Post-financial crisis: How are we doing?

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Global economic situation

- Global economy expanding again – pulled up by strong performance in Asian economies
- Recovery evident in financial markets, although conditions still difficult for borrowers
- Pace of recovery slow, mostly led by turn in inventory cycle
- Commodity demand increasing, boosting trade
- Lay-offs likely to continue in advanced economies - low demand, excess capacity, and tight credit
Global economic situation

1. Global:
   -0.8% (2009)
   3.9% (2010)

2. Advanced economies
   -3.2% (2009)
   2.1% (2010)
   US
   -2.5% (2009)
   2.7% (2010)

3. Emerging economies
   2.1% (2009)
   6.0% (2010)
Global economic situation

Source: IMF

**Financial Stress**

**Bank Credit to Private Sector**

Source: National authorities.

- Advanced economies
- USA
- Western Europe
- Japan
Global economic situation

Commodity Prices

- Energy*
- Metals
- Agricultural commodities

*Oil price: 2010 - $76/barrel
2011 - $82/barrel

Forecast

Merchandise Exports

- Emerging economies
- World
- Advanced economies

Source: IMF
Global economic situation

Employment

%  
-5  -4  -3  -2  -1  0  1  2  3  4  5

Source: IMF

Inflation

%  
-5  -4  -3  -2  -1  0  1  2  3  4  5  10  15  20  25

Source: IMF

Emerging economies
World
Advanced economies
Public policy

Policy critical in cutting adverse feedback loop between financial and real sectors

Monetary policy:

- rise in output gap has reduced inflation
- interest rates virtually at zero, and central banks committed to keeping rates low
- various measures used to ease financial conditions – “quantitative easing”
- hard to unwind if markets remain illiquid
“Helicopter Ben!”
Public policy

**Fiscal policy:**

- provided major stimulus in both advanced and emerging economies

- expansion largest in advanced economies, estimated to boost G20 GDP by 1% in 2009

- public debt rising fast, especially in advanced economies (110% of GDP by 2014)

- fiscal deficits will contract as recovery improves cyclical components of budget
Fiscal policy

Fiscal Balance

Source: IMF

Emerging economies
World
Advanced economies

Public Debt

Forecast

% of GDP

% of GDP

Source: IMF

1980 1990 2000 2010

-10 0 2

-10 0 2

-10 0 2

-10 0 2

0 100 120

0 100 120

0 100 120

0 100 120

Source: IMF

Forecast

1980 1990 2000 2010

Emerging economies
World
Advanced economies
Public policy

- Financial policy:
  - Most governments provided deposit and debt guarantees – low cost and easy to implement
  - Programs to recapitalize financial institutions have typically met with public skepticism
  - G20 economies have put in less than 6% of GDP
  - Capital remains short of that necessary to forestall further bank deleveraging – potential drag on recovery
Rebalancing world economy

- Trade deficits in countries such as US, matched by surpluses in emerging economies such as China, who also own large part of US public debt ($895 billion at end of 2009)

- Adjustments required in global demand
  - economies with trade surpluses need to increase domestic consumption
  - required to offset lower demand and higher savings rates in economies that have run trade deficits
Risks to sustained recovery

Key risk is that recovery stalls, and deflation becomes entrenched – could be triggered by too early exit from accommodative monetary policy.

Other risks include:

- Central banks have to tighten monetary policy by more than expected to deal with inflation.
- Large increases in public debt could unsettle global bond markets.
- Pressures for trade protection may build with increased unemployment.
Short vs. medium-term objectives

- Need to map course between unwinding support policies too soon/leaving them in place too long

Monetary Policy:

- in advanced economies, central banks can afford to maintain liberal monetary policy for a while

- once output gap narrows, and inflation becomes a concern, policy will need to be tightened

- inflation-targeting perhaps too narrow - more emphasis on macro-prudential tools needed
Short vs. medium-term objectives

- **Fiscal Policy:**
  - stimulus needs to be sustained until economic recovery on firm footing
  - but need to address long-term fiscal balances at some point by committing to deficit reductions
  - long-term increase in debt will place pressure on interest rates as recovery occurs, possibly crowding-out private investment
  - may also eventually cause flight from bonds
Short vs. medium-term objectives

- **Financial Policy:**
  - restructuring financial firms is key for normal lending to resume, i.e., toxic asset cleanup
  - exit strategies need to be clearly articulated
  - three key financial reforms necessary:
    (a) perimeter of regulation needs broadening
    (b) counter-cyclical frameworks required
    (c) international regulatory convergence