The Federal Reserve's Role in Financial Crises

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Background and Significance

How did the Federal Reserve's action help ease America out of the Great Depression and 2008 Recession?

- The Federal Reserve (Fed) ⟶ America's central bank
  - Oversees American banks and controls monetary policy
  - Is lender of last resort, stabilizes the economy, and mitigates financial crises
- Stock exchanges ⟶ buyers and sellers of securities can interact
  - Full of risky securities & can crash from a lack of confidence (one industry or whole economy)
  - The stock market is closely tied to America's economy ⟶ crashes can be catalysts for economic downturn

Great Depression

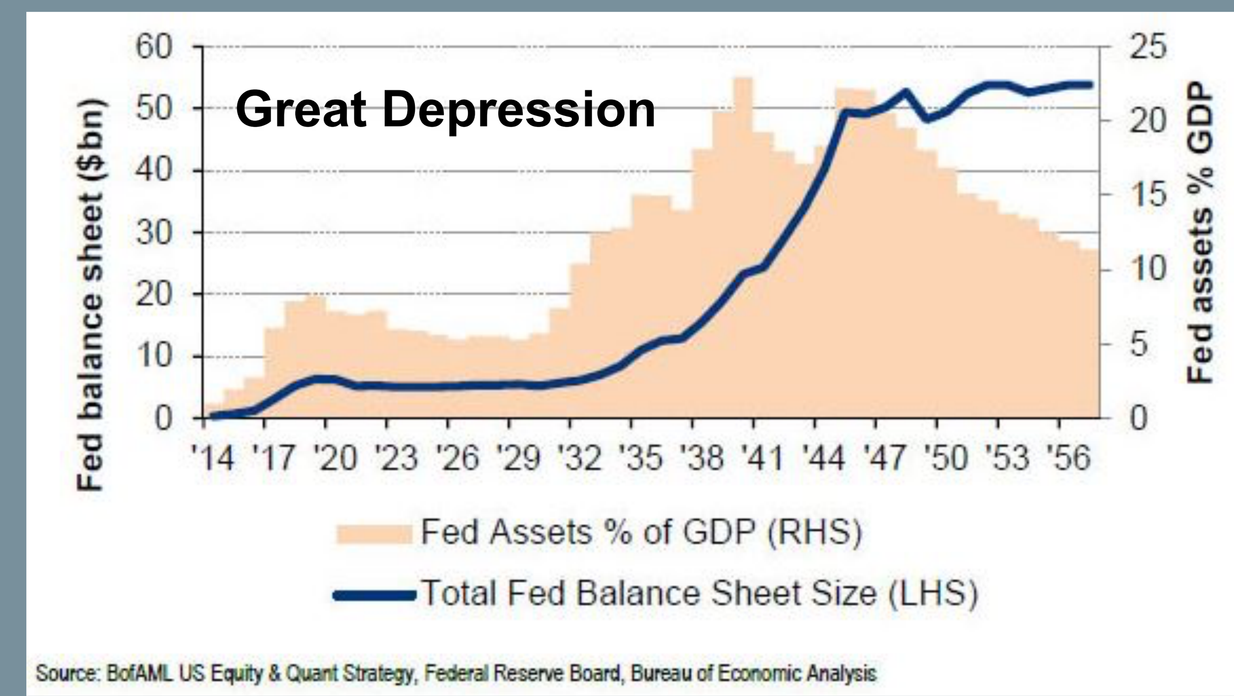
- WW1 and the gold standard
  - Difficult recovery from WW1 (deflation and devaluation)
- Well-off America eased credit to prop up European countries
  - Speculation, no way to stop it without harming the economy
- Turmoil in the Federal Reserve after Benjamin Strong's (respected NY Fed president) death in 1928
- Black Tuesday ⟶ little Federal help to banks or customers
- FDR comes into office with bank holiday and New Deal policies
  - Some are controversial, but they provided work and improved economic conditions until WW2

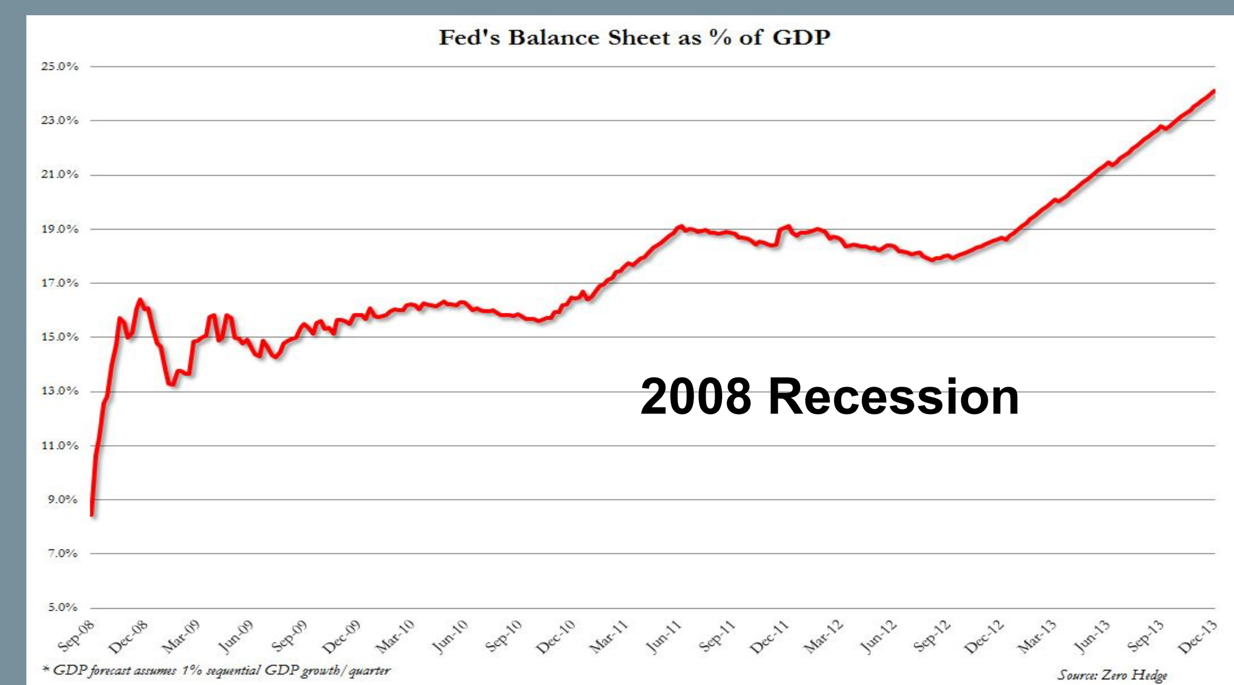
2008

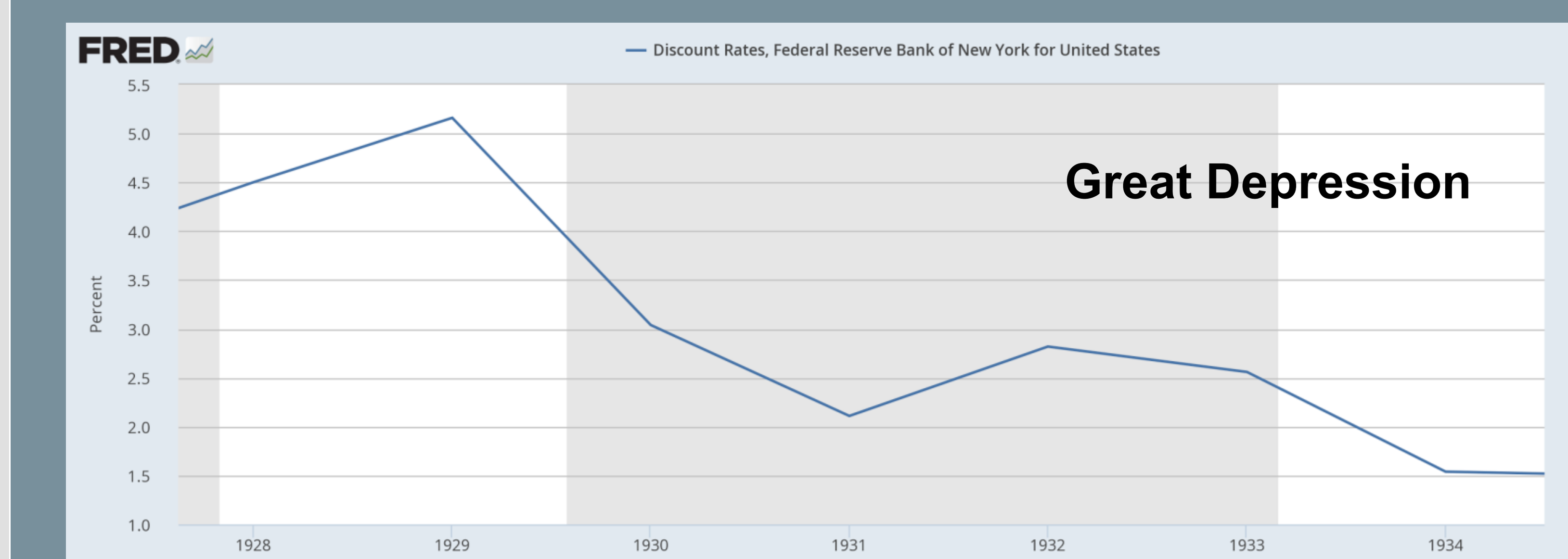
- Mortgages — especially mortgage-backed securities (MBS)
  - Standard mortgages make money, but new collateralized debt obligations (CDOs) created more traffic and reduced risk
- Financial companies ⟶ vertical integration + riskier mortgages
  - more and more defaults
  - conflict of interest with ratings agencies ⟶ eventual downgrade
- Selling sprees, entire industry at risk
- Government bailouts, introduction of TARP and QE, stress test

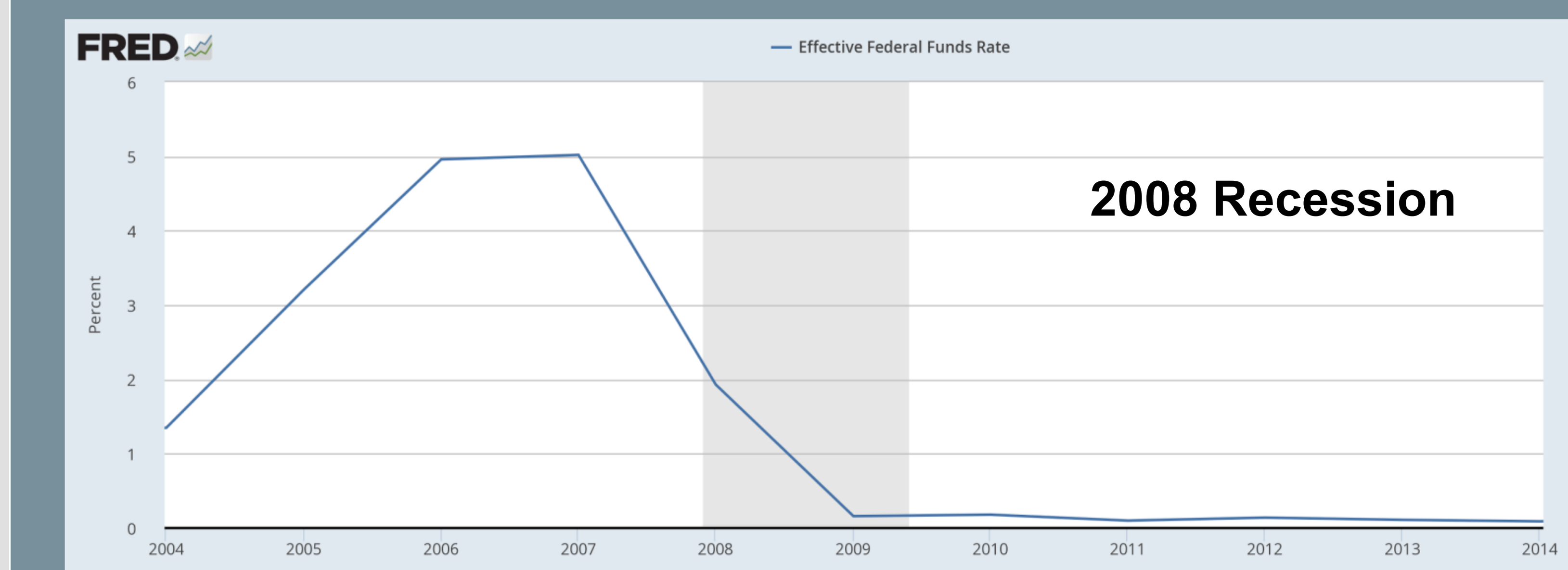
Data Analysis

Fed Balance Sheet as % of GDP



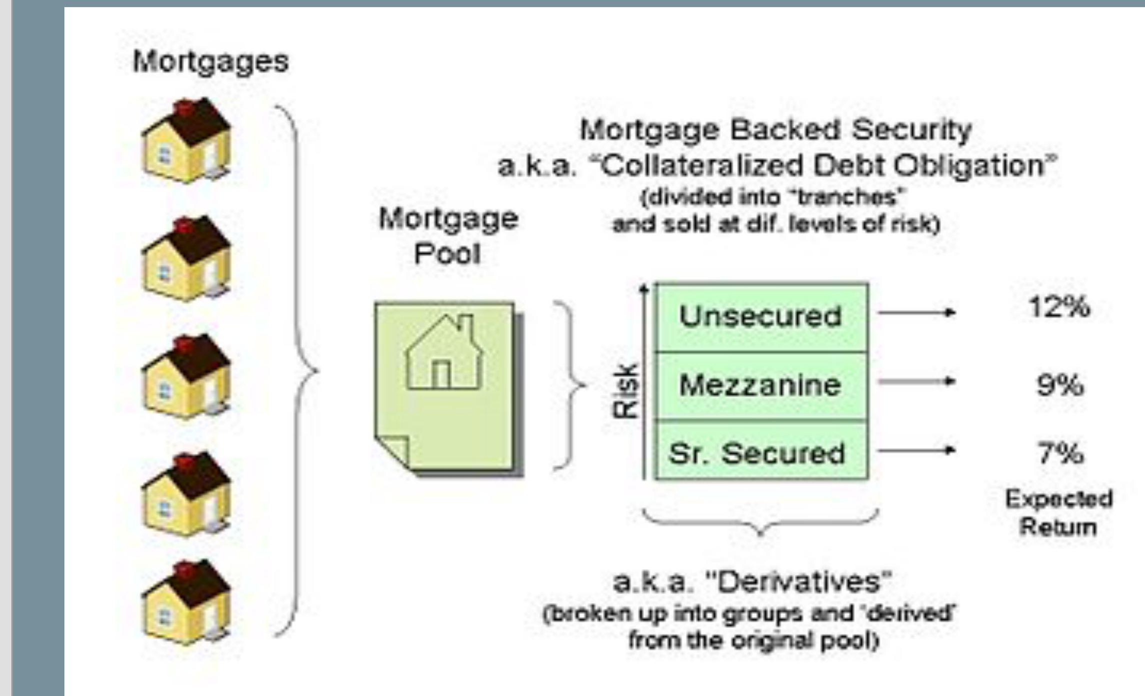


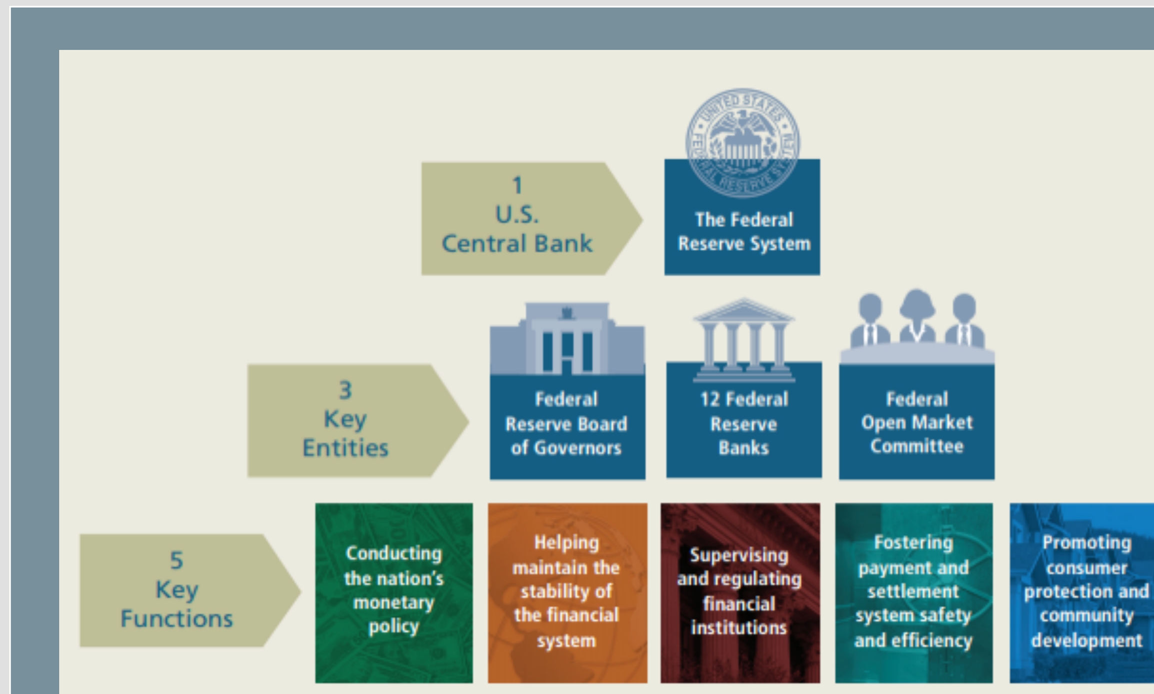




Conclusion

- Major difference between Fed action during in 1920s and 2000s
  - 2008 Fed ⟶ aggressive, unwilling to have a repetition of the Great Depression (which didn't fully recover until WW2)
    - Creative solutions to raise confidence in financial institutions
- Today, the economy is in a better place. The stock market is at all-time highs, and the Federal Reserve has begun to raise interest rates again.





Acknowledgements and Sources

I would like to thank my mentor and AAR teachers for all of their support in making this project possible.

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