

Federal Reserve Bank of Minneapolis
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Myths about the Financial Crisis of 2008*

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ABSTRACT _____

We show that four widely-held beliefs about the financial crisis of 2008 are false.

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Clearly, the United States and the world economy are undergoing a major financial crisis. Interbank borrowing and lending rates have risen to unprecedented levels relative to U.S. Treasury Bills. Several major financial institutions have failed. These real problems have also been associated with four widely-held myths about the nature of the financial crisis and the associated spillovers to the rest of the economy. The financial press and policymakers have made four claims about the nature of the crisis.

1. Bank lending to nonfinancial corporations and individuals has declined sharply.
2. Interbank lending is essentially nonexistent.
3. Commercial paper issuance by nonfinancial corporations has declined sharply and rates have risen to unprecedented levels.
4. Banks play a large role in channeling funds from savers to borrowers.

Here we examine these claims using data from the Federal Reserve Board. At least based on data up until October 8, 2008, we argue that all four claims are false¹.

Figure 1A displays weekly data on the total amount of bank credit for all U.S. commercial banks from 2001 onwards. Figure 1B displays the same data from the beginning of 2008 onwards. Bank credit consists of the aggregate amount of assets held by these banks excluding vault cash. As is clear from these figures bank credit has not declined during the financial crisis. Indeed, bank credit appears to have risen relative to trend in the month of September. Figures 2A and 2B display analogous data for loans and leases made by U.S. commercial banks. Again, we see no evidence of any decline during the financial crisis. Figures 3A and 3B display data for commercial and industrial loans. Again, we see no evidence that the financial crisis has affected lending to nonfinancial businesses. Figures 4A and 4B

display data for consumer loans and show no evidence that the financial crisis has affected consumer lending.

These figures show that the first claim, that banks have stopped lending to nonbank entities and individuals is false, at least in the aggregate as of October 8.

Figures 5A and 5B display data for interbank loans made by all U.S. commercial banks. These figures show that, at least in the aggregate, interbank lending is healthy. The second claim, that the volume of interbank lending has fallen sharply is false, at least as of October 8.

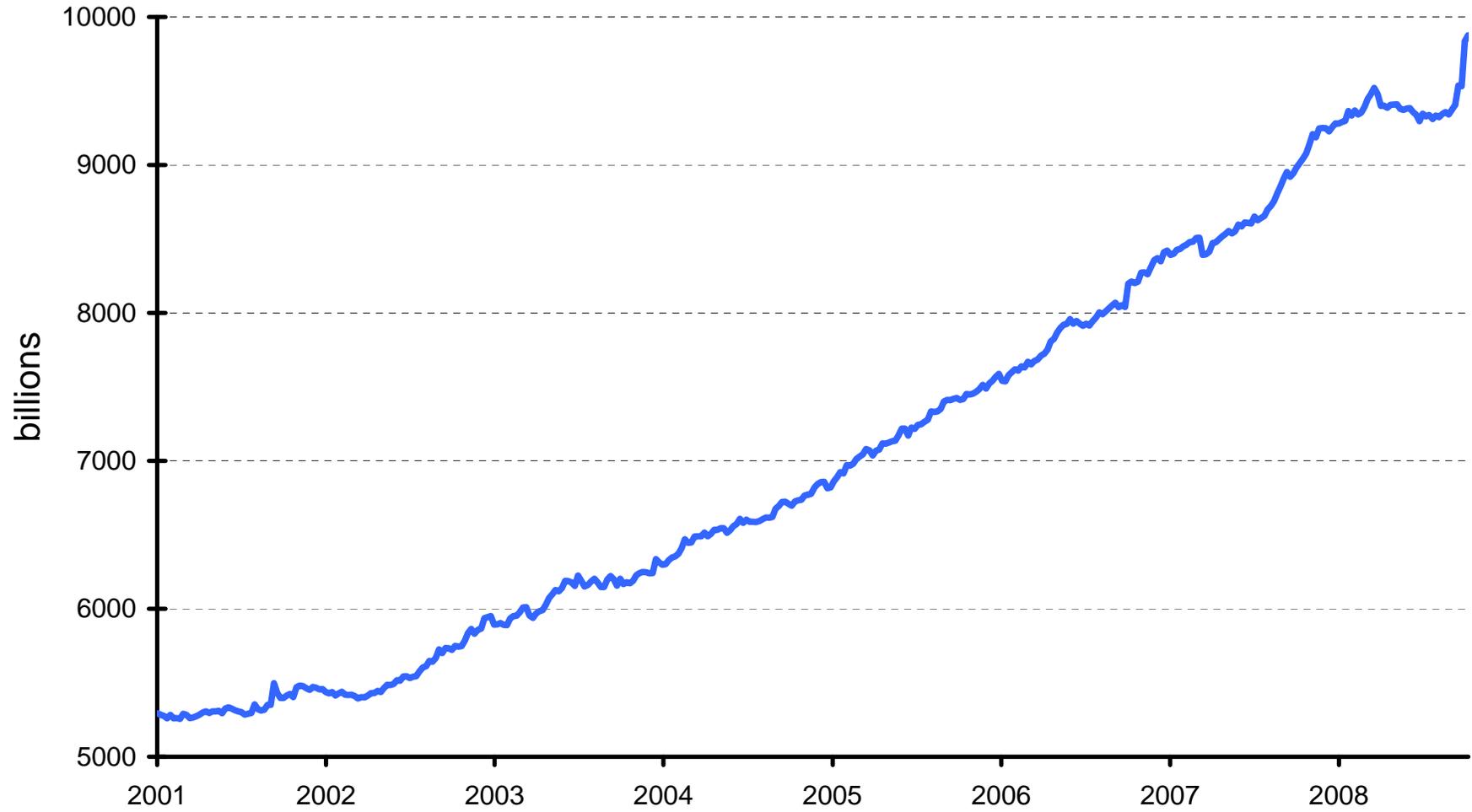
Figures 6A and 6B display data for the stock of commercial paper outstanding for financial and nonfinancial corporations. These figures show that, while commercial paper issued by financial institutions has declined, commercial paper issued by nonfinancial institutions is essentially unchanged during the financial crisis.

Figures 7A and 7B display data for the interest rate on commercial paper with a maturity of 90 days for financial and nonfinancial corporations. These figures show that, during the financial crisis, this interest rate has risen for financial institutions and has barely budged for nonfinancial institutions. Note that, even though the interest rates for financial institutions has risen recently, it is still well below the levels that prevailed from the beginning of 2006 to the middle of 2007. These figures show that the financial crisis has not led commercial paper rates to rise to levels well beyond historical levels. Taken together Figures 6 and 7 show that the third claim is false, at least as of October 8.

We now turn to data from the Federal Reserve Board's Flow of Funds Accounts. These data allow us to analyze the claim that bank lending to nonfinancial corporate businesses constitutes the bulk of borrowing of these businesses. Banks lend directly to such businesses

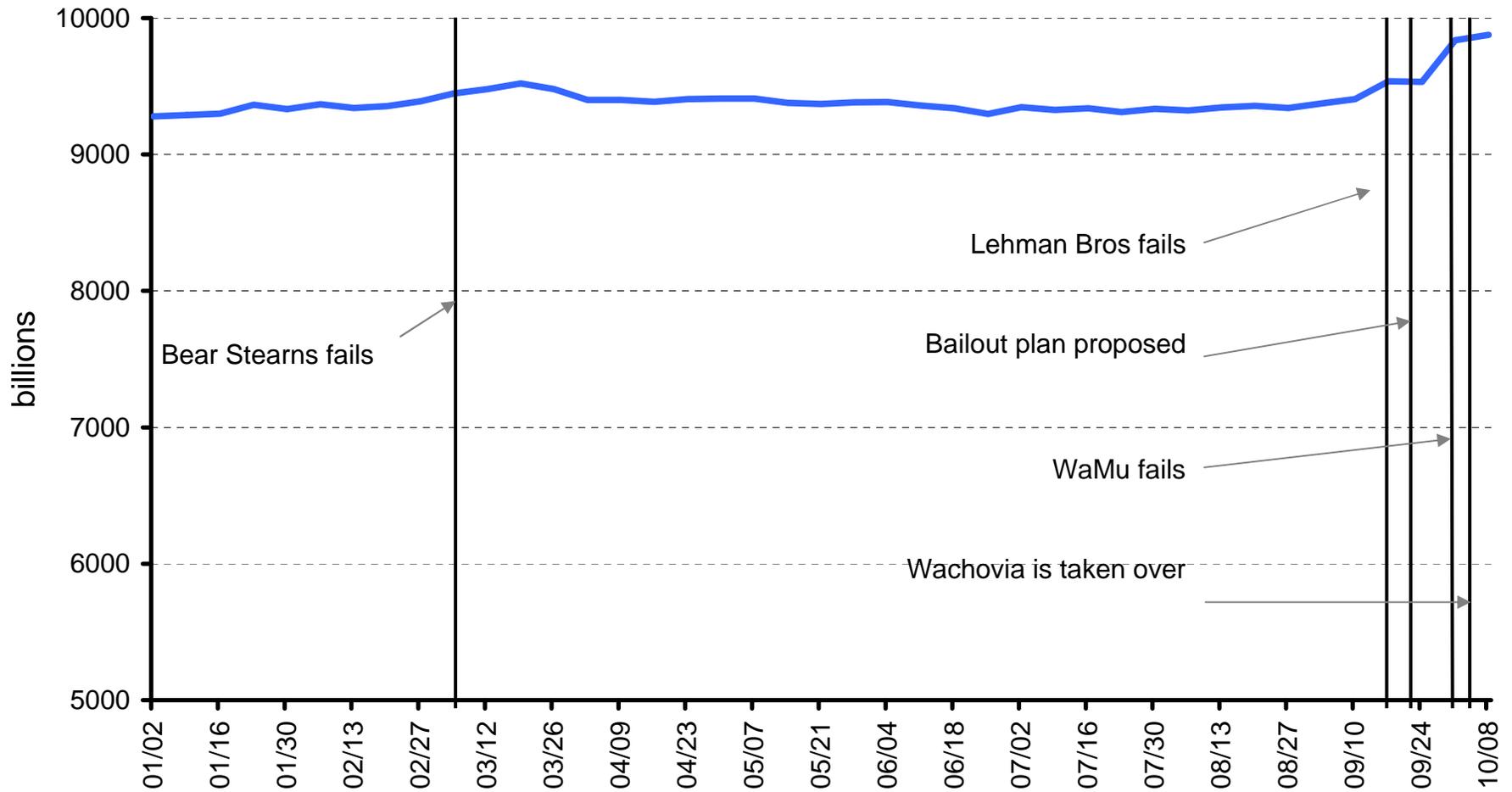
and indirectly by holding publicly traded bonds to these businesses. In the second quarter of 2008, an upper bound for such bank lending is approximately \$1 trillion. Nonfinancial corporate businesses obtain funds from banks and by issuing publicly traded bonds that are held by nonbank financial institutions such as life insurance companies as well as directly by households. The total amount of such funds is approximately \$4.5 trillion. Thus, roughly 80 percent of such business borrowing is done outside of the banking system. The claim that disruptions to the banking system necessarily destroy the ability of nonfinancial businesses to borrow from households is highly questionable.

Fig 1A: Bank Credit



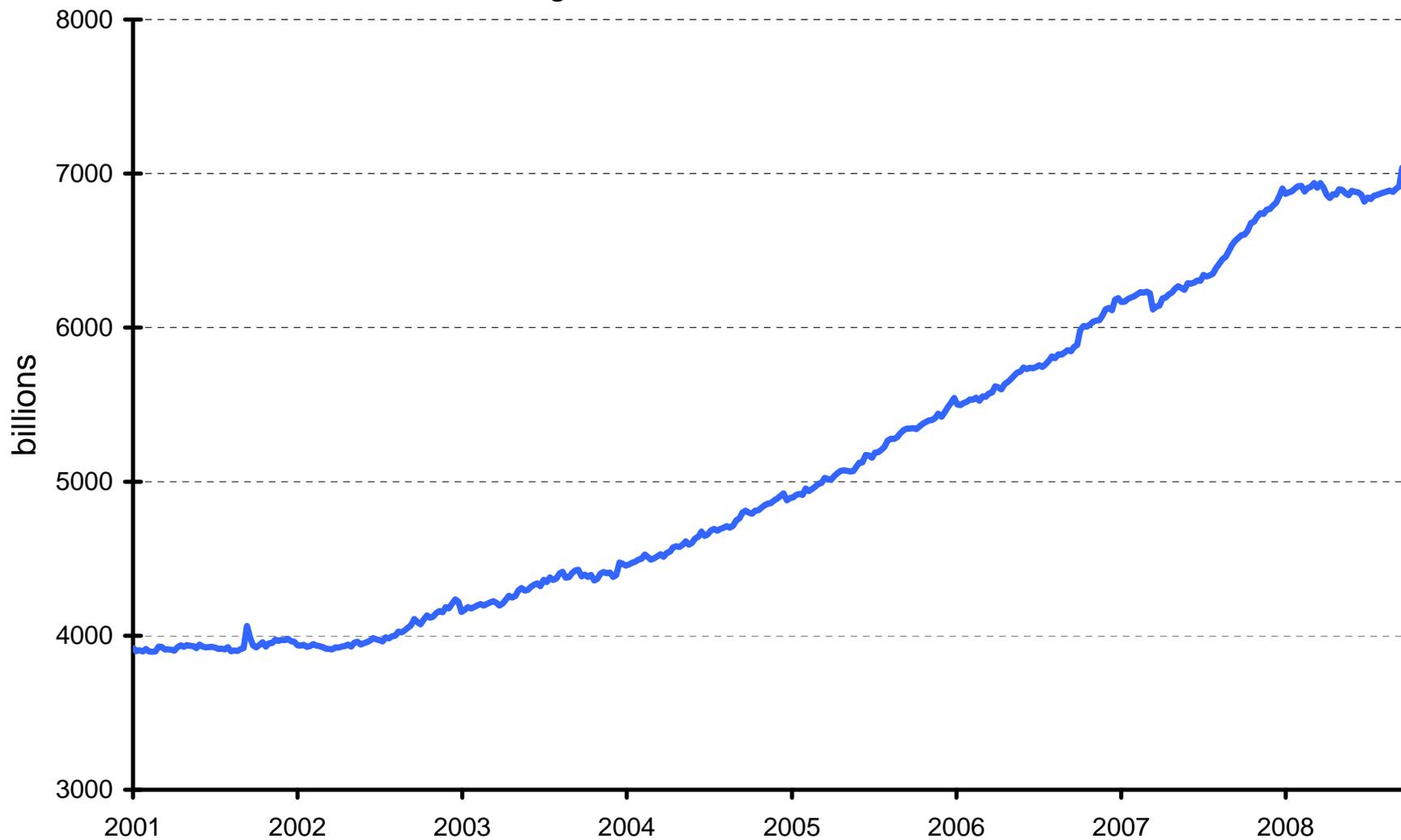
Source: Federal Reserve Board
<http://www.federalreserve.gov/releases/h8/Current/>

Fig 1B: Bank Credit (weekly 2008)



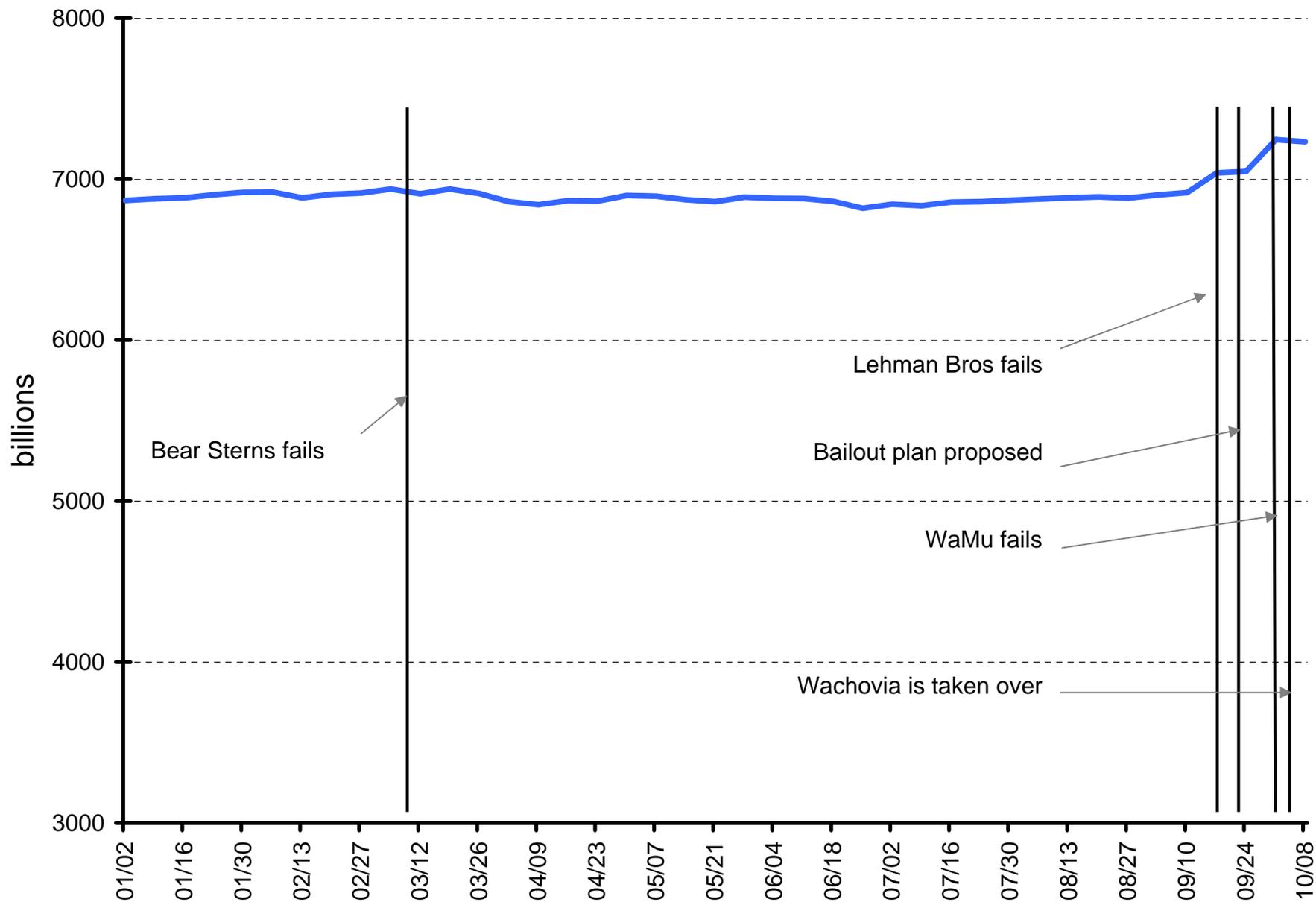
Source: Federal Reserve Board
<http://www.federalreserve.gov/releases/h8/Current/>

Fig 2A: Loans and Leases



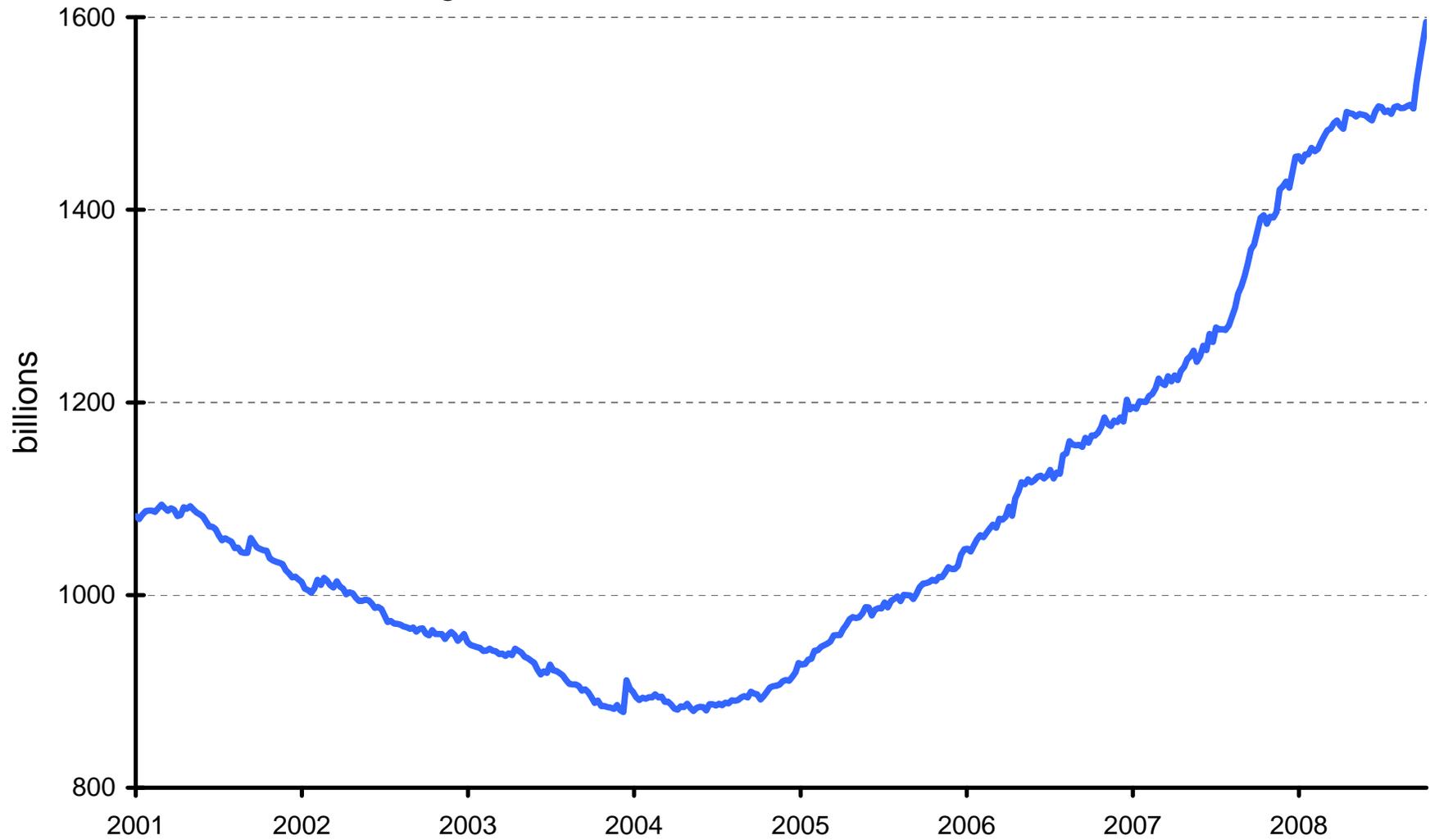
Source: Federal Reserve Board
<http://www.federalreserve.gov/releases/h8/Current/>

Fig 2B: Loans and Leases (weekly 2008)



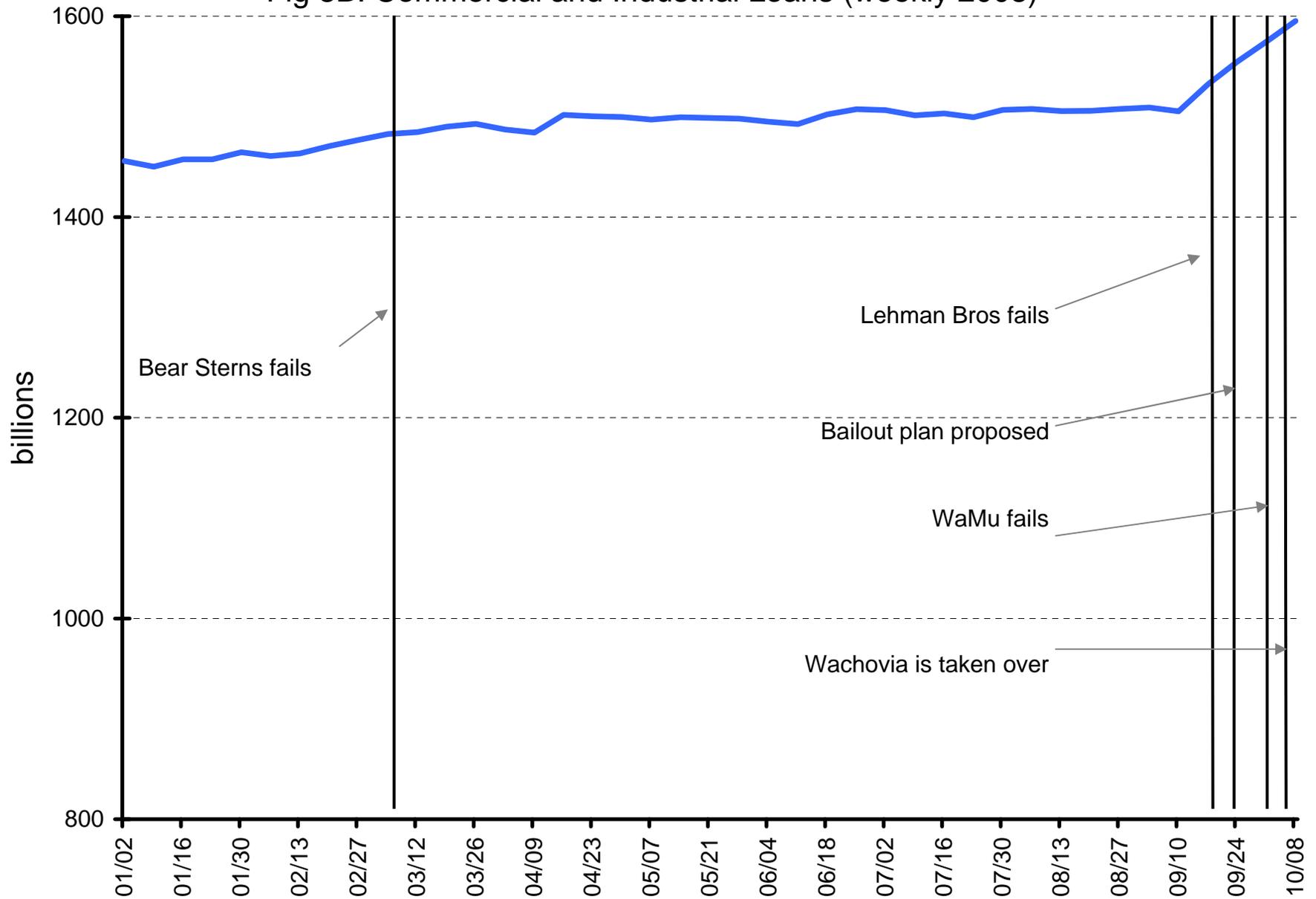
Source: Federal Reserve Board
<http://www.federalreserve.gov/releases/h8/Current/>

Fig 3A: Commercial and Industrial Loans



Source: Federal Reserve Board
<http://www.federalreserve.gov/releases/h8/Current/>

Fig 3B: Commercial and Industrial Loans (weekly 2008)



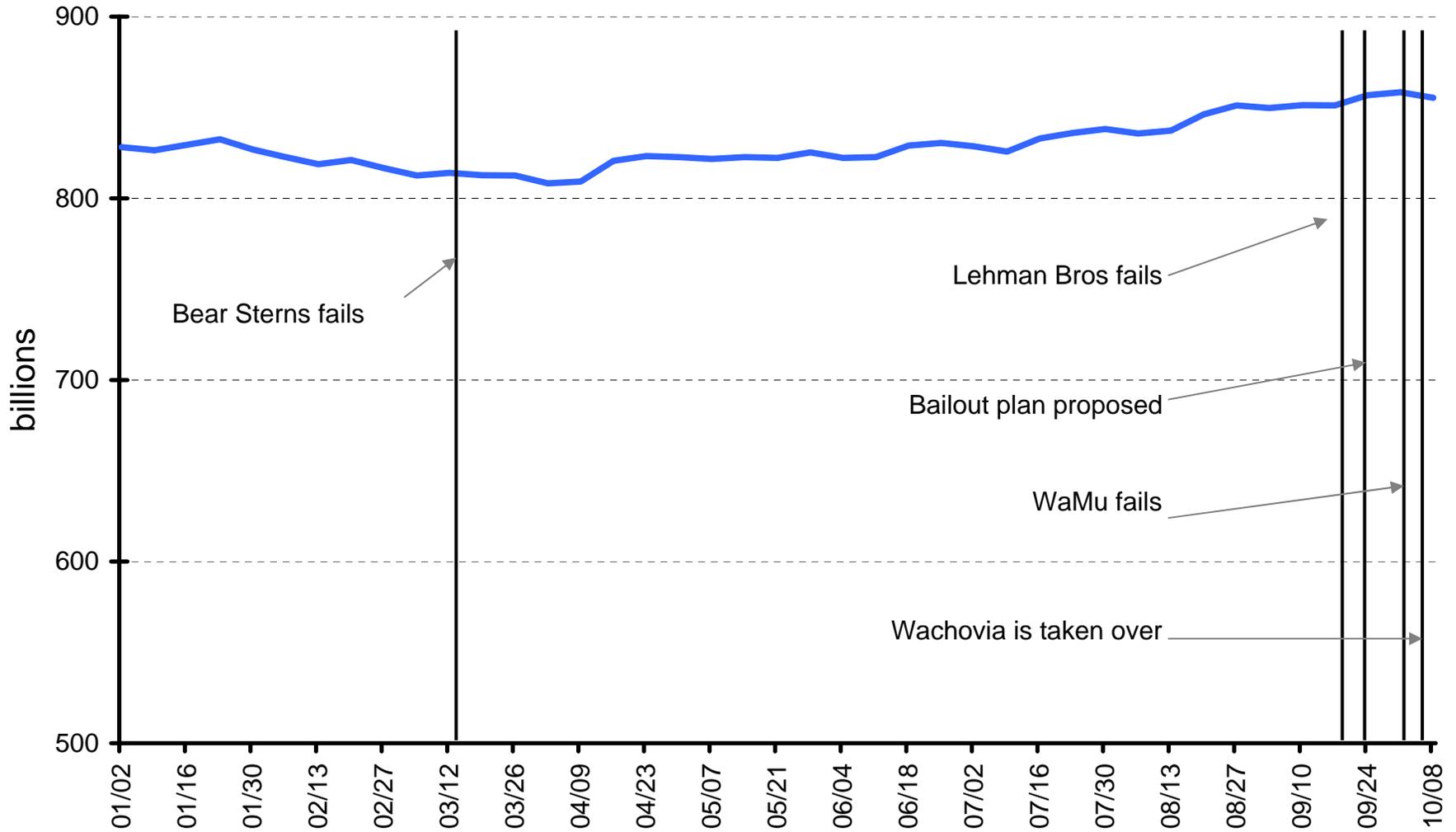
Source: Federal Reserve Board
<http://www.federalreserve.gov/releases/h8/Current/>

Fig 4A: Consumer Loans



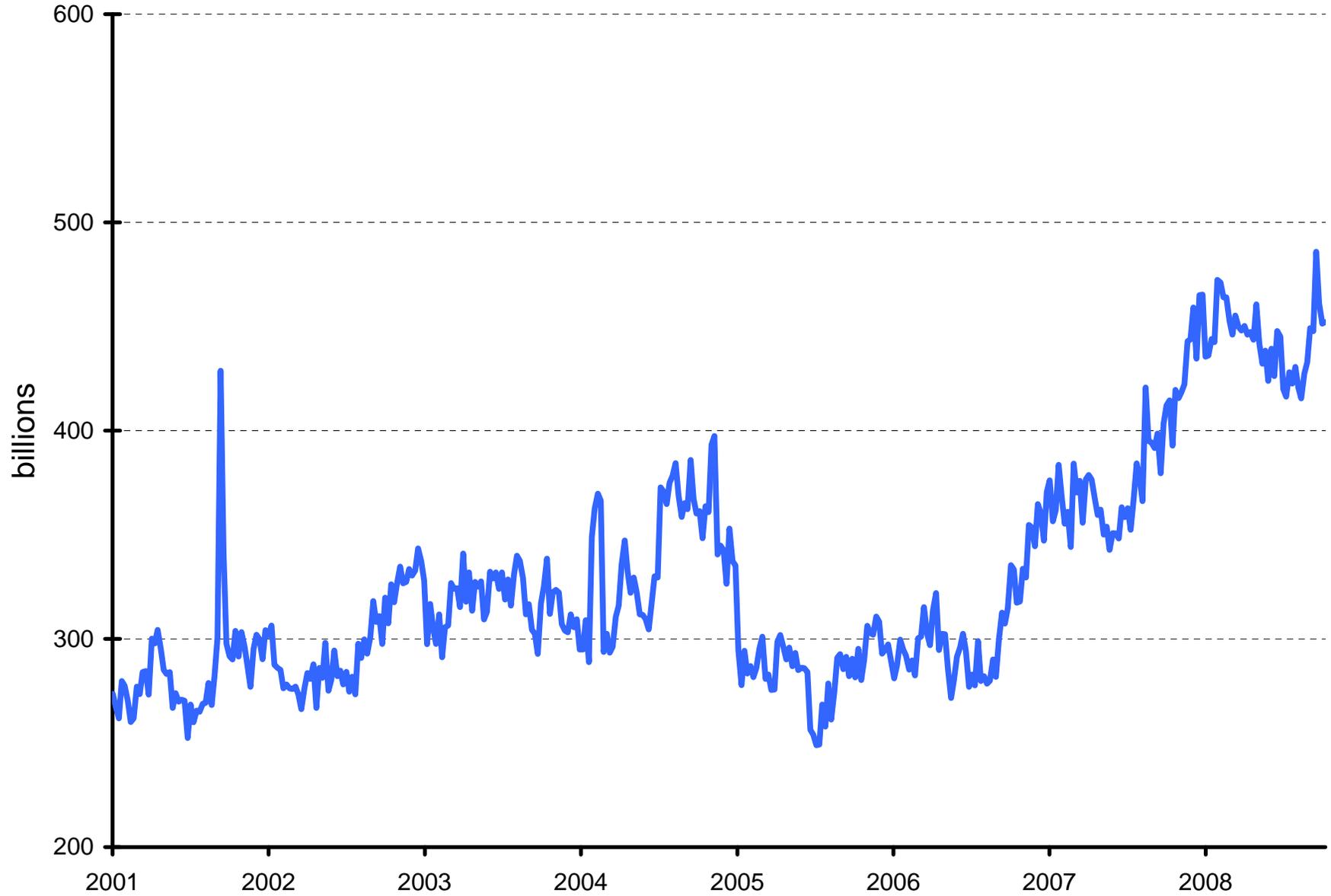
Source: Federal Reserve Board
<http://www.federalreserve.gov/releases/h8/Current/>

Fig 4B: Consumer Loans (weekly 2008)



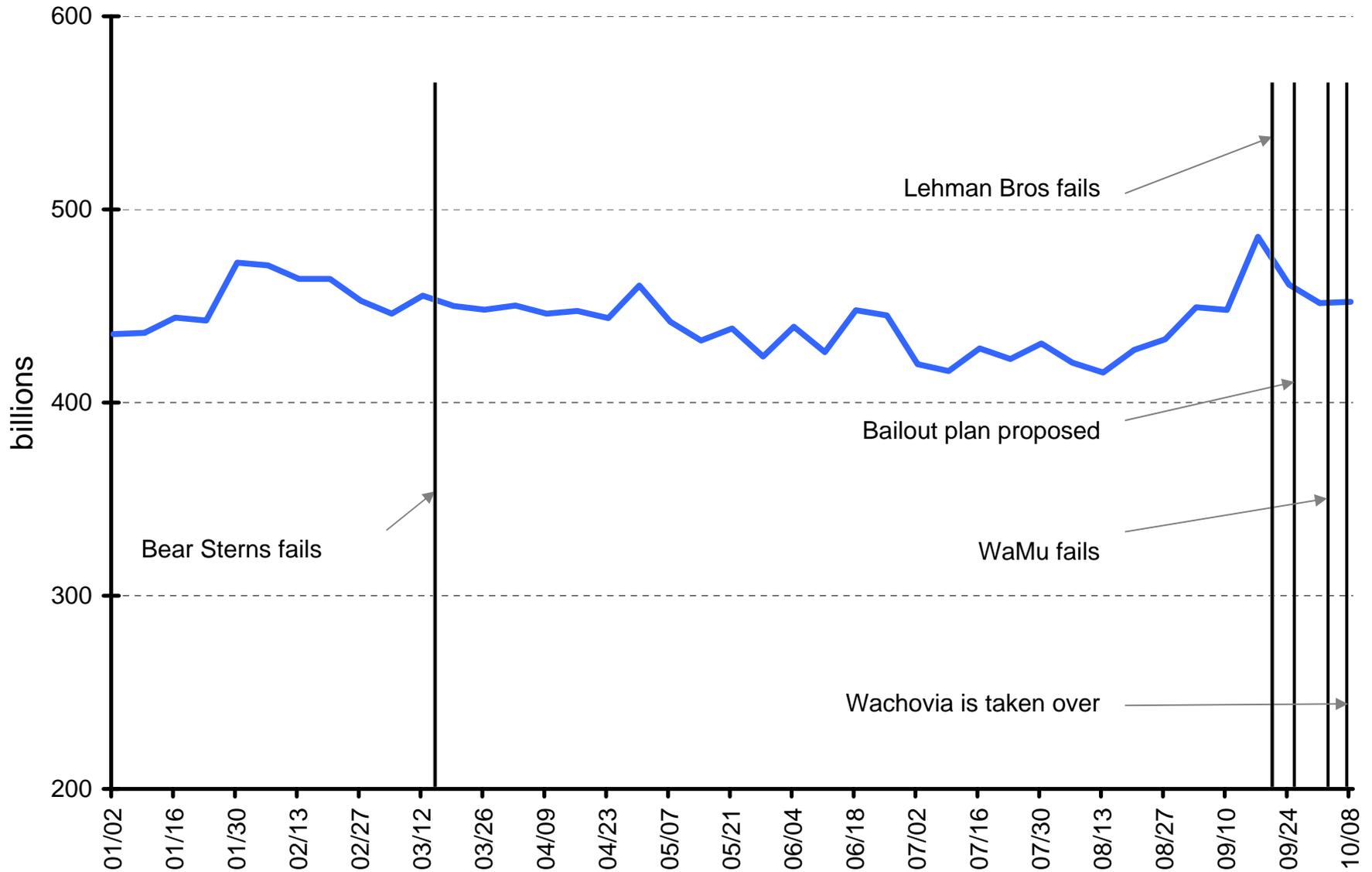
Source: Federal Reserve Board
<http://www.federalreserve.gov/releases/h8/Current/>

Fig 5A: Interbank Loans



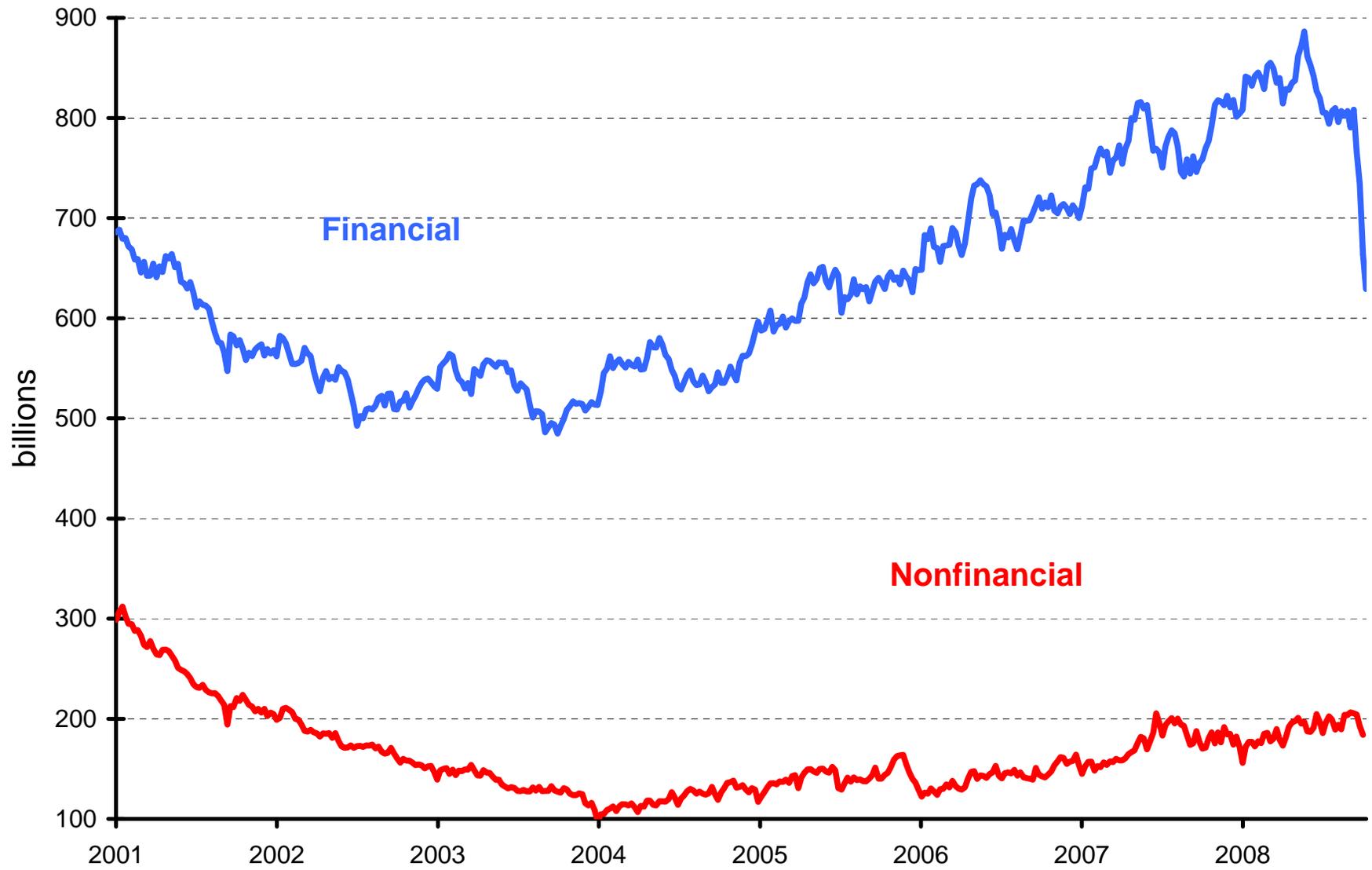
Source: Federal Reserve Board
<http://www.federalreserve.gov/releases/h8/Current/>

Fig 5B: Interbank Loans (weekly 2008)



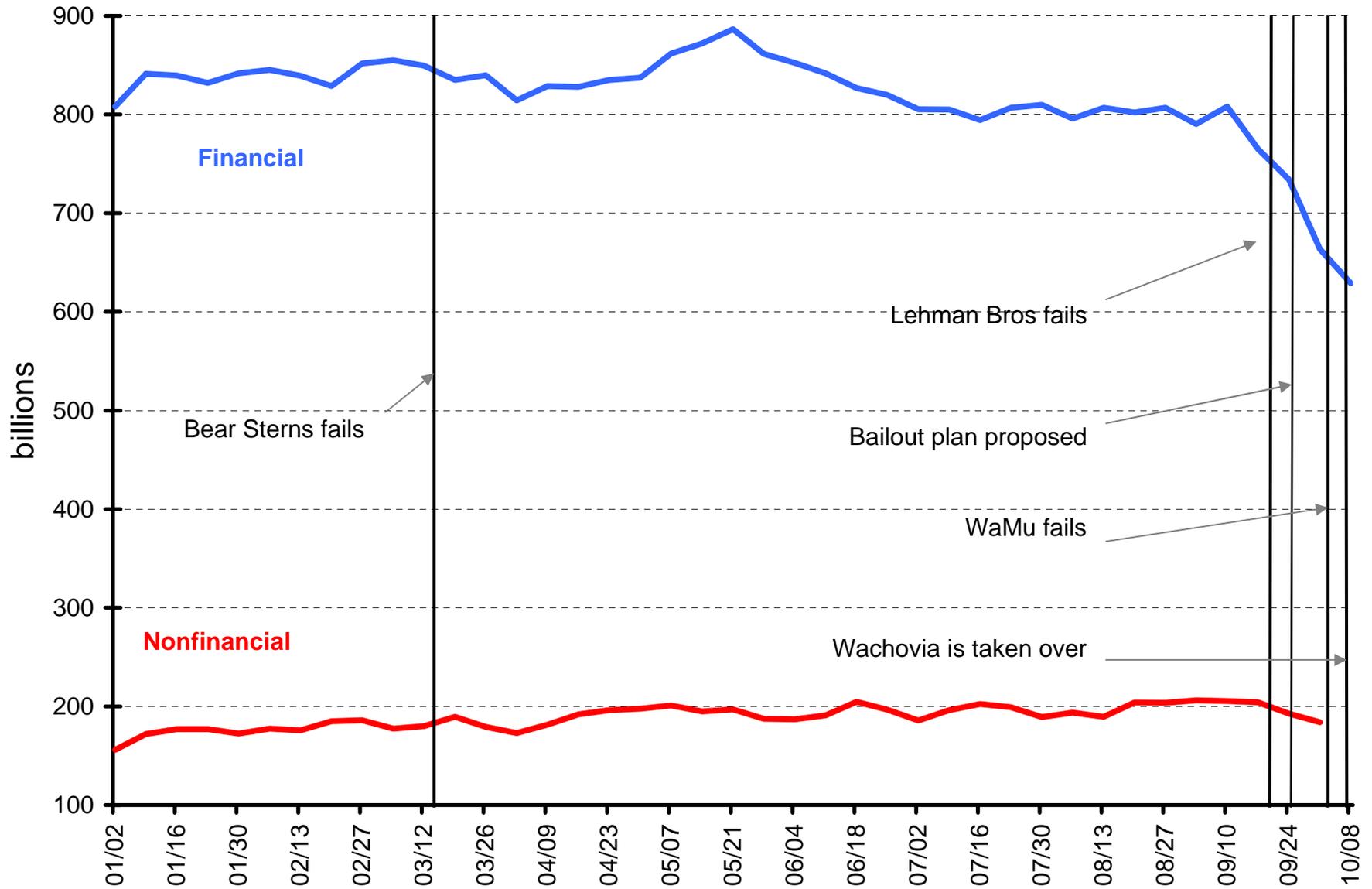
Source: Federal Reserve Board
<http://www.federalreserve.gov/releases/h8/Current/>

Fig 6A: Commercial Paper Outstanding



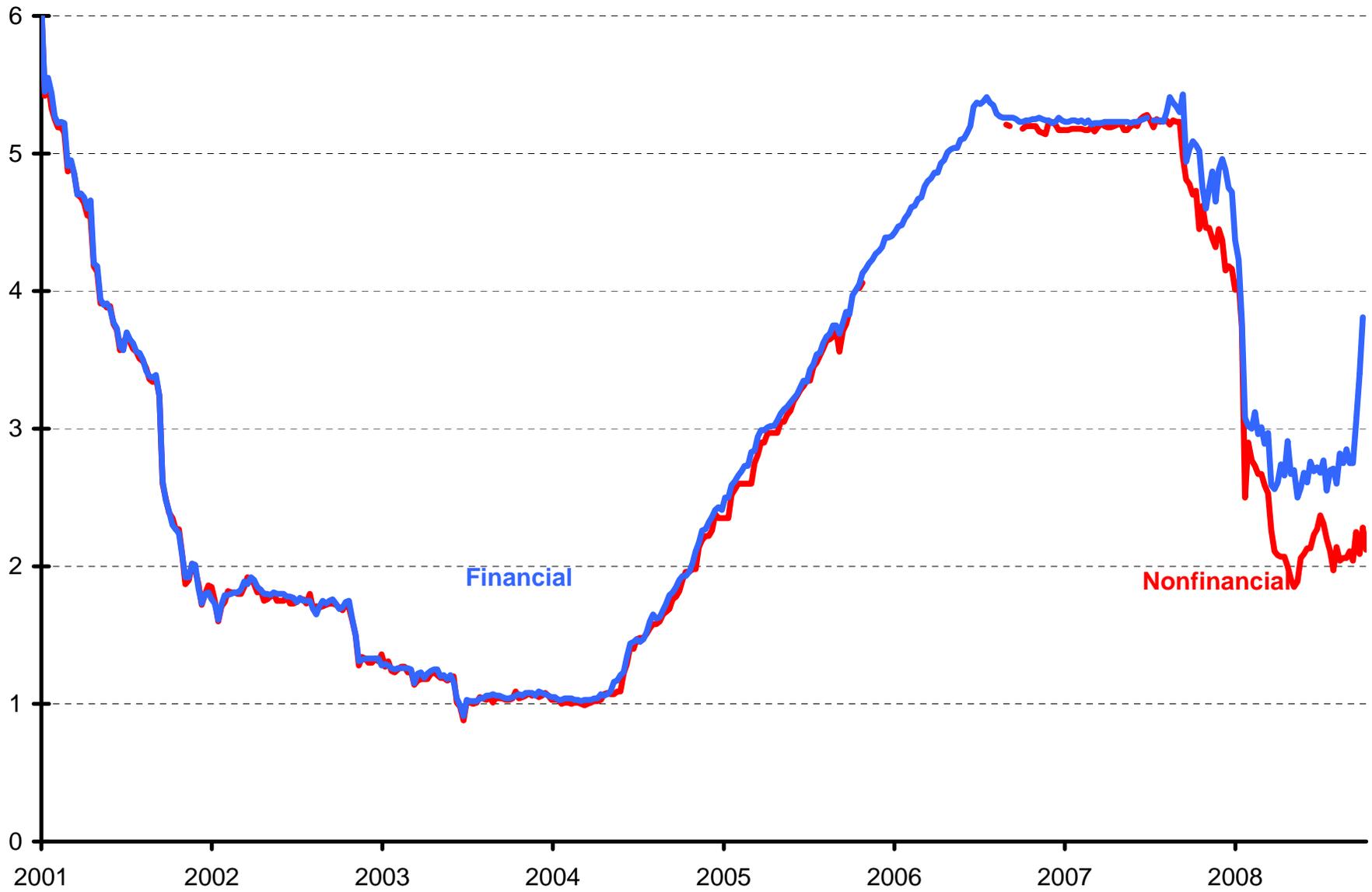
Source: Federal Reserve Board
<http://www.federalreserve.gov/releases/h8/Current/>

Fig 6B: Commercial Paper Outstanding (weekly 2008)



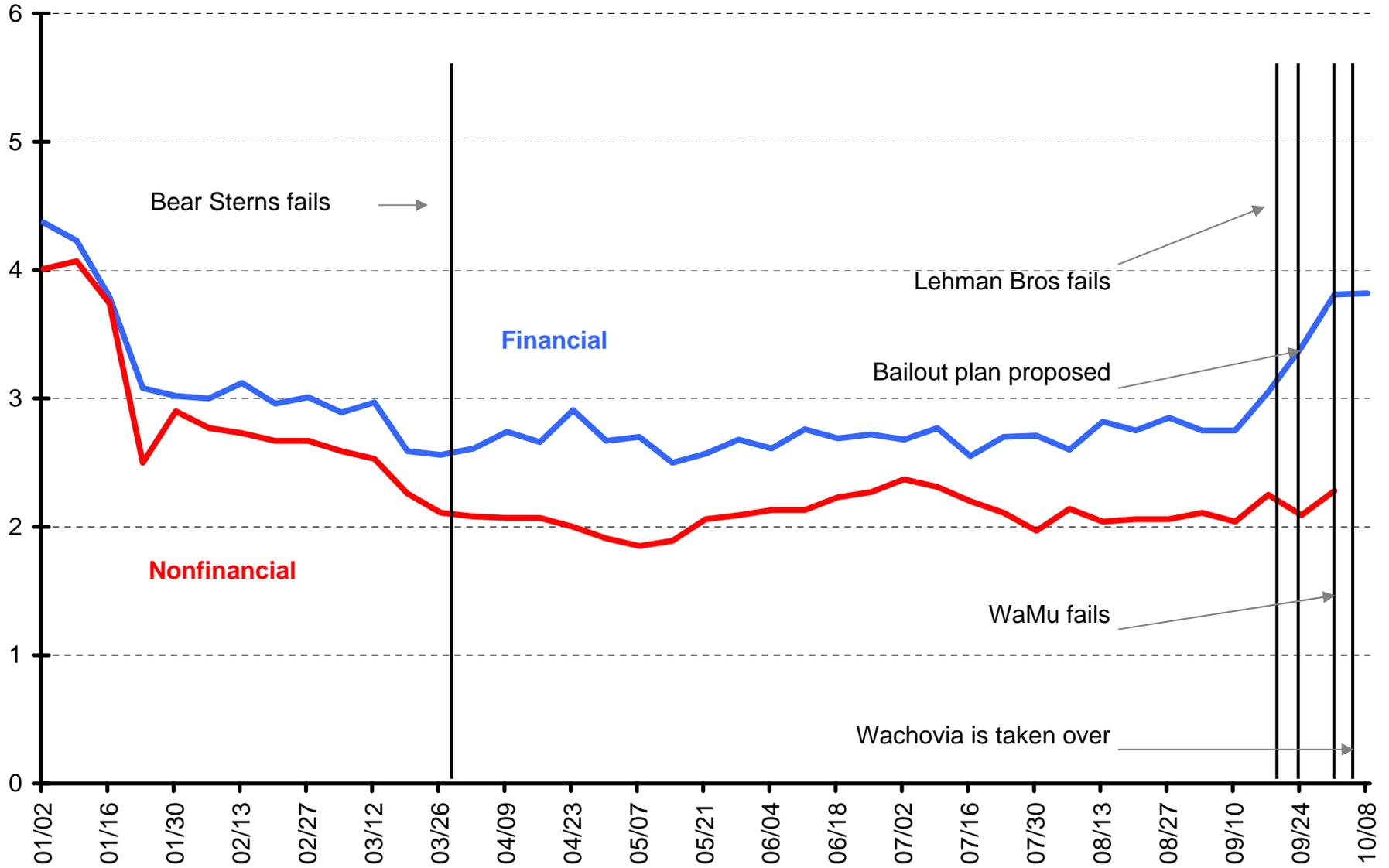
Source: Federal Reserve Board
<http://www.federalreserve.gov/releases/h8/Current/>

Fig 7A: Commercial Paper 90 Day Rate



Source: Federal Reserve Board
<http://www.federalreserve.gov/releases/h8/Current/>

Fig 7B: Commercial Paper 90 Day Rate (weekly 2008)



Source: Federal Reserve Board
<http://www.federalreserve.gov/releases/h8/Current/>