

When fortune frowned

Austin, America
and the global economy

Zanny Minton Beddoes

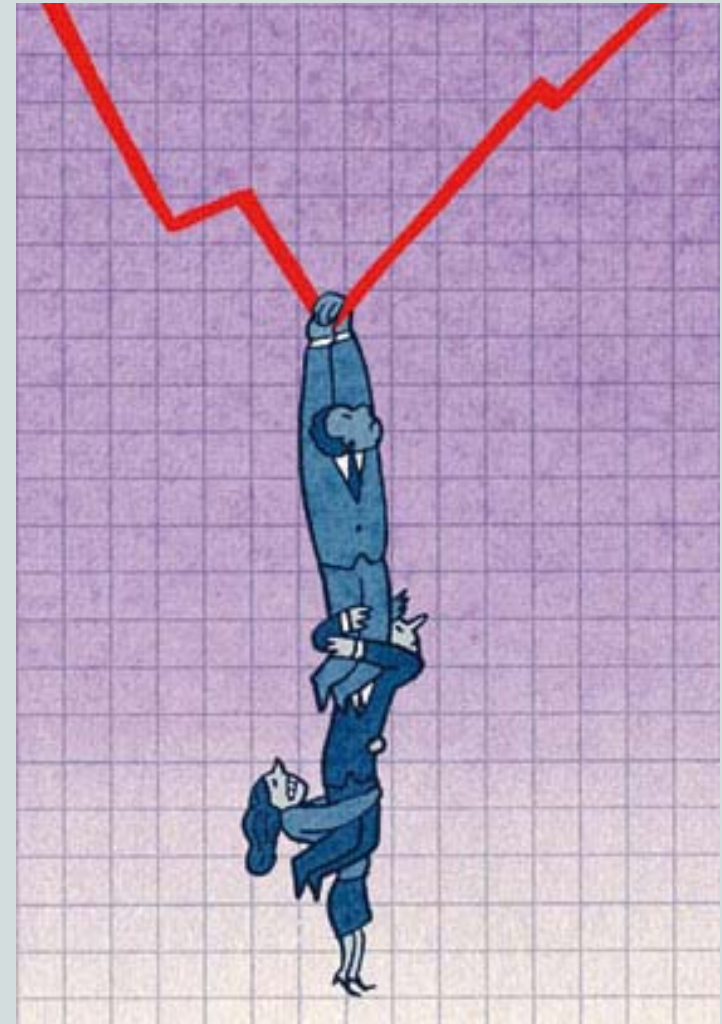
A grim picture

- Worst global financial crisis since the Great Depression
- Worst G7 recession since 1930s
- Longest US recession in post-war period – and probably deepest



Ingredients of an implosion

- Deleveraging
- Wealth destruction
- Confidence collapse
- Falling demand
- Rising unemployment

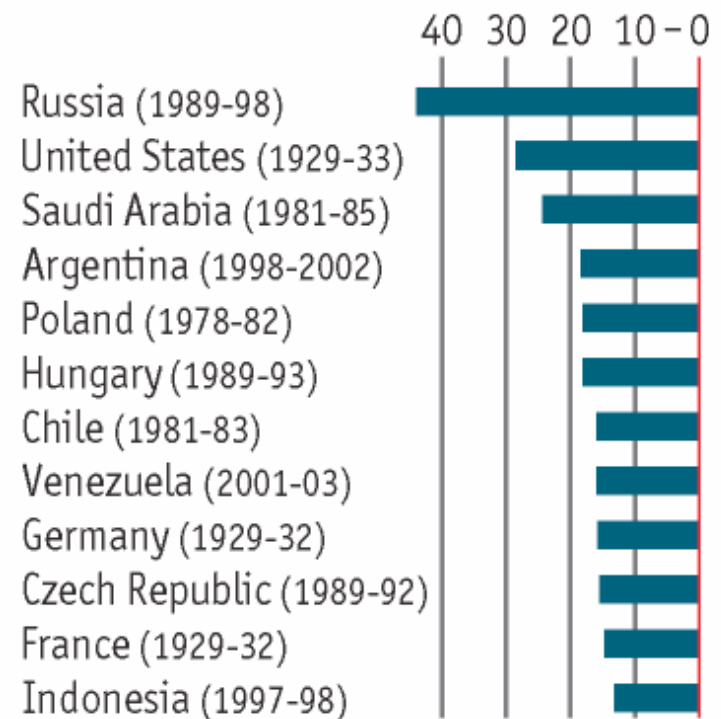


How bad could it get?

- From recession to depression?
- Deflation
- Anti-market backlash
- Protectionism

The dirty dozen

Real GDP, % fall from peak to trough*



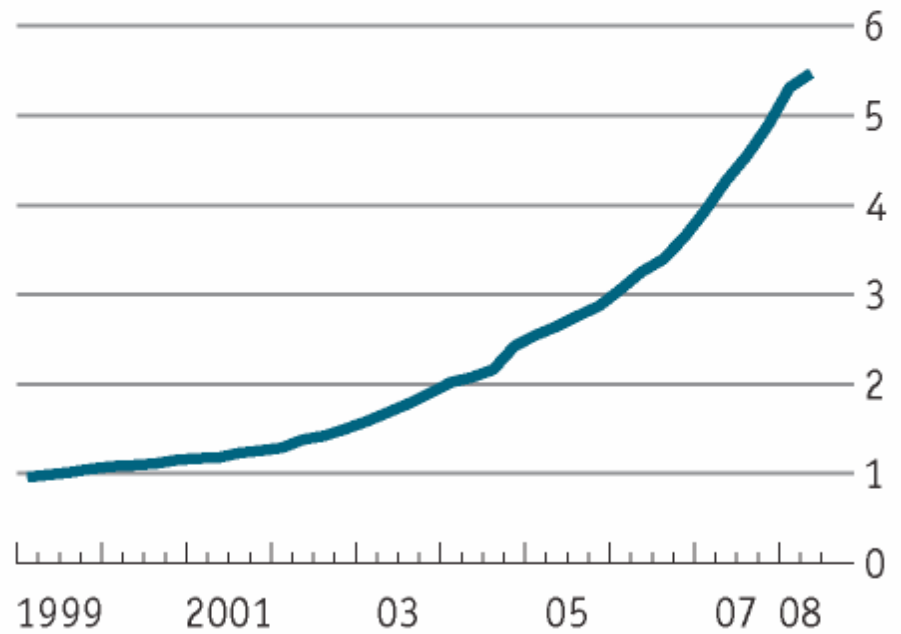
Sources: IMF; OECD; Bureau of Economic Analysis

Origins of a crisis

- Cheap credit

Picking up

Developing countries' foreign-exchange reserves
\$trn



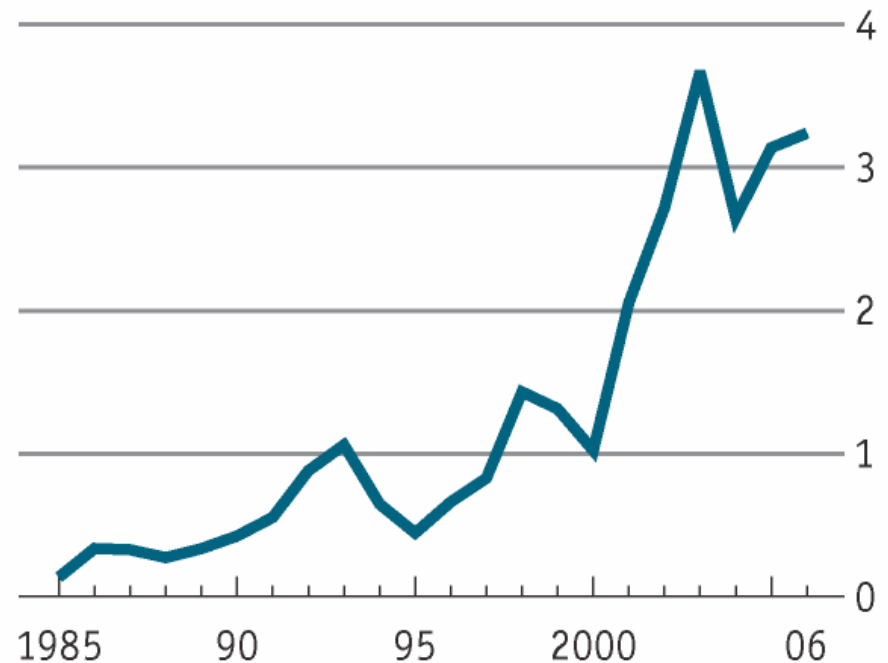
Source: IMF

Origins of a crisis

- Cheap credit
- Financial innovations

On a trend

US securitised issuance, \$trn



Source: American Securitisation Forum

Origins of a crisis

- Cheap credit
- Financial innovations
- Poor supervision

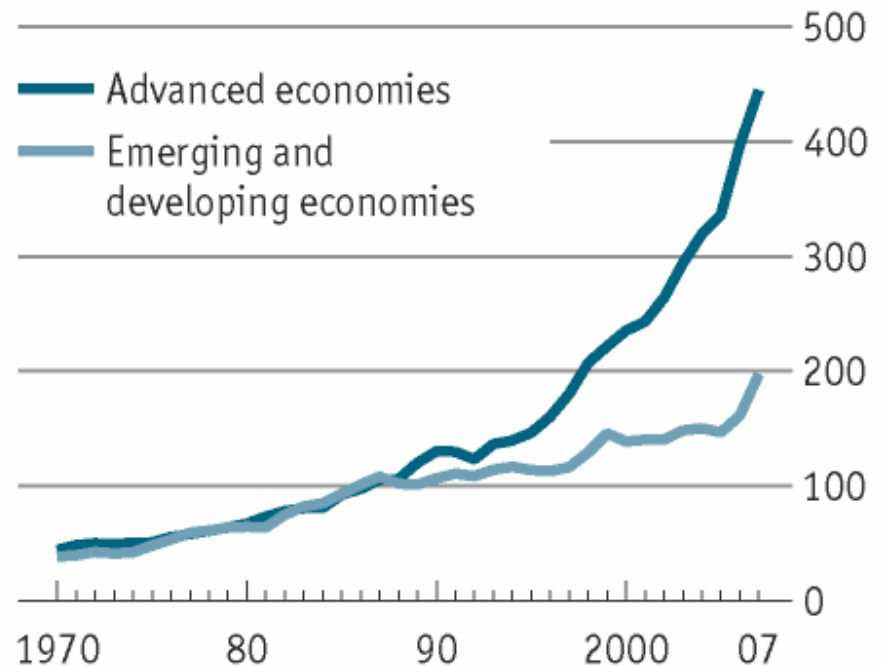


Origins of a crisis

- Cheap credit
- Financial innovations
- Poor supervision
- Financial globalisation

Globalisation reigns

Total foreign assets and liabilities as % of GDP



Source: Philip Lane and Gian Maria Milesi-Ferretti

Origins of a crisis

- Cheap credit
- Financial innovations
- Poor supervision
- Financial globalisation
- Government meddling

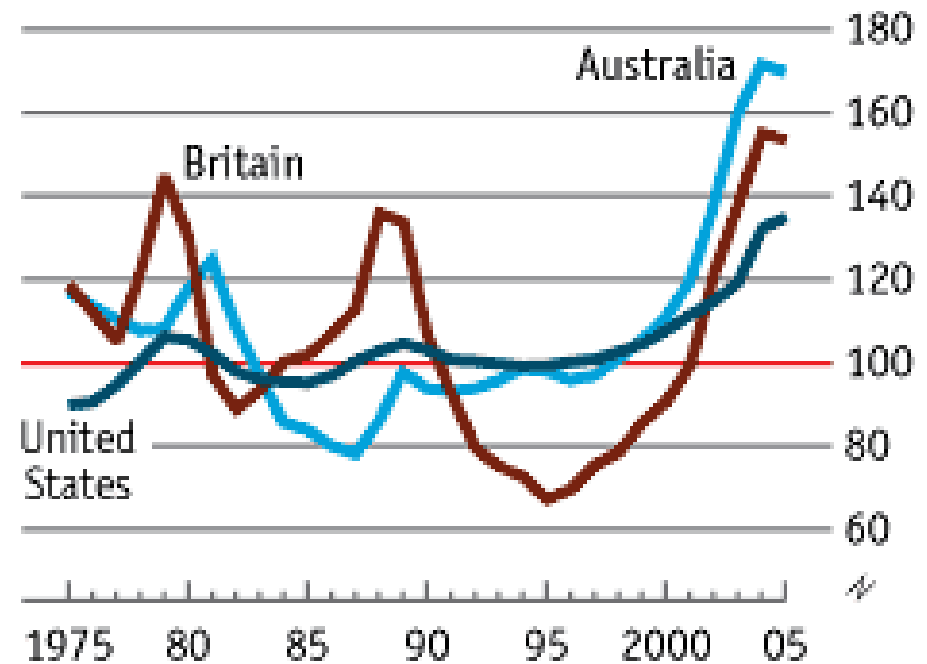


Signs of excess

- Housing bubble

Looking peaky

Ratio of house prices to rents
1975-2000 average=100



Source: *The Economist*

Signs of excess

- Housing bubble
- Credit bubble

Up, up and away

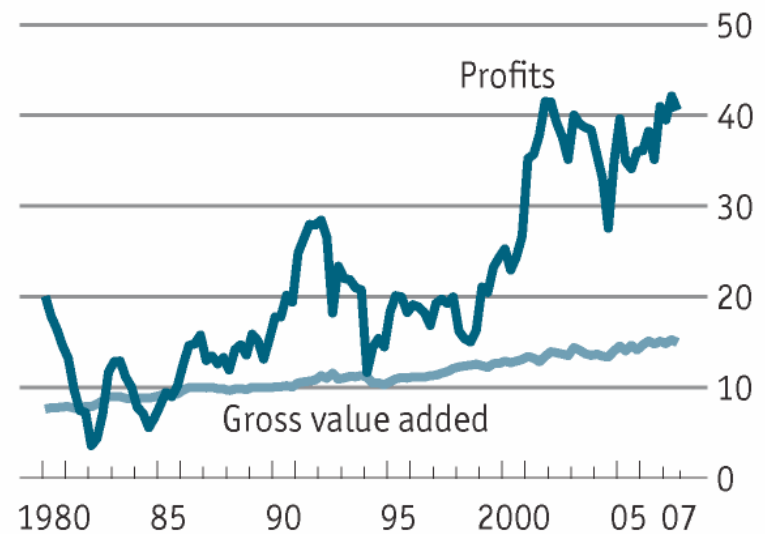
US financial assets as a % of GDP



Sources: Thomson Datastream; Federal Reserve

Money machine

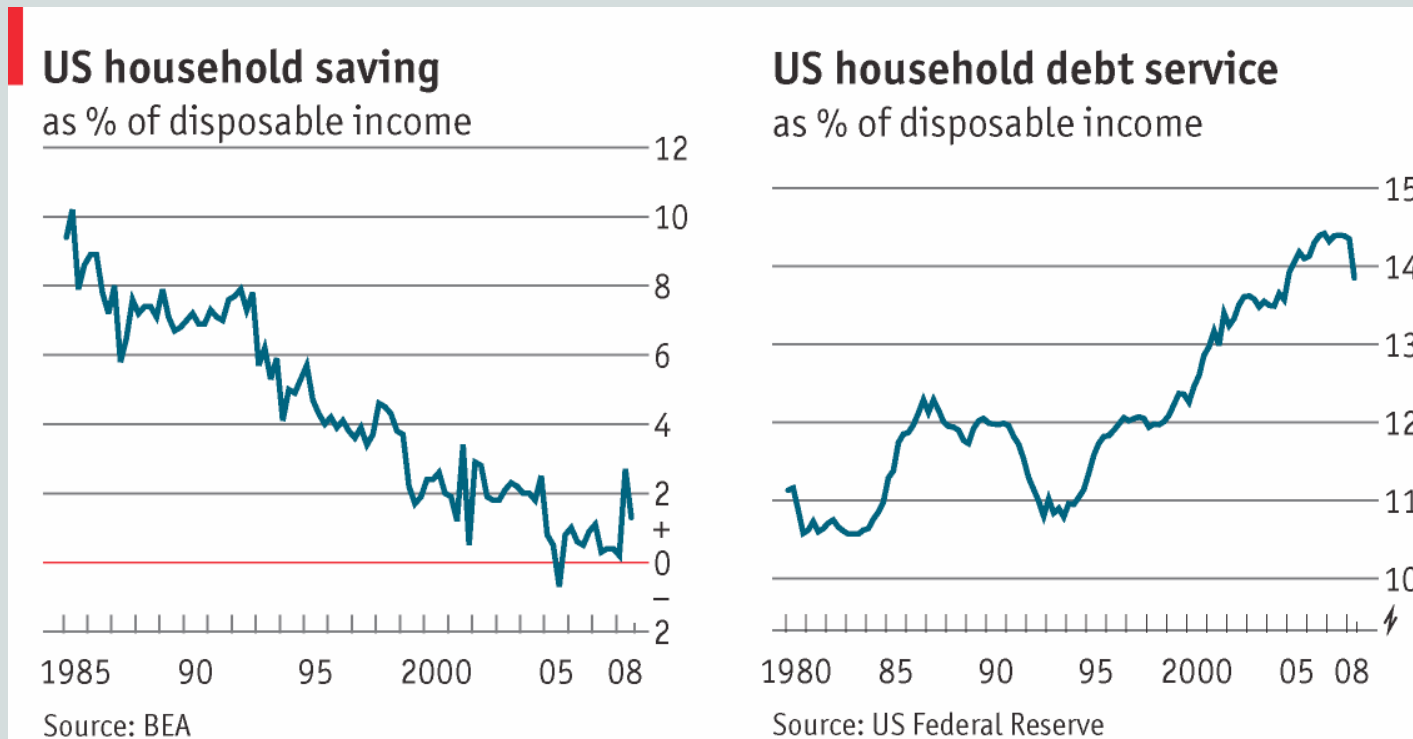
Finance industry profits and gross value added
As % of US corporate total



Source: BCA Research

Signs of excess

- Housing bubble
- Credit bubble
- Collapsing savings rate



From bubble to hangover

An inevitable headache

- Greed to fear
- Asset bust
- Return to thrift



From hangover to panic

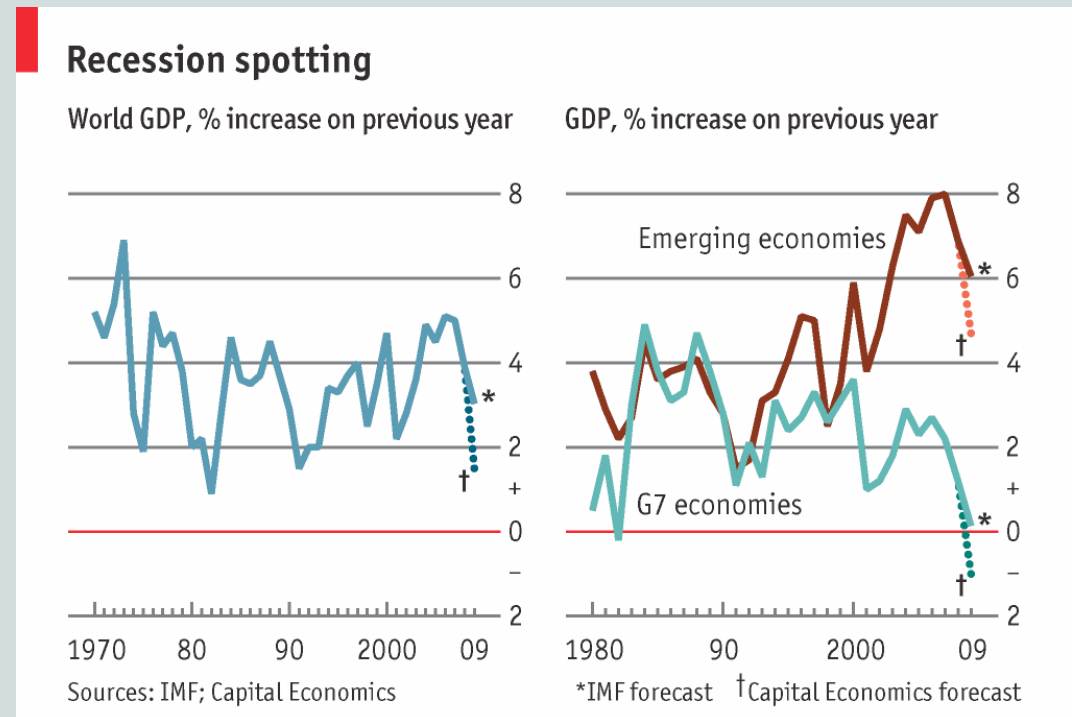
The Lehman error

- Changing the rules
- Holes in the TARP
- Crisis goes global fast



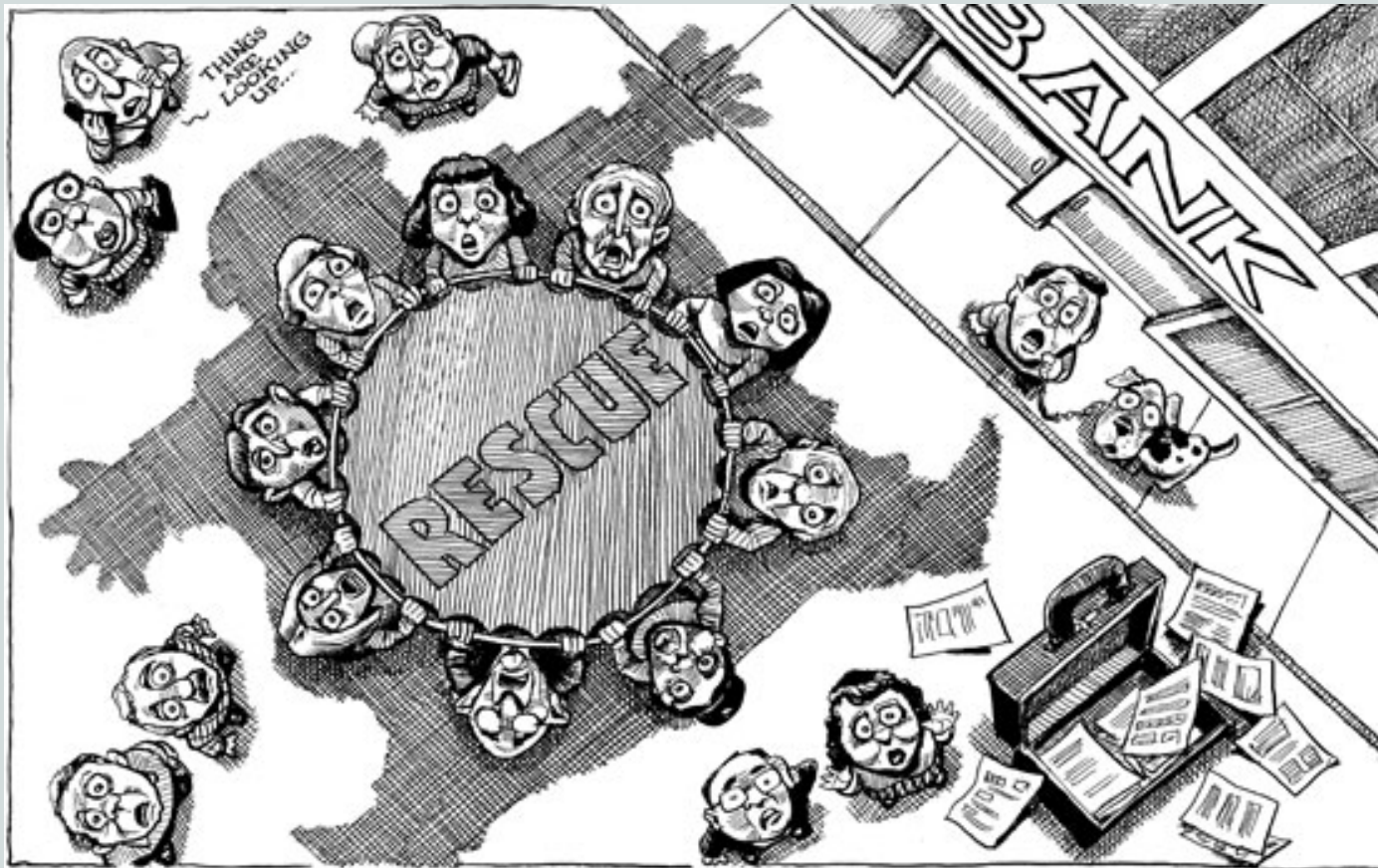
From banking crisis to global slump

- Output tumbling across the globe
- Global trade will contract for first time since 1982
- Private capital flows to emerging economies to halve
- Commodity prices have plunged



Cushioning the fall

Don't just stand there...



Ingredients of recovery

The global to-do list

- Strengthen banks
- Lower interest rates
- Quantitative easing
- Fiscal boost
- Rebalance world economy

America leads the way

A new New Deal?



A top class crowd

- Experienced technocratic team
- Deep bench of talent
- Centrists not ideologues



America's action plan

Even more creativity at the Fed

- Beyond 0% interest rates
- Quantitative easing
- 12 new lending schemes
- Bypassing banks
- \$2 trillion balance sheet



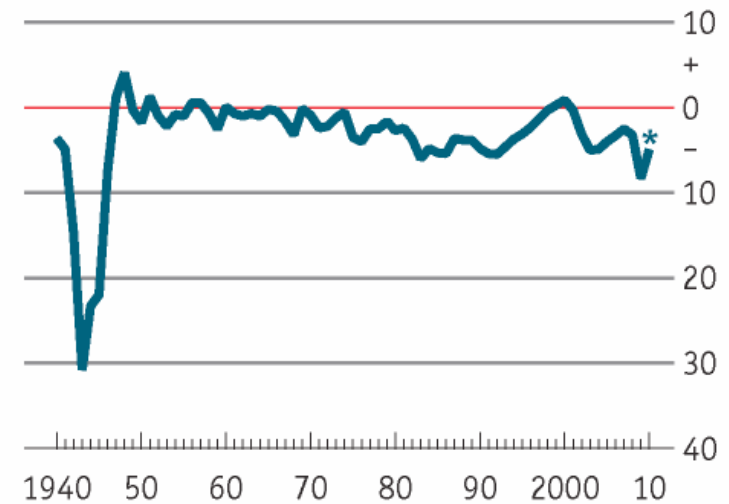
America's action plan

Bold fiscal stimulus

- \$700-800 bil over 2 years
- Middle-class tax cuts; business tax cuts
- Aid to states and localities
- Broader and extended unemployment insurance
- Big infrastructure spending

Back to the bad days

Budget balance as % of GDP



Source: Congressional Budget Office (CBO)

*2009-10 CBO estimates, excluding new stimulus

America's action plan

Remaking the financial rescues

- How to spend the remaining \$350 billion
- Broader bank recapitalization
- Removing bad assets
- Beyond the ad hoc approach



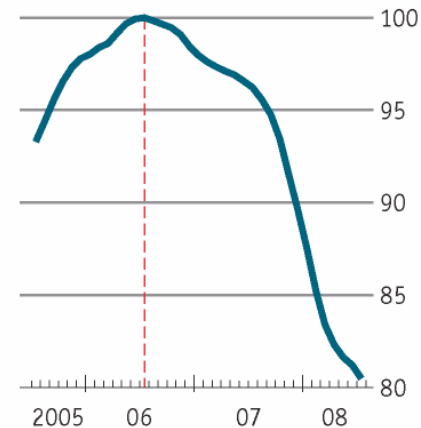
America's action plan

Homing in on housing

- Pipeline of unsold housing (still 11 months of supply)
- 3m face foreclosure
- House prices down 23% from peak (another 10-15% to go)
- Beyond lower mortgage rates

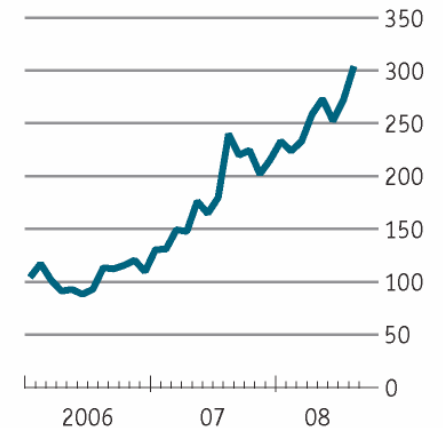
Falling off the property ladder

US house prices*, peak=100



Sources: Standard & Poor's; RealtyTrac

US foreclosures, '000



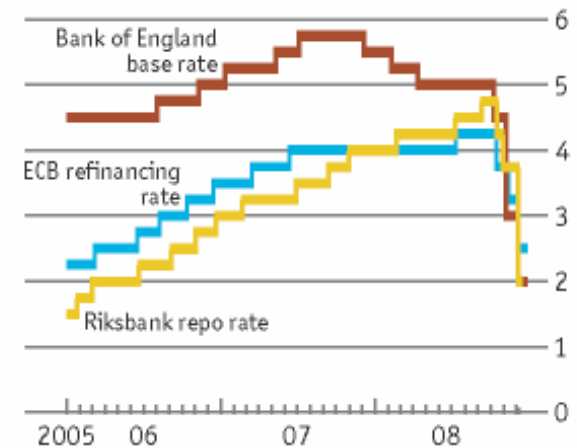
*S&P/Case-Shiller 20-city index

Europe: Time to step up the pace

- More rate cuts needed
- Coordinated fiscal stimulus
- Germany's misplaced prudence

Down they come

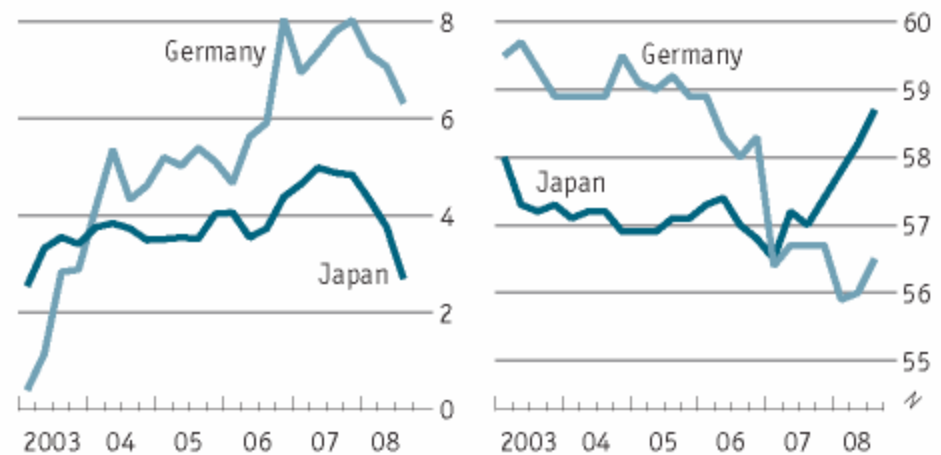
Key policy rates, %



Source: Thomson Datastream

Temperance societies

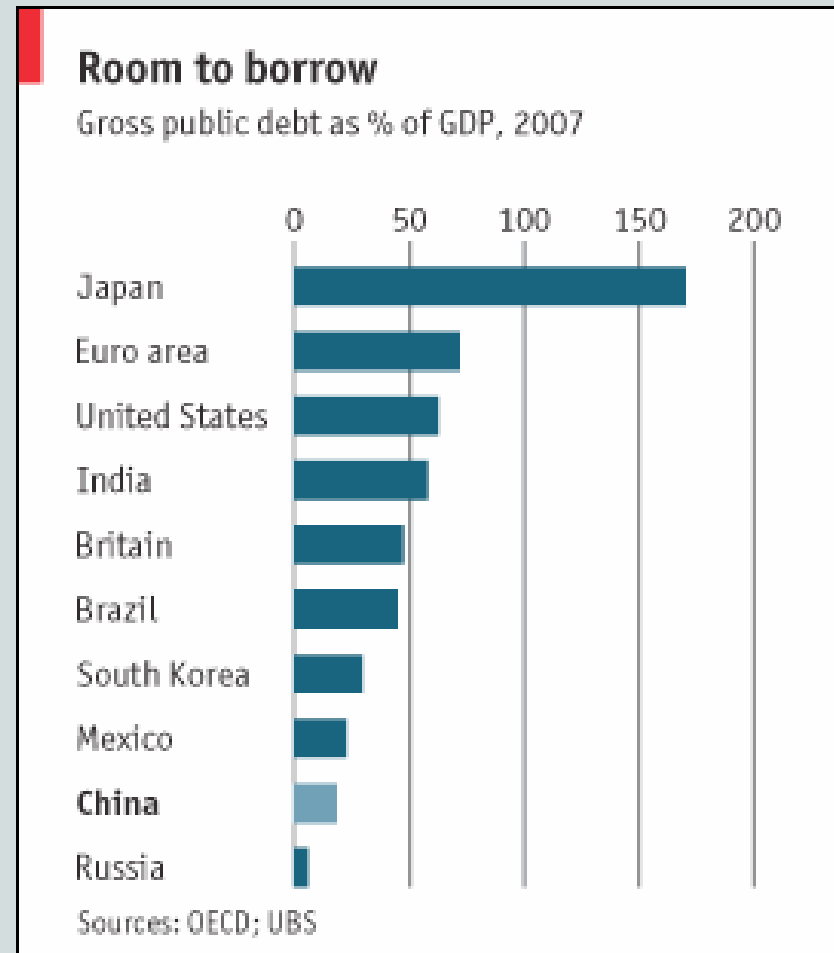
Current-account surpluses as % of GDP



Sources: Thomson Datastream

China has a big role

- Scale of stimulus
- Reorienting the economy
- Resisting exporter pressure



Will it work?

- Danger of excessive expectation
- Not the traditional post-war recession
- Sobering statistics

Will it work?

- Danger of excessive expectation
- Not the traditional post-war recession
- Sobering statistics
 - After average big post-war financial crash
 - Real house prices fell 35% over 6 years
 - Stock prices fell 55%
 - Unemployment rate rose 7 percentage points
 - Output fell 9%

Will it work?

- Glimmers of good news
 - Mortgage rates down
 - Corporate bonds spreads improving
 - Stock markets above November lows

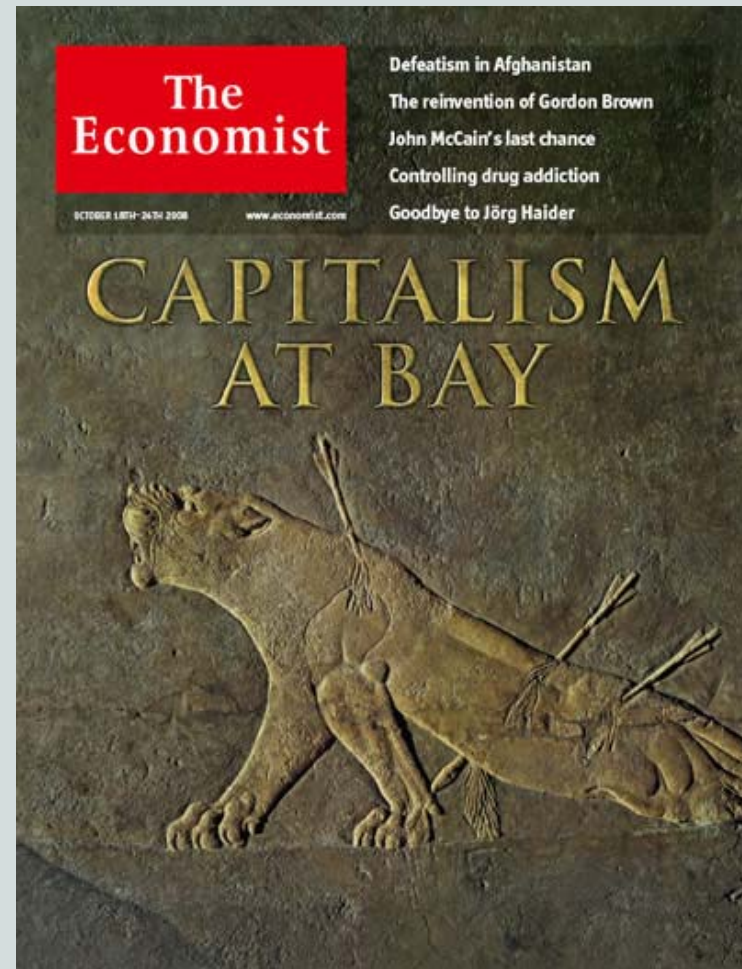
But 2009 looks grim

- Economy shrinks until mid-year at least
- Weak recovery; unemployment keeps rising
- Saving rate reaches 6%
- No help from the rest of the world
- Large budget deficit; weak economy



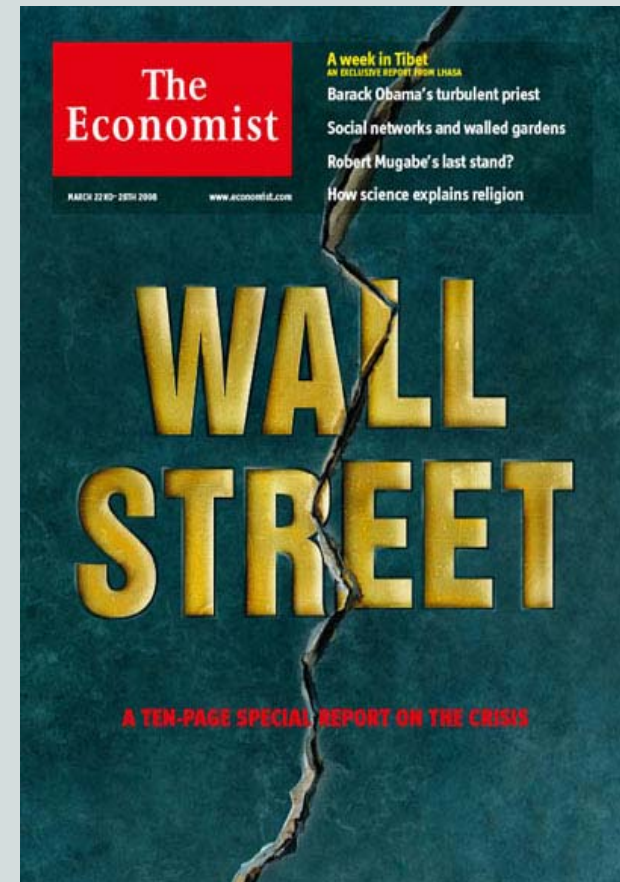
How big a turning point

- Future of finance
- Governments versus markets
- Global financial imbalances



Future of finance

- Shadow financial system shrinks
- Bank consolidation?
- Nationalised mortgage system?
- Will innovative edge be lost?



Free markets under threat?

- How far will Wall Street be hobbled?
- Backlash beyond finance?
- Risk of overkill?



A tough road ahead

- Nasty recession, weak recovery
- From excess consumption to thrift
- US government cannot power global demand
- Key to sustained recovery: more balanced global economy

