

# Content Review



# Lecture Review: Financial Crisis

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- ▶ bank failure; loss of confidence in financial markets; reluctance of banks to lend.
- ▶ leads to a substantial contraction in economic activity.
- ▶ Eg; GFC, Great Depression, Asian Financial Crisis, Sovereign Debt Crisis (Greek).



# Lecture Review: Financial Crisis

Stages of a financial crisis



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- ▶ **Stage 1:** Easy Credit and Asset Price Bubbles



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- ▶ **Stage 2:** Banking Crisis





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Stages of a financial crisis

- ▶ **Stage 1:** Easy Credit and Asset Price Bubbles
- ▶ **Stage 2:** Banking Crisis
- ▶ **Stage 3:** Debt Deflation



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Policies to address a financial crisis?



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- ▶ Modifications in prudential regulations.



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- ▶ Financial bailouts to troubled sectors and banks.
- ▶ Modifications in prudential regulations.
- ▶ Greater international cooperation on macro policies and bank regulation.





# Lecture Review: Great Depression

Stock Market Bubble and Bust



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## Stock Market Bubble and Bust

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- ▶ Margin lending and increase in leverage possible due to financial innovation.
- ▶ Excessive optimism led to huge speculation on stock prices.
- ▶ Wall Street Crash of October 1929 (Great Crash).



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Bank Failures, Money Supply, and Deflation



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- ▶ Bank regulation had size restrictions; small banks were not as robust/stable.
- ▶ Initial bank failures led to erosion in belief over stability of other banks.
- ▶ Bank runs and lower deposits led to contractions in the money supply.



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International Transmission of the Great Depression



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- ▶ Gold Standard was a major factor in the transmission of the Great Depression.