Discussion of Stock-Watson’s "Disentangling the Channels of the 2007-2009 Recession"
and
Del Negro-Schorfheide’s "Real-Time DSGE Model Density Forecasts During the Great Recession"

Nobuhiro Kiyotaki
Comparing Great Recession with Post-War Cycles

Stock-Watson use Dynamic Factor Model

- Shocks are common but bigger. Financial/Uncertainty shocks are main

- Propagation is similar

Del Negro-Schorfheide use DSGE model

- DSGE and Blue Chip did not forecast Great Recession until 2008Q4

- DSGE with financial friction forecasts recessions from 2009Q1 with current interest rate data, but does not always forecast better in the other cycles
Implications for recession with financial crisis

It is hard to predict financial crisis

financial/uncertainty shocks are volatile

possibility of multiple equilibria?

Once started, it is easier to predict the outcomes with updated information

propagation is similar with large financial/uncertainty shock

similar general equilibrium model w/ financial friction useful?

Historical studies of major financial crises is complementary
Theoretical conjectures

Before financial crisis, we can only find early warning signs and make contingent damage control

Whether financial system shifts the purchasing power from unproductive to productive, or

from risk-averse/pessimistic to risk-seeking/optimistic?

asset price inflation (especially real estate price), credit boom (rise of leverage rate or debt-income ratio), and capital inflow
During major financial crisis, we expect large contraction in production and asset price through financial accelerator

Reinhart-Rogoff average of major postwar financial crisis of advanced and emerging market economies:

- real GDP falls by 9.3% in 2 years, equity price falls by 56% in 3.4 years, unemployment rate rises by 7% in 4.8 years, housing price falls by 35% in 6 years, and government debt is almost doubled in 3 years
Recovery depends upon balance-sheet adjustment, real rigidities and trend

Recapitalization of financial intermediaries were slower in Japan and Europe than US

If businesses cannot reduce fixed capital and permanent employment easily, they hesitate in investing in these and intangible capital, leading to a slower growth

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A
B'
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0 Illiquid assets

liquid assets

D
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Illiquid assets
Quick recovery: output, working capital investment, temporary employment, stock price

Slow recovery: credit, fixed capital investment, permanent employment, real estate price

Legacy: government debts