The Economic Dynamics of Financial Crisis

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Abstract:

The current financial crisis comes from the subprime mortgage woos that occurred in the USA in 2007. Beginning with the failures of large financial institutions in the United States, it rapidly propagated into a global financial and economic crisis. Since the impact of financial crisis on the global economy is dramatic and wide spread, conducting research on the economic dynamics of financial crisis helps us to trace the root of financial crisis. This research studies the economic dynamics of financial crisis, the contagion of economic shocks, and how economic shocks interact with each other during the crisis period. Economic shocks include shocks in the stock market, housing market, credit market, and commodity market. Empirical evidences are examined at both the aggregate (macro) and individual firm (micro) level. At the macro level, we set up a VAR system in which the interactions of shocks in the stock market, housing market, credit market, and commodity market are examined. Variance decomposition and impulse response analyses offer us better understanding about the path of such shocks and the dynamics that economic system returns to equilibrium. At the micro level, quantile regression models are conducted on a cross-section of stocks to analyze the impact of economic shocks on stock market performance. Quantile regression examines the different responses of equity returns to financial crisis at the tails of the return distribution, and allows us to find factors contribute to good/bad performance during the crisis period.