

CASE DISCUSSION 1: THE U.S. RECESSION OF 2001

- During 2001,
 - 2.1 million people lost their jobs, as unemployment rose from 3.9% to 5.8%.
 - GDP growth slowed to 0.8% (compared to 3.9% average annual growth during 1994-2000).
- Took a couple of years before the recession ended. (Ended very quickly relative to GFC crisis)

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Dot-com bubble

From Wikipedia, the free encyclopedia

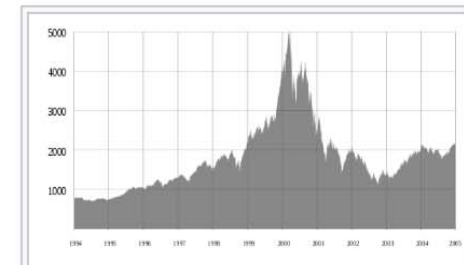
The **dot-com bubble** (also known as the **dot-com boom**,^[1] the **tech bubble**,^[2] and the **Internet bubble**) was a historic period of excessive speculation mainly in the United States that occurred roughly from 1994 to 2000, a period of massive growth in the use and adoption of the Internet.^[3]

The **Nasdaq Composite stock market index**, which included many Internet-based companies, peaked in value on March 10, 2000, before crashing. The burst of the bubble, known as the **dot-com crash**, lasted from March 11, 2000, to October 9, 2002.^{[3][4]} During the crash, many **online shopping** companies, such as **Pets.com**, **Webvan**, and **Boo.com**, as well as communication companies, such as **Worldcom**, **NorthPoint Communications** and **Global Crossing**, failed and shut down.^{[5][6]} Others, such as **Cisco**, whose stock declined by 86%,^[6] and **Qualcomm**, lost a big portion of their market capitalization but survived, and some companies, such as **eBay** and **Amazon.com**, lost value but recovered quickly.

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- 1 Prelude to the bubble
- 2 The bubble
 - 2.1 Spending tendencies of dot-com companies
 - 2.2 Bubble in telecom
- 3 Bursting of the bubble
- 4 Aftermath

Mechanism of the crisis through using the IS-LM model. What brought the economy downfall?



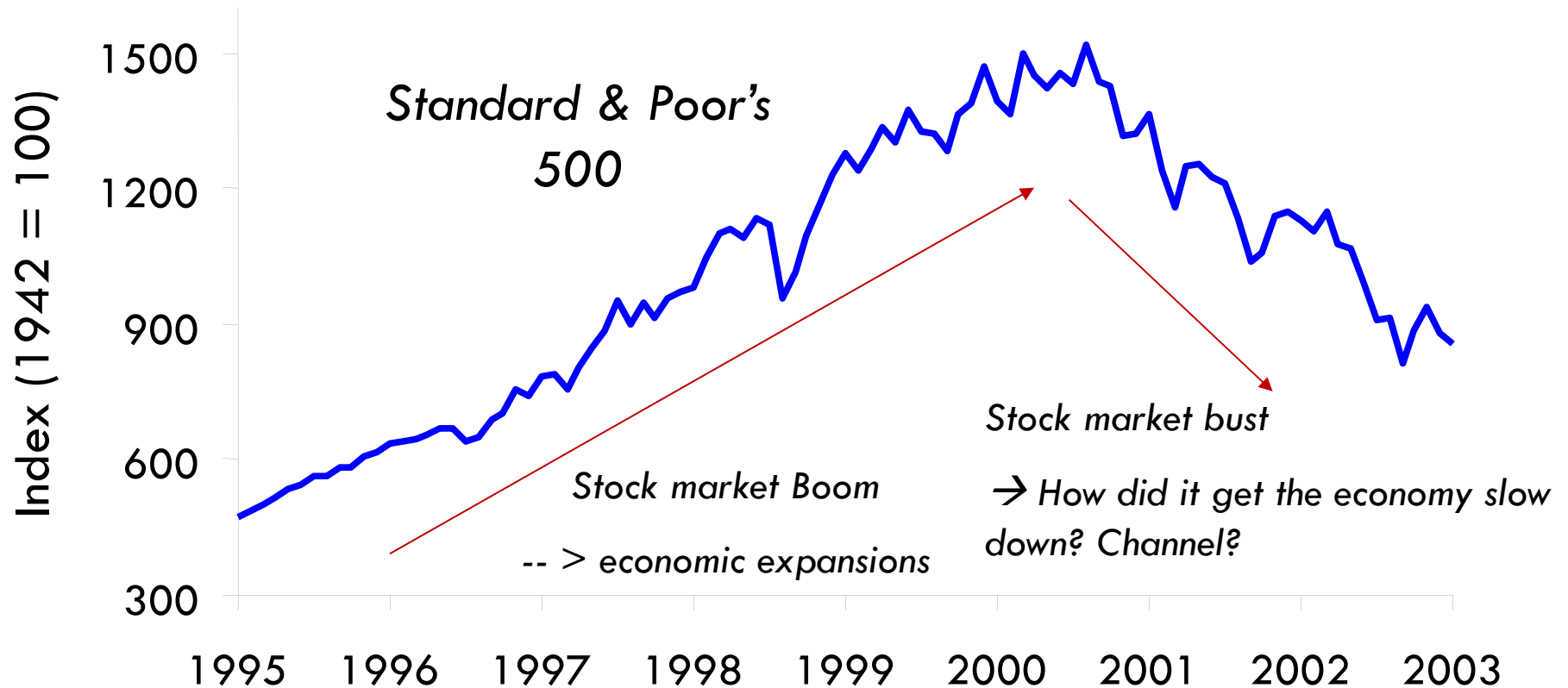
The NASDAQ Composite index spiked in the late 1990s and then fell sharply as a result of the dot-com bubble.



Quarterly U.S. venture capital investments, 1995–2017

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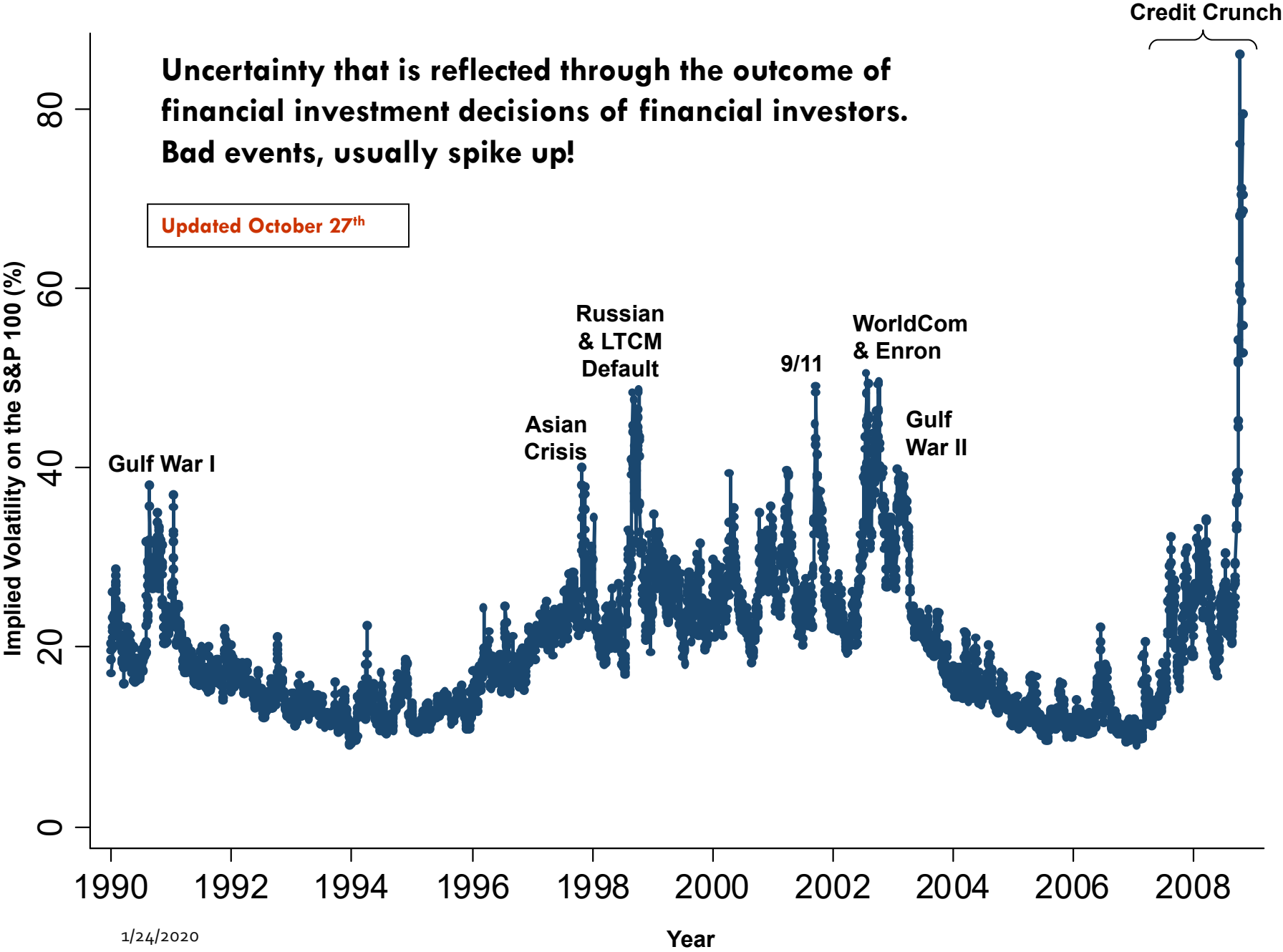
- **Causes:** 1) Stock market decline $\Rightarrow \downarrow C \rightarrow IS$ shift left



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- **Causes:** 2) 9/11
 - Terrorist attacks
 - How did the 9/11 affect US economy?

Credit Crunch: A Plot of Daily Stock Market Volatility



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- **Causes:** 2) 9/11
 - increased uncertainty
 - fall in consumer & business confidence
 - More caution on spending decisions
 - **result:** lower spending, *IS* curve shifted left

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- **Causes: 2) 9/11**
 - increased uncertainty
 - fall in consumer & business confidence
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 - **result:** lower spending, *IS* curve shifted left
- **Causes: 3) Corporate accounting scandals (fake accounts)**
 - Enron, WorldCom, *etc.*
 - Worrisome about the quality of company
 - **result:** cash hoarding, *LM* curve shifted left
 - Increase risk premia → reduced stock prices → discouraged investment

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- Why did the recession end relatively quickly?
Problems got contained fast
- Fiscal policy response: *shifted IS curve right*
 - tax cuts in 2001 and 2003 (Bush administration)
 - spending increases
 - Airline industry bailout
 - NYC reconstruction
 - Afghanistan war (The Keynesian Military spending!)

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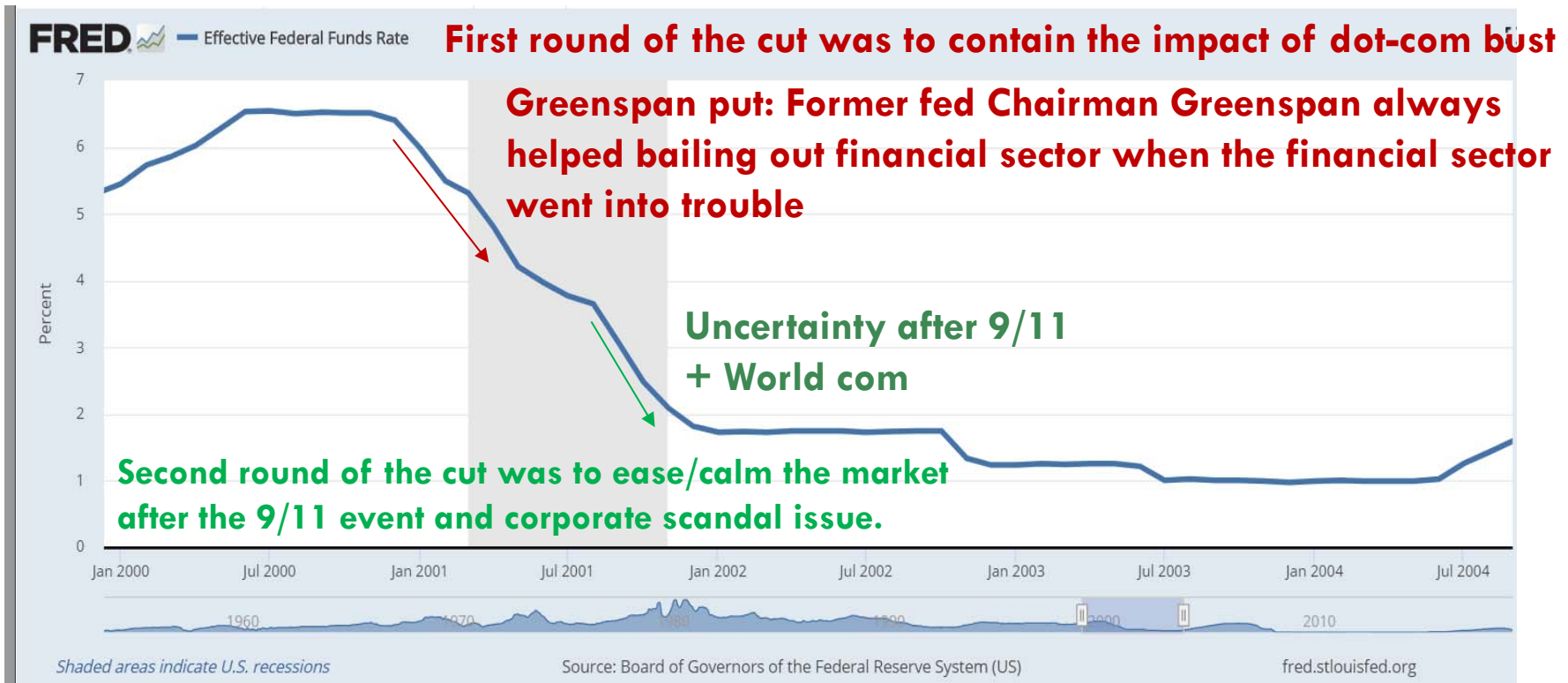
How big is the US fiscal multiplier? →
varied with respect to fiscal programs; spending v.s. tax cut

Table 1 Ranges for US cumulative output multipliers (source: CBO (2012a), Table 2).

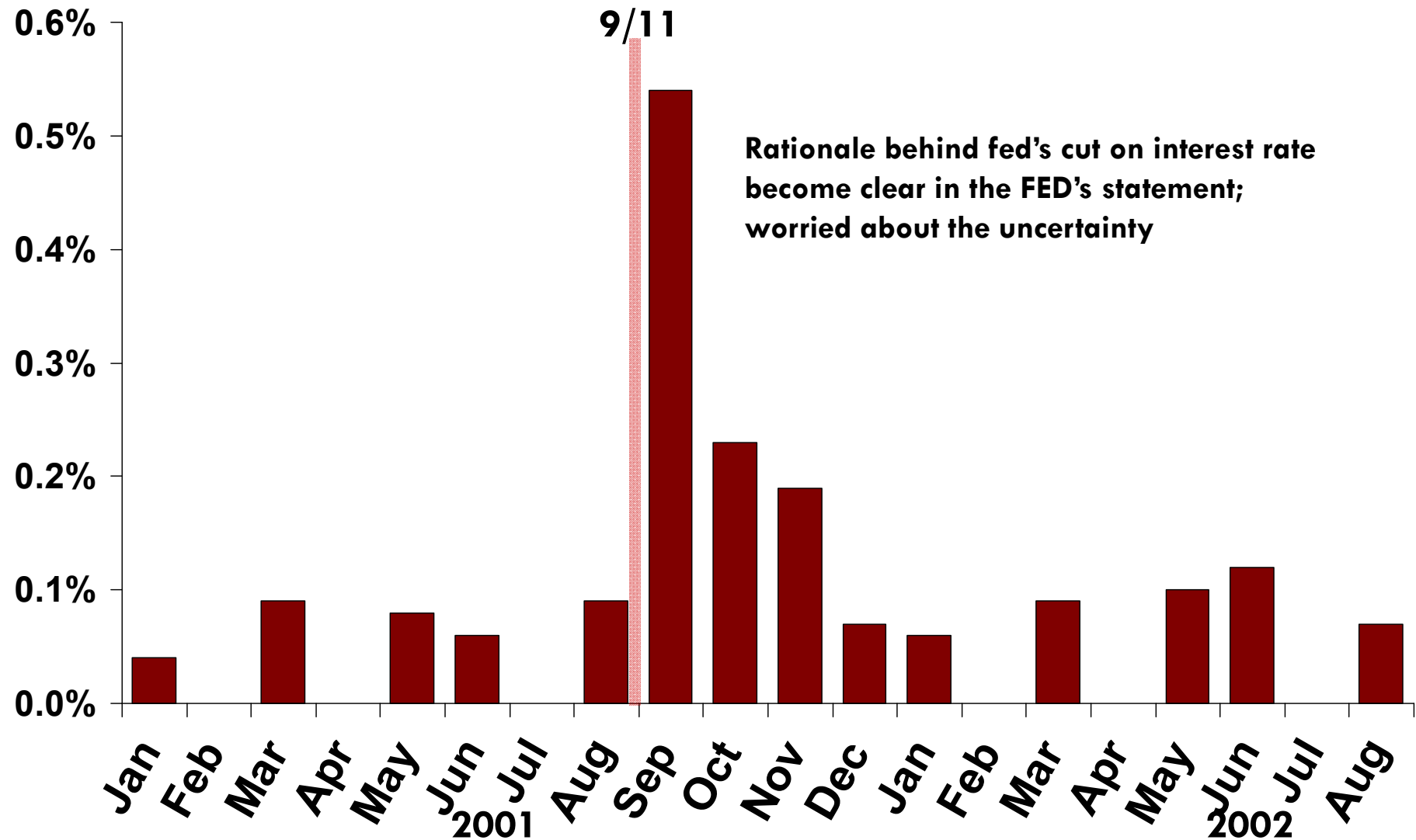
Type of activity	Estimated output multipliers		
	Low estimate	High estimate	
Purchase of goods and services by the Federal Government	0.5	2.5	} Purchas (G)
Transfer payments to state and local governments for infrastructure	0.4	2.2	
Transfer payments to state and local governments for other purposes	0.4	1.8	
Transfer payments to individuals	0.4	2.1	} TR / Tax
One-time payments to retirees	0.2	1.0	
Two-year tax cuts for lower- and middle-income people	0.3	1.5	
One-year tax cut for higher-income people	0.1	0.6	

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- **Monetary policy response:** shifted *LM* curve right



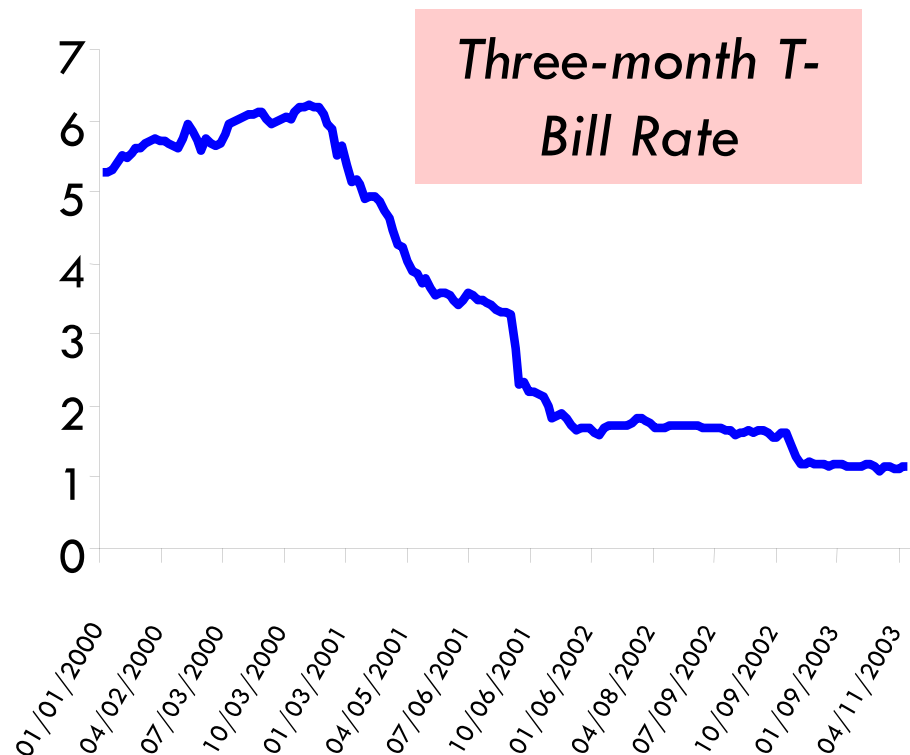
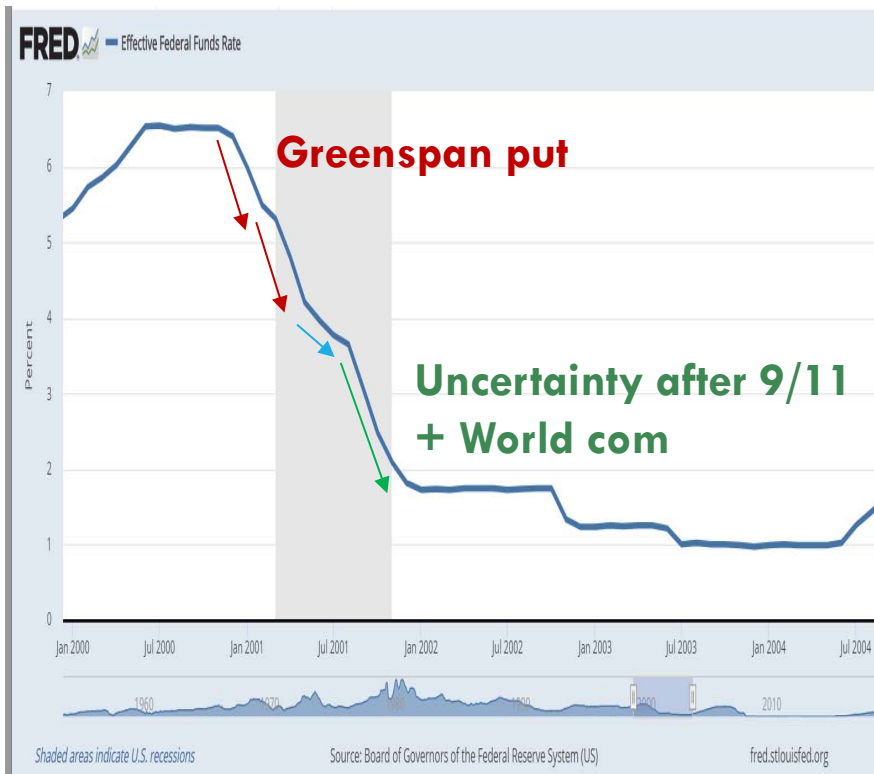
Frequency of word "uncertain" in FOMC minutes



Source: [count of "uncertain"/count all words] in minutes posted on <http://www.federalreserve.gov/fomc/previouscalendars.htm#2001>

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- **Monetary policy response:** Interest-rate pass through



Fed cut policy rate, allow other general interest rates to decrease, and hence easing financial market conditions.