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Journal of Economic Perspectives
ISSN 0895-3309 (Print) | ISSN 1944-7965 (Online)

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What Happened: Financial Factors in the Great Recession

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JOURNAL OF ECONOMIC PERSPECTIVES
VOL. 32, NO. 3, SUMMER 2018
(pp. 3–30)

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Article Information

Abstract

At the onset of the recent global financial crisis, the workhorse macroeconomic models assumed frictionless financial markets. These frameworks were thus not able to anticipate the crisis, nor to analyze how the disruption of credit markets changed what initially appeared like a mild downturn into the Great Recession. Since that time, an explosion of both theoretical and empirical research has investigated how the financial crisis [illegible] how it was transmitted to the real sector. The goal of this paper is to [illegible] plete description of the Great Recession must take account of the financial distress facing both households and banks and, as the crisis unfolded, nonfinancial firms as well. Exploiting both panel data and time series methods, we analyze the contribution of the house price decline, versus the banking distress indicator, to the overall decline in employment during the Great Recession. We confirm a common finding in the literature that the household balance sheet channel is important for regional variation in employment. However, we also find that the disruption in banking was central to the overall employment contraction.

Citation

Gertler, Mark, and Simon Gilchrist. 2018. "What Happened: Financial Factors in the Great Recession." *Journal of Economic Perspectives* 32 (3): 3–30.

DOI: 10.1257/jep.32.3.3

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Author Disclosure Statement(s)

Public (Legacy) Comment (posted on 8/7/2018)

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E32 Business Fluctuations; Cycles

E44 Financial Markets and the Macroeconomy

G01 Financial Crises

G21 Banks; Depository Institutions; Micro Finance Institutions; Mortgages

R31 Housing Supply and Markets