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

Global GDP Growth

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)

Source: IMF
Global economic situation

Financial Stress

Private Sector Credit Growth

Source: IMF

Advanced economies
USA
Western Europe

UK
USA
Euro Zone
Global economic situation

Commodity Prices

Forecast

Exports

Source: IMF

Energy*
Metals
Agricultural commodities

Emerging economies
World
Advanced economies

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

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
Output gaps

US – Output Gap

Source: IMF

Output gap*

*Actual GDP growth – potential GDP growth

Euro area – Output Gap

Source: IMF

Forecast

*Actual GDP growth – potential GDP growth
Global economic situation

Inflation

Source: IMF

Emerging economies

World

Advanced economies
Monetary policy

Short-Term Interest Rates

Money Supply

Source: IMF

US
Euro area
Japan

Base money + reserves
Reserves
Base money

% G3 GDP

%
“Helicopter Ben!”
“Mervyn’s Monetary Magic!”
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

Public Debt

Source: IMF

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