

ECO 209 Macroeconomic Theory and Policy

Case Study No. 3

Case Study No. 3 on ***Balance-Sheet Recession*** will be discussed in class during the week of November 20. The required short-readings have been posted on the course website. Read these articles and come to class ready for the discussion. The following questions will help you in your preparation:

- 1) What is a “balance-sheet recession”? What are the causes of this “type” of recession? What are the usual causes of a more “typical” recession?
- 2) What does “deleveraging” mean? How is deleveraging being done? What are the economic consequences of widespread deleveraging? Why the “deleveraging of the financial sector can be particularly deep, quick and nasty”?
- 3) What was the experience of Japan during the 1990s? What type of economic policy did Japan implement during that time? What has been the experience of the U.S. since 2007 (and of Canada since 2008)? What type of economic policy have since the American and Canadian governments been implementing?
- 4) Why does expansionary monetary policy not work during a balance-sheet recession?
- 5) What is a “liquidity trap”? Is the liquidity trap experienced during a “balance-sheet recession” somehow different from the “typical” liquidity trap?
- 6) What kind of government action is needed during a balance-sheet recession? What was the experience of Japan during the 1990s? What has been the experience of the U.S. and Canada since 2007?
- 7) What type of expansionary fiscal policy should be implemented under these circumstances? Would tax cuts work during a balance-sheet recession?
- 8) During a balance-sheet recession, should we worry about government deficits? Should governments cut their deficits to “calm down” the markets? What is needed to restore the “confidence” of consumers and businesses?