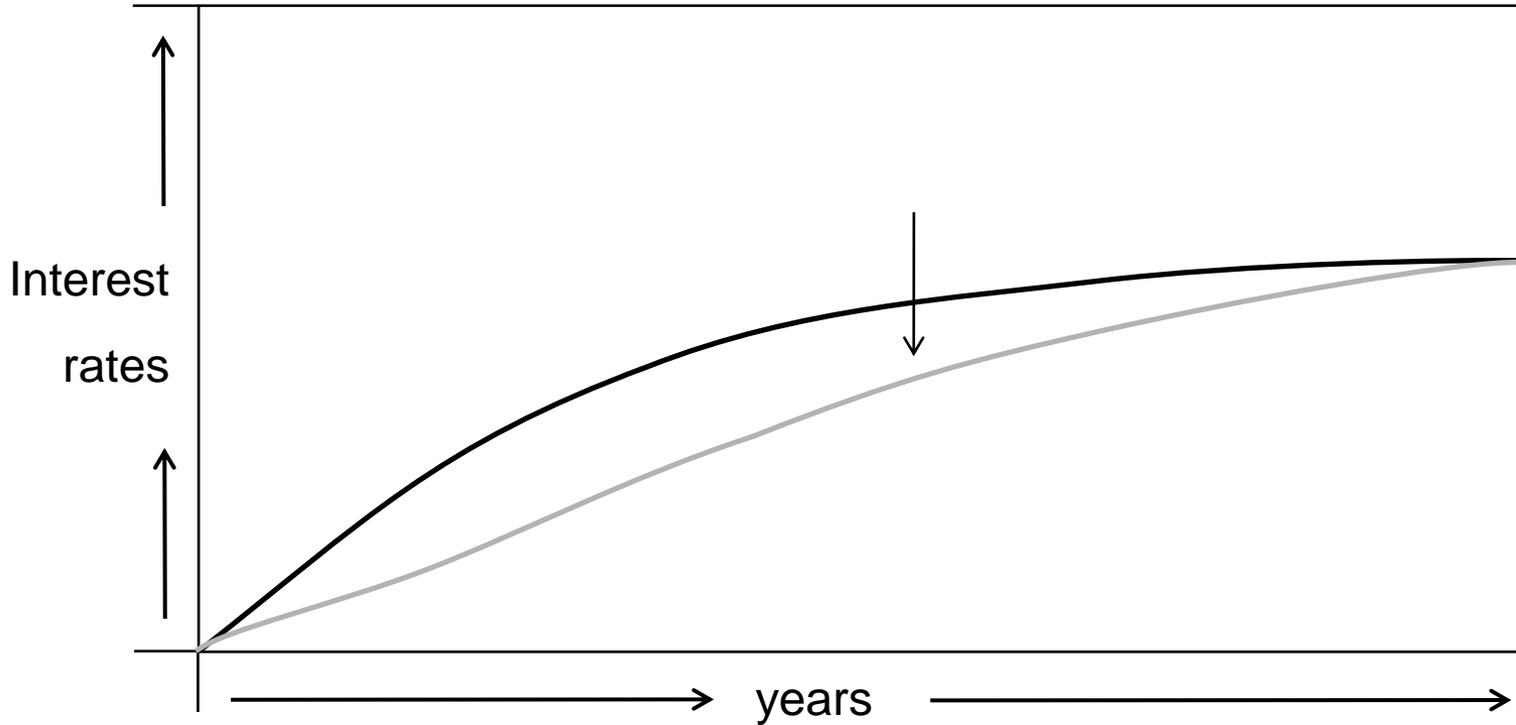
Say you will keep rates low as long as needed



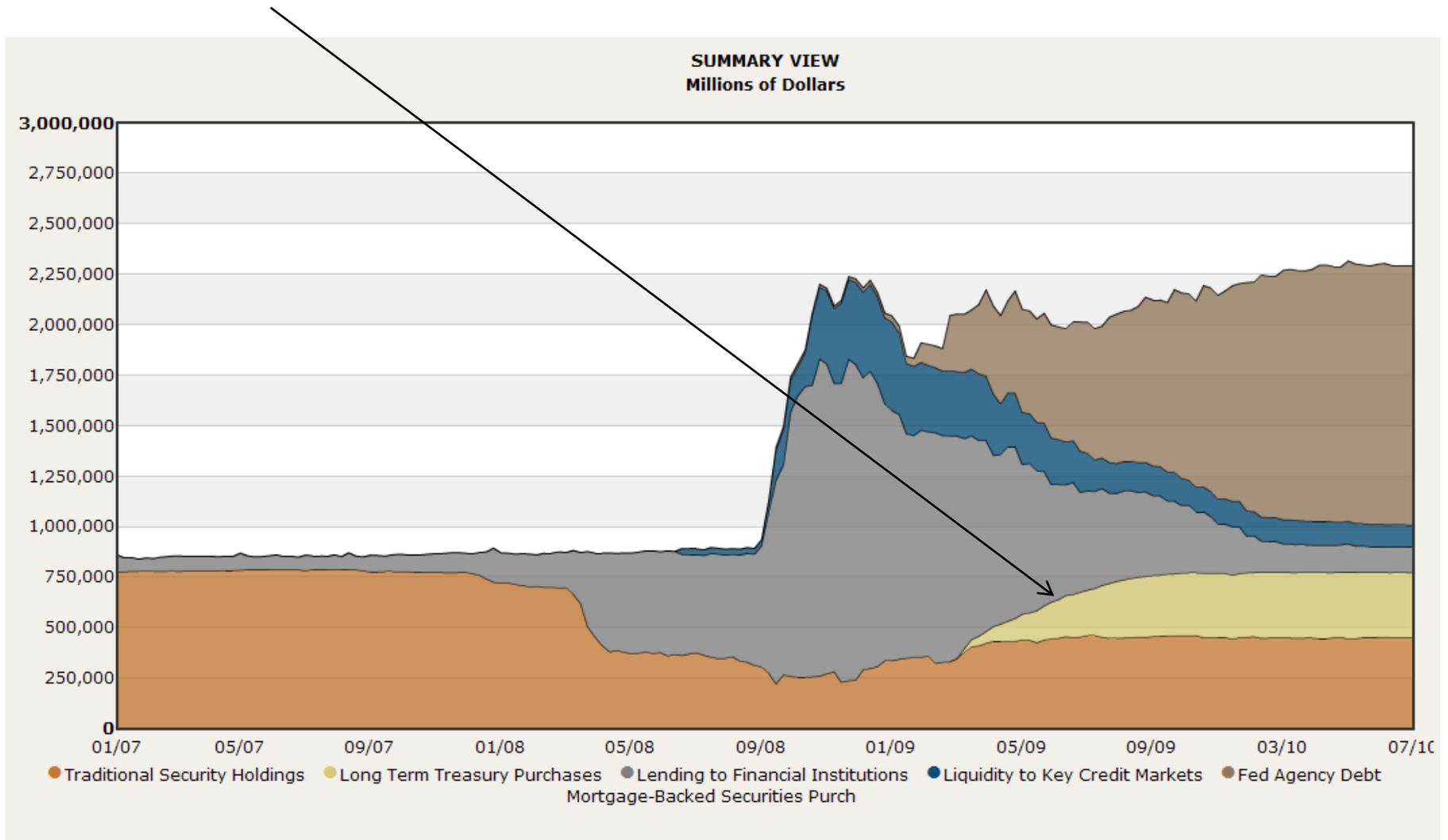
“Extended period” text in FOMC statement

“The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period.”

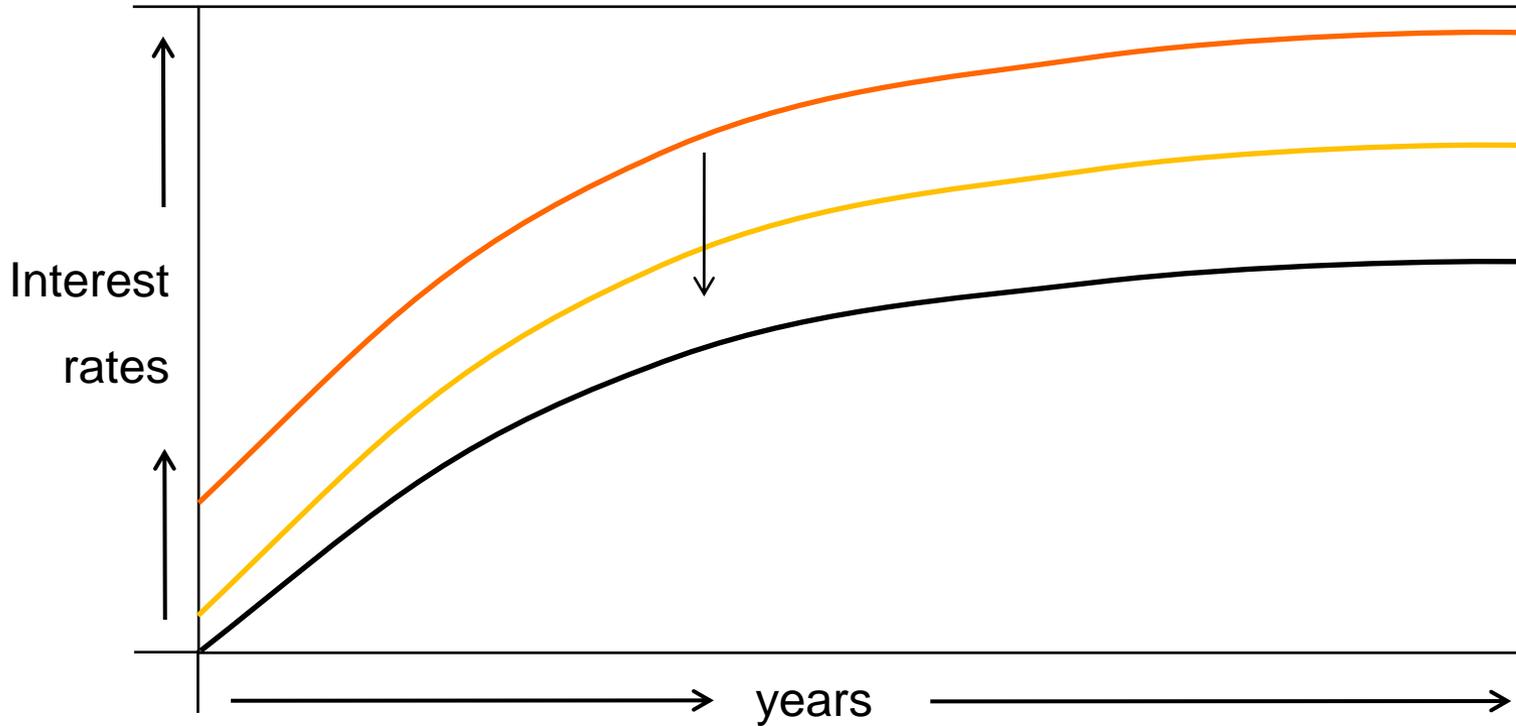
Buy long term (government) bonds



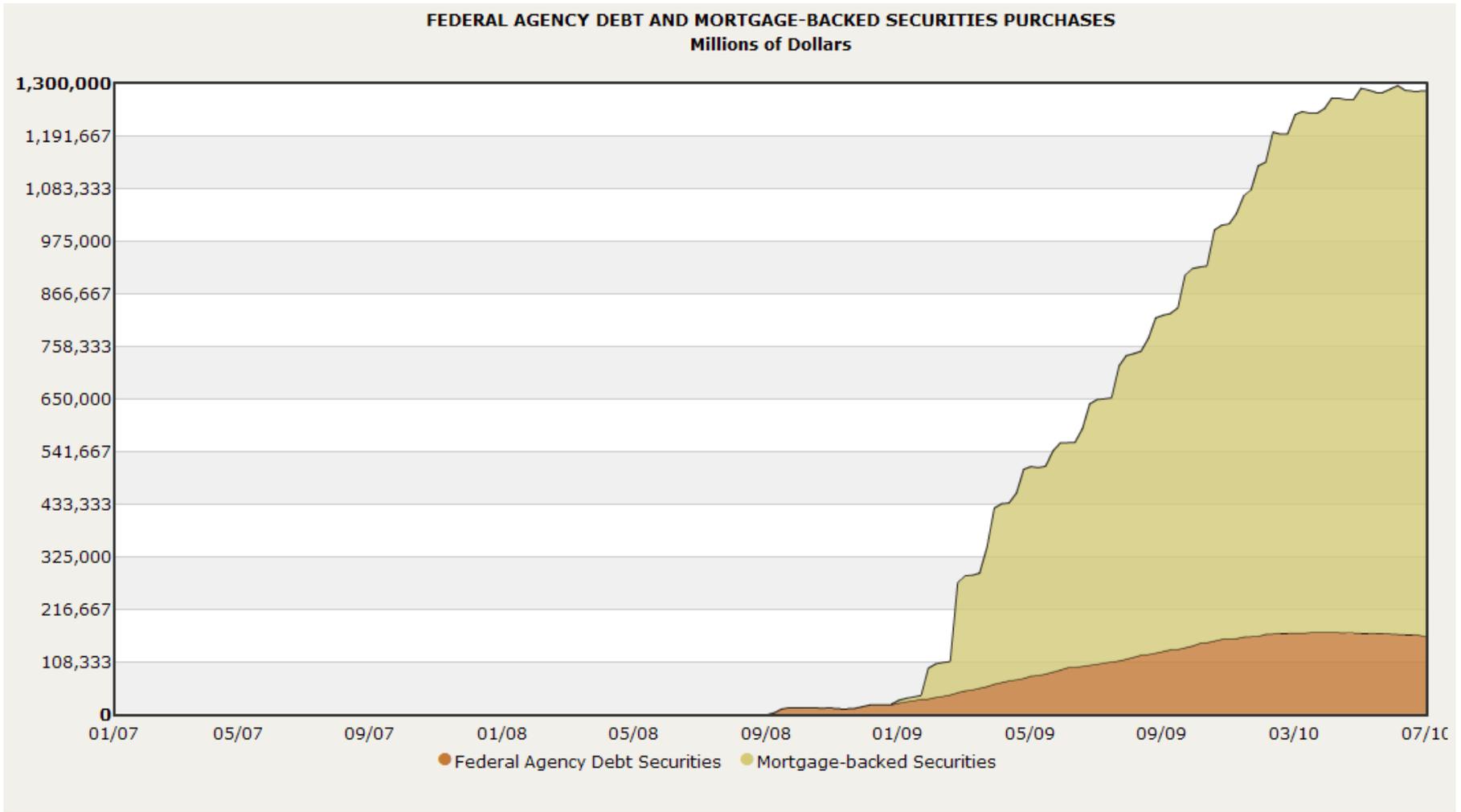
Treasury purchases



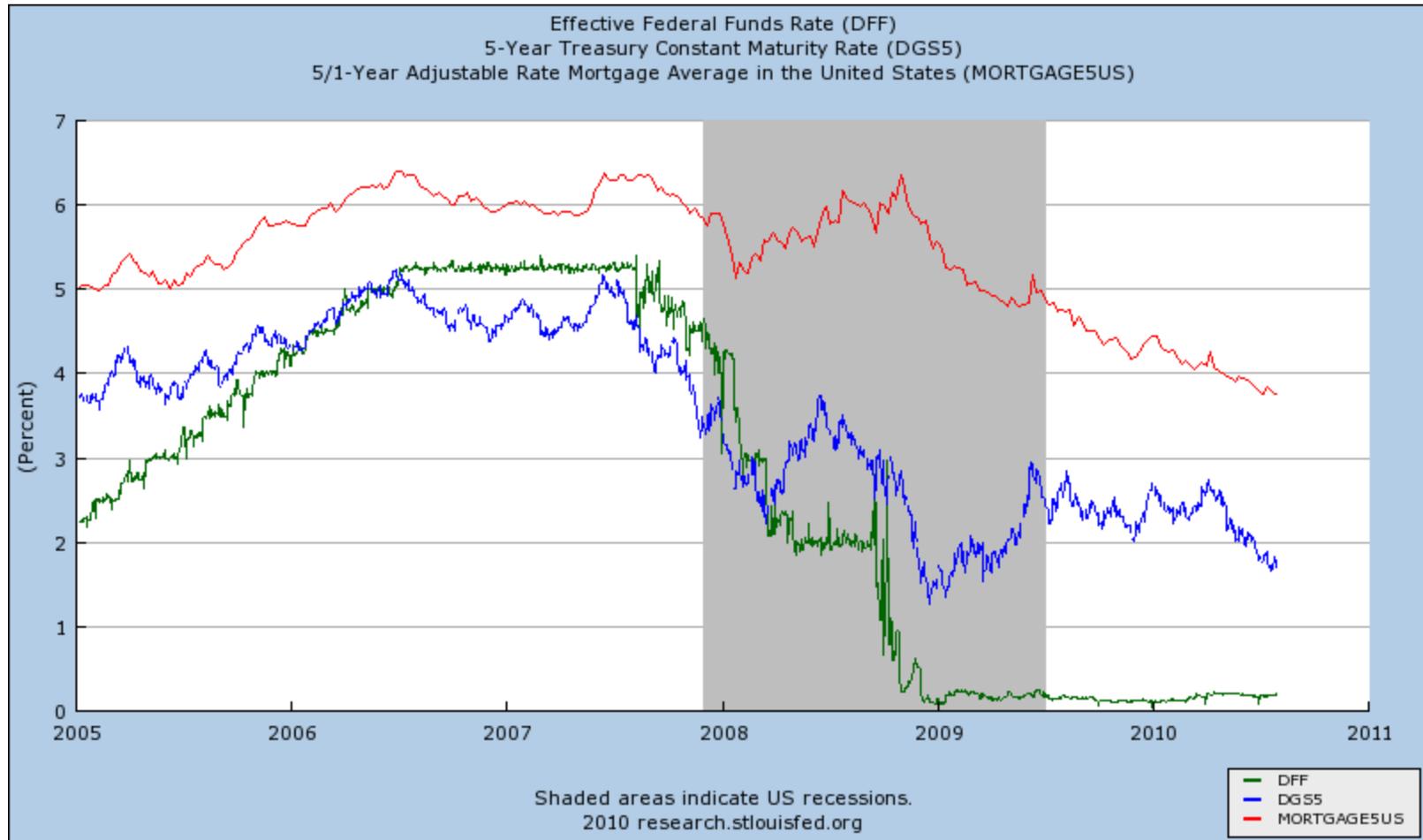
Buy mortgage backed bonds



Supporting the mortgage market



Fed funds rate and 5-year interest rates



<http://research.stlouisfed.org/fred2/>