

# POL2012: Theories and Models in Political Economy

The financial crisis, recession and stagnation

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Department of Sociology and Political Science



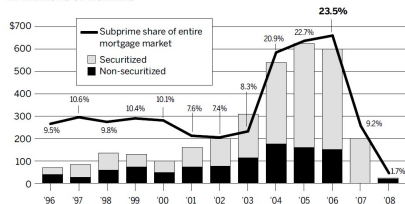
# The 2007-2008 financial crisis

- ▶ Real estate bubble
- ▶ Home prices up 60% 2000-2006
- ▶ Subprime loans
- ▶ Securitization
- ▶ Crisis goes global

## Subprime Mortgage Originations

*In 2006, \$600 billion of subprime loans were originated, most of which were securitized. That year, subprime lending accounted for 23.5% of all mortgage originations.*

IN BILLIONS OF DOLLARS



NOTE: Percent securitized is defined as subprime securities issued divided by originations in a given year. In 2007, securities issued exceeded originations.

SOURCE: Inside Mortgage Finance

Figure 5.2

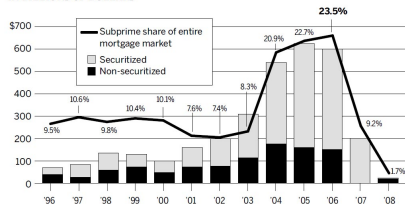
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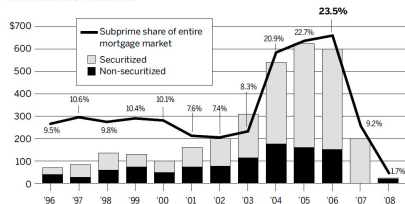
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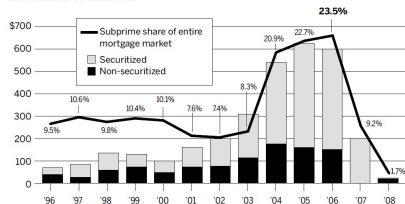
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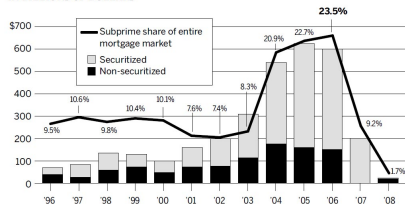
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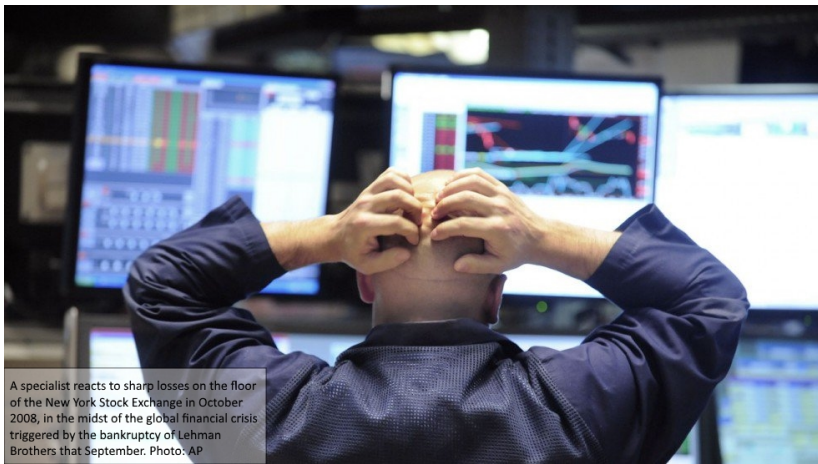
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A specialist reacts to sharp losses on the floor of the New York Stock Exchange in October 2008, in the midst of the global financial crisis triggered by the bankruptcy of Lehman Brothers that September. Photo: AP

But why did it happen?



# Response

- ▶ \$200 billion injected into the market by the Fed, the ECB and the Bank of England
- ▶ Expansionary monetary policy → low interest-rates
- ▶ United States continued stimulus in the range of \$800 billion
- ▶ ECB turned to fiscal discipline
  - ▶ Sovereign debt

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# The problem of diversity

- ▶ What is appropriate for Germany may not be appropriate for certain other EU countries
- ▶ And vice-versa
- ▶ The United States has this problem too!
- ▶ However, it is easier to get Americans to bail out fellow Americans

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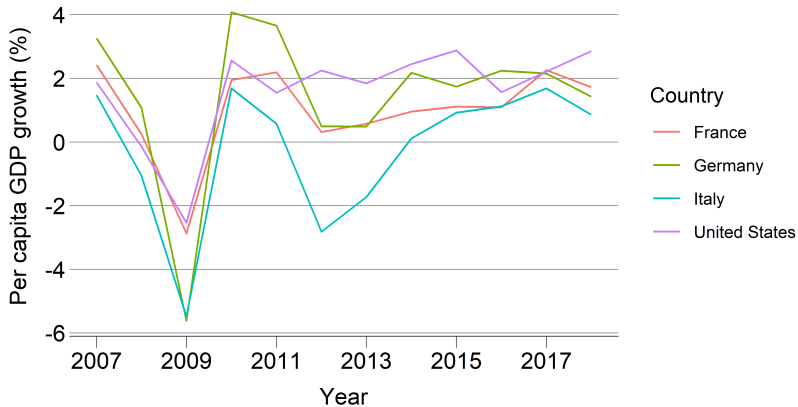


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Who do you think fared better?

# Recovery



# Lazy Southern Europeans or draconian Germans?



# Some perspectives

- ▶ Piketty: “Germany has never repaid its debts. It has no right to lecture Greece.”
  - ▶ Two ways to repay debt:
    - ▶ Strict budgetary discipline over 100 years
    - ▶ Inflation, tax on private wealth, debt relief
- ▶ Krugman: Eliminating deficits during a crisis is a recipe for depression. Leave the Euro.
- ▶ Ferguson: Clean slate makes no sense if the problem is structural (see Fukuyama ch6 for account of some of Greece’s structural problems)

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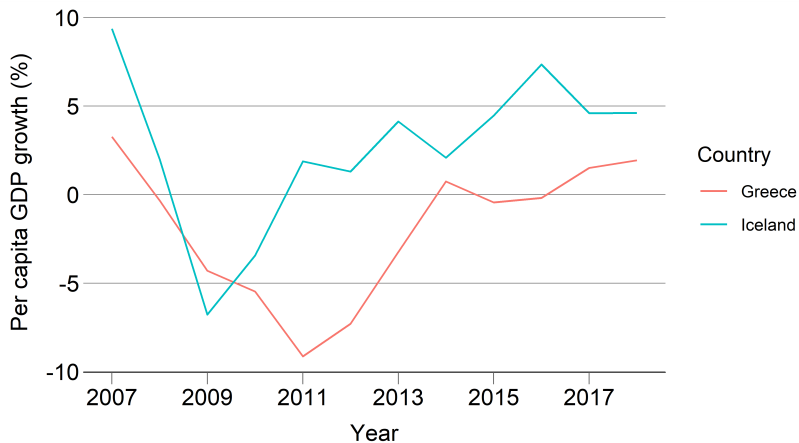
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## Is the west going the way of Japan?

- ▶ No/low growth, little/no inflation, low/negative interest rates