

# Econbrowser

Analysis of current economic conditions and policy

[« The other shoe begins to drop | Main | Fiscal stimulus: the case for block grants »](#)

December 18, 2008

## Credit Crunch or Not

One of the debates regarding the current financial crisis is whether in fact there is a crisis, or whether in fact the financial system is operating normally. I've been skeptical myself of the "times are normal view", but here is some evidence that the credit crunch is real. The findings also reinforces my view that un-nuanced reliance on highly aggregated volume statistics (e.g., [Chari et al. 2008](#)) is likely to result in misleading inferences (See the [rejoinder](#) from the Boston Fed's economists). From the conclusion to [Tong and Wei \(2008\) ungated version of Tong and Wei](#):

In this paper, we propose a methodological framework to study the underlying mechanisms by which a financial-sector crisis may affect the real sector, and apply it to the case of the subprime mortgage crisis. In particular, we are interested in documenting and quantifying the importance of tightening liquidity constraints and the deterioration of consumer confidence on non-financial firms. We ask the question: could an ex ante classification of the firms based on their degrees of liquidity constraint and sensitivity to demand contraction prior to the subprime crisis help to predict their ex post stock price performance during the crisis period? We find the answer to be a resounding yes. Both channels are at work; liquidity constraints appear to be more significant quantitatively in explaining cross firm differences in the magnitude of stock price declines. A conservative estimate is that a tightening liquidity constraint is likely to explain at least half of the actual drop in stock prices for firms that were liquidity constrained to start with.

In order to reach these conclusions, we propose a novel methodology that distinguishes a shock to the supply of finance from an expected contraction of economic demand. We measure a firm's sensitivity to demand contraction by its stock price reaction to the September 11, 2001 terrorist attack (change in log stock price from September 10, 2001 to September 30, 2001). We measure a firm's liquidity constraint by the Whited-Wu (2006) index, valued at the end of 2006. We conduct extensive robustness checks to ensure that these indicators are valid and informative. For example, we verify that the 9/11 index is not contaminated by the impact of a liquidity constraint itself. While liquidity constraint and demand sensitivity, as measured by these two indicators, have statistically significant power in predicting stock price movement during the subprime crisis period, placebo tests suggest that they do not predict stock price movement in a period shortly before the subprime crisis broke out. An alternative measure of a firm's dependence on external finance proposed by Rajan and Zingales (1998) and valued based on information during 1990-2006 also has predictive power about stock price movement during the subprime crisis period.

Correctly diagnosing the transmission channels for a financial crisis to affect the real

economy has implications for designing appropriate policy responses to the crisis. For the subprime mortgage crisis, our analysis suggests that policies that aim primarily at restoring consumer confidence and increasing demand, such as a tax rebate to households, will probably be insufficient to help the real economy; policies that could relax liquidity constraints faced by non-financial firms are likely to be indispensable. Our methodology should also be useful in other contexts where effects of a financial shock to the real economy need to be measured. We leave these applications for future work.

To illustrate their methodology and key findings, consider the following:

If subprime problems disproportionately harm those non-financial firms that are more liquidity constrained and/or more sensitive to a consumer demand contraction, could financial investors earn excess returns by betting against these stocks (relative to other stocks)? This is essentially another way to gauge the quantitative importance of these two factors. We now turn to a “portfolio approach,” and track the effects of the two factors over time. Specifically, we follow three steps. First, we classify each non-financial stock (other than airlines, defense and insurance firms) along two dimensions: whether its degree of liquidity constraint at the end of 2006 (per the value of the Whited-Wu index) is above or below the median in the sample, and whether its sensitivity to a consumer demand contraction is above or below the median. Second, we form four portfolios on July 31, 2007 and fix their compositions in the subsequent periods: the HH portfolio is a set of equally weighted stocks that are highly liquidity constrained and highly sensitive to consumer demand contraction; the HL portfolio is a set of stocks that are highly liquidity constrained, but relatively not sensitive to a change in consumer confidence; the LH portfolio consist of stocks that are relatively not liquidity constrained but highly sensitive to consumer confidence; and finally, the LL portfolio consists of stocks that are neither liquidity constrained nor sensitive to consumer confidence. Third, we track the cumulative returns of these four portfolios over time and plot the results in Figure 6.

Here is Figure6:

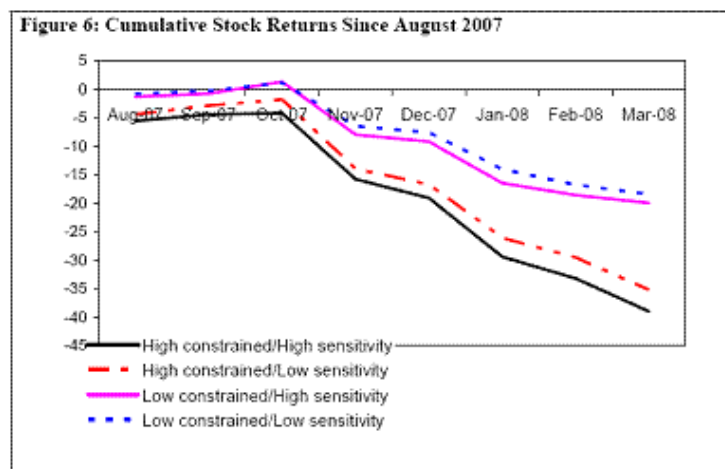


Figure 6: from Tong and Wei (2008).

They conclude that about half of the decline in stock prices is due to the credit crunch, with the other half attributable to the decline in consumer confidence.

By the way, if you think the "no financial crisis" view is a rare anomaly, see: [\[1\]](#), [\[2\]](#).

Technorati Tags: [credit crunch](#), [lending](#), [liquidity constraints](#), [recession](#), and [consumer sentiment](#).

**Posted by Menzie Chinn at December 18, 2008 12:20 PM**

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**Comments**

"They conclude that about half of the decline in stock prices is due to the credit crunch, with the other half attributable to the decline in consumer confidence."

Talk about over reaching...

**Posted by: Bob\_in\_MA at December 18, 2008 01:28 PM**

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Would someone please send me a copy of the Tong Wei paper.

thank you,  
Joseph

**Posted by: js at December 18, 2008 02:31 PM**

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This was a very slow reaction to these two papers...

**Posted by: Daniel at December 18, 2008 02:43 PM**

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I think I'm with Bob here...1/2 with Bob and 1/2 bobbing...reaching *out* it appears...but "resoundingly" so.

Hmmm...note this compilation takes us to July 08 (somewhat dated and elevated stock values then, yes?) and where is the empirical regimen that distinguishes the independence of these 2 variables: consumer confidence and credit crunch?

Could the gobs of scattered TARP and TAF funds have influenced the results?

Does Bob think the conclusion over-reaches because 1/2 is too large a fraction? too crude a precision?

I, too, would not pay \$5 to punish myself with the whole thing.

**Posted by: calmo at December 18, 2008 03:46 PM**

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Time to Bailout Main Street

To the surprise of very few who have been paying attention, the Wall Street bailout has had little positive effect on making credit available to businesses or individuals. The \$350 trillion in TARP funds already made available, plus the almost \$1 trillion in loans directly from the Federal Reserve, have only been used to replace capital already recognized as lost, or to buttress balance sheets in anticipation of the write-offs to come as the economy slides deeper into recession.

Also to the surprise of no one, every industry, trade group, union, state government, and municipality lobbyist has formed a long line in order to get "their share" of the bailout. The federal government will continue to write checks to every interest group possible before they do what they presumably already know needs to be done: make credit available directly to the American people and small businesses via temporary government backing of basic credit facilities.

We need to drive the economy via consumer behavior. The following plan lubricates the wheels of the economy by making available sensible, properly leveraged credit.

An old axiom of government is that for every action, there is an equal and opposite over-reaction. This is the current situation in our credit market. Failure to regulate leverage has led to a current environment where lenders expect to be over-regulated. Only customers with spotless credit are able to make purchases. Yet, due to the economic downturn, many people with good jobs, down payments, and the ability going forward to repay loans will have blemished credit.

There are many who share blame that got us into this mess. But the solution is to reward good future behavior. The blame game can continue until the end of time, but we must lay a foundation to get us back to a market-based, productive economy once again.

America's economy is a credit based, leveraged one. We can not expect this to change over night and remain an economic super power. As such, we must return to the lessons learned in the wake of the great depression, which was largely caused by stocks being bought on margin without proper leverage: A borrower must have sufficient skin in the game (i.e. a proper down payment) if the lender has any chance to expect repayment. Thus, in this proposal, the borrower's down payment of hard money is key to getting new loans. The other keys of credit include capacity, and income verification, an easy process that many lenders did away with during the last decade, is also prominent.

read more

<http://controlcongress.com/uncategorized/time-to-bailout-main-street>

**Posted by: [John Konop](#) at December 18, 2008 04:00 PM**

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The Myth of Increased Lending in The Fed's Latest Figures ...

What are we seeing in the increase in all these categories ? I mean companies are borrowing less for inventory and expansion. People are buying fewer houses and cars and just about everything else. On top of that banks are writing hundreds of billions off their books as bad debt ! Yet the borrowings keep going up!

Could it be that the banks are unwinding their off the balance sheet SIVs (Structured Investment Vehicles) onto their books as they were required to do by Jan 1, 2009, until recently, when it was pushed back.

That sure would explain how their balance sheets could expand when nobody is borrowing. It would also explain the swelling of banks level 3 assets. Those are assets that can't be marked to market (level 1) or marked to model (level 2). In the real world Level 3 assets are called marked to "marked to make believe" .. Yves Smith has a great post on this Quelle Surprise! Banks

Increase "Mark to Make-Believe" Assets to \$610 Billion.

So the big increase in lending is just the reclassification of the SIVs off balance sheet bank assets (debts) on to the balance sheet. As soon as they got there the banks wisely classified them as level 3 assets so that the accountants or auditors would have to give them a pass on the validity of their worth.

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From the Financial Times:

The biggest US financial institutions reported a sharp increase to \$610bn in so-called hard-to-value assets during the third quarter, raising concerns about the hidden dangers on balance sheets.

So-called level-three assets, classified as hard to value and hard to sell, rose 15.5 per cent from the second quarter, according to analysis by the Market, Credit and Risk Strategies group of Standard & Poor's.

Level-three assets have risen all year for most banks as they have found it virtually impossible to sell mortgage-backed securities and collateralised debt obligations.

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So are we seeing massive new lending or are we seeing "off the balance sheet" "structured investment vehicles" otherwise known as toxic debt, being put on the balance sheet ? The latter my friend , the latter.

**Posted by: [mmckinl](#) at December 18, 2008 04:48 PM**

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I like economics, most of the time, but technobabble such as that demonstrated above tries my patience. It is not hard to know if there is a credit crunch: the banks will tell us. In Tennessee, before the bailout proposal, the Congressmen called up all the bankers they knew. They asked if there was a credit crunch. The bankers all said there was no credit crunch. They had plenty of money to loan, but few businesses that wanted to borrow. I spoke with a VP at Bank of America in Memphis, and he said the same thing: lots of money to loan, but no borrowers. We have a borrower crunch, not a credit crunch. I'm not buying the methodologies or the conclusions of the economists above.

**Posted by: [Dr. T](#) at December 18, 2008 06:01 PM**

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This is not technobabble. It is an attempt to learn something from data. It may have weaknesses, most such attempts do. But it is more detail than I want to wade through to evaluate the results.

The example of calling bankers in Tennessee suggests to me that banks large enough to deal on the international market are in a different situation from regional or local banks.

On the other hand, the inability of people to use loans constructively is a reality.

See, I can talk like an economist, even if I aren't one. On the other hand is essential.

I seek other studies on this issue, but I do not discount this one because it is complicated.

**Posted by: [ReformerRay](#) at December 18, 2008 07:16 PM**

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Calmo,

I was referring to the idea that someone could find some formula to ascertain that, "about half of the decline in stock prices is due to the credit crunch, with the other half attributable to the decline in consumer confidence."

For some reason, our current predicament has given economists the idea that their formulae can answer all the unanswerables and provide us with the path to salvation. Look at Krugman over at the Times showing us how we (and the Chinese, Germans, Brits, etc.) can spend our way out of this. If you don't believe, he can "prove" it>

Never mind the track record of economists over the last two years. You see, the NOW have all the answers. Yes, I know, Shiller saw it coming, Roubini saw it coming... But so did a lot of cab drivers and plumbers.

Frankly, I'm not sure we wouldn't be better off with a cab driver as the next Treasury Secretary, at least he wouldn't be foolish enough to say something like, "about half of the decline in stock prices is due to the credit crunch, with the other half attributable to the decline in consumer confidence."

**Posted by: [Bob\\_in\\_MA](#) at December 18, 2008 07:52 PM**

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*It is not hard to know if there is a credit crunch: the banks will tell us.*

And the banks' interest in such openness would be, *what*, exactly?

My only point being that there might well be some point in resorting to detective work.

**Posted by: [prostratedragon](#) at December 18, 2008 08:04 PM**

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<http://www.minneapolisfed.org/pubs/fedgaz/09-01/cover.pdf>

is a non-technobabble look at what is happening in their Fed district, based on some surveys that they did to get some answers to the very question. The most interesting comment to come out of the survey was that there is a sort of credit vertigo; bankers are being pulled in opposite directions by the folks at the top that exhort them to lend and the examiners that hold real power telling them to tighten up their lending standards. The banks want regulators to get their message straight.

The conclusion is that right now everyone is feeling out the "new normal credit market." It isn't a lack of money that is holding people on all sides back "but rather information, and confidence in the future, and in the parties to any credit transaction."

**Posted by: [colonelmoore](#) at December 18, 2008 10:14 PM**

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Bob, I think the idea was to question the validity of the existence of a credit crunch. As opposed to a mere crisis in consumer confidence...and so Dr T chimes in that in his survey (anecdotal is one I understand at least), there were no borrowers. Ergo, no fraction whatsoever for 'the credit crunch'. But \*prostrate\* thinks banks would never fess up and are lying in Dr T's case. And many-handed ReformerRay thinks small local banks might be different from ones that have larger clients and possibly constrained by over-leveraged bets resulting in capital constrained lending or worse. No doubt about the year long record of "commercial banks" using the TAF to counter the evidence from Dr T who may still be right about the local banks there.

My belief is that some large banks are insolvent, not illiquid...to warrant the TAF rescue/stay-of-execution actions over the last 13 months...and the Fed's refusal to hand over the information to Bloomberg...actions that do nothing but erode confidence in the entire banking industry...so cultivate that "lack of consumer confidence". Similarly, bankers are familiar with a deflationary environment and need to raise real interest rates to cover for deflating dollars and inflating risks of non-payment...so cultivating that resistance to lend environment: "the credit crunch". (Actually, with declining house prices, there are prolly very few banks that are not capital constrained from the loss of those RE related income streams and HELOCs gone sour, yes?)

Therefore, reasonable for lay people (me and Ray) to suspect both, but unable to quantify portions...unlike the econometricians who overwhelm Bob and me with "1/2".

The stock market analysis resulting in that "yes", means that a significant portion of the stock market decline will bounce back as soon as consumer confidence returns...a happy result for stockholders...esp the 1% that own 2/3 of it...which was one of the reasons I was not resoundingly happy or convinced.

But mmcknl takes a detour, noting the FT pc on the possibility of toxic SIVs banging onto the balance sheet...does not mean that banks are lending suddenly...\$610B? No.

Thanks for the heads up to Nakedcapitalism.

**Posted by: [calmo](#) at December 18, 2008 11:04 PM**

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calmo ...

"structured finance arrangements. Securitizations reported on Schedule S add about \$2 trillion in 2007"

[http://www.rgemonitor.com/financemarkets-monitor/254797/off-balance\\_sheet\\_accounting\\_and\\_monetary\\_policy\\_ineffectiveness](http://www.rgemonitor.com/financemarkets-monitor/254797/off-balance_sheet_accounting_and_monetary_policy_ineffectiveness)

I believe that most of the 610 billion was part of this 2 trillion in off balance sheet assets being put back on the balance sheet by order of FASBY to be done by Jan 1, 2009, Pressure was applied to FASBY's board and the date was pushed back to Nov. 15,2009 .

It was during this time, around Spring 2008, that the SEC under Cox made level 3 assets all but out of bounds for auditors ...

**Posted by: [mmckinl](#) at December 19, 2008 12:33 AM**

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Interesting attempt to supplement data crunching with other information and perspective.

May I suggest that the data crunching would be more persuasive if a more sensitive technique

were used?

Multiple regression analysis, using each stock as a data point, measures of confidence and credit crunch as independent variables and numeric change in value of each stock as the dependent variable will provide a better picture of what % of the variation in the dependent variable is due to each independent variable.

Assuming the data are good and the distribution of the variables are amenable to regression analysis.

This comment does not answer the question - it merely suggests another kind of data crunching that might help.

**Posted by: [ReformerRay](#) at December 19, 2008 04:38 AM**

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From the real world, here on main street:

The consumer was driven out of the market by, 1) Gasoline at \$4.25 per gallon and is still trying to refill his/her wallet. That will take at the very least 9 months. 2) Bank credit cards were/are playing a game called universal default, by which they were able to beat up the user with usury levels on all their credit cards for an offense on one of them. Not to mention rate increases at will. The laws are being changed back, but not effective til 2010. I'm sure the delay is to make sure the bankers can get one more pound of flesh. 18 months to correct this situation. 3) The damage done to folks credit rating by the actions of these banks has locked up the housing market for refinance, even at historic low interest rates. 4) Babyboomers who have held the economy together while in a vise between their parents and their children are tapped out and have just lost half of their 401ks.

There is a sea chane going on out here in "The Real America." Boomers are done spending, our kids can't get a decent job to begin spending and the old folks are dying off at the slowest rate in history.

The banks are going to reap what they have sown in America. Socialism is on the rise because the capitalists went crazy with greed and have not shown even minimal moral standards of conduct.

I concur with the problem being 1/2 credit card debt, but no it is not a confidence issue aa much as the issue of the American people finally choosing the hard but correct road back from econominc slavery to being an unencumbered free people.

BTW, we did not need an economist to figure out what happened. We actually talk to each other out here in the hinterlands in good and bad times.

**Posted by: [Steve](#) at December 19, 2008 07:50 AM**

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Menzie said: "...They conclude that about half of the decline in stock prices is due to the credit crunch, with the other half attributable to the decline in consumer confidence."

I find this completely reasonable, since a similar line of research was performed quite a while ago. Jeremy Siegel ("Stocks for the Long Run") did an analysis of the so-called "Nifty Fifty" stock market darlings of the 1970's, comparing their valuations at the time to their subsequent performance over the next couple of decades.

His conclusion: The stocks as a group ultimately generated earnings that justified their "overvaluation" at the stock market peak in the early '70's. However, as a result of \*low consumer confidence\* those stocks became undervalued and remained that way for several years during the mid- to late-70's and early '80's.

As to the point made by Dr. T about there being a borrower shortage and not a credit shortage, that fits with a personal anecdote. A few months ago I was solicited by a local bank with the offer of a substantial HELOC at 75 bp below prime with a 15-year balloon, along with no-fee checking and a couple of other small sweeteners. So now I have access to a huge credit line (for me, anyway) at a low rate of interest against which I would only have to repay the monthly interest for the next decade and a half.

But I'm not borrowing against my HELOC. I have access to a positively shocking chunk of money but I'm not spending it out of normal financial prudence that has nothing to do with consumer confidence, recession, or fear of the future.

Sebastian

**Posted by: Sebastian at December 19, 2008 08:13 AM**

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I read both the Fed papers above and did not find them to be technical in the least. Sure I couldn't plow through it like an article in the NYTimes but it is a lot more informative than what can be found in the NYT. I am going to read the Tong-Wei paper today. If you are bothered by the technical nature of the paper I suggest you find a more accessible blog, I don't think Dr Hamilton has ever declared this blog economics for the people. Economic analysis is technical in nature; to best understand the current crisis a grasp of the Consumption-Savings framework is necessary. So take your first order conditions and then get back to me once you have a grasp on C-S. Part of the problem we have in this country is all of the arm-chair economizing that goes on. Further more, we will be better served by the new treasury secretary who himself understands C-S, clearly Paulson does not, I'm certain its too challenging a topic for HBS MBAs.

Economic events can not be understood in real-time and this readjustment is no different. If the current crisis is viewed using DSGE framework the 50-50 estimate of the economic effects of the current Crisis is seems to be a good first swag. Consumer Confidence being viewed as a shock to B in U(BC1,C2) and credit crisis being a TFP shock. If we view MBS/ABS as technology calling a shock to this technology is clearly a TFP shock. The result is unambiguous a TFP shock which has had downstream effects on consumer preference.

**Posted by: [BETL](#) at December 19, 2008 08:22 AM**

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I was gonna offer a comment here, but calmo is a hard act to follow.

**Posted by: don at December 19, 2008 10:43 AM**

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O don! ( as in the antiquated evocative: "O Chair! how hard thou art!") I B so easy...and keen on extracting whateva you have...nothing beats my keen layman vacuum of intelligence, the Prime Hoover.

So, BETL...for whom there is nothing inaccessible

"If you are bothered by the technical nature of the paper I suggest you find a more accessible blog, I don't think Dr Hamilton has ever declared this blog economics for the people."

was that a deliberate run-on sentence testin our impeccable literary standards or just careless and somewhat misplaced snobbery?

Moreover,[*snobbering in as only I can, like this*]

*Economic analysis is technical in nature [generally, even knitting analysis is "technical" so do not labor needlessly here. We are reasonably competent English speakers and don't need to learn the meaning of "analysis". Instead tell us something about economic analysis, that it is mathematically robust, that without discrete Fourier transforms it would be in the dustbin...something --anything that fills this empty bin: "is technical" ]; to best understand the current crisis [begging the question by 1/2 as per conclusion, yes? ]a grasp of the Consumption-Savings framework is necessary. [and incontestable. Those who derive the occasion for doubting based on the common ("accessibly challenged" would B BETL's script, but I am here to translate: this means you English speakers competent to use words like "consumption", "saving", "crisis", "confidence") language of the unwashed...need a technically robust thrashing...so shuddupanlisten. (a paraphrase an mo of Descartes) ]So take your first order conditions and then get back to me once you have a grasp on C-S*

**Posted by: [calmo](#) at December 19, 2008 12:43 PM**

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@"BETL": you must be an arrogant pseudo-Krugman.

**Posted by: [John Lee](#) at December 19, 2008 01:24 PM**

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John Lee, it could B, BETL iznot arrogant nor pseudonymous but has...something. And your crowbar duzznot...so far.

Ok, club me: what have you got?...besides a short fuse...Me? a lot of respect for Menzie who did not put this up because it's Christmas...but because

*I've been skeptical myself of the "times are normal view", but here is some evidence that the credit crunch is real. The findings also reinforces my view that un-nuanced reliance on highly aggregated volume statistics (e.g., Chari et al. 2008) is likely to result in misleading inferences and I know that I'm missing the force of the argument and BETL may not be...like he says.*

**Posted by: [calmo](#) at December 19, 2008 02:56 PM**

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I apologize for my previous post, I am a jackass for posting it.

**Posted by: [betl](#) at December 19, 2008 03:18 PM**

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I apologize for my post, I am a jackass for it. There are a lot of excuses I would like to make but I wont bother to spill the ink.

More over I apologize to JH. I am grateful for this place and the content. I appreciate that actual content is discussed rather than just headlines.

**Posted by: [betl](#) at December 19, 2008 03:23 PM**

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Apologies aside I still agree with the thesis asserted in the MPLS Fed paper. There has been far too much armchair economizing going on during this crisis, particularly at the Treasury. It is very difficult, even for the brightest economists, to apply existing framework to the situation as it unfolds. As the paper asserts the Treasury appears to be leading the race to the bottom, directionless. As I'm sure has become clear I have a fair amount of venom for Paulson, having to do with my perception of incompetence. There are few that profited more handsomely from the run-up and to now do such a poor job trying to fix the situation is incomprehensible. He was clearly a success on the Street but is twisting in the wind here.

So, I repose the question of the cited paper; What are we trying to fix and how will we know when the correct remedy has been applied?

My take: I think an approximation of real cost of funding can be calculated using a company's cost of funds but CDS prices must also be incorporated. Then coefficients from before and during crisis can be compared, thus negating the reliance on spread values as indicators. Finally, I think this is just a big repricing of risk, across the board - not an original though I know. Companies are reevaluating their IRR targets of potential projects and consumers reevaluating their desire for goods today at the expense of tomorrows.

**Posted by: [betl](#) at December 19, 2008 04:00 PM**

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Thanks for getting back to us BETL (or betl) and even addressing our (possibly jackass) sensitivities to being bethumped by the heavily weighted econometric m.o. the details of which (costing \$5...and devoted attention for the less well-equipped lay (me and Ray)) not readily available...or sought...owing to the "resounding"? conclusion --those fractions mostly: 1/2? I'm not proud to own up to some jackassness...just a tightwad and refuse to pay \$5 to confirm it.

In more detail: I am not confident that I understand the piece (lack of this consumer's confidence) and fear that spending precious resources here will only exacerbate that declining confidence...so I am unwilling to trade my \$5 for the scholar's work even though they're starving (the credit crunch).

**Posted by: [calmo](#) at December 19, 2008 04:39 PM**

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Sorry for my rant-like post. It's been a bit of a preoccupation of mine recently, that the prescriptions and assessments from economists have changed over the last year, but their confidence in their own analytic skills seems unshakable.

I just have a feeling Nassim Taleb may well prove correct, that we probably aren't even conceiving of what will transpire over the next few years.

As to whether the credit crunch is real, isn't it true that in 1907-1908 and 1929-1933, the problem started in money center banks and worked outward? No one could argue that there is a credit crunch for M&A deals. But here, our local bank of a half-dozen branches is doing very well. Of course, the hospital just started laying people off. And the state university is facing big cut backs. And the other local colleges' endowments are down 30+% and they will be cutting back...

Check back in a year or two and our local bank might be experiencing some real deterioration in their portfolio and may need to tighten lending.

**Posted by: [Bob\\_in\\_MA](#) at December 19, 2008 04:44 PM**

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This paper sounds like nonsense. The liquidity and demand shocks can affect stock prices only to the extent that they truly are shocks, i.e., unanticipated. It's quite likely that many investors saw the falloff in demand coming, given the many housing bubble stories in the media prior to July of 2007. The liquidity problems at major banks were much more of a surprise, but even they were anticipated to some extent, as evidenced by the steady rise in CDS prices in early 2007.

A serious paper along these lines would look at market-based measures of expected liquidity problems and demand changes and use the innovations in these series to try to explain contemporaneous movements in individual stock prices. Using an instrument with but a single effective observation (9/11/2001) is laughable.

**Posted by: [Jeff](#) at December 20, 2008 07:06 AM**

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"Sorry for my rant-like post. It's been a bit of a preoccupation of mine recently, that the prescriptions and assessments from economists have changed over the last year, but their confidence in their own analytic skills seems unshakable."

Maybe that is because the economists who aren't confident in their analytic skills don't make predictions, analysis etc. But I fully agree with you. Why should we believe economists? And why should it be necessary to understand economics in order to judge it. As Jesus stated you can judge a tree by its fruit.

The fruit of economics and all sciences is prediction. With physics the fruit is good...Haley predicted the return of the comet, Maxwell's laws predicted the existence of radio waves etc. And these sciences are useful tools. You can use them to design things like antennas and orbital trajectories. What exactly can you do with economics?

**Posted by: [assman](#) at December 20, 2008 08:19 AM**

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James Maxwell, no kidding assman. So an engineer, then? Just an electromagnetic hobbyist?...like me who has just barely enough math to appreciate the notorious elegance of his contribution. Nonetheless, economics is not physics (fuggedabout those Buddhists...so much depends on forgettin the right stuff). Heisenberg meets sociology in a delightful crash (according to The Bed Sheets) and we wouldn't B spendin our precious time here if we were merely billiard balls careening from one post to the next right? Right?

So...carefully select the experts (Taleb is a discard, people), recognize their work, and nibble away, keeping them honest and your teeth sharp...performing honorably (you see how the Bed Sheets sneak up on you...) repaying those who guide you (even if itiz off the bridge) and got you this far (even if it is the ravine below the bridge...) somewhat equipped. Trashing the whole business isnotit.

..so about this "rant"-generating piece (successful then, in my teeth-sharpening manual) and apologies for same (humbling beyond words...don't make me cry)...has anyone spent the \$5?

**Posted by: [calmo](#) at December 20, 2008 10:42 AM**

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I re-read all the above comments. Much fun but I could not really learn anything. Still don't know what is what..

**Posted by: [ReformerRay](#) at December 21, 2008 06:31 AM**

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Ok, that does it.

Resoundingly.

Nobody is willing to pay the \$5 to confirm/deny the author's conclusion.

Tight-wad consumers...ie zero consumer confidence (ie 100% lack of cc)...a lousy \$5 is enough to constitute a barrier (even for fabulously wealthy, but obviously thrifty, Sebastian) and sellers so far are unwilling to reduce prices...ergo 0% (ie 0/1) credit crunch.

We could band together and buy it now for \$1/share or wait them out, yes? Ok, 10 cents/share and MC can backstop us for the rest.

Similarly,

HF's looking for business with the TALF have asked for and received concessions NOW (Dec 19?) for assets (toxic debts with no Econbrowser buyers) and for the next 3 years...revisable "as facts change" as Paulson bully-puts it.

**Posted by: [calmo](#) at December 21, 2008 12:57 PM**

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**To everyone:** Here is an ungated version of [Tong and Wei](#).

**Posted by: [Menzie Chinn](#) at December 21, 2008 01:51 PM**

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