Real Interest Rates and the Savings and Loan Crisis: The Moral Hazard Premium

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Real interest rates rose to historically high levels in 1980 and remained high throughout the decade. Macroeconomists attribute this phenomenon to a combination of tight monetary policy, fiscal deficits, and variable inflation rates. This paper presents preliminary evidence for an additional explanation of high real rates that is related to the decade-long crisis in the savings and loan industry. Deposit insurance, moral hazard, and regulatory forbearance provide the incentives and the means for insolvent thrifts to issue liabilities that compete with Treasury securities in the market for funds. Thus, as the magnitude of the thrift crisis grew during the 1990s, so did pressure on Treasury yields. Even if the effect of the S&L crisis on interest rates is small, the increased cost of financing the public debt adds significantly to the total costs associated with the savings and loan fiasco.

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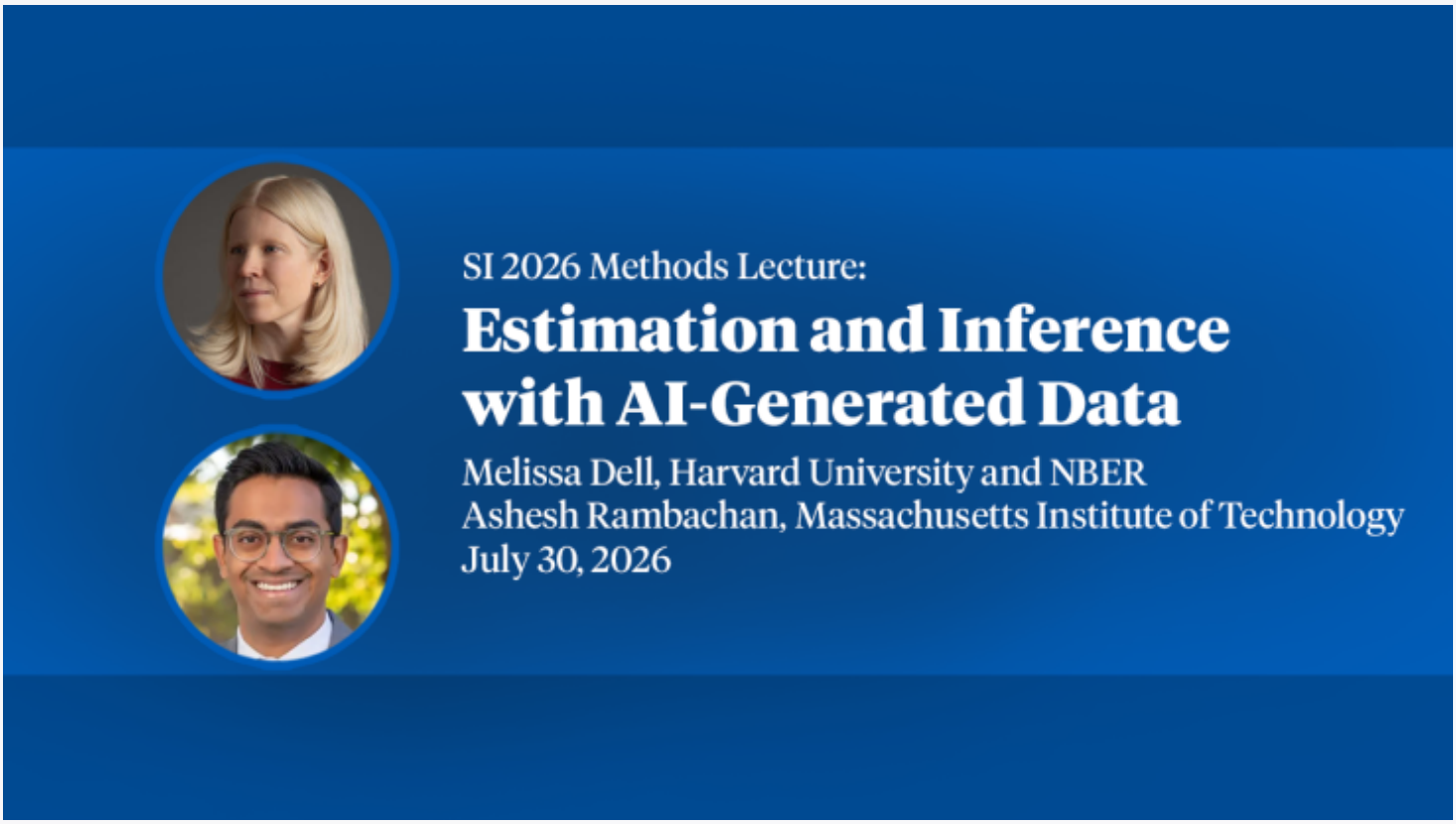


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