

Is this a “Minsky Moment”?

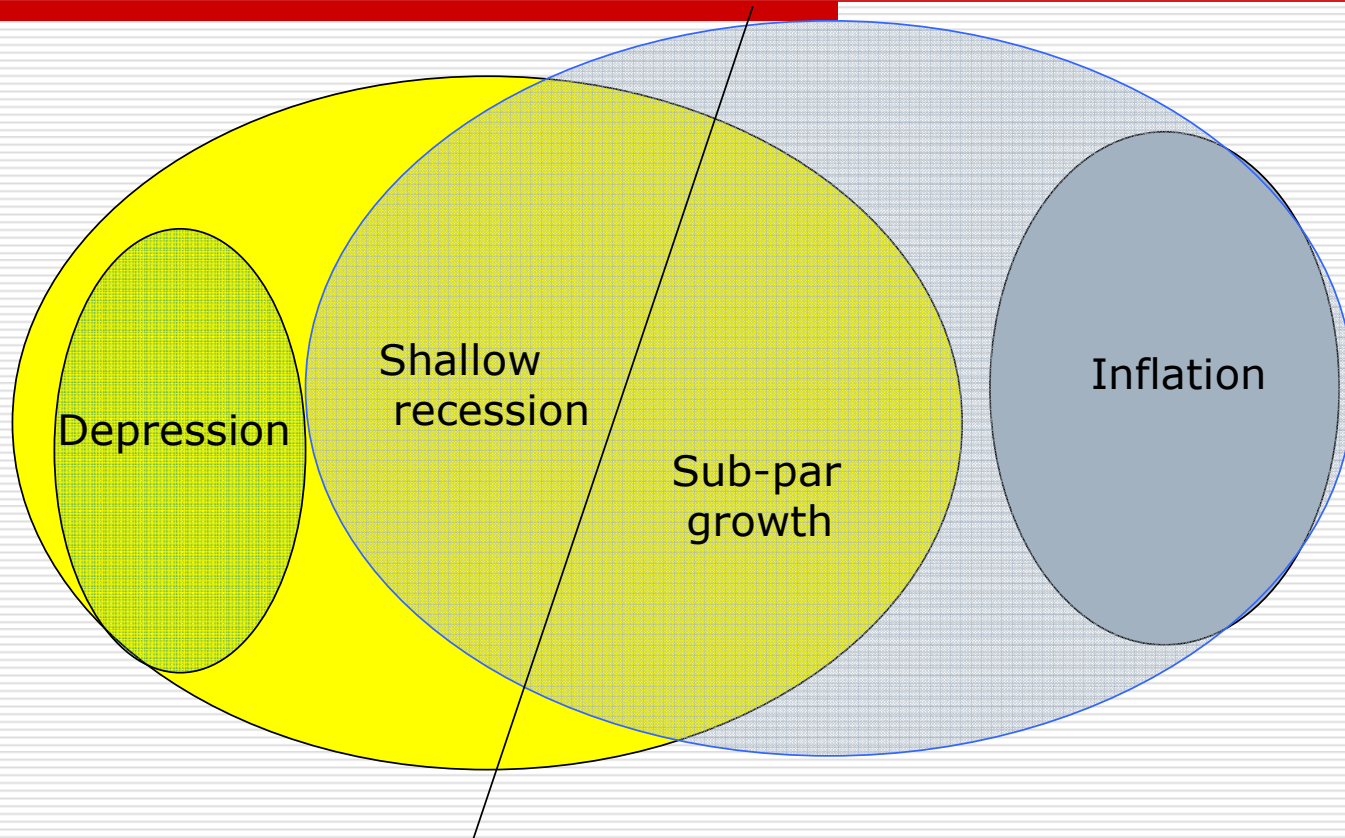
Vincent Reinhart
Resident Scholar
American Enterprise Institute

December 17, 2007

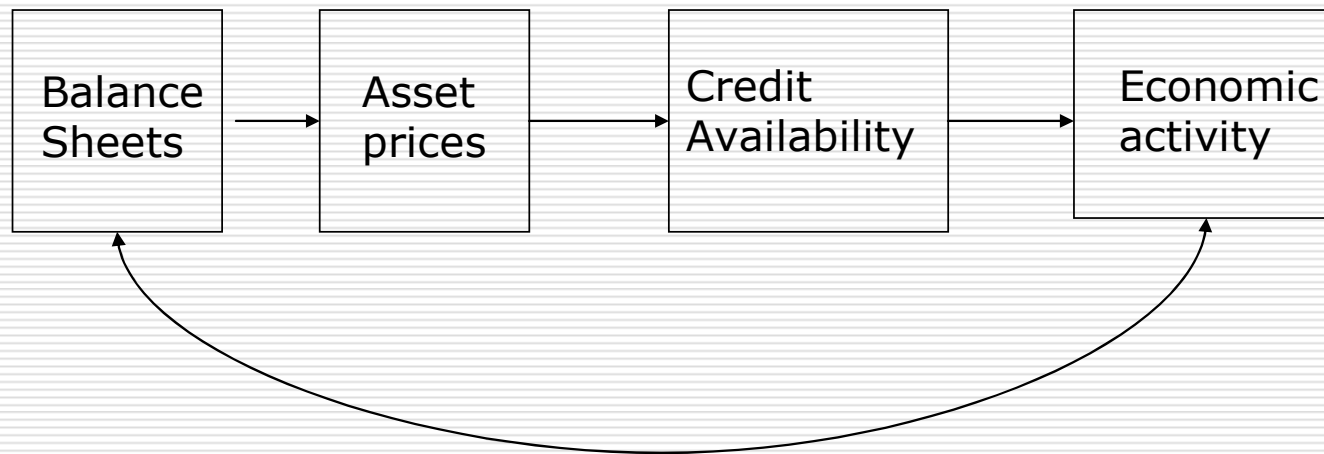
In my presentation

- Some initial observations on Prof. Calomiris's paper
 - The macroeconomics of the meltdown in mortgages
 - The financial consequences
 - A homework assignment
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A map of the world



Is this a "Minsky Moment"?



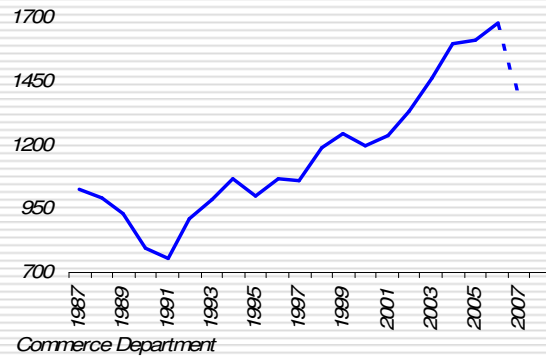
Or a Fisherian fissure?

- “Over indebtedness means simply that debts are out of line, are too big relatively to other economic factors.”
 - “It may be started by many factors, of which the most common appears to be new opportunities to invest.”
 - Irving Fisher, “Debt Deflation,” 1933
 - A Minsky moment
 - Accuses “mainstream macroeconomics”
 - The mainstream includes
 - Selection mechanisms
 - The financial accelerator
 - Admit all of these are hard to quantify
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Macroeconomics

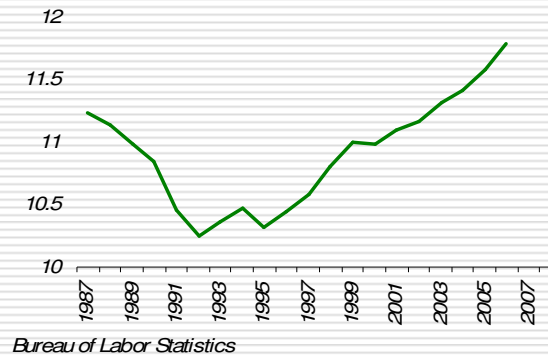
Single-family house permits

Units, thousands

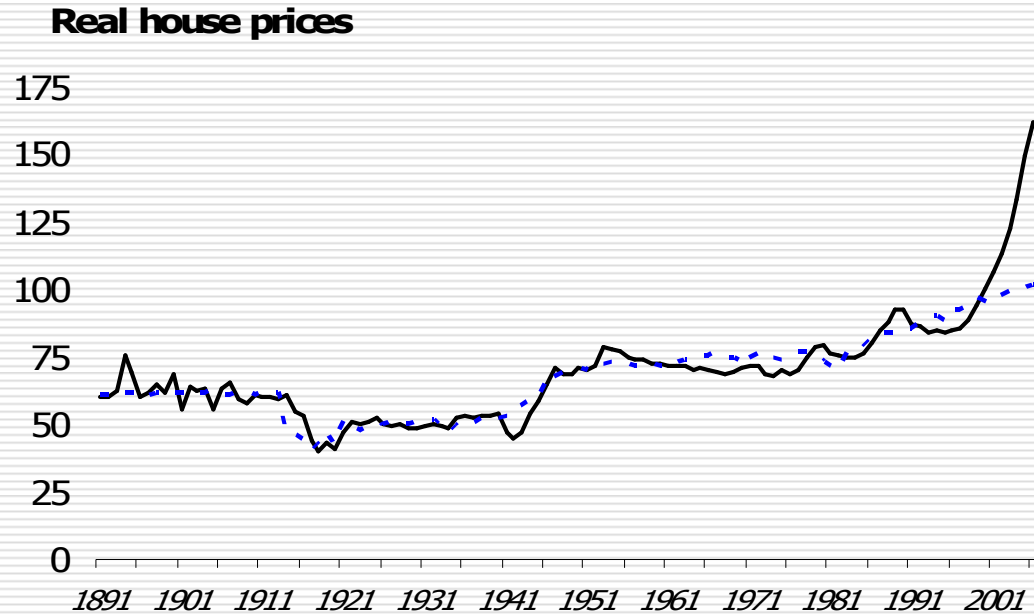


Employment in construction and finance

Share of total employment, percent



House prices reflected that demand...



Source: Shiller, Commerce

Aggregate household balance sheet

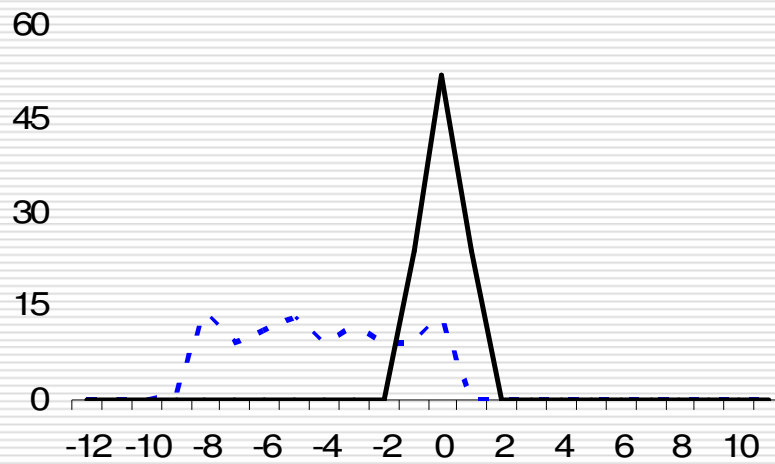
\$trillions, 2007:Q3

Assets	72.8	Liabilities	14.2
<i>Real estate</i>	23.2	<i>Mortgages</i>	10.4
<i>Financial</i>	45.3	<i>Consumer Credit</i>	2.5
<i>Durable Goods</i>	4.0	Net worth	58.6

Federal Reserve

Finance

Portfolio return
Probability of occurrence



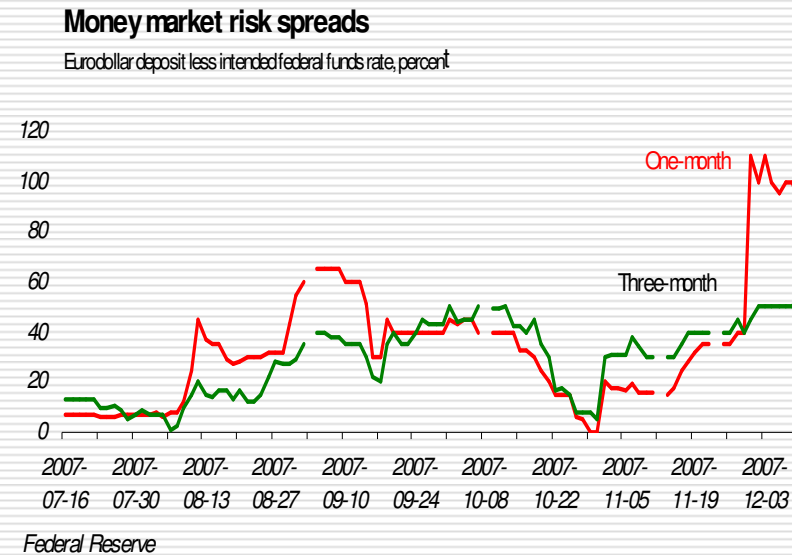
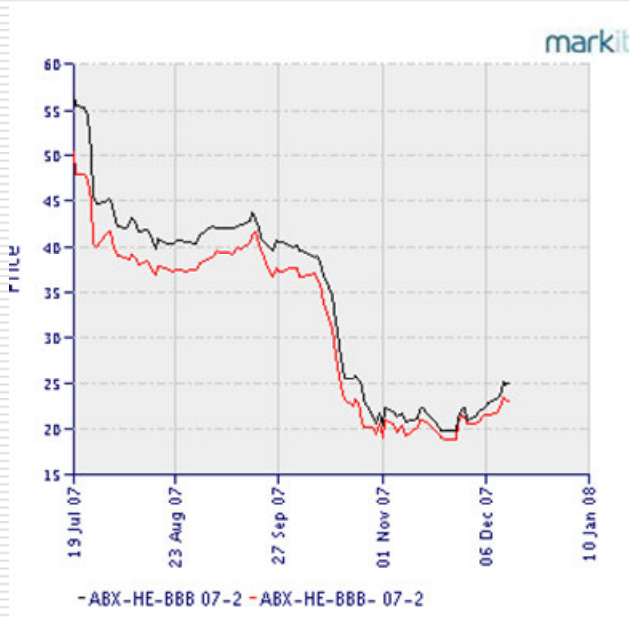
Lower mean return

Higher variance of returns

“A riddle, wrapped in a mystery,
inside an enigma”

- *Riddle*: What are securities backed by mortgage collateral worth?
 - *Mystery*: Who holds those securities?
 - *Enigma*: How will market participants react?
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This applies both to securities and to firms...



Increased uncertainty leads to...

- Selection
 - Of the instrument offered
 - By the par-value constraint

 - Higher risk premia

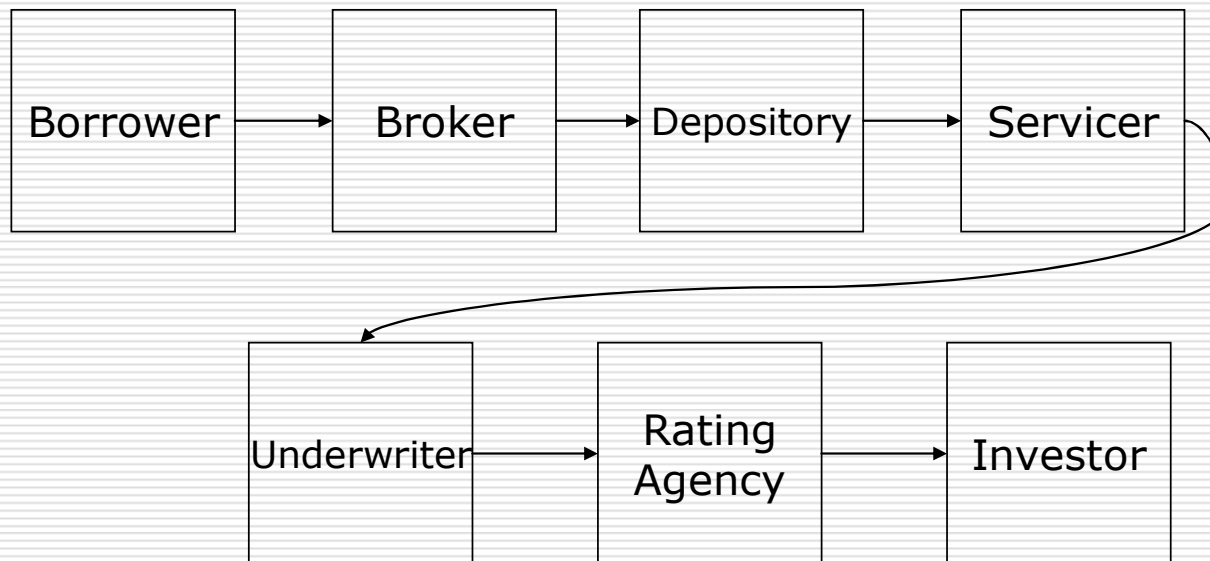
 - Increased risk aversion
-

The market loss can be
a multiple of the
economic loss.

Homework assignment

- For those who care about markets
 - Macro theorists
 - Monetary policy makers
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About regulation



Repeated evidence of poorly aligned incentives.

About macro theory

- Some relative prices serve multiple purposes
 - They both
 - Direct the flow of resources
 - Matter for the allocation of the stock of assets intertemporally
 - These include
 - Equity prices
 - Exchange rates
 - House prices
-

About monetary policy

- Strategy: How should you deal with something that is difficult to quantify?

 - Implementation: How does the distribution of reserves matter?
 - In case you didn't notice, the Federal Reserve held a Constitutional convention to rewrite the monetary Articles of Confederation.
 - No one else was invited.
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