

# How and When Will the Global Economic and Financial Crisis End?

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# TOPICS TO COVER

I. Current position of U.S. and world economies

II. What policymakers are doing

- Fiscal policy
- Monetary policy
- Financial rescue package (TARP)
- Confidence measures

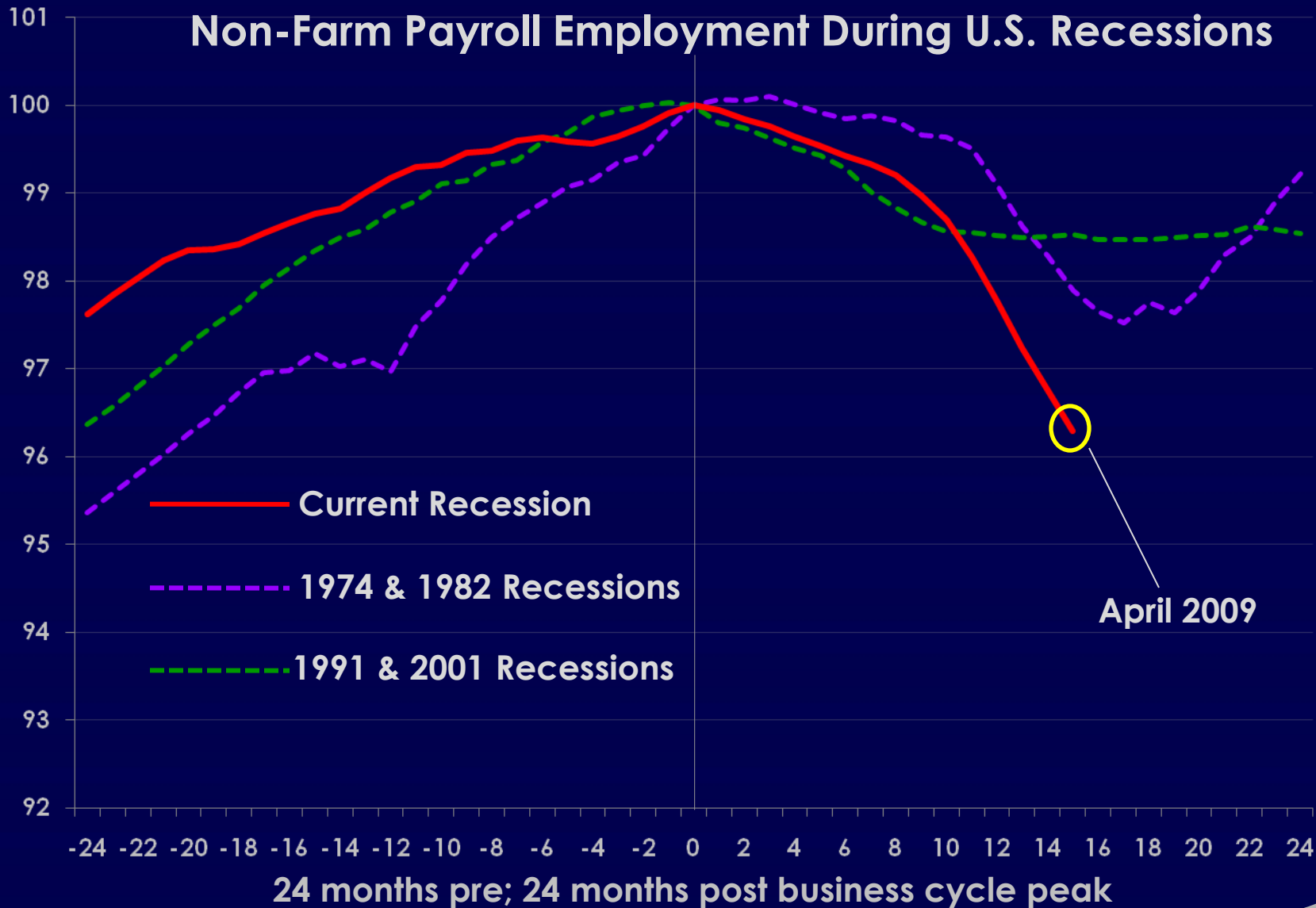
III. How and when the economic recovery will begin

IV. Risks

# WORLD GDP GROWTH ESTIMATES BEING REVISED DOWNWARD BY IMF

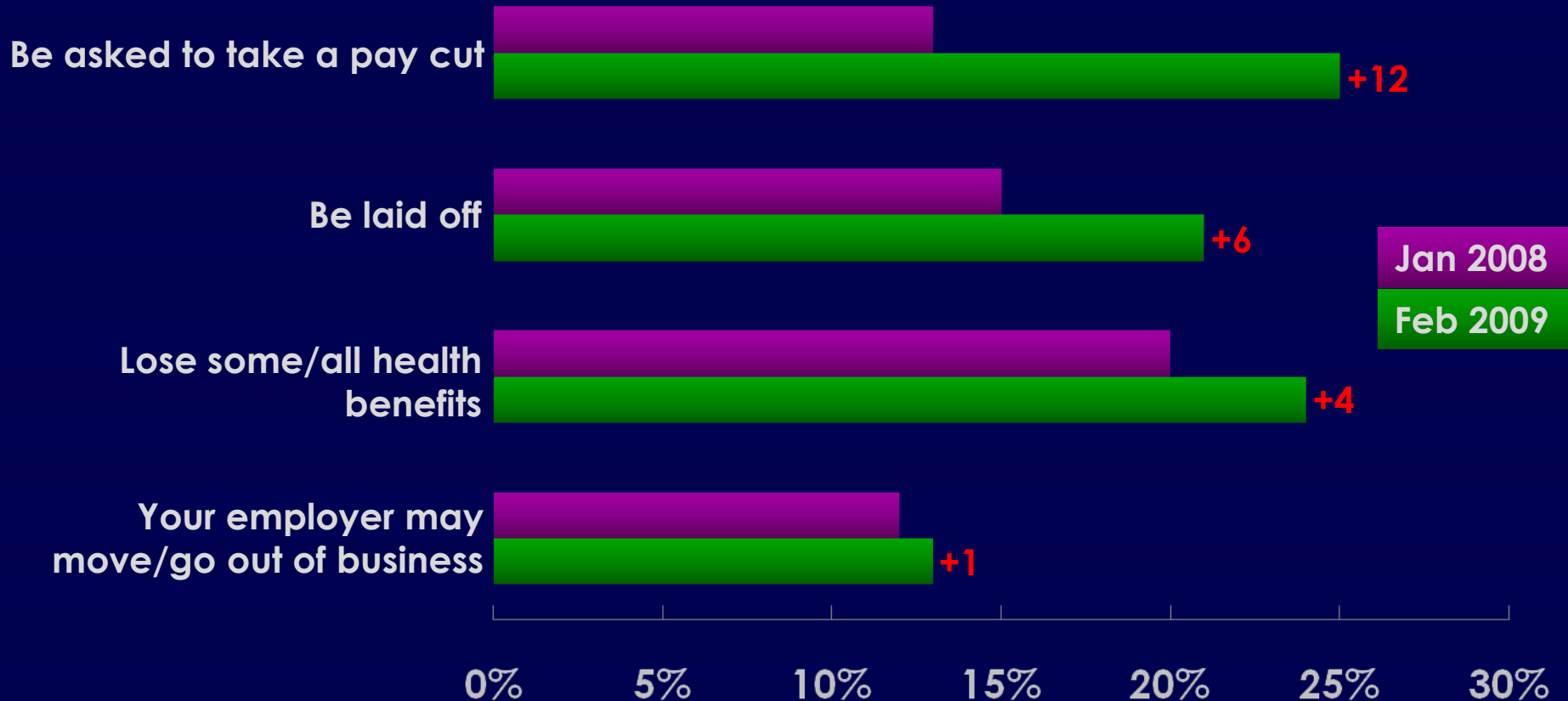
	2009 Growth (%)	Revision from Nov. 2008 to April 2009
U.S.	-2.8	-2.1
Euro Area	-4.2	-3.7
U.K.	-4.1	-2.8
Japan	-6.2	-6.0
China	+6.5	-2.0
Asian NIEs	-5.6	-7.7
<b>World</b>	<b>-1.3</b>	<b>-3.5</b>

# U.S. EMPLOYMENT LOSSES: DEEPEST OF ALL RECESSIONS



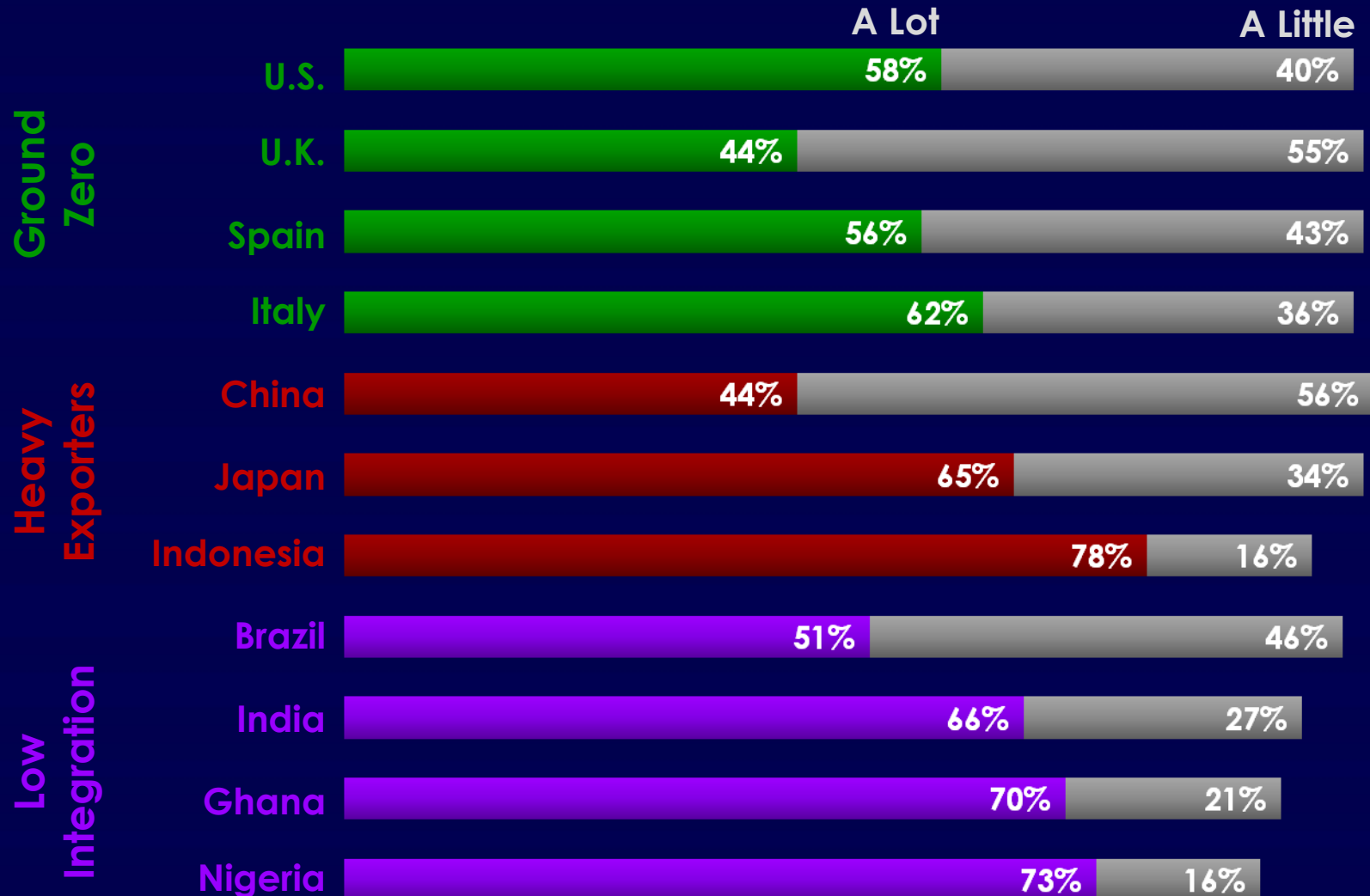
# NEGATIVE RIPPLE EFFECTS ON CONFIDENCE

“Very/somewhat likely in the next year that you may...”



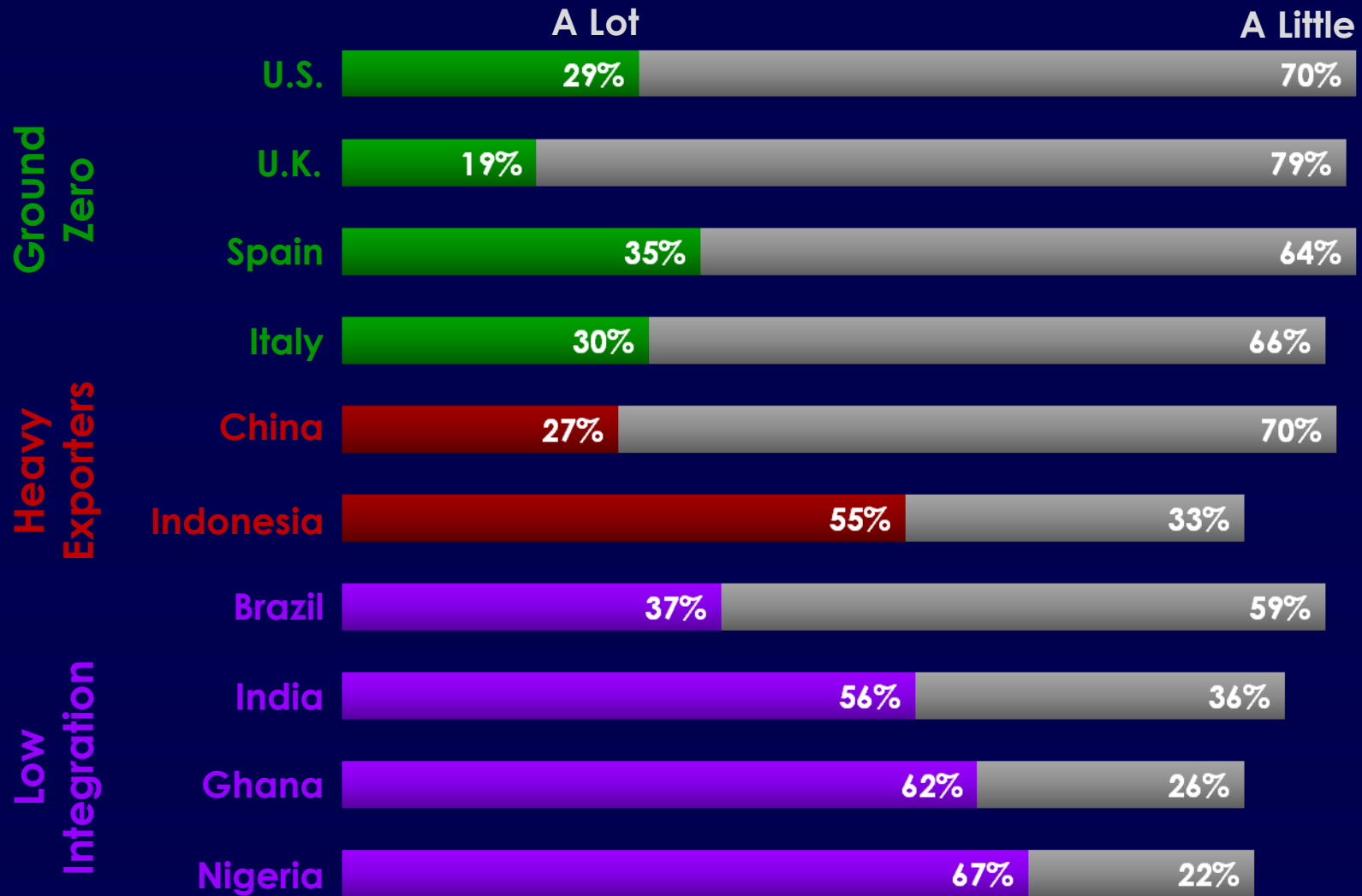
→ Overall, 44% of American are now worried about their jobs/job security

# HOUSEHOLDS FEELING THE EFFECTS OF ECONOMIC DOWNTURN AROUND THE WORLD



Source: BBC World Service Poll, March 2009

# HOUSEHOLDS FEELING THE EFFECTS OF GLOBAL SHORTAGE OF FINANCIAL CREDIT



Source: BBC World Service Poll, March 2009

# POLICY RESPONSES

I. Fiscal policy

II. Monetary policy

III. Financial rescue packages (TARP, etc.)

IV. Confidence measures

# POLICYMAKERS' FEAR: ANOTHER GREAT DEPRESSION

1929-1933

**GDP: -30%**

**World Trade: -67%**

**Unemployment Rate: 25%**



IT'S HARD TO KNOW  
IN THIS CASE  
HOW BIG IS TOO BIG.

Defibrillator



BUT EASY TO GUESS  
HOW SLOW IS TOO SLOW.

TOLLS

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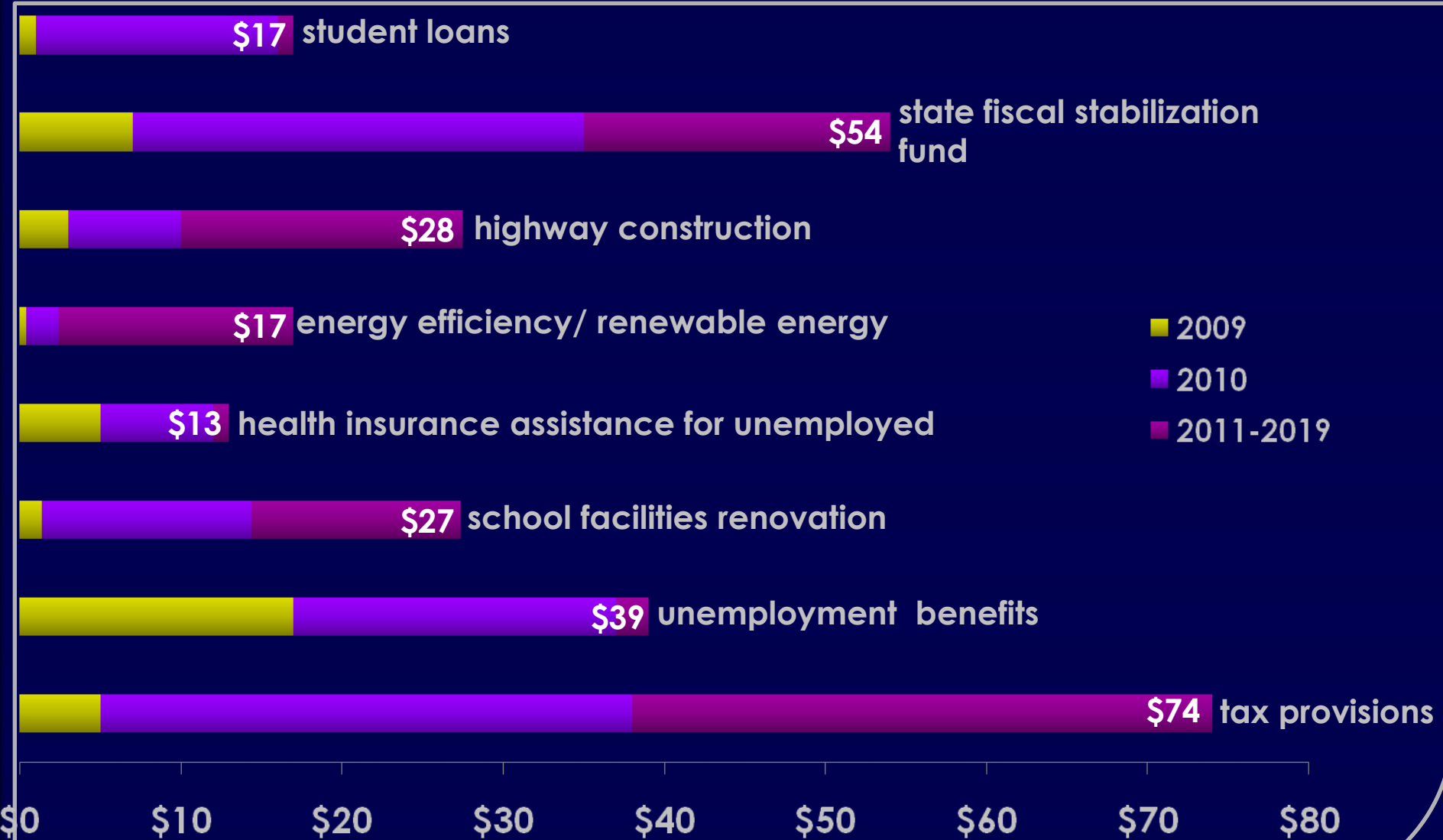
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# HOW DOES OBAMA'S \$787 BILLION STIMULUS PLAN COMPARE TO HISTORICAL GOVERNMENT EXPENDITURES?

	Years	Expenditure at the time	2008 Equivalent Dollars
World War II	1940s	\$290 billion	\$3.6 trillion
Vietnam War	1960s	\$111 billion	\$698 billion
Iraq War	2003-2008	\$551 billion	\$597 billion
Korean War	1950s	\$54 billion	\$454 billion
Interstate Highway System	1950s-60s	\$58 billion	\$425 billion
Race to the Moon	1960s	\$36.4 billion	\$237 billion
Savings and Loan Crisis	1980s	\$153 billion	\$256 billion
Louisiana Purchase	1803	\$15 million	\$217 billion
Marshall Plan	1940s	\$12.7 billion	\$115.3 billion
Work Projects Administration	1930s	\$7 billion	\$100 billion

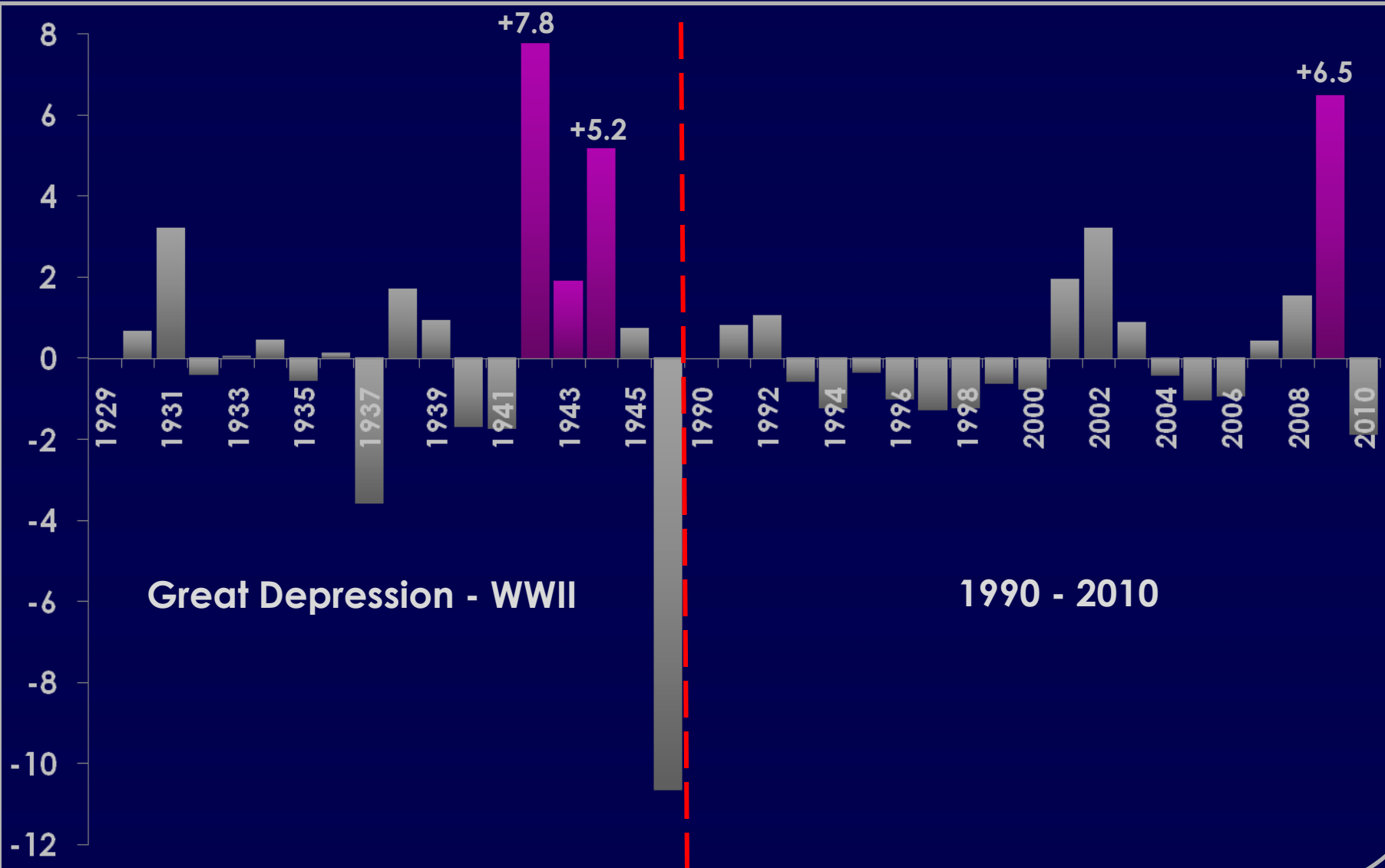
Source: The Washington Post

# TIMING & SCOPE OF THE US STIMULUS PACKAGE (BILLIONS)



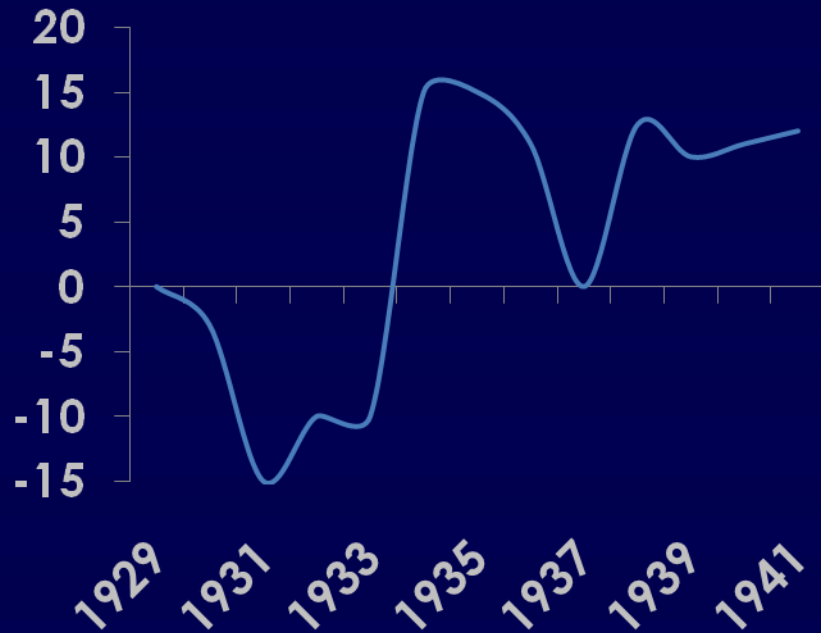
Source: Congressional Budget Office, February 13, 2009

# TODAY'S FISCAL IMPULSE – ON PAR WITH ONSET OF WWII

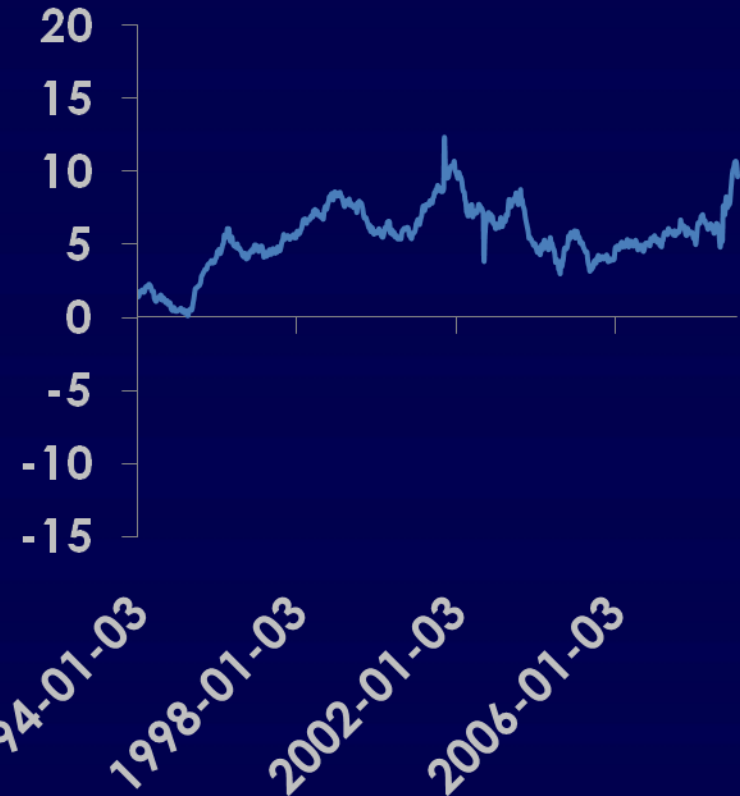


# MONEY SUPPLY EXPANSIONARY TODAY, UNLIKE THE GREAT DEPRESSION

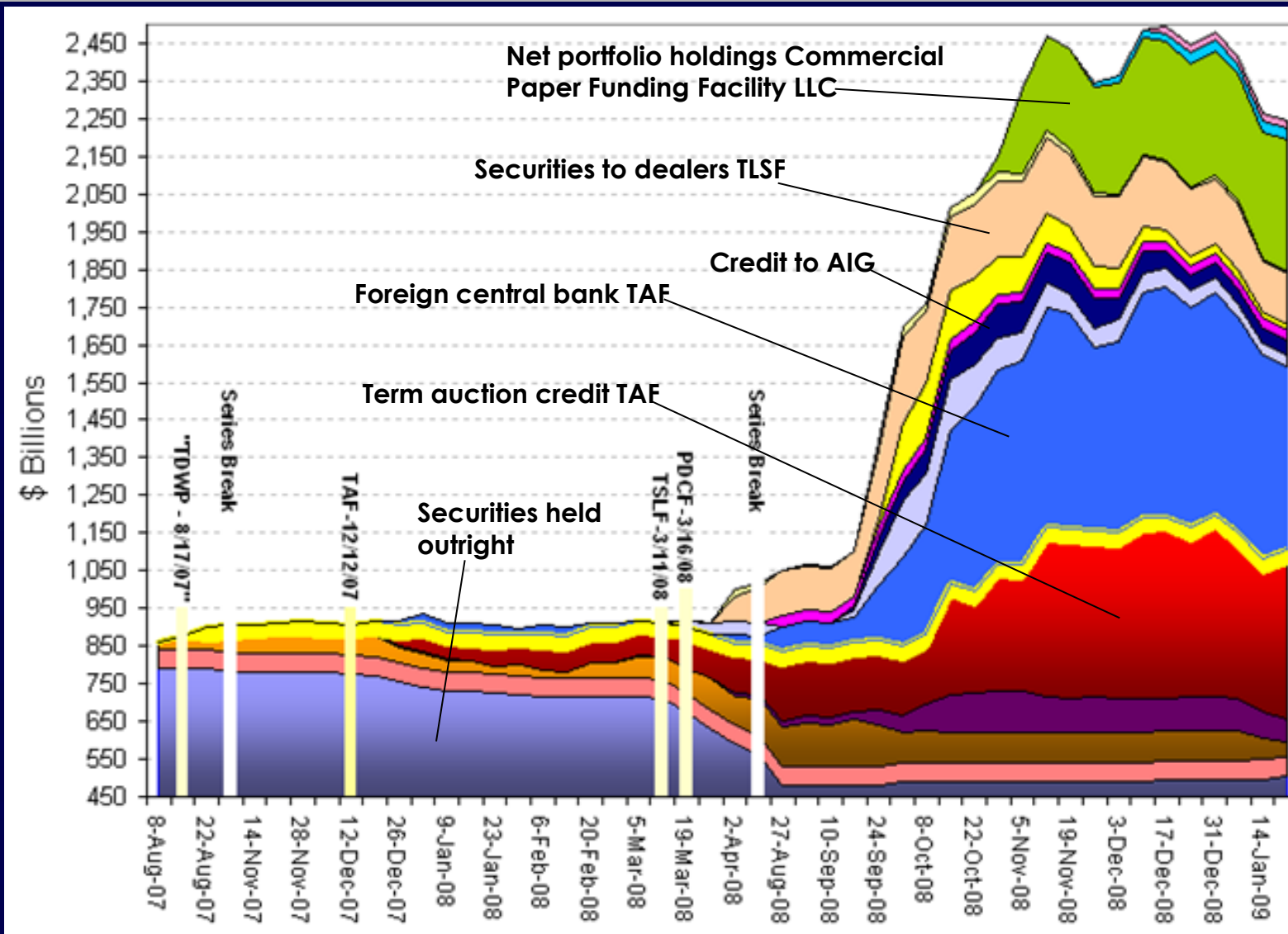
## M2 Percent Change Q4/Q4 1929-1941



## M2 Percent Change Year/Year 1994-2009



# A MASSIVE EXPLOSION OF THE FEDERAL RESERVE'S BALANCE SHEET



# SHORT-TERM CREDIT MARKETS: STARTING TO THAW

TED Spread



# LONG-TERM CREDIT MARKETS: TURNED THE CORNER, BUT STILL A LONG WAY TO GO



# IMPETUS FOR THE TARP

- Political challenge: intervention into the banking system was considered anti-capitalist: “bailout” = dirty word
  - Paulson and Treasury wanted to buy assets and inject capital into banks back in March 2008
  - Government intervention unsellable without a “crisis on the doorstep” to show Congress
- Crisis hit in Sept 2009 – credit flows were effectively frozen
  - Case-by case intervention (e.g., Lehman, AIG) not working
  - Lack of liquidity threatening businesses beyond Wall Street finance world
- Sept 2008 TED Spread exceeded 300 bps – worse than Black Monday 1987.
- Sept ‘08 Pew Survey: 57% American supported banking bailout
- Oct 2008 TED Spread around 460 bps.

# TARP: BASICS OF THE PLAN

- Passed by Congress on October 3, 2008
- Covered more than 600 banks
- Authorized for \$700 billion in loans
- Largest recipients of funds = Citigroup, Goldman Sachs, Bank of America, JPMorgan Chase
- Controversial provisions:
  - No more “golden parachutes” for executives
  - No more incentives to top executives for taking on unnecessary/excessive risk
  - Bailout funds apply to GM and Chrysler

# TARP: THE POSITIVES AND NEGATIVES

## POSITIVE

- Many banks say lending increased
- Several banks posted quarterly profits
- Average bank stock up 25%

## NEGATIVE

- Banks still have “toxic assets”
- Rising losses from credit cards and commercial real estate
- No financial regulatory reform yet

# TARP AND THE BANKS: EXTRACTION PROCESS

- Already \$68 billion approved for TARP payback, including \$2 billion of interest and dividends
  - The U.S. government earned 4% rate of return
- 10 banks financially stable enough to start repaying funds:
  - Goldman Sachs
  - JPMorgan Chase
  - Morgan Stanley

} \$1.2 billion in dividends to taxpayers
- Banks not yet repaying funds:
  - Citibank
  - Bank of America
  - Wells Fargo

} \$90 billion given to these two banks alone
- Banks have raised \$85 billion in capital since the Stress Tests

# PAIN HEAVILY U.S. CENTERED: POTENTIAL GLOBAL FINANCIAL WRITEDOWNS (2007-10)

		April 2009 Estimate	Implied Cumulative Loss (%)
 <b>United States</b>	<i>Loans</i>	\$1,068 Billion	7.9%
	<i>Securities</i>	\$1,644 Billion	12.6%
	<b>Total all Loans and Securities</b>	<b>\$4,054 Billion</b>	<b>7.0%</b>
 <b>Europe</b>	<i>Loans</i>	\$888 Billion	4.3%
	<i>Securities</i>	\$305 Billion	10.0%
	<b>Total all Loans and Securities</b>	<b>\$1,193 Billion</b>	<b>7.0%</b>
 <b>Japan</b>	<i>Loans</i>	\$131 Billion	2.0%
	<i>Securities</i>	\$17 Billion	2.2%
	<b>Total all Loans and Securities</b>	<b>\$148 Billion</b>	<b>2.1%</b>

# U.S. BANK "STRESS TEST" RESULTS

THE GOOD

JPMorganChase 

New capital needed  
(6% threshold)

--

New equity needed  
to absorb future losses

--

Estimated consumer  
mortgage losses

\$39 B

Goldman  
Sachs 

--

--

--

THE BAD

Bank of America 

--

\$34 B

\$44 B

citi 

--

\$5 B

\$28 B

WELLS  
FARGO 

--

\$14 B

\$47 B

THE  
UGLY

GMAC 

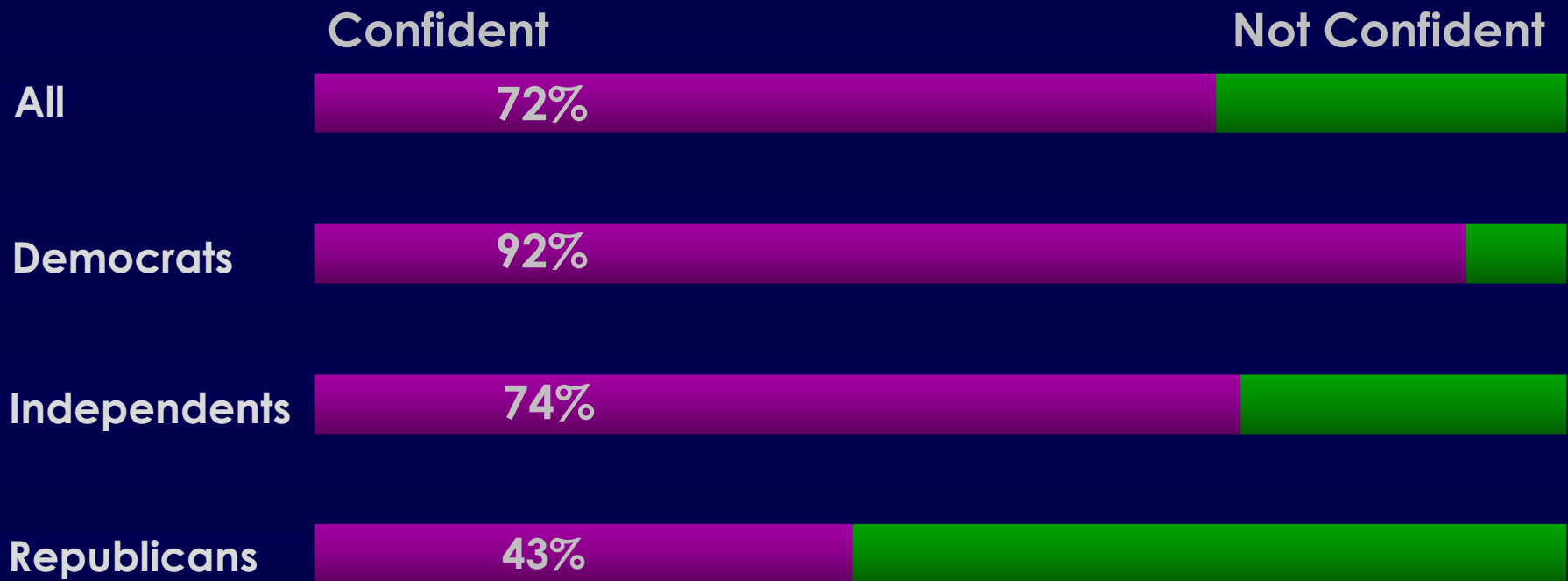
\$9 B

\$12 B

\$3 B

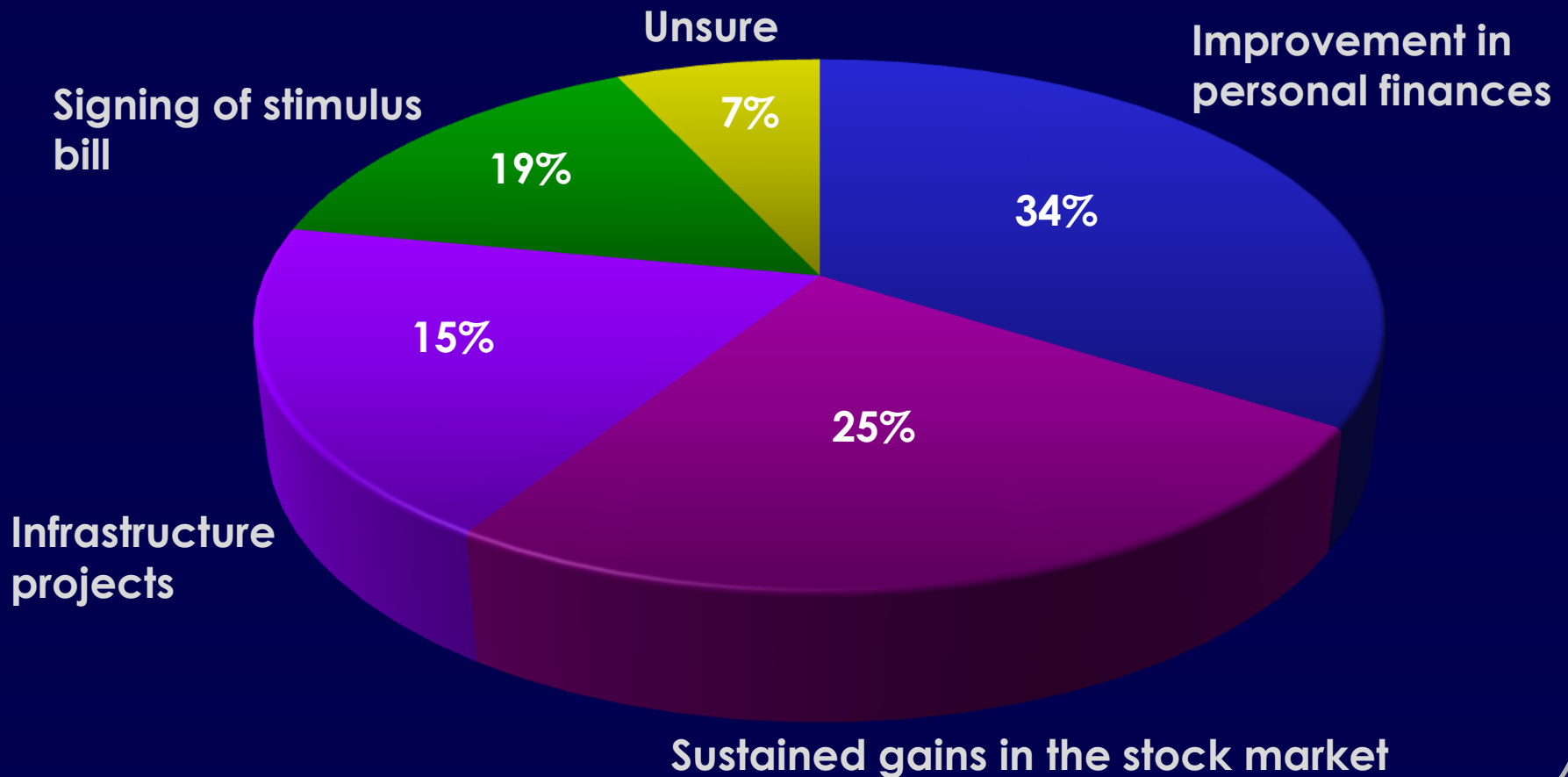
# PUBLIC CONFIDENCE IN OBAMA'S ECONOMICS

"How confident are you that Obama's economic program will improve the economy?"



# PUBLIC CONFIDENCE IN THE U.S. ECONOMY

"Which of the following would have the greatest positive effect on your confidence in the U.S. economy?"



# NEW IMF STUDY OF RECESSION DURATION AND DEPTH

- Based on sample of 65 recessions over past 50 years in 21 industrial countries
- Examples of Recessions Associated with Financial Crisis

Australia                      1990: Q2 – 1991: Q2

Finland                         1990: Q1 – 1993: Q3

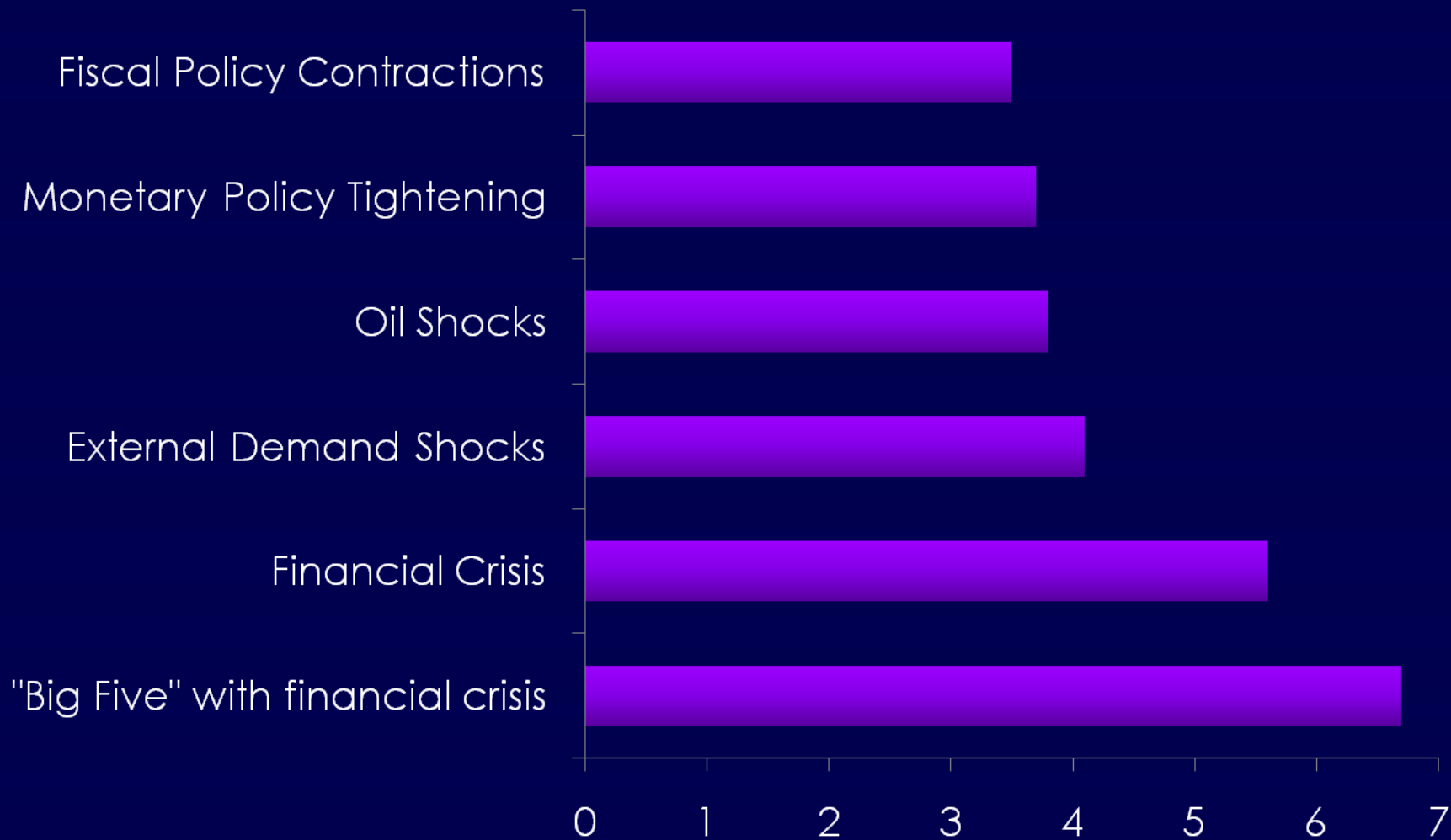
Japan                            1993: Q2 – 1993: Q4

Sweden                         1990: Q2 – 1993: Q1

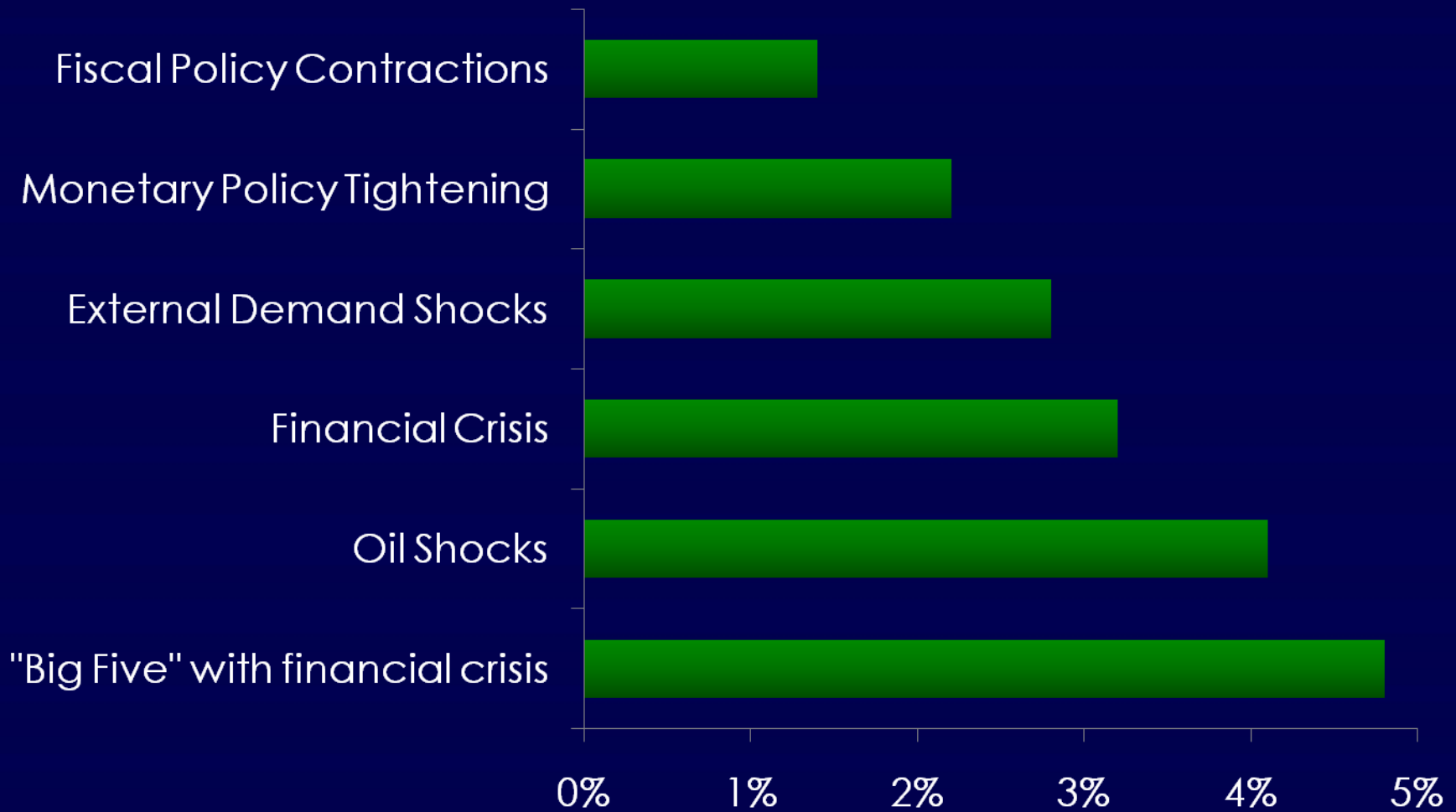
United Kingdom              1973: Q3 – 1974: Q1

- Study based on regression analysis.

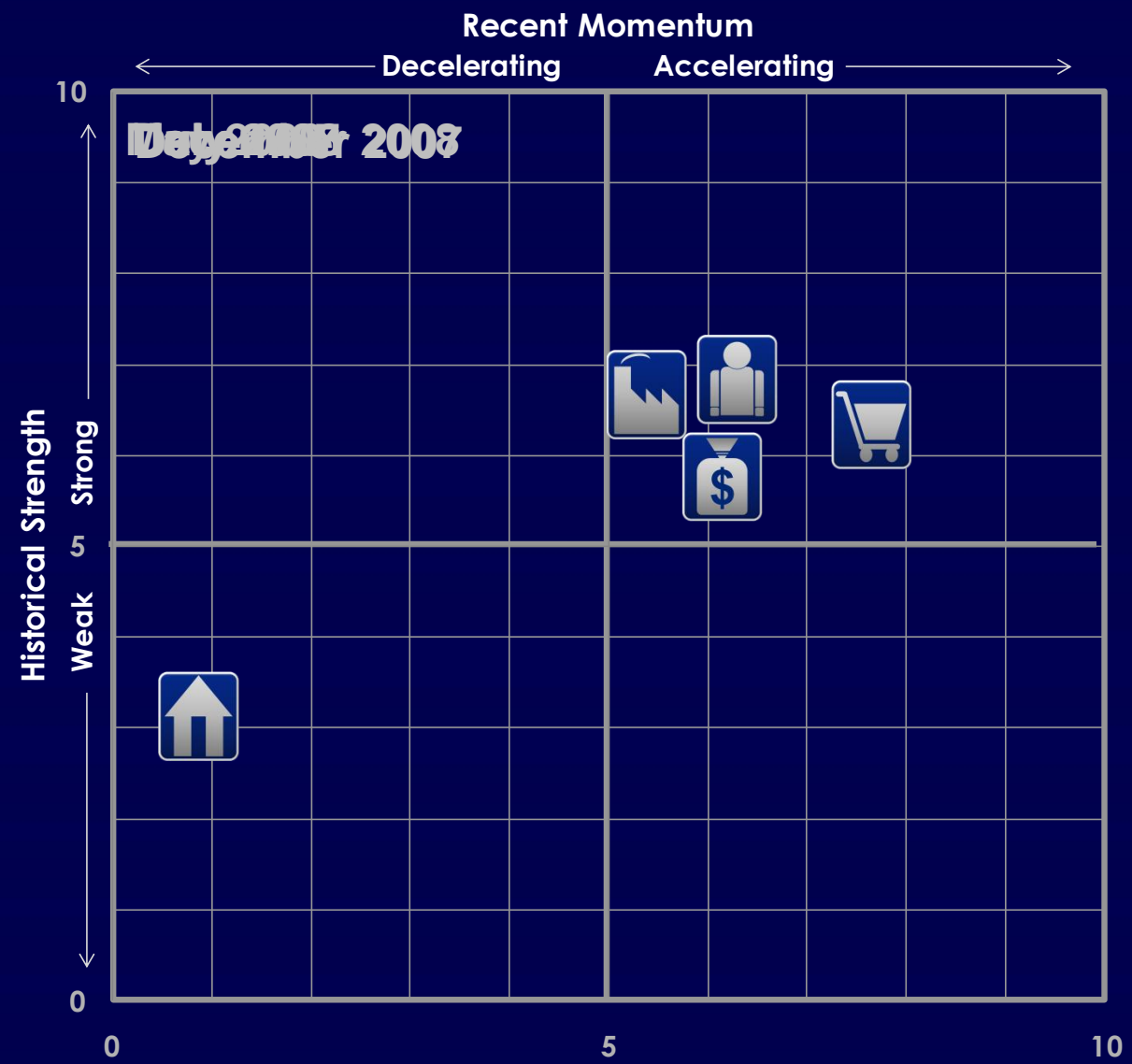
# ANALYSIS OF RECESSIONS: AVERAGE DURATION (QUARTERS)



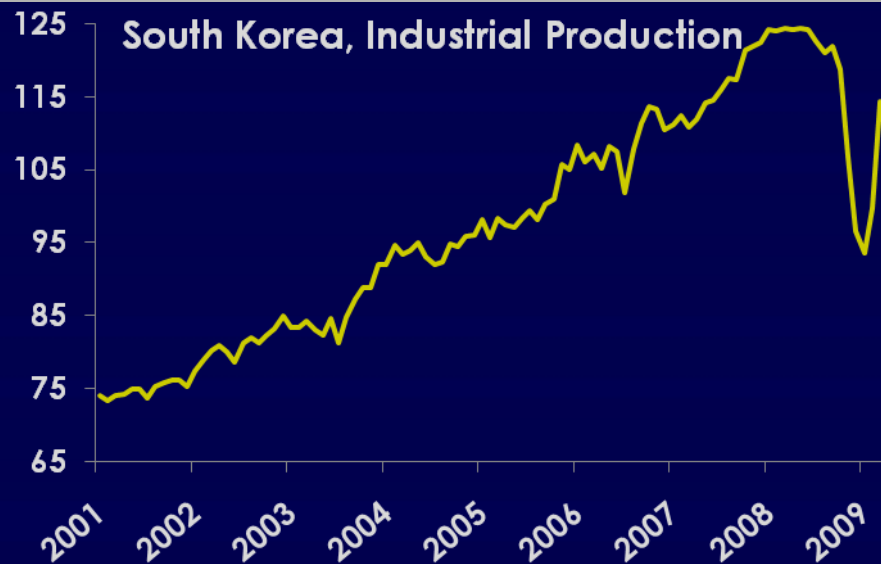
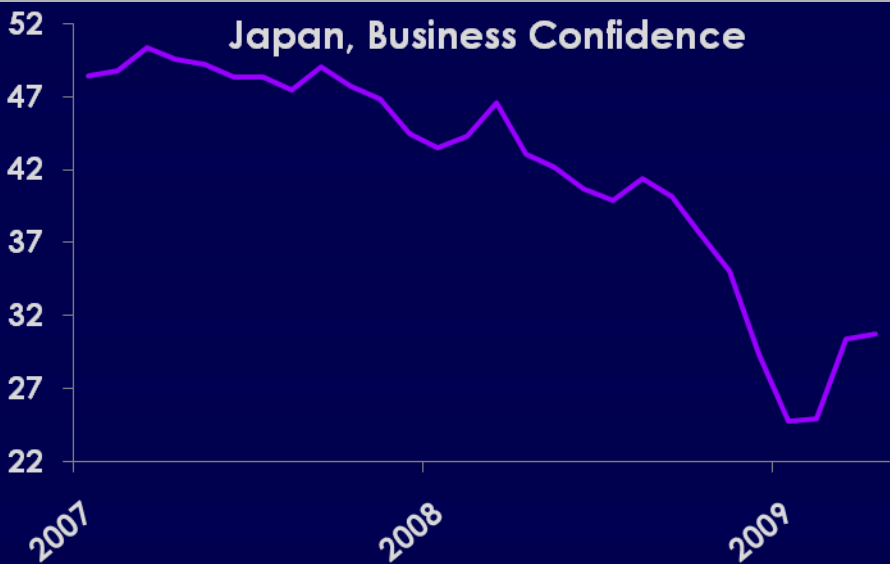
# ANALYSIS OF RECESSIONS: OUTPUT LOSS (% FROM PEAK)



# KEYBRIDGE RESEARCH U.S. ECONOMIC MOMENTUM MONITOR



# SOME "GREEN SHOOTS" AROUND THE WORLD



# KEY TO OUTLOOK: U.S. PERSONAL SAVING RATE NOW REBOUNDED FROM HISTORIC LOWS



# FACTORS SUPPORTING GLOBAL RECOVERY

- U.S.: \$787 billion stimulus package, 0% interest rates, TARP, TALF, PPIP, TAF, small business loans
- China: \$586 billion stimulus package, 50% increases in M2 and loans
- France: \$46 billion Paris transport infrastructure, cut of VAT on restaurants
- New Zealand: interest rate cuts
- Brazil: interest rate cuts
- Globally: money growth of +10.1% year on year, 600 similar policy initiatives

# MOST LIKELY CASE NOW FOR U.S. ECONOMIC GROWTH

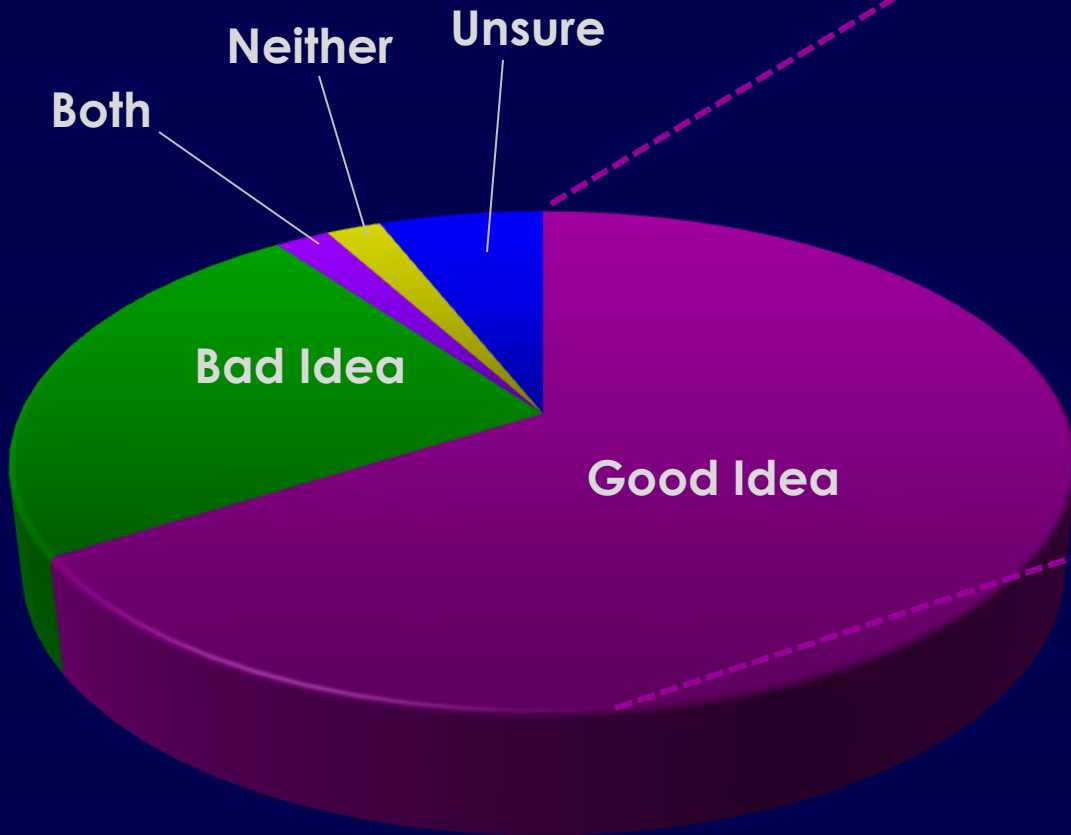
- Massive stimulus policy does restart U.S. economy
- Economy hits bottom during August-October 2009
- Modest growth in 2009Q4 to 2010Q2 as households continue to rebuild savings (+1 to +2% SAAR)
- Credit market unthawing continues—banks start slowly returning to lending by 2010Q1-Q2
- Labor markets still weak for rest of 2009—unemployment rate keeps climbing until early 2010
- Public starts to believe in Obama's economic policies and they gain acceptance
- Commodity prices remain weak for first 2 years of recovery, as is the historical pattern

# MOST LIKELY CASE NOW FOR ECONOMIC GROWTH IN REST OF WORLD

- Massive stimulus policy in China helps to restore Asian growth, but exports remain weak. Construction sector helps economy grow moderately.
- Korea and Japan remain soft until early-mid 2010 because of slow recovery of export demand to US and EU.
- EU recovery lags behind global recovery because of late easing of monetary policy/strong euro. Negative GDP until early 2010.
- Unthawing of global capital markets helps restore credit flows to “stronger” emerging markets, like Brazil and India.
- Massive IMF and official flows help restore credit flows to “weaker” emerging markets, like Ukraine, African countries.
- Oil exporters tread water with oil prices remain in the \$60-\$70s.
- World GDP returns to positive range for 2010, gather speed as year progresses. 2011 return to normalcy.

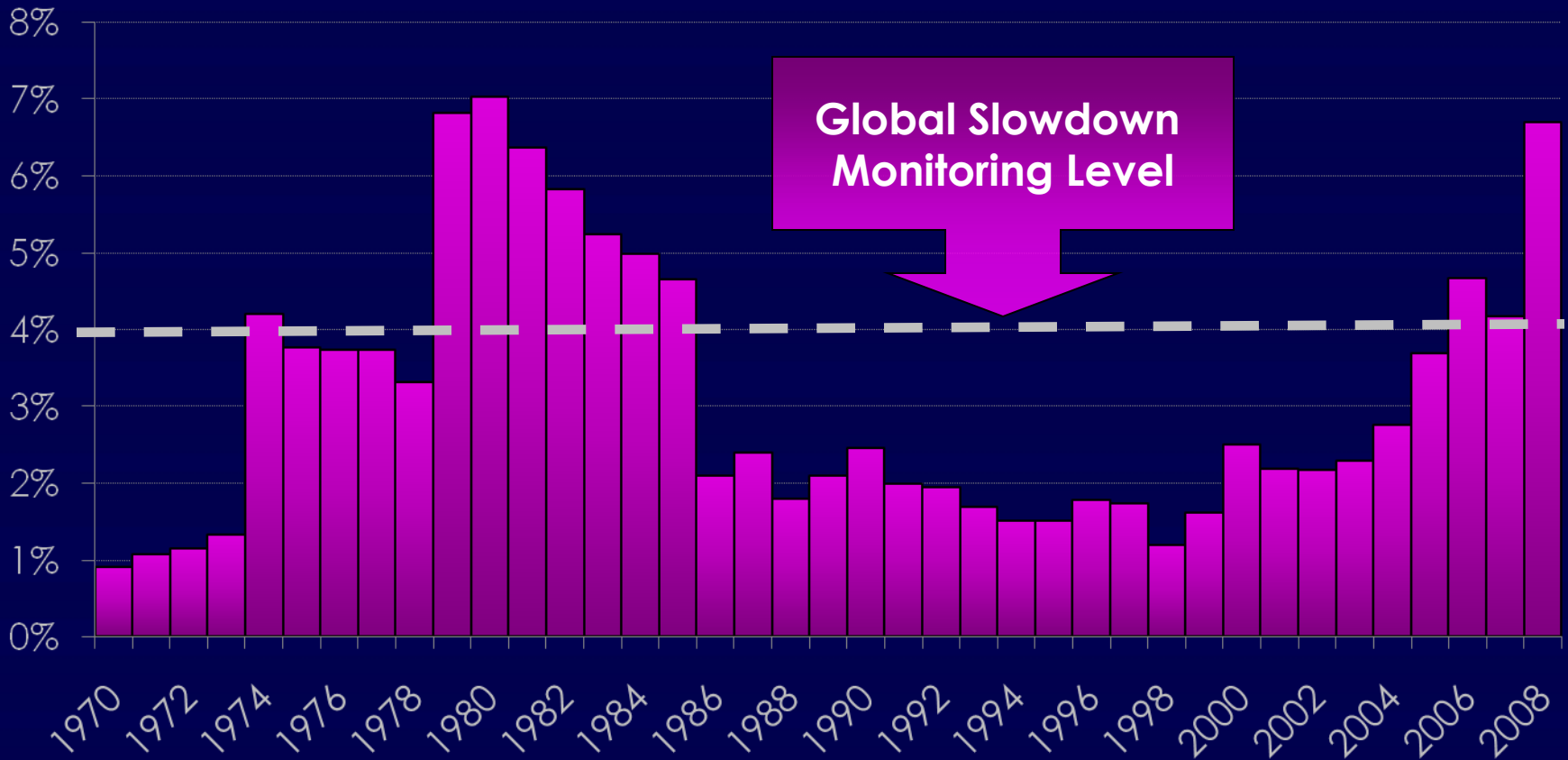
# IS AMERICA BECOMING PROTECTIONIST?

Is the 'Buy America Provision' in the Stimulus Bill a good or bad idea?



1930: Smoot and Hawley

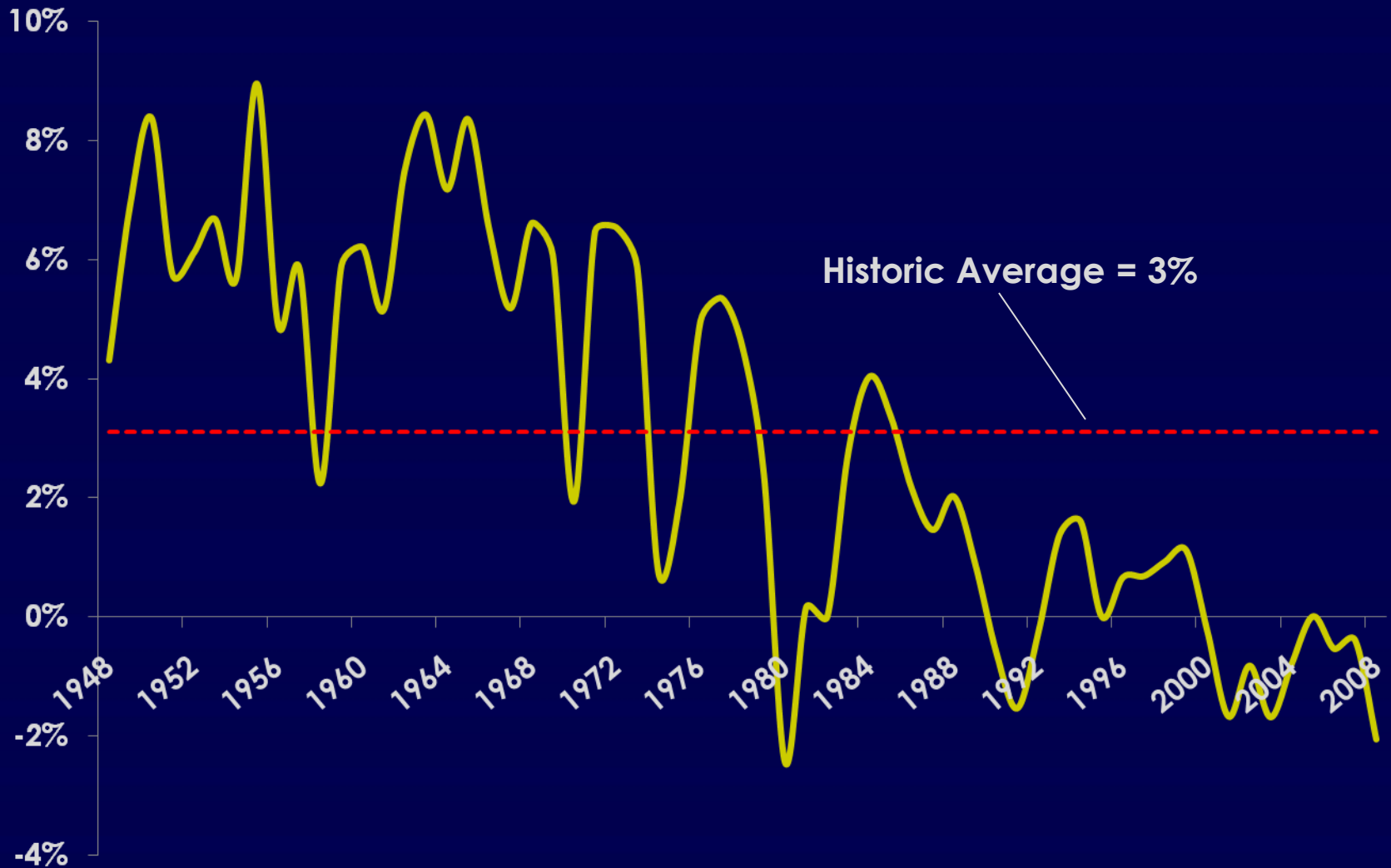
# THE WORLD OIL BILL (AS A SHARE OF GDP)



# INFLATION RISKS?

- The driving risk factors: global money supply +10.1% and massive fiscal stimulus
- The counterweights: wage moderation around the world
  - Japan: wages -3.7% year on year
  - Korea: wages -2.1% year on year
  - United Kingdom: wages +0.1% year on year
  - Wage cuts/freezes around the world
- Policy challenge—can stimulus be turned off after economic takeoff, before inflation?
- One possibility—a smaller “cleanup” recession in 2011-12?

# VEHICLE AND PARTS MANUFACTURING PROFITS, PERCENTAGE OF TOTAL U.S. PROFITS



Source: BEA, NIPA Tables 6.16B-D