The Current U.S. Recession

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PLAN OF TALK

1. Background material: U.S. economy
2. A theoretical framework
3. Contraction of 1929-1933: analysis
4. Panic of 2008: analysis
1 U.S. Economy: Essential Background
U.S. GDP, DEVIATIONS FROM TREND, 1870-2008
U.S. RECESSION OF 2007 - 2010

Trend line: On trend in 2005-06

Trend growth rate (annual): 2.8%

= log(real gdp), BEA data

= log(real gdp, projected),

from WSJ, 8/13/09
2 Theoretical framework

- “Normal” recession or liquidity crisis?

- How identify, respond to financial crisis?

\[ Mv = Py \]

\[ \$ \times \left( \frac{1}{t} \right) = \left( \frac{\$}{\text{apple}} \right) \times \left( \frac{\text{apples}}{t} \right) \]

- Liquidity crisis? Sudden fall in $Mv$; induces fall in $Py$

- Which one? $P$ or $y$?
3 Contraction of 1929-1933

Milton Friedman and Anna J. Schwartz,

*A Monetary History of the United States*
U.S. GDP, DEVIATIONS FROM TREND, 1870-2008

Percent Deviations

1929
1944
1982
1933

1880 1900 1920 1940 1960 1980 2000
CONTRACTION OF 1929 - 1933

Year-to-year Percent Changes

<table>
<thead>
<tr>
<th>Year ending</th>
<th>Real GDP</th>
<th>Price level</th>
<th>Bank deposits</th>
<th>Reserves</th>
</tr>
</thead>
<tbody>
<tr>
<td>1929</td>
<td>5.9</td>
<td>2</td>
<td>-1.4</td>
<td>-3.1</td>
</tr>
<tr>
<td>1930</td>
<td>-9.3</td>
<td>-4</td>
<td>-4.7</td>
<td>4.3</td>
</tr>
<tr>
<td>1931</td>
<td>-8.0</td>
<td>-8.8</td>
<td>-20.6</td>
<td>-5.9</td>
</tr>
<tr>
<td>1932</td>
<td>-14.1</td>
<td>-9</td>
<td>-11.3</td>
<td>2.2</td>
</tr>
<tr>
<td>1933</td>
<td>-2.1</td>
<td>-2.6</td>
<td>-11.6</td>
<td>7.8</td>
</tr>
<tr>
<td>1934</td>
<td>7.4</td>
<td>7.7</td>
<td>16</td>
<td>35.8</td>
</tr>
</tbody>
</table>
• Cumulating these changes, real output fell 34% from 29 peak to 33 trough

• Price level fell 24%

• Add these to get a 58% decline in spending on goods and services in this 4 year period

....or dollar value of $Mv$ and of $Py$

• Which: $M$ or $v$?

• Which: $P$ or $y$?
In 1929: \[
\frac{\text{bank deposits}}{\text{GDP}} \geq 0.5
\]

In 1933: \[
\frac{\text{bank deposits}}{\text{GDP}} \geq 0.5
\]

- What could have been done?

- Look at reserves!
4 Panic of 2008

• Repeat of 1930?

• Differences and similarities
U.S. RECESSION OF 2007 - 2010

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= log(real gdp, projected),

from WSJ, 8/13/09
• In 1930, the Federal Reserve stood by and watched as spending and production declined

• In 2008, the Federal Reserve did exactly the opposite

• In August, 2008, there were $45 billion of reserves in the banking system

• By the end of the year, there were $821 b.

• By August, 2009 there were $856 b.