
The first global economic crisis of the
XXI century: shock or change of regime?
Prospects for development

François Bourguignon

Paris School of Economics

UN, New York, 10/09/09

Chronique of a tempest

- Fall-Winter 2007: A hurricane in sight
- Summer 2008: The storm strikes
- Fall 2008:
 - Policy mistake and the hurricane on the verge of becoming a tsunami
 - Emergency measures
- Winter 2008-9: The global economy in the torment
- Summer 2009: Some green shoots?
- Fall 2009: Is the worst behind ?
- Winter 2009 and beyond: "Business as usual" in the global economy or "change of regime"?

Trying to draw lessons...

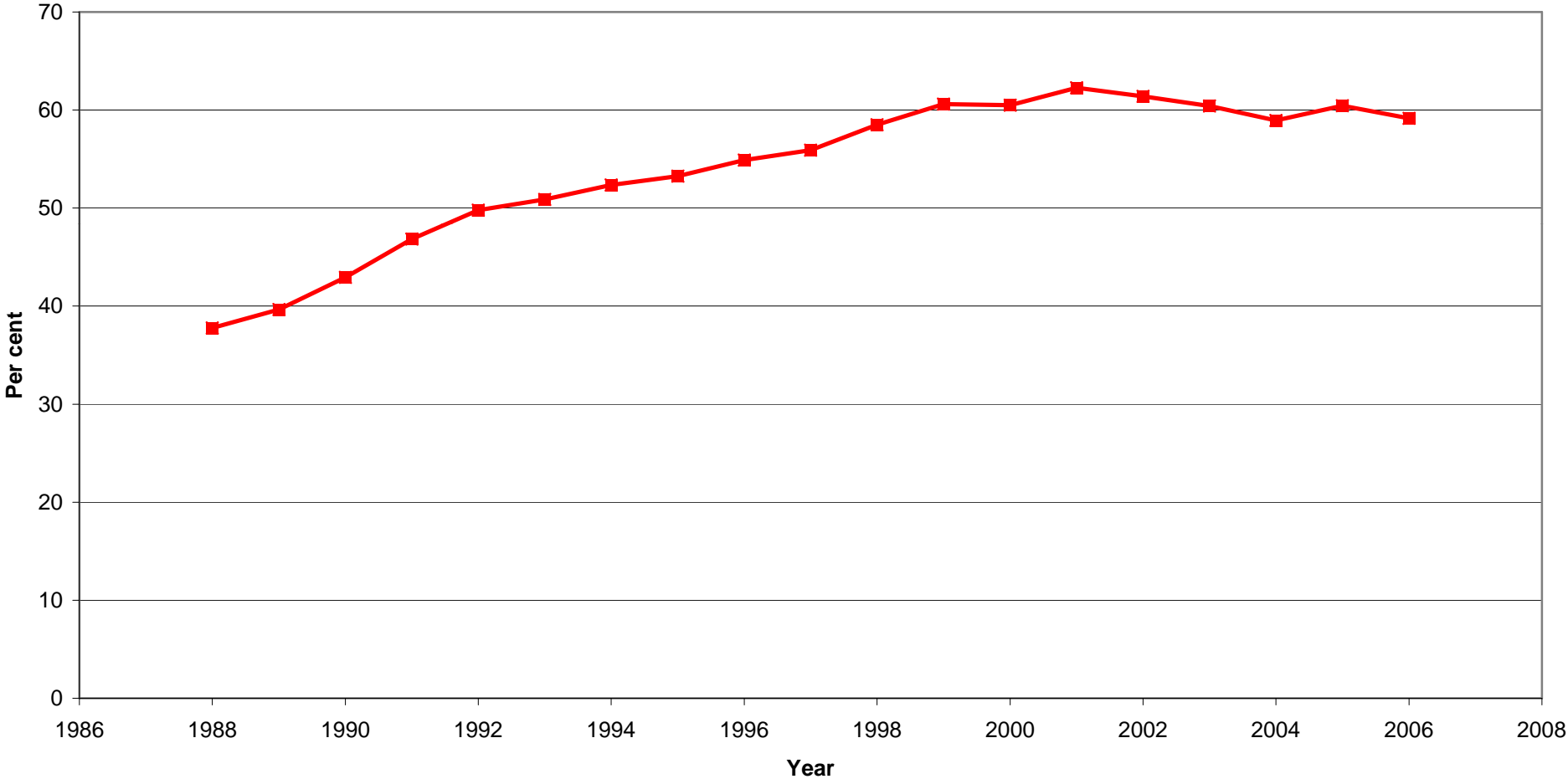
1. Origin, causes and dissemination of the crisis
2. The policy instruments at hand and how they were used
3. Where from here? Various scenarios for the medium-run
4. Long-run: a change of regime?

1. Genealogy of the crisis

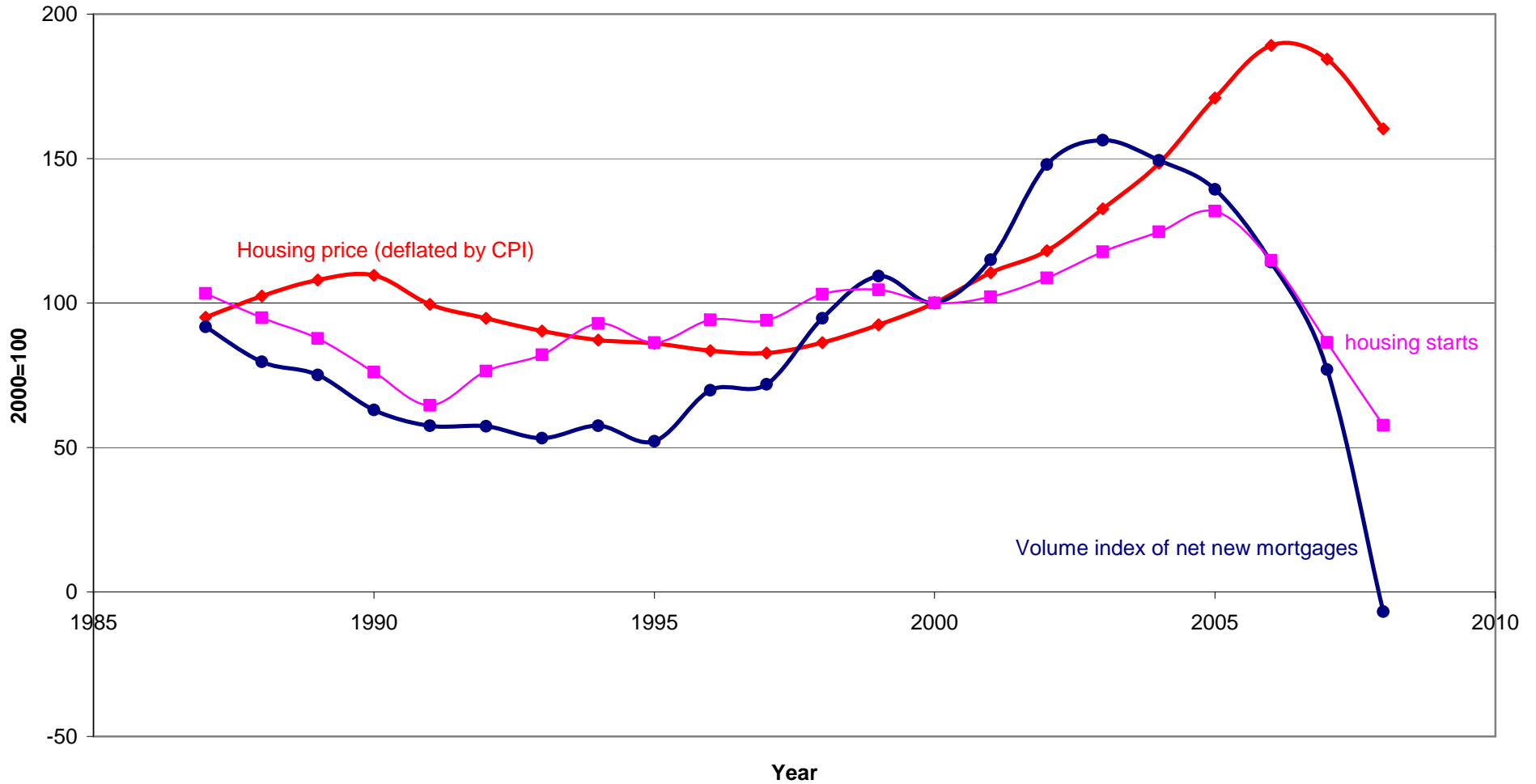
A combination of *mutually reinforcing* causes :

- ❑ The *housing bubble* in US (and in several developed countries: UK, Spain, Ireland, ..)
- ❑ Badly regulated financial instruments and neglect of *systemic risk*: structured finance and credit multipliers in US and elsewhere
- ❑ The *2001 lowering of interest rates* in the US and the *global saving glut*: over-leveraging and excessive risk-taking in developed countries
- ❑ The raise in interest rates and the *burst of the bubble* triggered by default on subprimes in the US

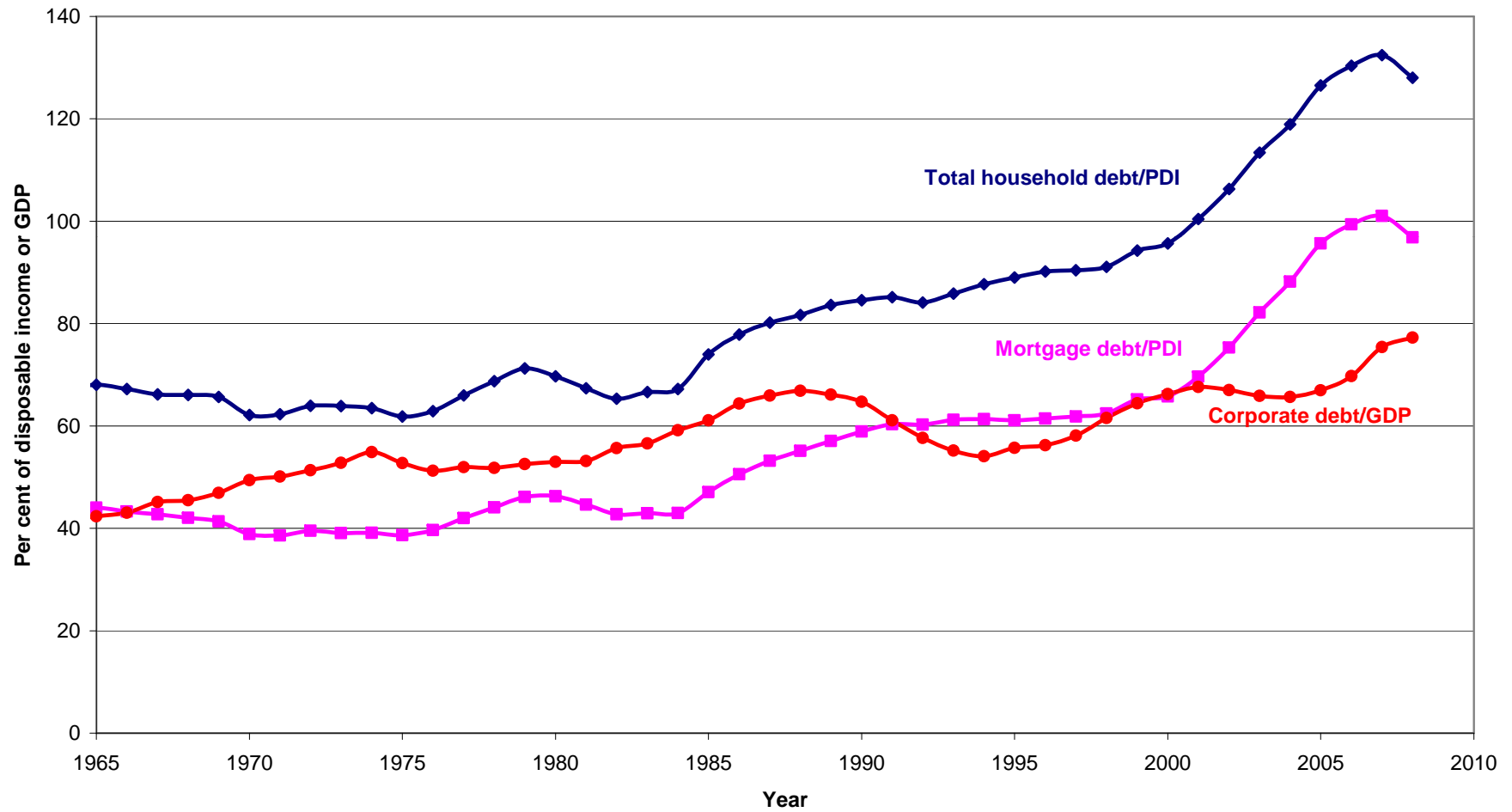
**Growing importance of Mortgage-Backed Securities in US mortgage market:
share of outstanding mortgage claims held in MBS, 1988-2006**



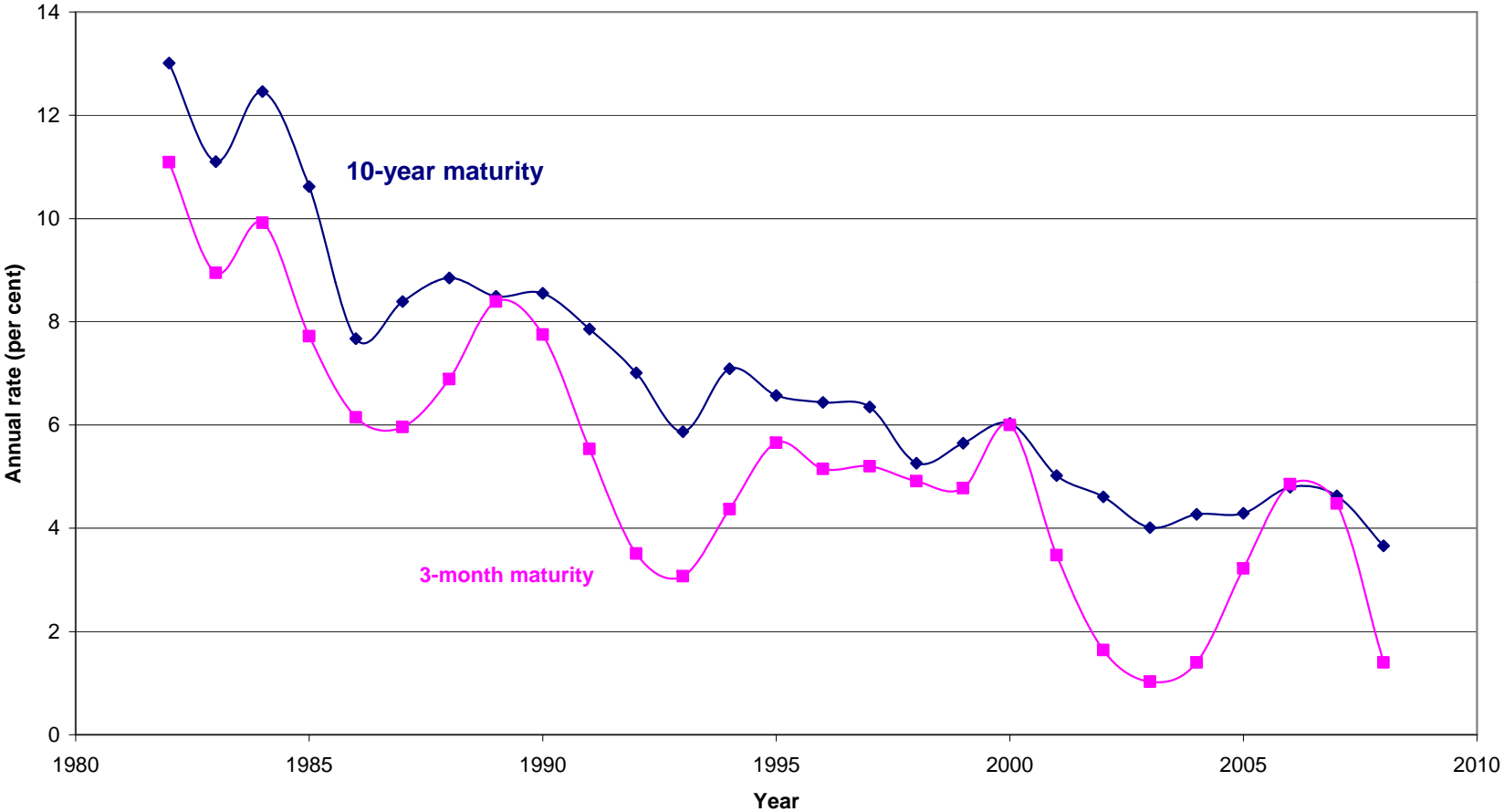
Housing sector: relative housing price and volume index of net new mortgages and housing starts, 1985-2008



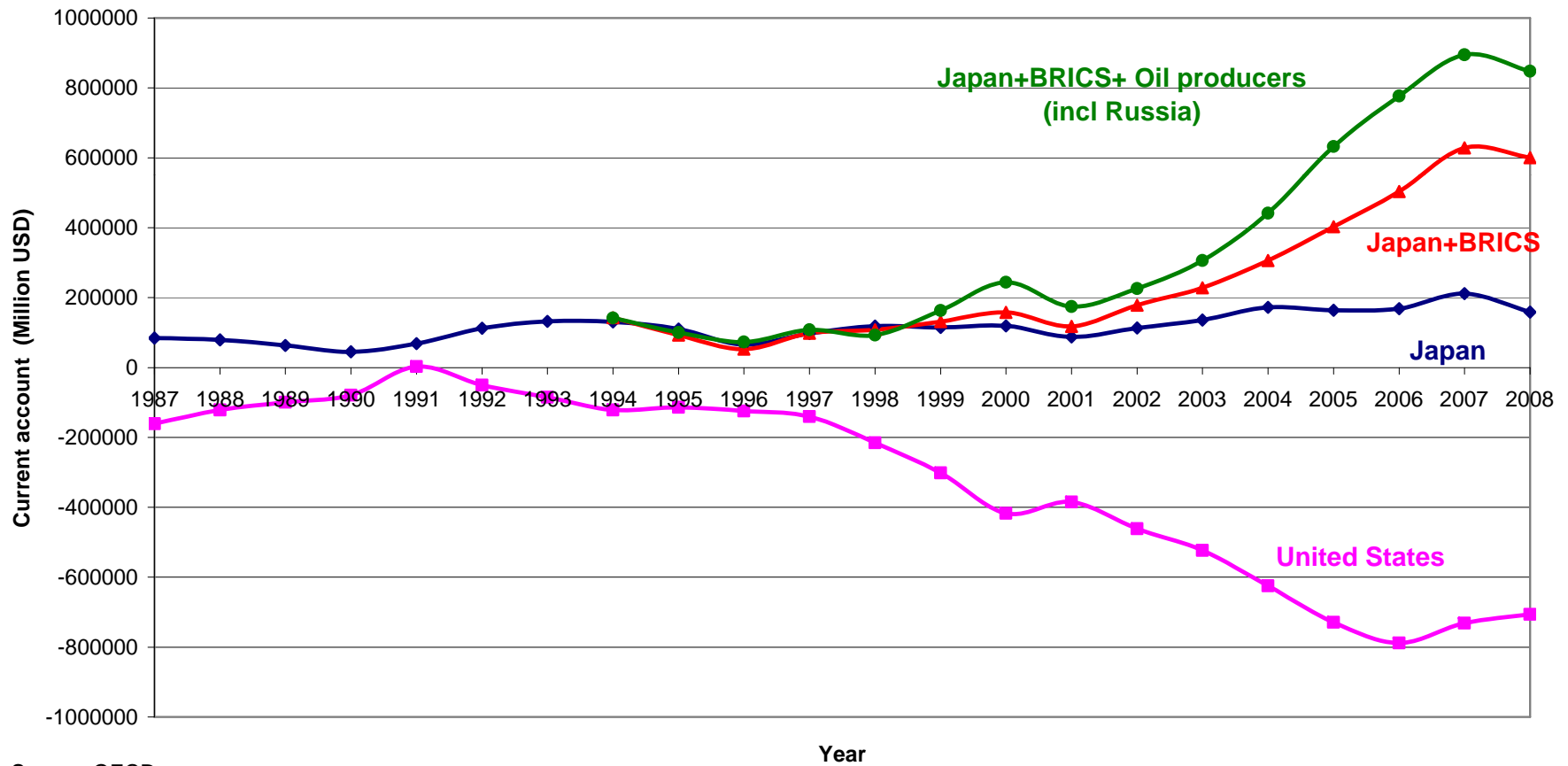
Leverage of the US economy: debt/income ratio, 1965-2008



Long- and short-term interest rates: US T-bills



Global imbalances: Current Account surplus and deficits of selected countries, 1987-2008



Source: OECD

The surprisingly fast dissemination of the crisis to the global economy

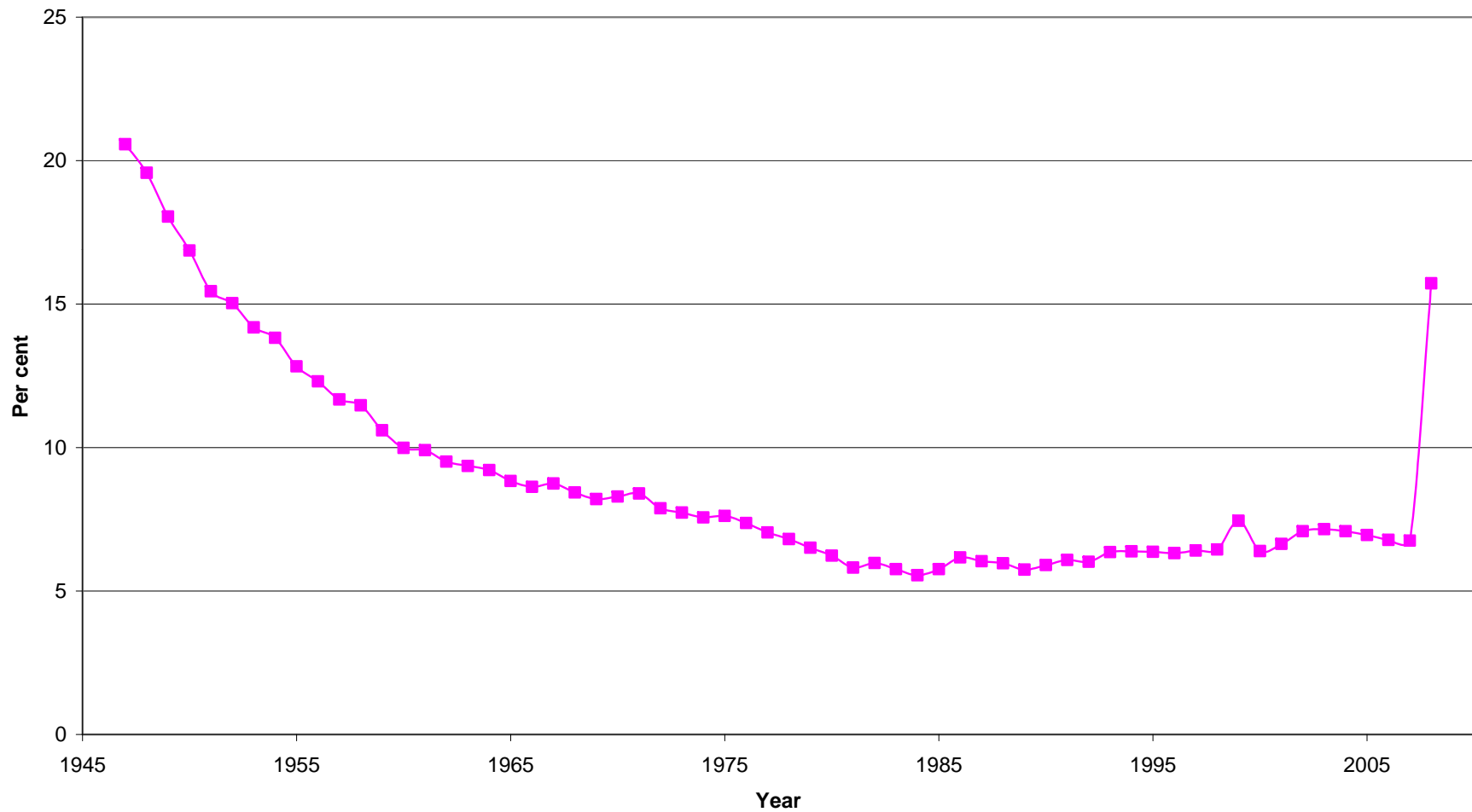
- ❑ Direct contamination among developed countries: *toxic assets* and exposure in US financial market
- ❑ International accounting standards (mark to market)
- ❑ *Little initial direct impact* in developing countries (except Eastern Europe and CIS)
 - Indirect impact through *'flight to quality'*: spreads and credit rationing
 - No initial impact on poorer countries with limited access to international credit market
- ❑ But **extremely powerful** contagion to **real economy** through credit crunch, trade and "just in time" management. Developing countries affected too.

2. The policy instruments at hand and how they were used

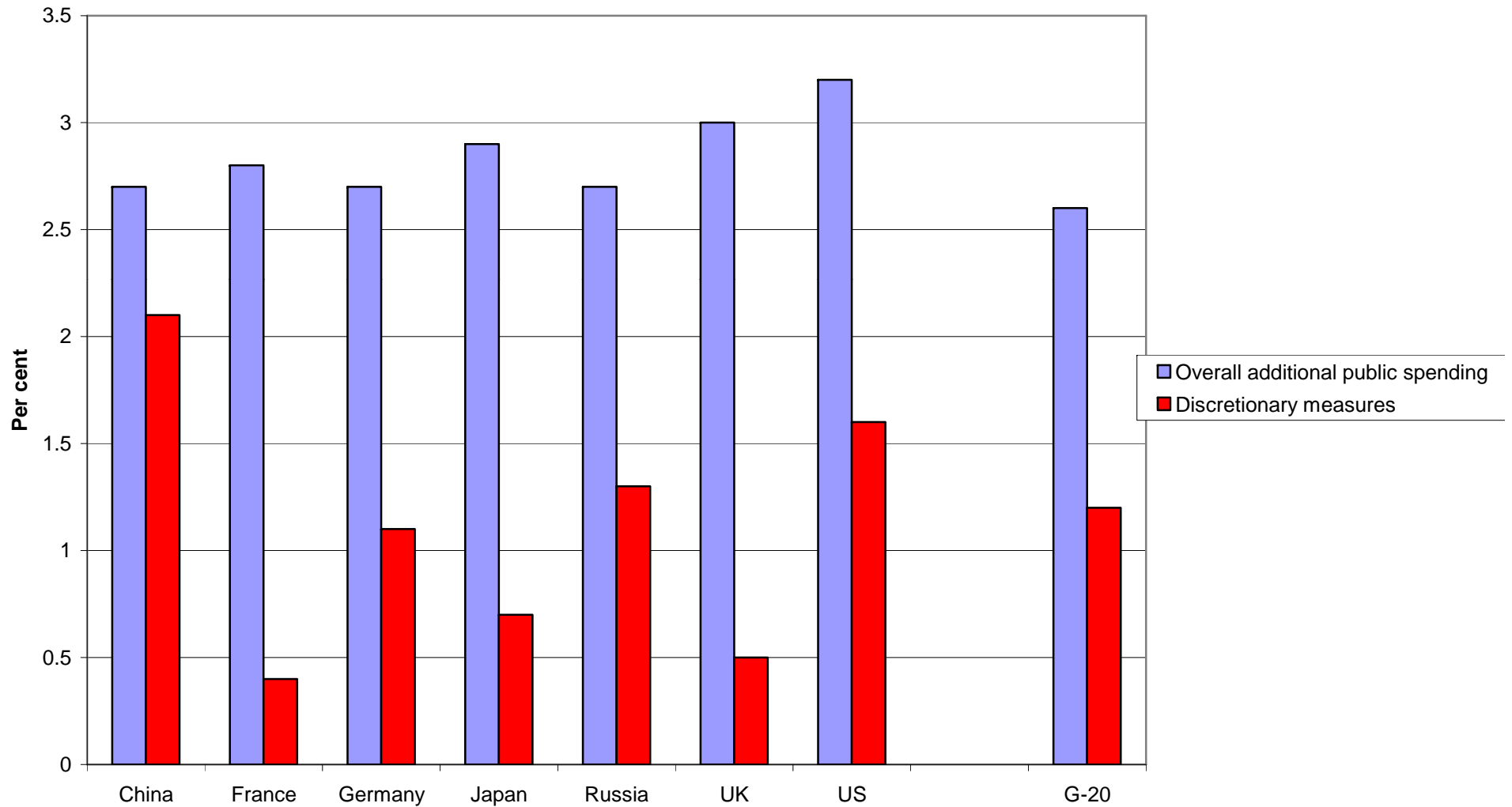
Lessons from the 1930s and subsequent crises:

- *Monetary policy*: salvage banks and inject liquidity so as to avoid credit crunch (Lehman Brothers probably a mistake)
- Unconventional monetary policy at zero interest rate (*quantitative easing*)
- Fiscal policy: an offensive *stimulus strategy*;
 - Yet, counter-cyclical policies not feasible in many developing countries

Federal Reserve total financial asset/GDP: US, 1947-2008



Planned fiscal stimulus in major economies: average 2008-10/GDP



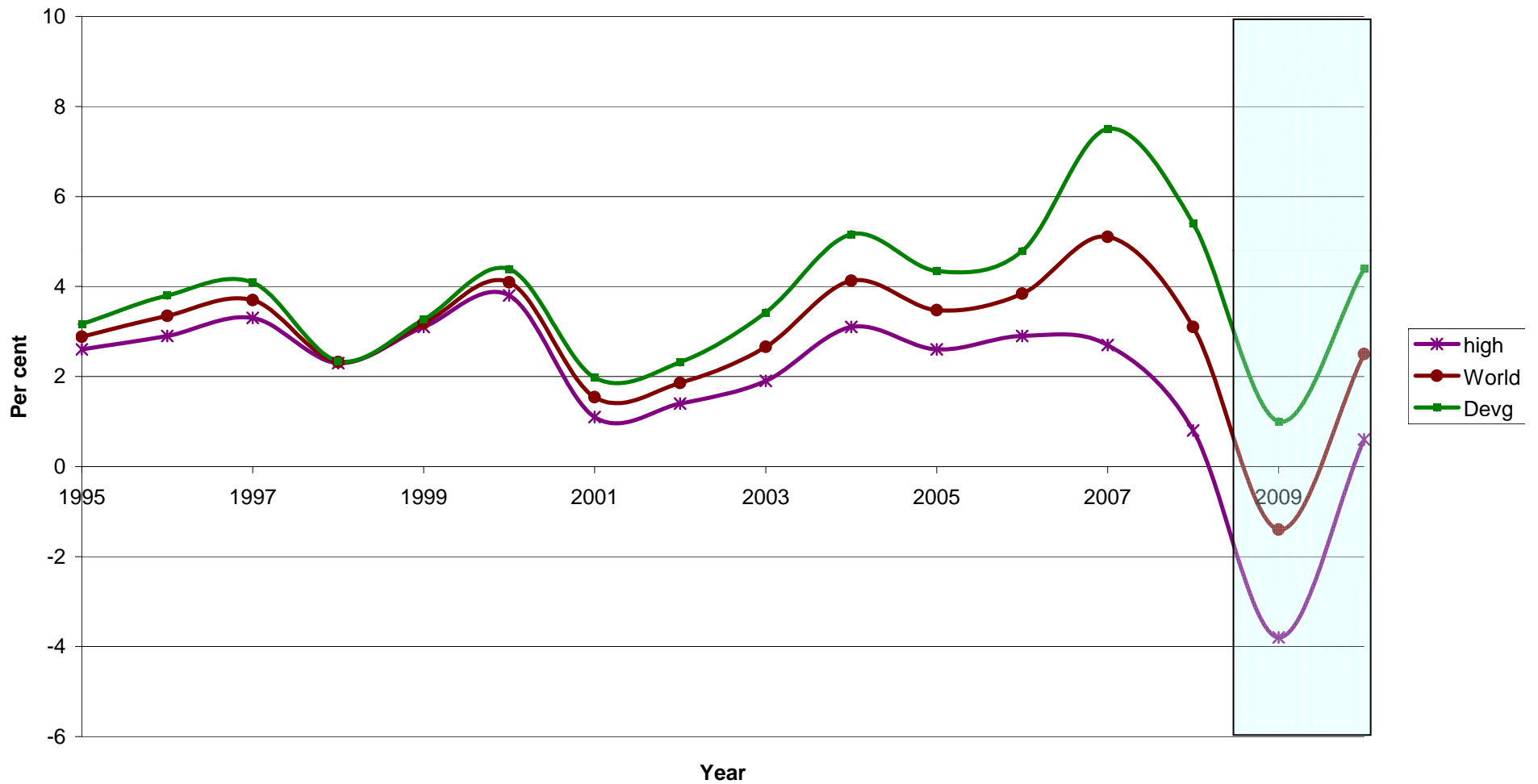
Is it enough?

- Huge size of contractionary factors:
 - Deleveraging: drop in consumer demand in the US = 3-4 per cent of GDP!
 - Plus contraction in investment
- Few international recovery factors (decoupling issue)
- Logic of recovery, not of growth

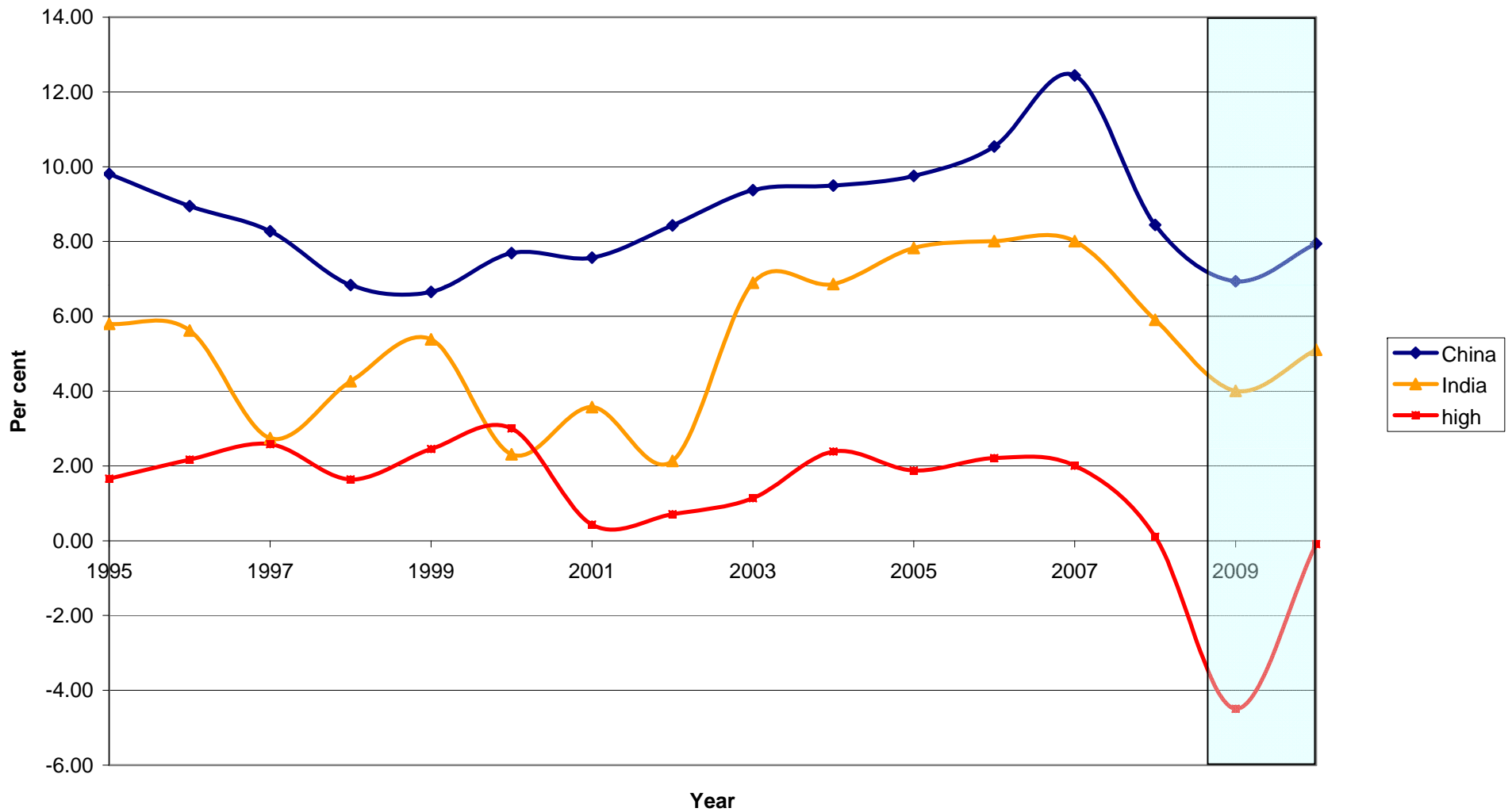
3. Where from here? Various scenarios

- The immediate impact (2009):
 - Global economy slow down: - 1.4 per cent (GDP)
 - Crisis originated in developed countries but all developing countries affected: *"coupling"*
 - Yet growth persistently higher in developing countries: *"decoupling"*

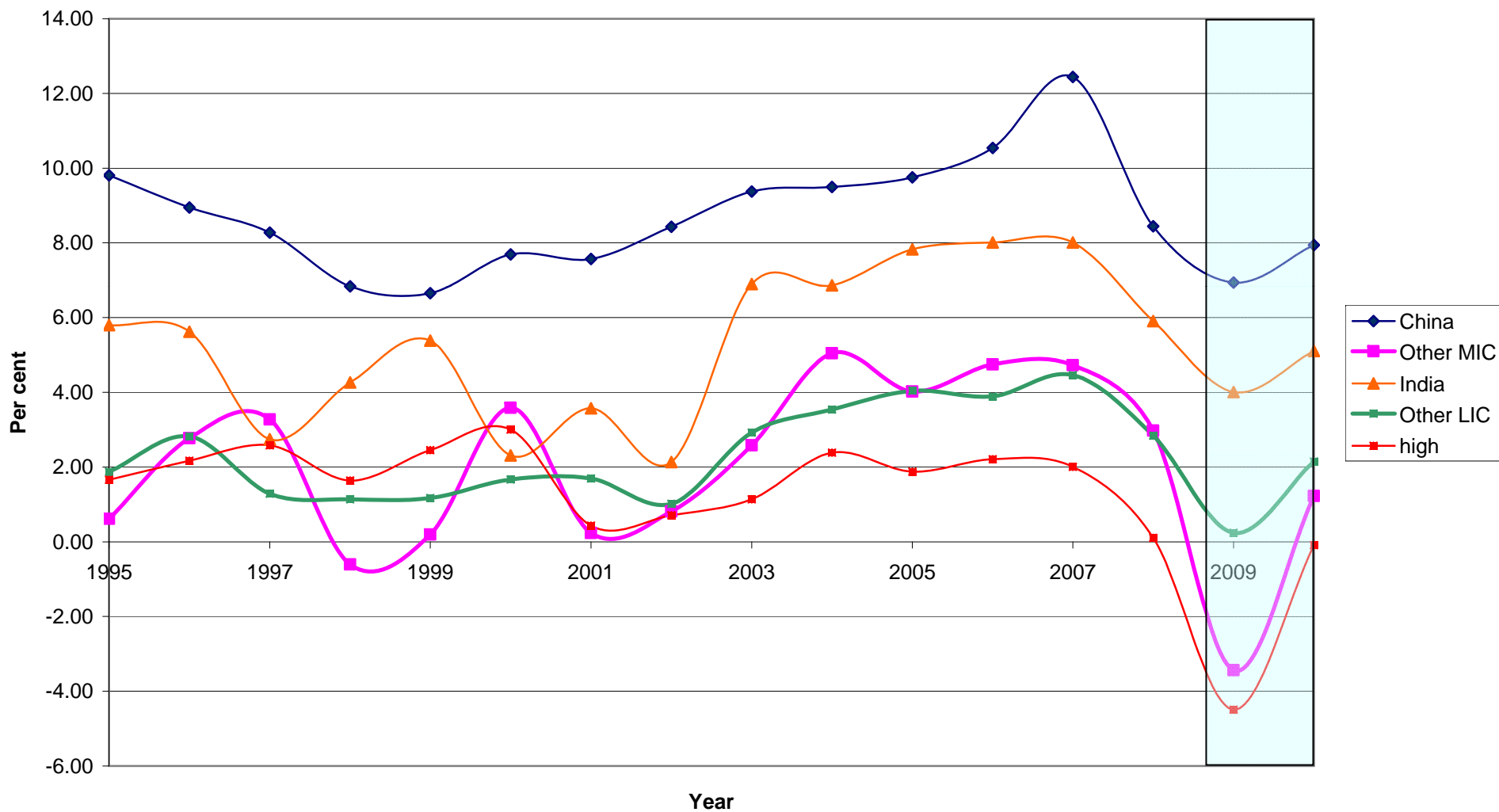
Coupling and decoupling: GDP growth rates in developed and developing countries: 1995:2008 and forecasts



Real GDP per capita growth rates of selected groups of countries: 1995-2007 + forecasts



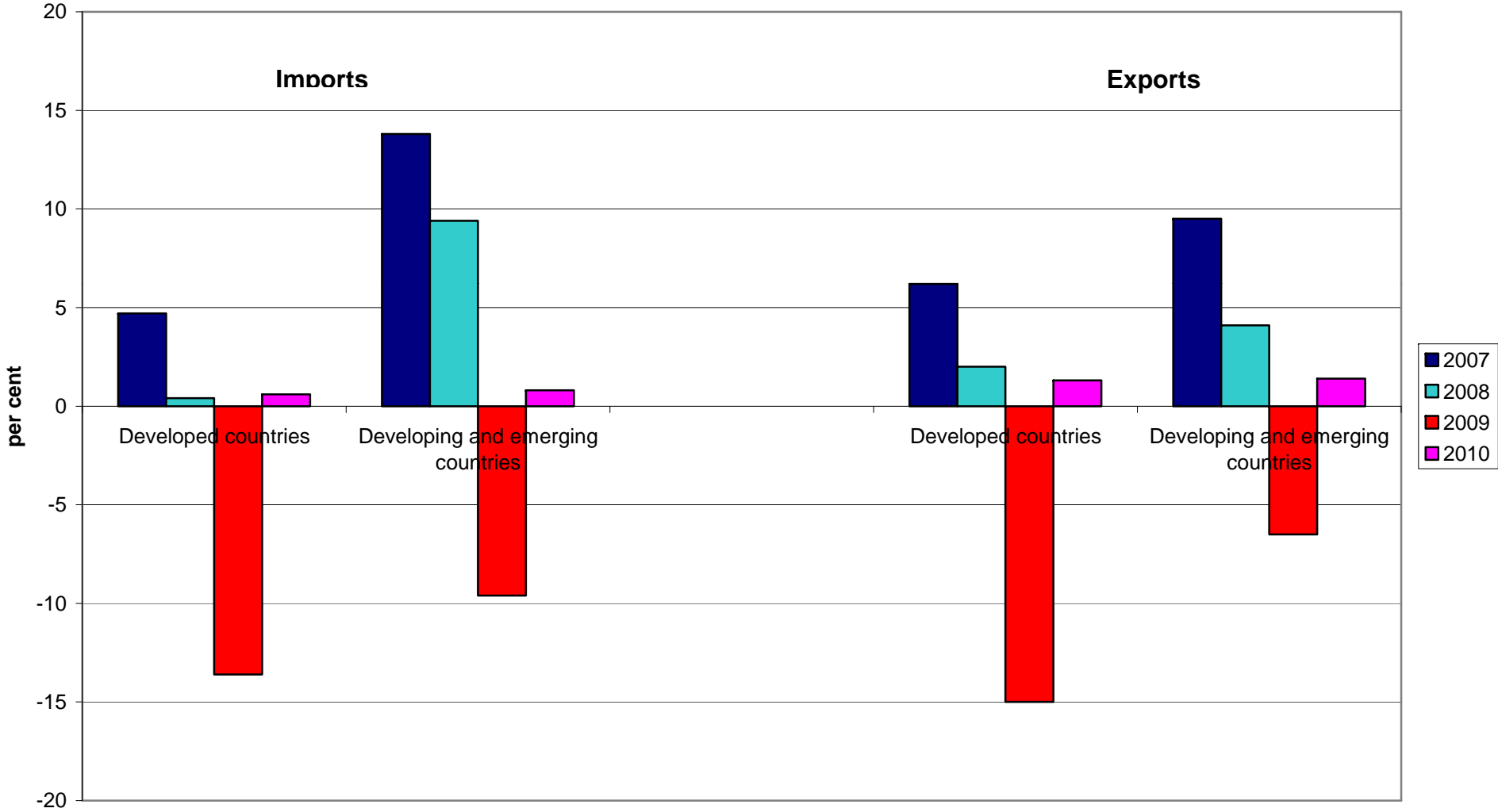
Real GDP per capita growth rates of selected groups of countries: 1995-2007 + forecasts



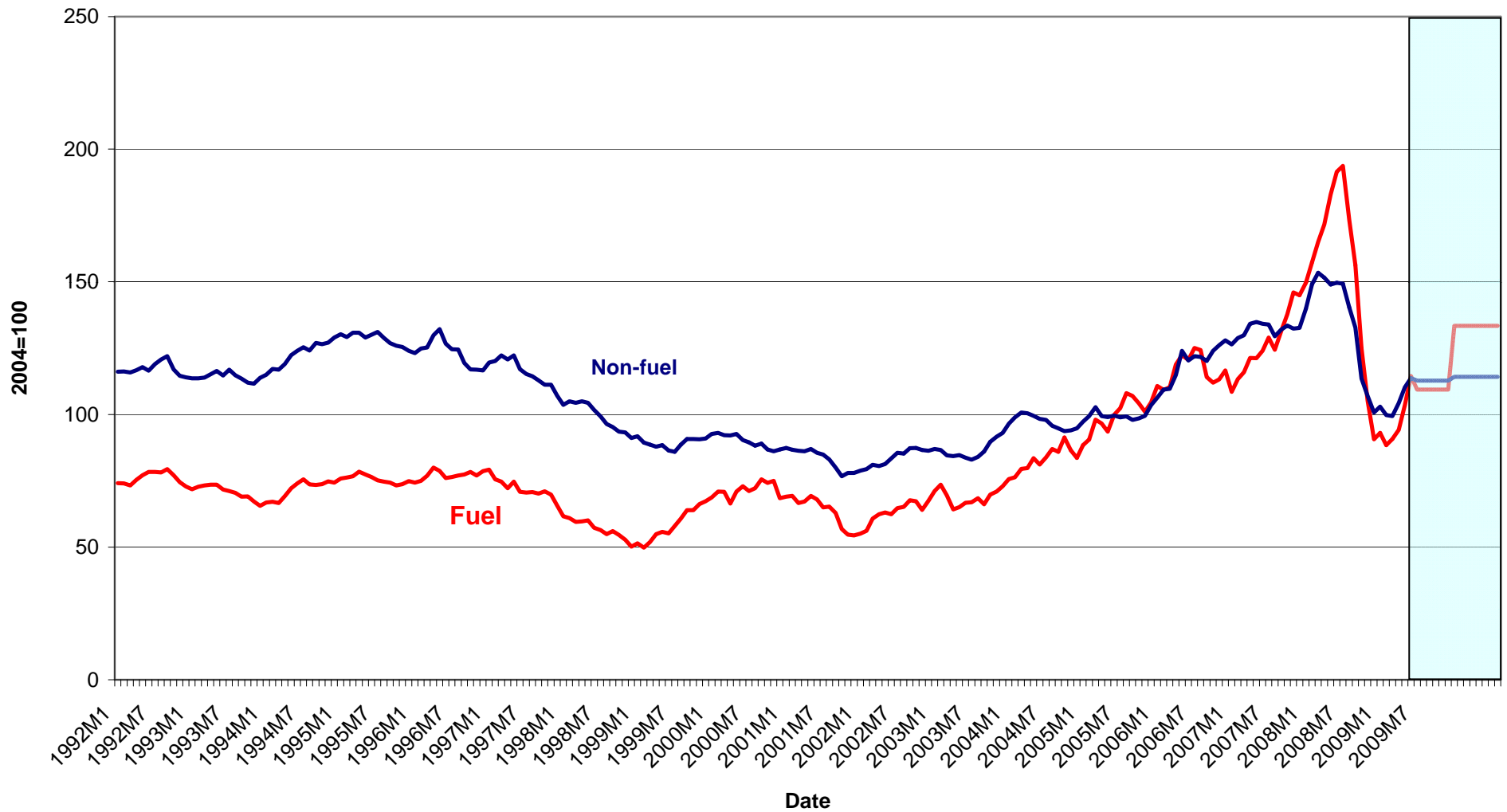
Where from here? Various scenarios

- The immediate impact (2009):
 - Global economy slow down: - 1.4 per cent (GDP)
 - Crisis originated in developed countries but all developing countries affected: *"coupling"*
 - Yet growth persistently higher in developing countries: *"decoupling"*
- Except for big countries (China, India, Brazil, ..), developing countries strongly dependent on developed countries' growth
- Contagion channels: trade, migration, finance, aid, ..
- Impact on development objectives (MDGs)

2009-10 IMF prospects for global trade: annual rates of growth



Evolution of commodity prices (IMF indices) relative to US PPI: 1992-2009 monthly



Where from here? Various scenarios

- The L-U-V-W debate
- The likelihood of the L scenario
 - Deleveraging likely to take time: slow growth of final demand
 - Cleaning the financial mess unlikely to be over
 - Public indebtedness: front loading growth with full repayment or preparing for inflation defaulting?
 - Emerging countries unlikely to become global growth engines
- The risk of a W-scenario
 - Issue of the exit strategy

4. Towards a change of regime in the global economy ?

- *Global imbalances*: necessary adjustment of Chinese development strategy
- Slow down of globalization and *progress towards decoupling*
- Continuing *North-South rebalancing*
- *Weak medium-run prospects* for development of small and medium-sized countries
 - The importance of South-South trade
 - Renewed competition for labor intensive manufacturing
 - The role of development assistance
- ... The climate change agenda