



The Federal Reserve And Financial Crises

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The views expressed are those of the speaker's and should not necessarily be attributed to the Federal Reserve Bank of Dallas or the Federal Reserve System.

What is a Financial Crisis?

“A financial crisis is fueled by fears that the means of payment will be unobtainable at any price and, in a fractional reserve banking system, leads to a scramble for high-powered money. It is precipitated by actions of the public that suddenly squeeze the reserves of the banking system. In a futile attempt to restore reserves, the banks may call loans, refuse to roll over existing loans, or resort to selling assets.”

Anna Schwartz, 1986

Resolving a Crisis

“A panic, in a word, is a species of neuralgia, and according to the rules of science you must not starve it. The holders of the cash reserve must be ready not only to keep it for their own liabilities but to advance it most freely for the liabilities of others. They must lend to merchants, to minor bankers, to ‘this man and that man’ *whenever the security is good.*”

Walter Bagehot, 1873 (emphasis added)

A Caveat

“It is by no means intended to imply, that it would become the Bank of England to relieve every distress which the rashness of country banks may bring upon them; the bank, by doing this, might encourage their improvidence. The relief should neither be so prompt and liberal as to exempt those who misconduct their business from all the natural consequences of their fault, nor so scanty and slow as deeply to involve the general interests.”

Henry Thornton, 1802

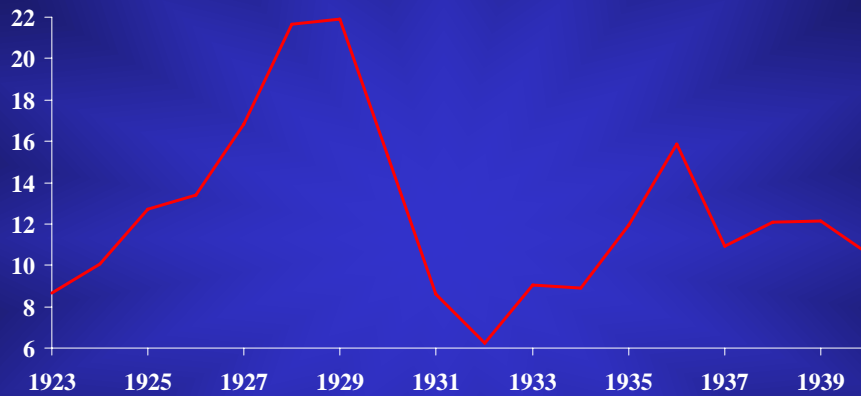
Financial Crises

- Great depression
- Stock market crash of 1987
- Asian financial difficulties/Russian default of 1998?
- September 11, 2001
- Current subprime woes?

Index of Common Stocks

1923-1939

Index 1941-1943=10

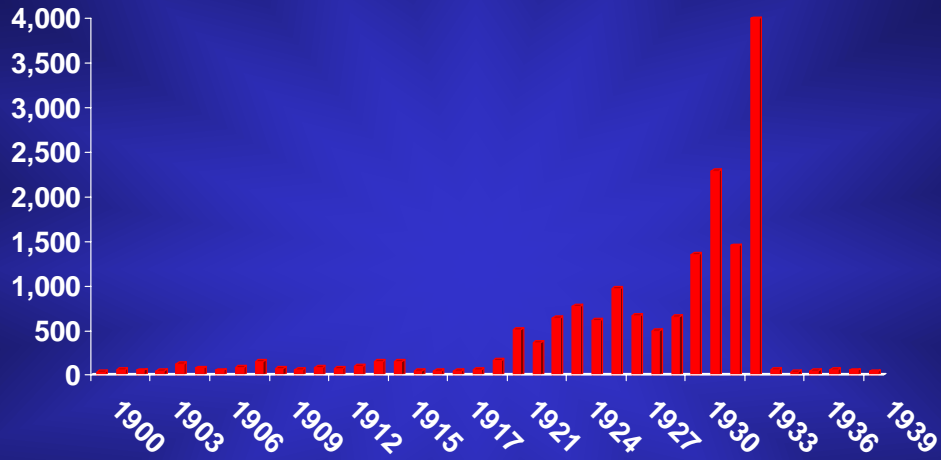


People milling about outside of a bank that closed, ca. 1933.
National Archives photo.

Bank Suspensions

1900-1939

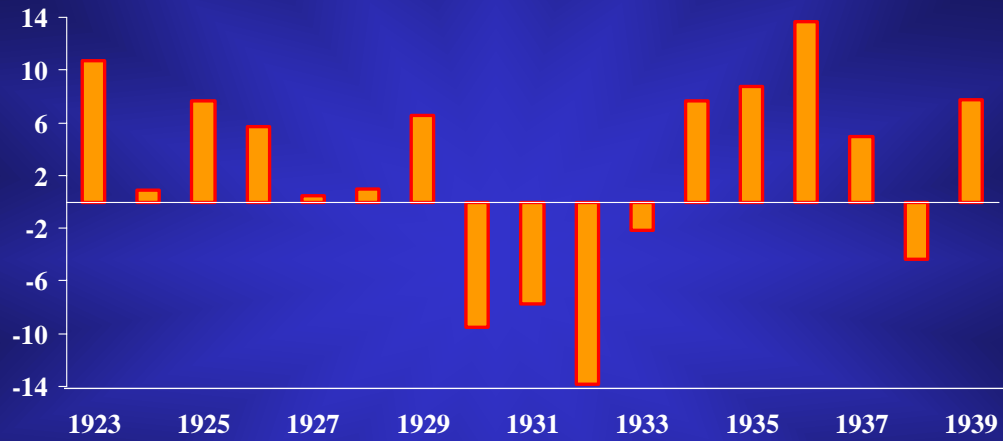
Number of Banks



Real GDP Growth

1923-1939

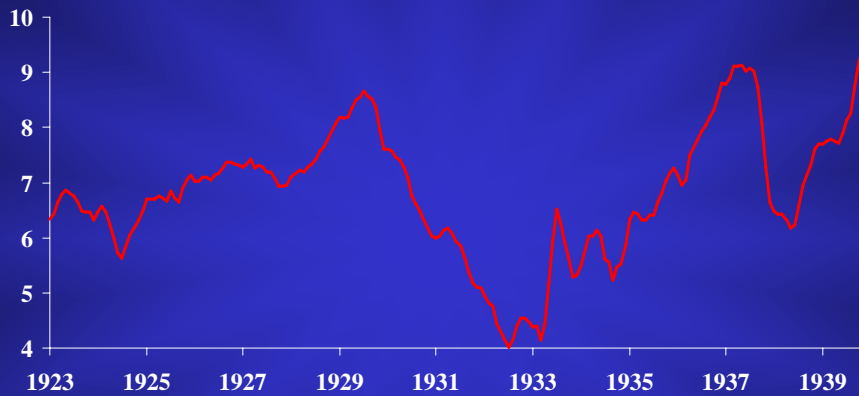
Percent



Industrial Production Index

1923-1939

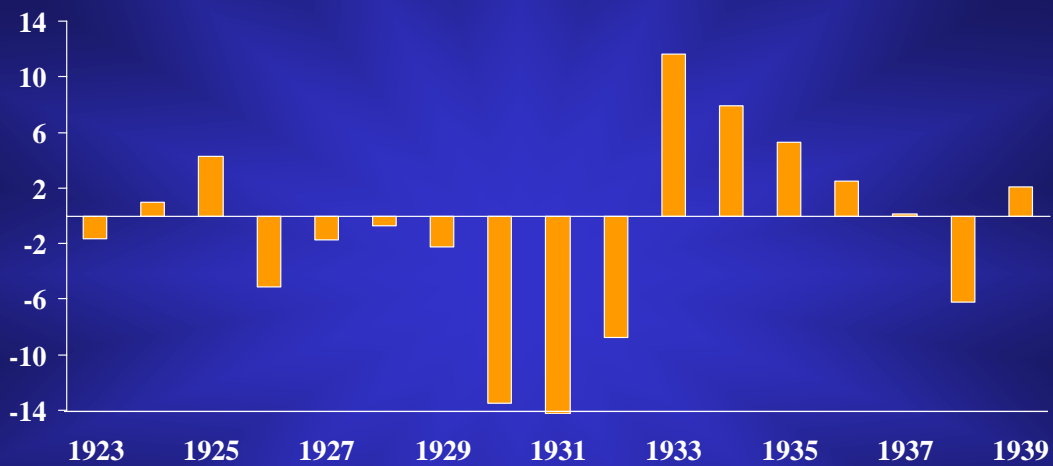
Index 2002=100



Deflation – Wholesale Prices

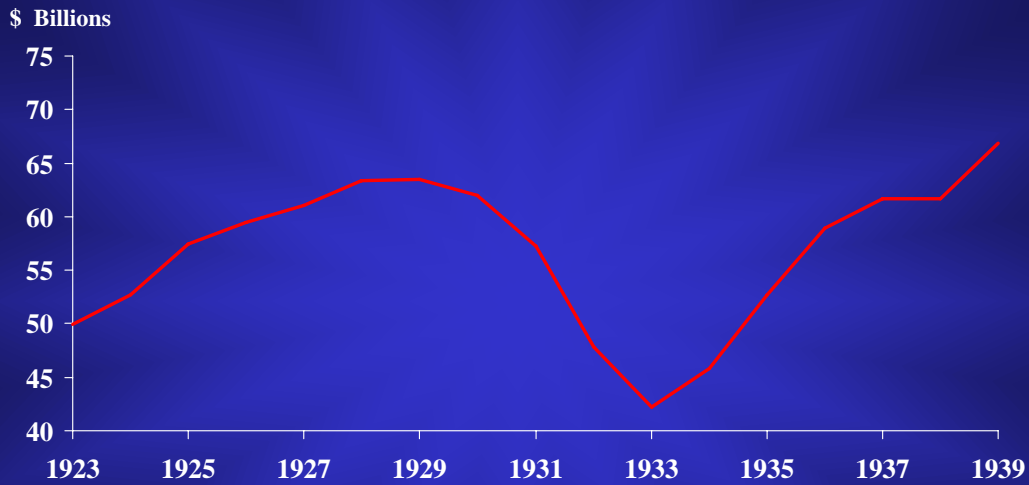
1923-1939

Percent



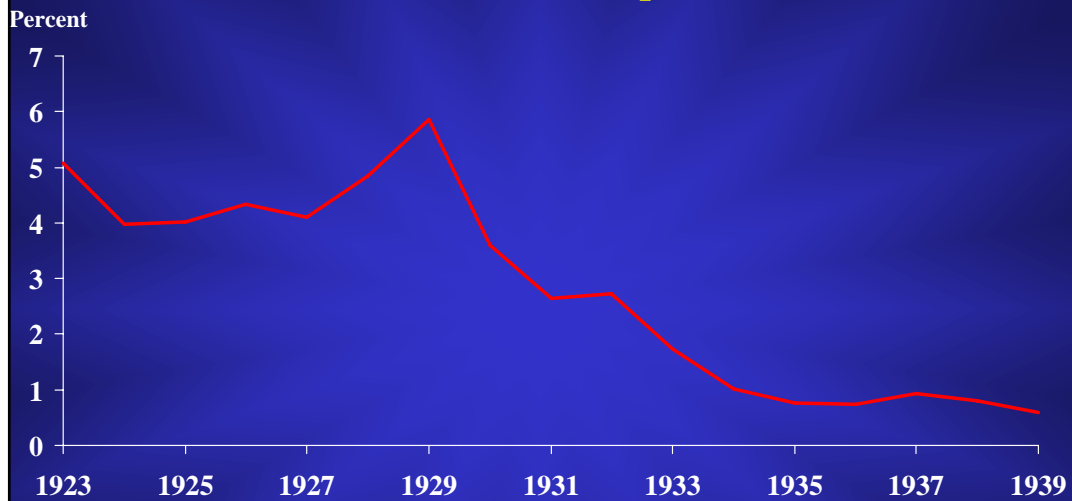
Money Supply – M2

1923-1939



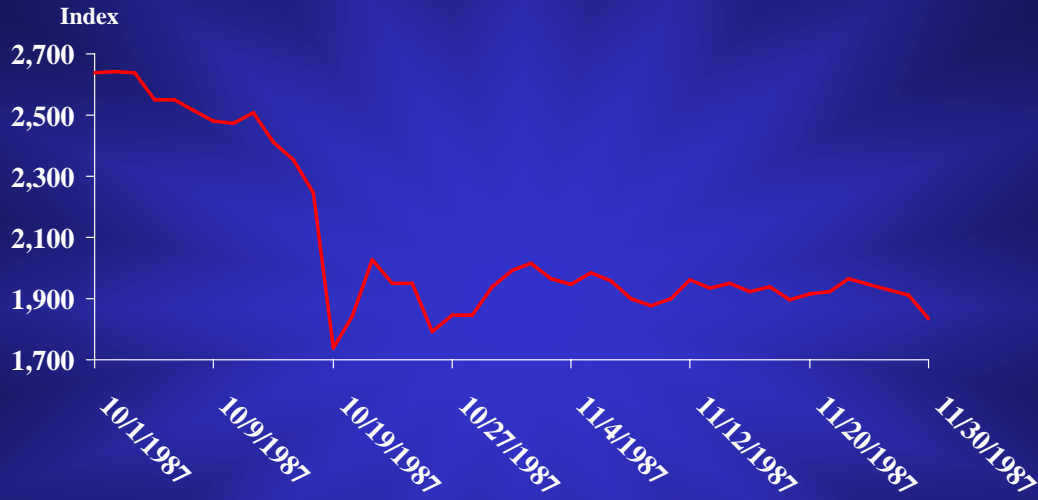
Interest Rates

Yields on Commercial Paper 1923-1939



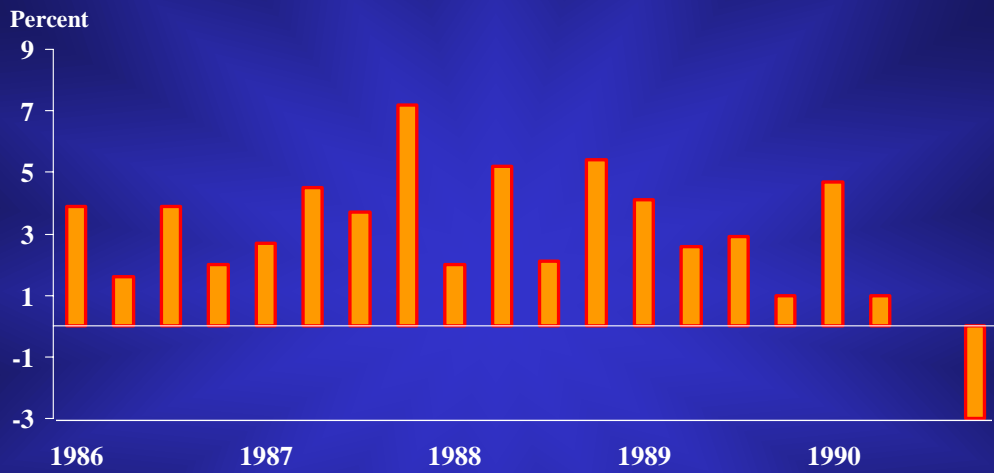
1987 Stock Market Crash

Dow Jones Index



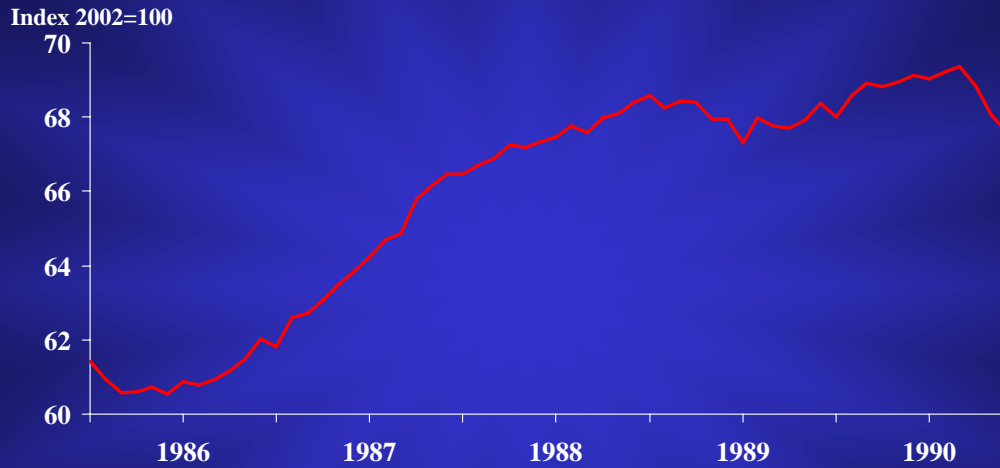
Real GDP Growth

1986-1990



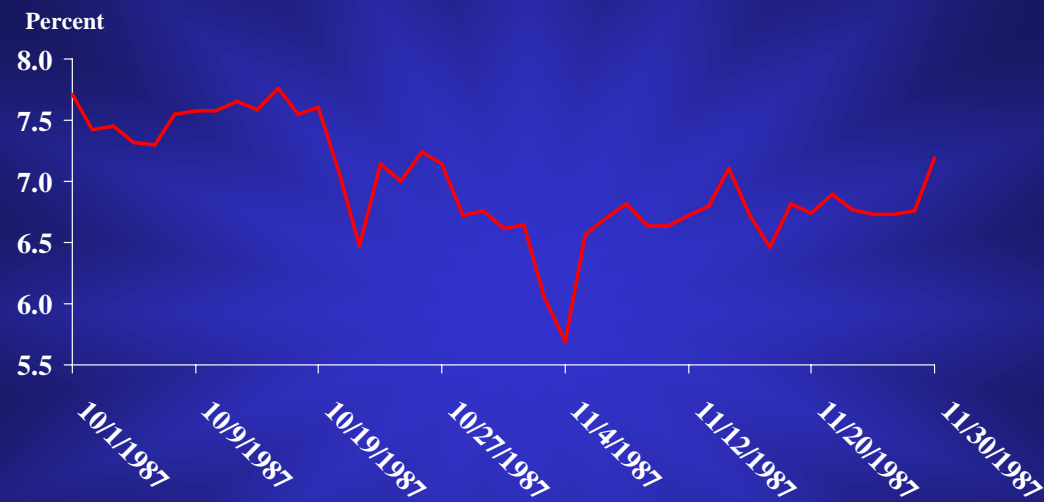
Industrial Production Index

1986-1990



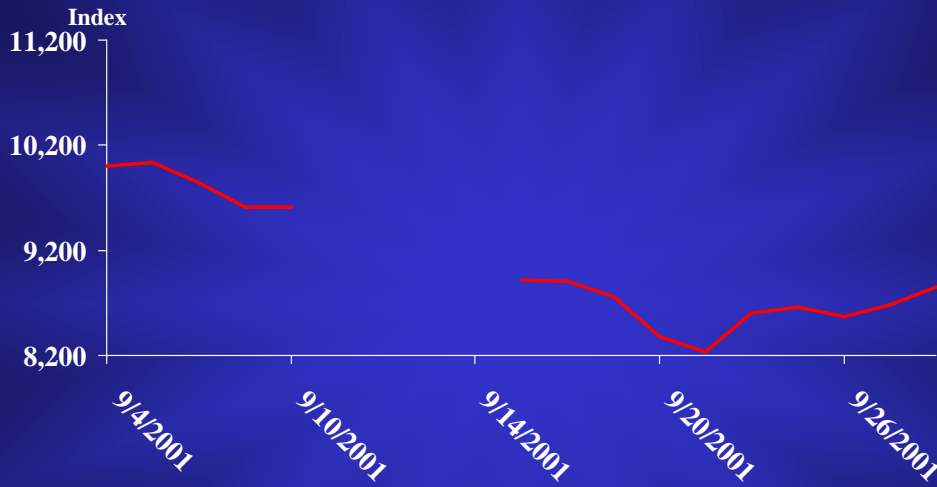
Federal Funds Rate

October – November 1987



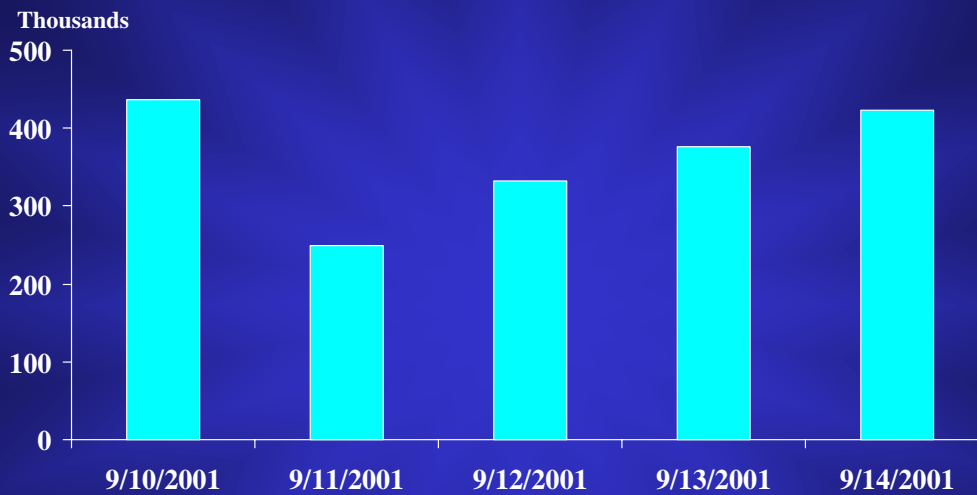
September 11, 2001

Daily Dow Jones Average September 2001



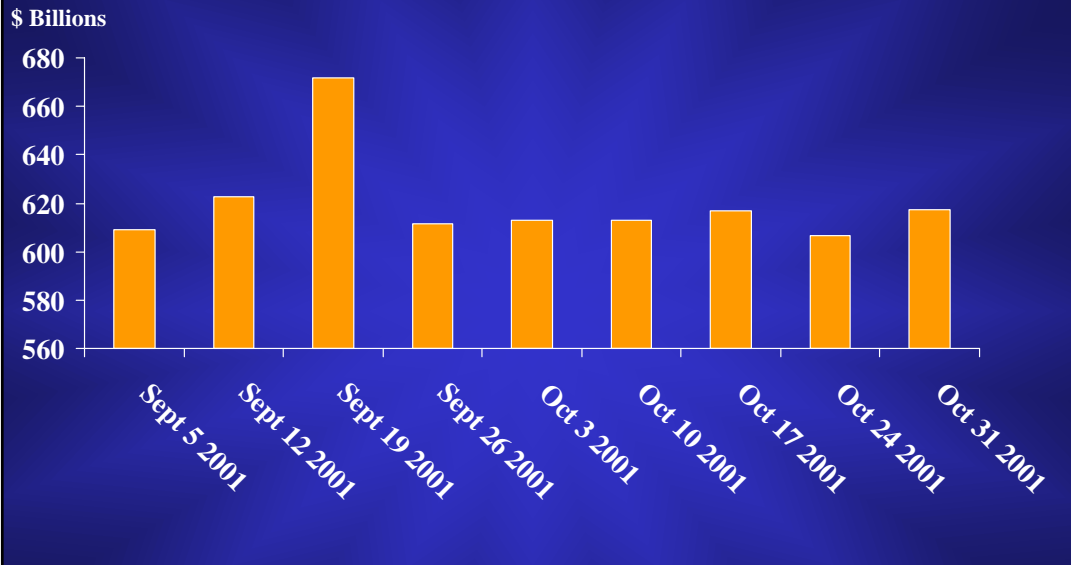
September 11, 2001

Fedwire Payments Volume



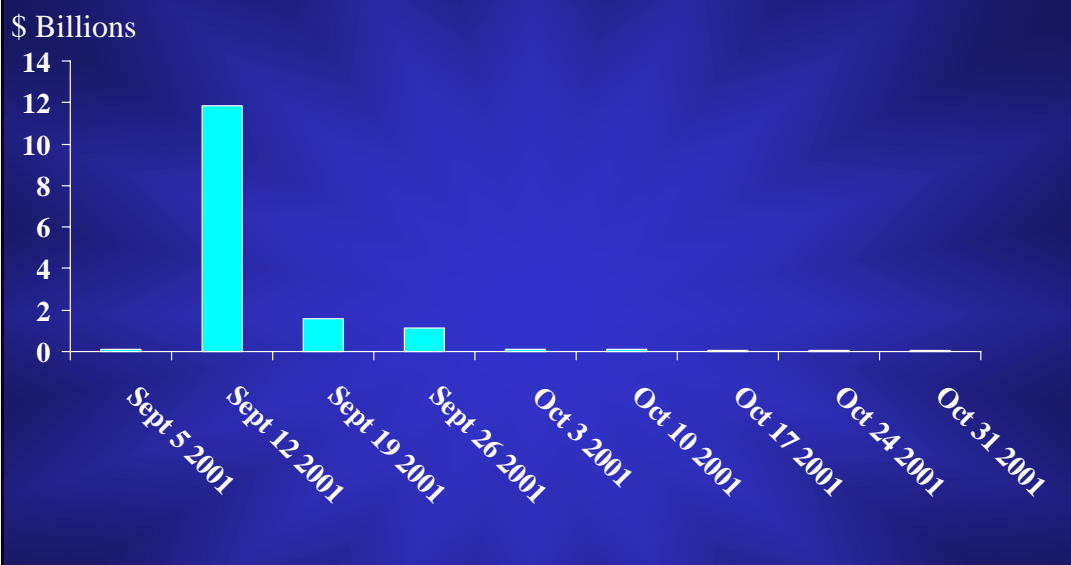
Reserve Bank Credit

Weekly September – October 2001



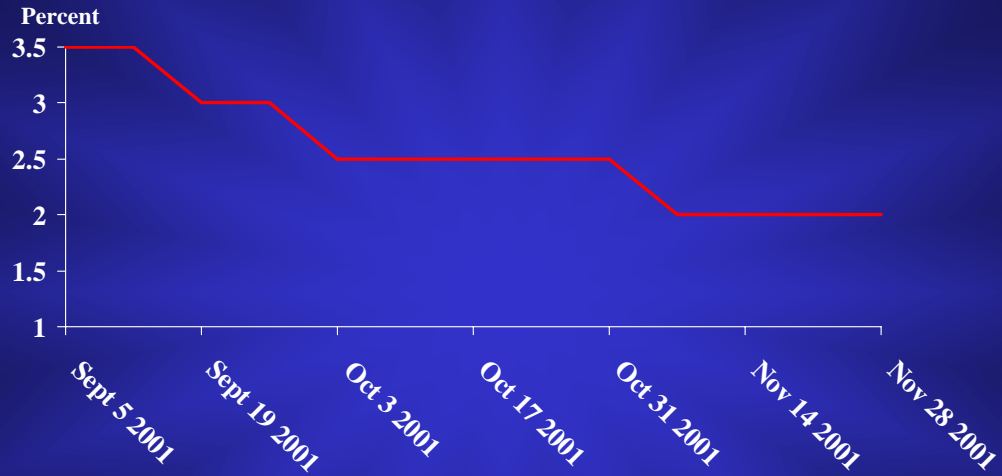
Discount Window Borrowing

Weekly September – October 2001



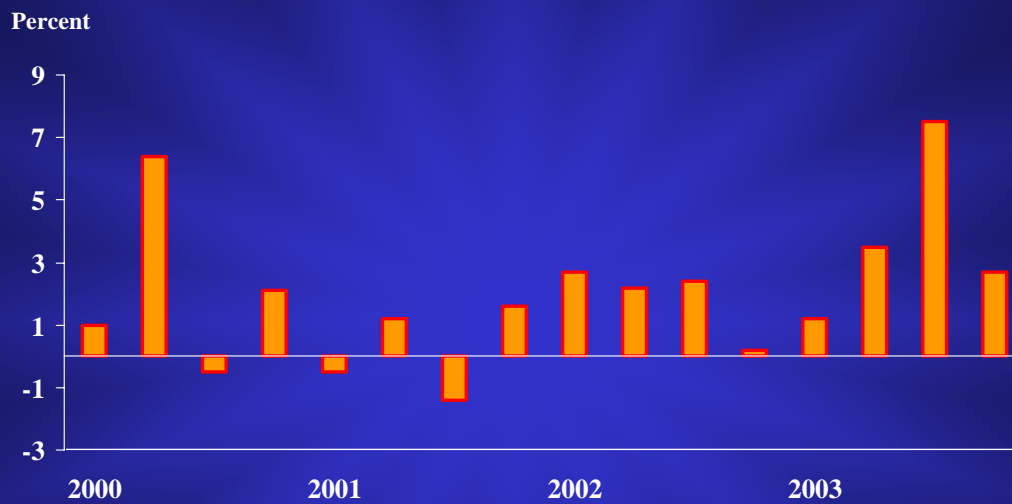
Federal Funds Rate Target

September – November 2001



Real GDP Growth

2000-2003



Conclusion

- Identifying crises can be difficult
- Real crises can disrupt economic activity
- Monetary policy responses can make a difference

