Federal Reserve Bank
of Minneapolis

Fall 1991

Quarterly Review

Can a "Credit Crunch" Be Efficient? (p. 3)

Edward J. Green
Soo Nam Oh

A Bleak Outlook for the U.S. Economy (p. 18)

David E. Runkle

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Vol. 15, No. 4 ISSN 0271-5287

This publication primarily presents economic research aimed at improving policymaking by the Federal Reserve System and other governmental authorities.

Produced in the Research Department. Edited by Preston J. Miller, Kathleen S. Rolfe, and Martha L. Starr. Typeset by Correan M. Bona and Joseph R. Piepgras. Graphic design by Phil Swenson, Barbara Birr, and Beth Grorud, Public Affairs Department.

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In This Issue

Crunch

When it comes to the topic of a credit crunch, policymakers and academics couldn't be farther apart. But perhaps the two sides can be brought closer together after reading "Can a 'Credit Crunch' Be Efficient?" (p. 3) in which Edward J. Green and Soo Nam Oh split some of the important differences.

The differences between the two groups were highlighted this last year. Policymakers gave the credit crunch a major role in the recession by emphasizing the refusal of banks to make loans to creditworthy customers. All year policymakers regularly exhorted banks to loosen up. Academics, in contrast, reasoned that since interest rates are no longer subject to ceilings, a credit shortage could not exist. If prospective borrowers could not get loans, it was only because they were bad credit risks. Since reduced lending was seen as an efficient market outcome, academics saw no need for policy intervention. They regularly exhorted policymakers to let the market take care of itself.

Green and Oh find some merit in both views. Their analysis supports policymakers in suggesting that credit crunches can occur even when there are no interest rate ceilings. In their model, financial intermediaries provide a form of welfare-improving insurance that in recessions has them restricting loans to creditworthy customers while offering better terms to customers who experience bad times. However, since the credit crunch in the Green-Oh model is efficient, their analysis also supports academics in finding no need for policy intervention.

Dud

If the U.S. economic recovery has indeed begun, it's clearly a dud. That won't change soon, according to David E. Runkle in "A Bleak Outlook for the U.S. Economy" (p. 18). Runkle predicts that in the first year of this recovery, output will rise only about half as fast as usual at this stage of the business cycle.

Although Runkle's view is not much different from that of the current consensus, he arrives at it in a very different way. The consensus view seems to be that the recovery must be weak because the recession was shallow. Runkle takes a longer-run view. He shows that although the recession was shallow, it didn't start at sea level: the economy has been growing so weakly for so long that output is now about as far below trend as it has been in any recession since 1948. Runkle attributes the weak recovery to what he finds unusual in the latest recession—how much the general weakness in demand has been due to weakness in consumer spending.

Economic theory suggests that major changes in consumption reflect changes in the long-term income prospects of individuals; people decide to spend less, for example, when they think their income has been more or less permanently cut back. These sorts of changes, of course, are reflected in the growth of national income. Therefore, Runkle investigates whether the United States' long-term growth potential has declined. He finds reasons to think so. Perhaps most notable is his evidence that the total number of hours worked is likely to grow more slowly in the foreseeable future. That Runkle traces to slowdowns in the entry of women and baby boomers into the labor force and in the growth of hours worked per person.

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