


# 3<sup>o</sup> Seminário Internacional de **RENDA FIXA**



008:           The Great Recession of  
                  A Drama in Three Acts

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# How Did We Get To Where We Are? I

- ▶ **Globalization Is at the Heart of the Story**
  - Since 1950, international trade has grown at twice the rate of world GDP
  - First, Western Europe recovered; next came Japan, progressively followed by others in Asia.
  - Eastern Europe, Latin America and Africa have only joined in the 1990s
- ▶ **There Has Been Rising Convergence**
  - Capitalism Triumphed Almost Everywhere
  - The Lowest Income Countries Grew Faster

# How Did We Get To Where We Are? II

- ▶ Globalization Began To Take a New Twist in the 1980s and 1990s
  - Thatcherism: Privatization and Less Regulation
  - The US Became the Great Recipient of Foreign Investment
    - Technology Advance and Productivity Gain Occurred
    - Growing US Consumption –and Growing Imports– Fueled Rapid Global Expansion
  - Financial Flows Progressively Became More International and More Sophisticated
    - The Asian and Russian Crises Gave Initial Warnings

# How Did We Get To Where We Are? III

- ▶ US Economy Slows in 2000 After A Record of Continuing Expansion for Almost a Decade
  - Yet After September 11, 2001 Comes A Final Burst
    - A Housing Boom, Sparked by Very Low Interest Rates
    - Consumption Expands, Fueled by Rising Wealth
    - The United States Absorbs 70% of World Total Foreign Investment and Imports Soar
    - Commodity, Mineral and Petroleum Prices Rise
    - Banking and International Finance Flourishes
      - CDOs, SIVs and Credit Default Swaps Proliferate


# How Did We Get to Where We Are? IV

- ▶ The Rest of the World Joined In
    - The EU and Japan Managed to Expand
    - Recovering Asia and the BRICs Sparkled
      - Their Share of Global Growth and International Trade Progressively Increased
  - ▶ Increasing Signals of US Problems Occurred
    - Housing Investment Began to Turn Down by 2006
    - Employment Increases Were Minimal
    - Industrial Capacity Utilization Remained Low
    - Income Distribution Worsened
- 


# Policy Responses I

- ▶ Bernanke and the Fed Begin To React To the Slowing Economy
  - Interest Rates Decline Rapidly After September, 2007
    - Federal Funds Rapidly Fall From 5.25% to 2%
  - Cooperative Central Bank Arrangements Established to Expand Credit But Market Interest Rates Rise
  - A Dramatic Decision in March, 2008: Bear, Stearns Is Acquired by JP Morgan, after the Fed Guarantees the Assets
- ▶ A Record Tax Rebate of \$167 Billion Occurs
- ▶ Freddie Mac and Fannie Mae Are Nationalized
- ▶ Is This Intervention Enough?

# Policy Response II

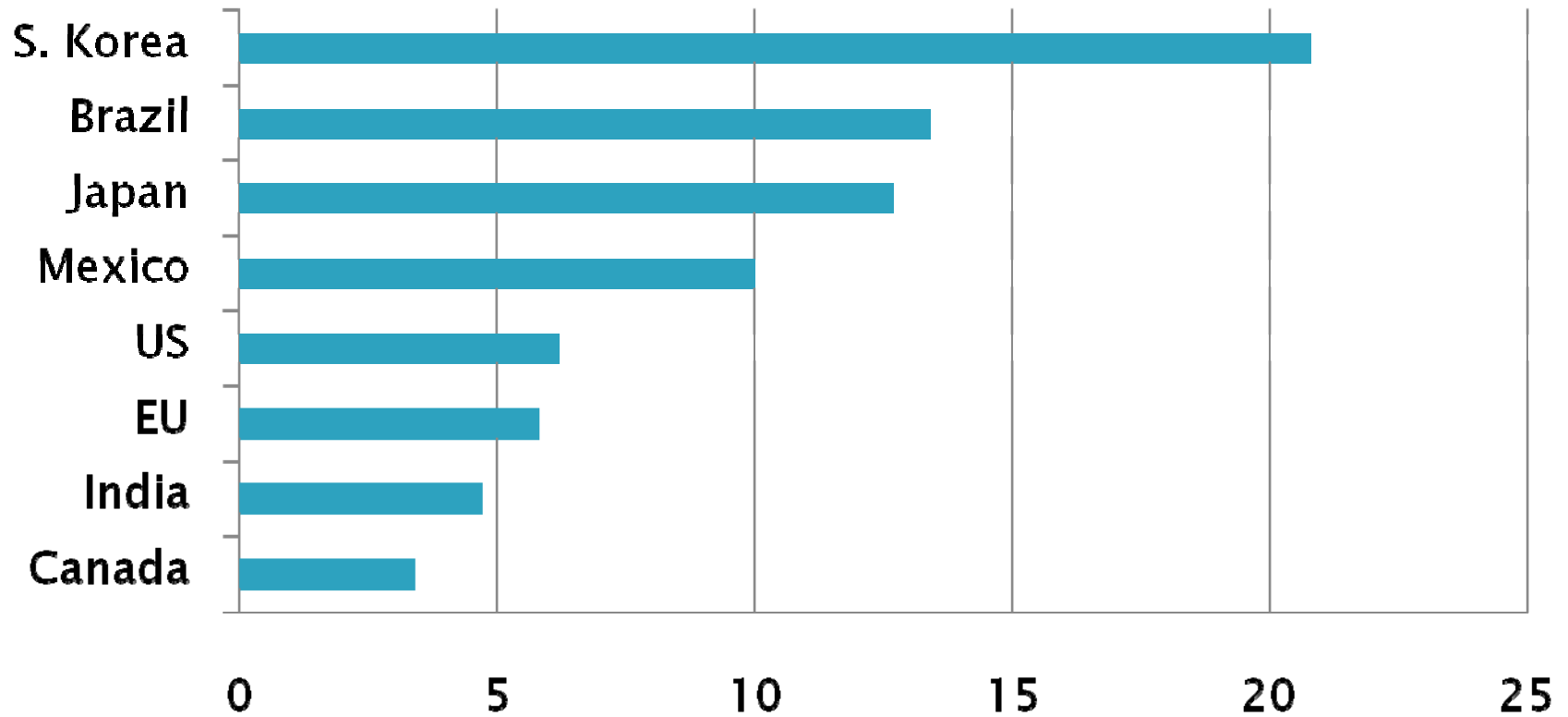
- ▶ **September Is the Cruellest Month**
    - Lehman Brothers Fails and the Lights Go Out
    - AIG Has to be Saved: Hundreds of Billions of Credit Derivative Swaps
    - Merrill Lynch Is Bought by Bank of America
    - The Federal Reserve Bank Rediscounts Everything
    - The Stock Exchange Falls, and Falls, ...
    - Congress Passes \$700 Billion Assistance Package
- 

## Policy Response III: The World Reacts

- ▶ By mid-2008, the Rest of the Developed World Has Already Begun to Weaken
  - ▶ Commodity and Oil Prices Begin A Rapid Decline
  - ▶ After September, Developing Countries Sink
  - ▶ Interest Rates Begin to Fall Progressively and Exchange Rates Devalue Against the Dollar
  - ▶ International Trade No Longer Acts as a Positive Stimulus
- 

# Results in the 4th Quarter 2008

## Negative 4th Qtr Growth



# Will Recovery Soon Occur? I

- ▶ **President Obama Commits to Recovery**
  - **Monetary Expansion**
    - Fed Has Dropped Interest Rate to Zero and Increased Rediscounts
    - US Committed to Selling Off Bad Commercial Bank Assets
      - Citibank Is Quasi-Nationalized; Others May Follow
    - Credit Availability to Borrowers Is Objective
  - **Mortgage Refinancing**
    - New Funds Available to Homeowners in Trouble
      - \$75 Billion Plus \$200 Billion Fed Money to Help

# Will Recovery Soon Occur? II

- Aggressive Fiscal Policy
  - \$787 Billion Stimulus Plan Approved Within a Month
    - Infrastructure Investment, Medicaid Help to States, Other Expenditures
    - Tax Reductions for the Great Majority
  - Extension for Fiscal 2009 Just Approved
  - New 2010 Budget Proposed
    - Focus on Health, Education and Energy
  - US Projected Deficit for 2009/10 Goes to Double Digits

# Will Recovery Soon Occur? III

- ▶ The London Meeting of the G-20
  - Will There Be A Coordinated Policy?
    - More Support for the IMF
    - Elimination of Financial Safe Havens
    - Study of Greater Global Coordination, Even as National Regulation Is Increased
    - Rejection of Protectionism
- ▶ Is That Enough to Avoid A Continuing Decline Into 2010?
  - Or Is Europe Doing Too Little Deficit Financing?

## Will Recovery Soon Occur? IV

- ▶ At Best, There Will Be Lack of Growth Until the End of the Year
  - Predictions Are Changing In One Direction Only
    - China and India Alone Will Manage Reasonable Expansion in 2009
- ▶ Many in the US Say That Greater Stimulus Will Be Necessary To Enable Recovery
  - US Household Wealth Has Fallen By \$11 Trillion, or Almost 20% in 2008
    - Almost All Was Financial Assets; Less Than 10% Real Estate
    - That Reduces Consumption, Representing 70% GDP

## Will Recovery Occur Soon? V

- ▶ Even With Greater Deficit, Recovery in 2010 Is Likely to Be Slow
  - Employment Always Lags
- ▶ Greater Coordination of G-20 Matters
  - Advances in Regulation Will Occur
- ▶ So The Great Recession of 2008 Will End
  - A Drama, But Not Quite a Tragedy
- ▶ Does the Global Economy Simply Resume As It Earlier Had Been?

## But Soon After The Recovery ...

- ▶ Is This A Real Return to International Equilibrium, Or Will Problems Soon Recur?
  - Global Trade and Capital Flows Remain Unbalanced
    - China's Exchange Rate is Still Undervalued
    - US Dependence Upon Foreign Saving May Increase
      - For the time in two centuries, the world's economic power is already the world's largest debtor
  - Difficult Adjustments Lie Ahead for the US
    - US Must Increase its Domestic Savings Rate While Reducing Income Inequality
    - US Must Reduce its Fiscal Deficit With an Aging Population
    - US Must Reduce its Current Account Deficit

## But Soon After The Recovery...

- ▶ And Globalization Must Be Retained While Resolving This Disequilibrium
  - Developing Countries Have Entered Late and Are Beginning to Benefit
  - The Temptations of Greater Protection Are Seductive
- ▶ This Combination of Requirements Is the Real Challenge the G-20 Has to Face In the Not So Distant Future

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