# In the Wake of the Financial Crisis: What Next?

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# Outline of This Afternoon's Conversation

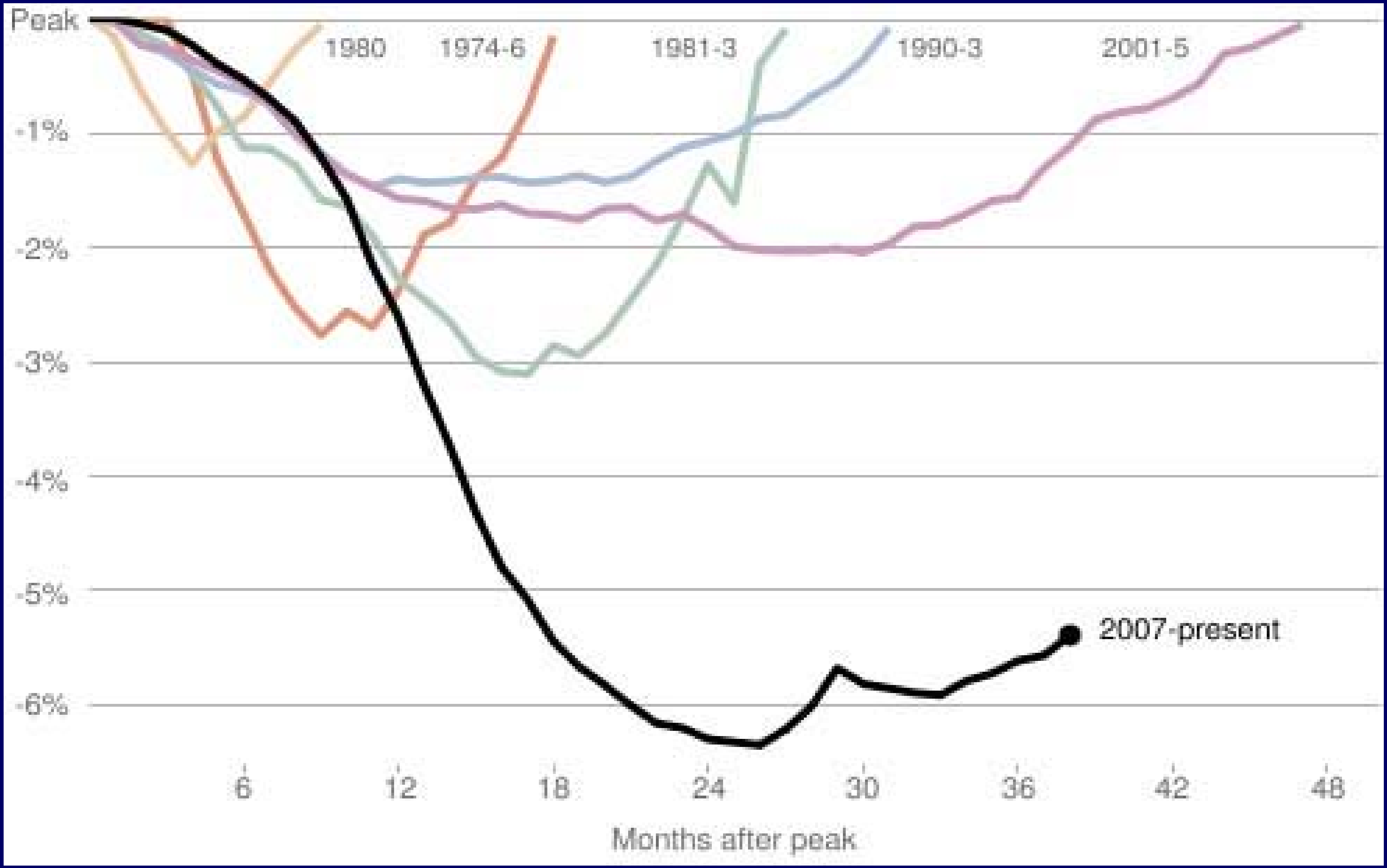
- What Is the Outlook for Economic Recovery?

- Will the Many Policy Challenges Be Met?

- Let's Explore These Questions with 5 Numbers.

# #1:  January 2020

# Tigger to Eeyore to Piglet
# Employment Changes from Recession Starts



# The Pressure on Household Income Statements

- Many labor-market measures remain grim.
  - Over 24 million Americans are un- or underemployed.
  - Labor-force participation rate has fallen since Crisis/Recession started and has not recovered--by about 2.5 percentage points. Had this not happened, unemployment today would be about 11.5%.
  - 45.1% of all unemployed have been so for 27+ weeks.
- Gallup: "Unemployment now stands alone as … the most important problem facing the country."

# Pressure on Incomes, Not Just Jobs: Ebbing Tides

- Change in average real total money earnings, by educational group, 2000 through 2009.

| Group | Employment Share | Earnings Change |
|---|---|---|
| LTHS | 8.7% | -10.0% |
| HSG | 28.8% | -9.4% |
| SC | 27.5% | -6.6% |
| CG | 22.5% | -5.5% |
| Masters | 8.9% | -1.3% |
| Ph.D. | 1.8% | +1.8% |
| MD,JD,MBA | 1.8% | +11.1% |

- Recessions reduce incomes for most workers for years. 2009 real median household income: $49,777—down 4.2% from 2007, and nearly at the level of 1997.

# How Long Will This Pressure Last?

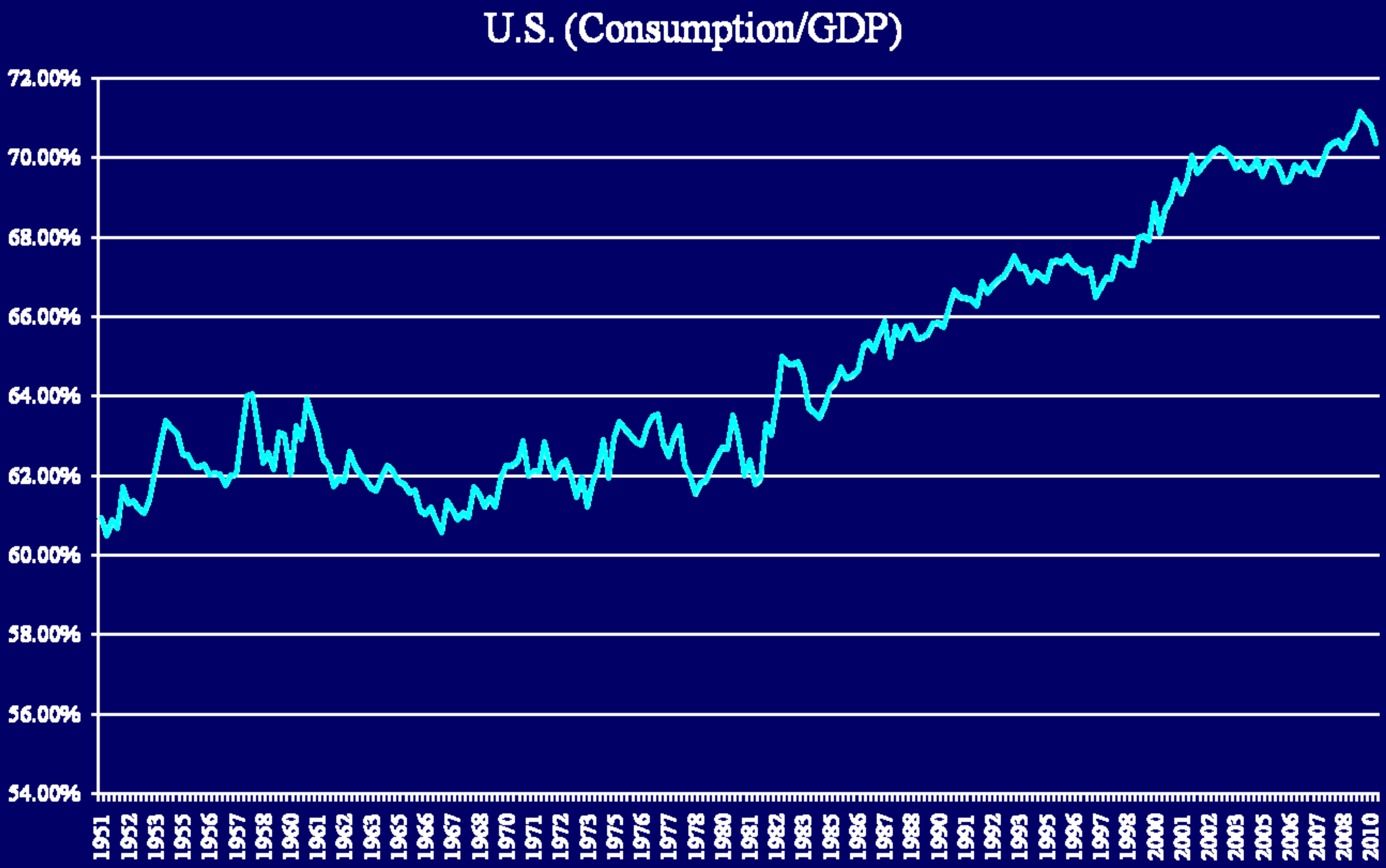
- Peak to trough, 8.8 million payroll jobs were lost—and on net all private-sector jobs (7.6%).
- Aggressive hiring by large and small businesses alike has yet to resume. The 108.9 million U.S. private-sector payroll jobs in May was the same the U.S. economy had in July 1999.
- It took 48 months to regain the lost 2.0% of jobs in the 2001 recession. At that rate, the U.S. would again reach 12/07 total payroll jobs around *January 2020*.

# Takeaways for You and Your Companies

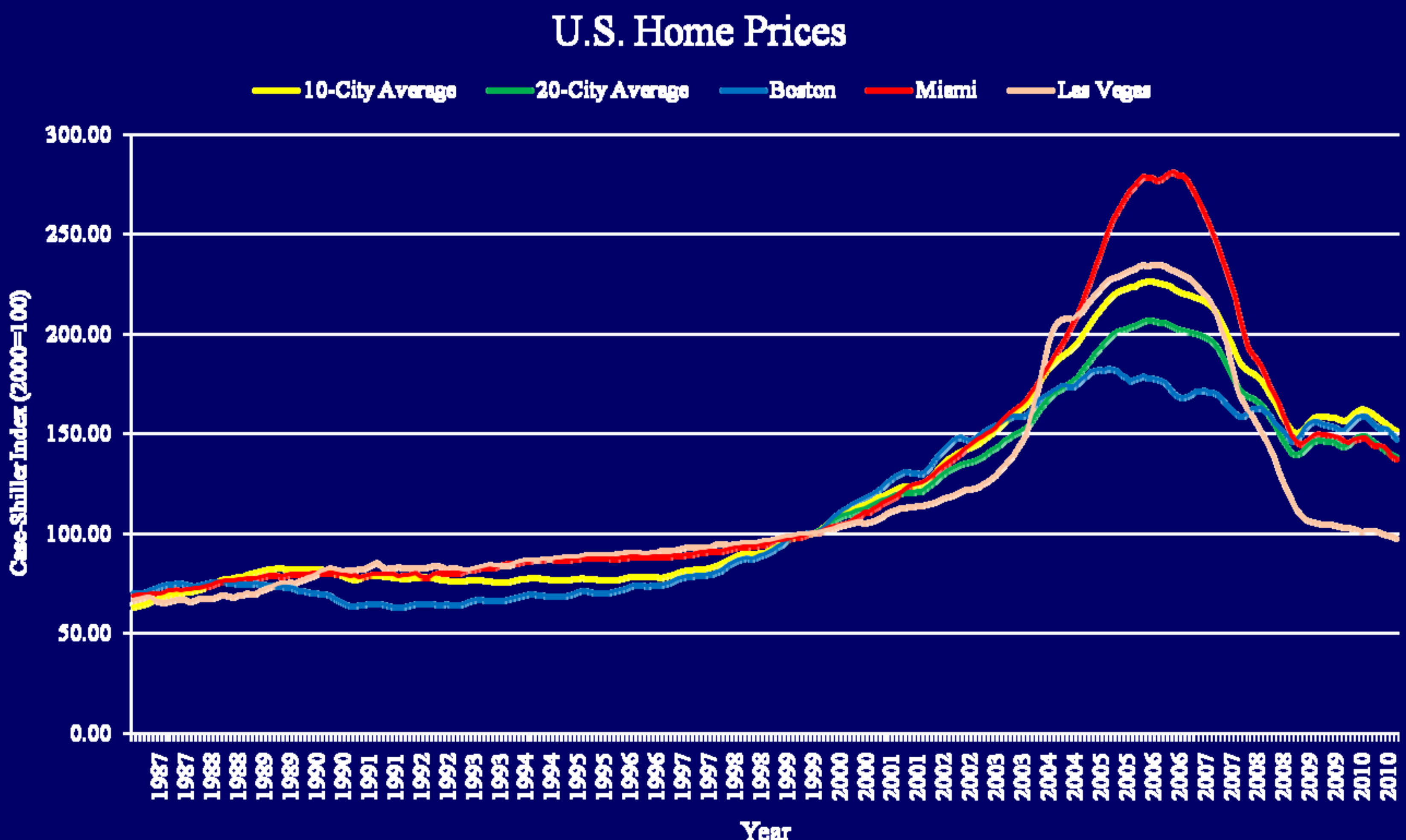
- How reliant are your companies on recovery of the U.S. labor market in general and on the related income statements/spending of U.S. households?
- Higher-skills, higher-income U.S. workers have fared better amidst the Crisis—as they had been faring for decades before the Crisis. But many of even them have faced income pressures over the past decade.
- How do your companies rely on the success of particular types of U.S. workers? Think of Wal-Mart's challenges in recent quarters and years (with stock price basically flat at $50).

# #2: 70.6%

# Do We Really Want This To Climb More?



# Tigger to Eeyore to Piglet: Pressure on Household Balance Sheets



# The Pressure on Household Balance Sheets

- Household balance sheets fell deeply during the Crisis, but have rebounded a fair bit since ($ trillion).

| Item | 9/30/07 | 3/31/09 | 12/31/10 |
|---|---|---|---|
| Assets | 78.8 | 62.6 | 70.7 |
| Real Estate | 21.0 | 15.7 | 16.4 |
| Fin. Assets | 50.8 | 40.2 | 47.6 |
| Liabilities | 14.3 | 14.1 | 13.9 |
| *Net Worth* | *64.5* | *48.5* | *56.8* |

- Net worth of U.S. households is now $7.7 trillion, or 11.9% below its peak—but far less than the decline at the trough of $16 trillion, or 24.8%. Liability decline is accounted almost entirely by mortgage defaults.

# Can the U.S. Economy Be Re-Balanced?

- Consumption spending by households accounted for *70.6%* of total U.S. GDP in 2010 ($10.35 trillion!). This is very, very high.
- America needs to re-balance its demand and jobs more towards exports and capital investment, in part to avoid precipitating another World Financial Crisis.
- Will the United States find the will to imagine and implement policies needed to foster growth in output and jobs via investment and exports?

# Takeaways for You and Your Companies

- How reliant are your companies on exporting and capital investment vs. on household consumption spending?
- How reliant are your companies on particular U.S. policy supports, versus on the overall economic environment in the United States and the global economy? Think of the many clean-energy and real-estate companies today that are heavily dependent on U.S. government policy.

# #3:  0%

# The Global Challenge for Monetary Policy

- The Federal Reserve and many other central banks around the world (e.g., ECB, BOE, BOJ) have pursued dramatically aggressive, innovative, and historic policy to cushion economic impact of World Financial Crisis.
  - They slashed target policy interest rates (e.g., U.S. Fed Funds interest rate) to historic lows, often very near zero.
  - They printed trillions of dollars to purchase government debt and many other historically never-held assets (e.g., Fed bought over $1 trillion in mortgage-backed securities).
  - The net impact has been to explode the size of the balance sheets of many central banks (e.g., Fed's rose from about $850 billion pre-Crisis to about $2.8 trillion today).

# How 0% Aims To Shorten January 2020

- “Higher stock prices will boost consumer wealth and help increase confidence, which can also spur spending. Increased spending will lead to higher incomes and profits that, in a virtuous circle, will further support economic expansion.”
  - – Fed Chairman Ben Bernanke, *Washington Post* op-ed, 11/4/10
- “When QE2 ends in June, like I think it will, then $1.5 trillion worth of check writing basically disappears. Because of that, investors are already anticipating the event and heading for the exits.”
  - – Bill Gross, founder and co-chief CIO of PIMCO

# The Global Challenge for Monetary Policy

- If and when the World Financial Crisis and recession pass, how will the Fed and other central banks unwind all this historic expansionary policy?
  - What principles will guide lending what to whom when?
  - "The usual defense of, well, we shouldn't intrude on the integrity and independence of the Fed, I think, no longer applies."
    Max Bauchus, Chairman of Senate Finance Committee
  - Who currently chairs the House Financial Services Subcommittee on Domestic Monetary Policy and Technology?
- Central banks face a trifecta of technical, economic, and political challenges for reverting to typical policy.
  - Waiting too long to shrink money supplies and balance sheets will stimulate price inflation.

# Central Bankers Struggling with No Playbook

# Takeaways for You and Your Companies

- There remains historic uncertainty about both the future path of global monetary policy and the impact of this policy on the real economy.
- How exposed are your companies to increases—perhaps sharp and unexpected—in U.S. and global interest rates?
- "Pimco's Gross Dumps Treasurys, and the Market Yawns." --*WSJ* 3/10/11

# #4:  $1.65 trillion

# The Global Challenge for Fiscal Policy

- OMB has estimated a FY 2011 federal deficit of about *$1.65 trillion* (10.9% of GDP)—on top of FY 09/10 deficits of about $2.7 trillion (nearly 10% of GDP) in two years.
  – (Taxes/GDP) ≈ 15% and (Spending/GDP) ≈ 26%.
  – Excluding world wars, these are all U.S. records.
- The depth of the current fiscal hole has made the ten-year fiscal prognosis much worse than pre-Crisis.
  – At the end of this year, U.S. (debt/GDP) ≈ 73%.
  – U.S. CBO now forecasting 2020 U.S. (debt/GDP) ≈ 90-100%.
  – Beyond 2020 the fiscal outlook is only darker: PV shortfall of Social Security, Medicare, and Medicaid ≈ $50 trillion.
- Ditto Ireland, Greece, Iceland, U.K., Portugal, Spain, Italy: how will all these sovereign deficits and debts evolve?

# Governments Do Face Budget Constraints

- When any government spends more than it collects in taxes, then it faces a limited set of options.
  - Sell debt to private actors—domestic and/or foreign.
  - Default/restructure its existing debt obligations.
  - Receive transfers from other governments/IGOs.
  - Sell debt to its central bank—i.e., central bank prints money.
- The World Financial Crisis is now a sovereign debt "issue" in many countries. Different countries are making and will make very different choices here.
  - Iceland, Ireland, Greece, Portugal, Spain, U.K., Japan, U.S., …
- Will these capital-markets pressures devolve into a financial crisis like in fall 2008? If so, yikes.

# Is This Athens?  For Better or Worse, No.

"A Greek Crisis Is Coming to America"

– Niall Ferguson, *FT* op-ed, 2/10/10

# Takeaways for You and Your Companies

- There remains historic uncertainty about both the future path of global fiscal policy and the impact of this policy on the real economy.
- How exposed are your companies to fiscal austerity that is coming from both U.S. states and the U.S. federal government?
- How exposed are your companies to increases—perhaps sharp and unexpected—in U.S. and global interest rates?

# #5: 75%

# America's Educational Lead Is Shrinking

- America's dramatic educational upgrading of the 20th century largely stopped in the past 40 years.
  - In 1969 the U.S. high-school graduation rate was 77.1%, up from just 5% in 1900. That same rate today is about *75%*.
  - Male rates of college attendance/completion have also flat-lined.
- Meanwhile, the skill upgrading in many other countries continues—often at an accelerating rate.
  - Today among industrialized nations, U.S. ranks 16th in college-completion rates and 20th in high-school completion rates.
  - Recently released 2009 PISA results for 65 countries: U.S. 15-year-olds were 15th in reading, 23rd in science, and 31st in math.
  - What country scored first in all three categories? China.

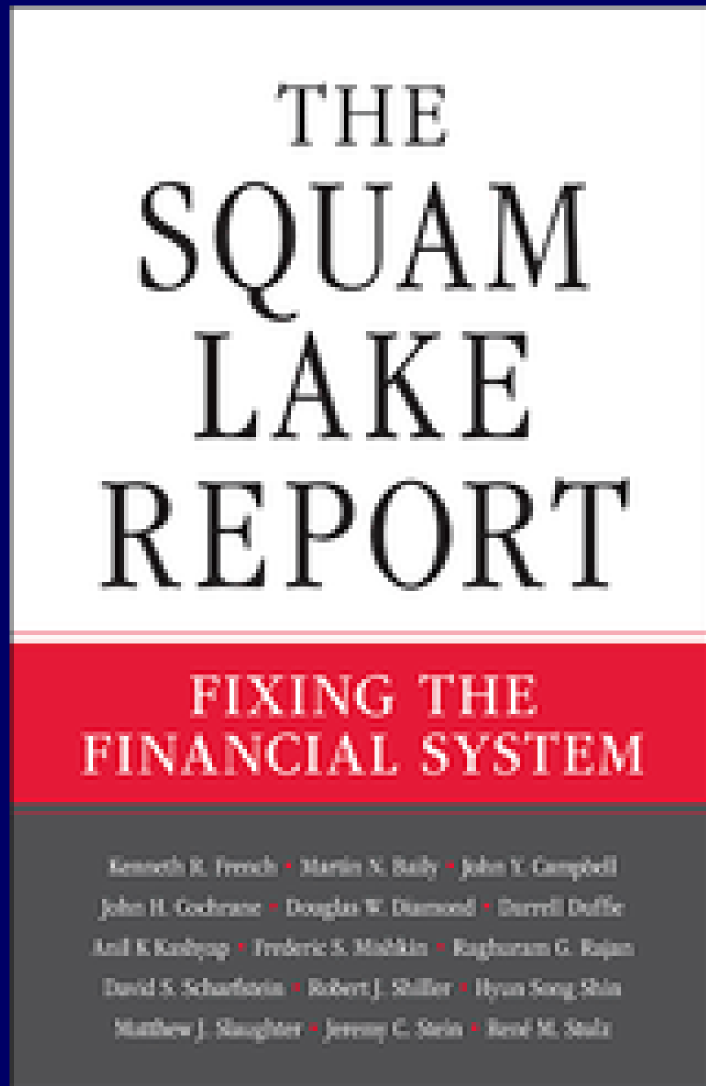
# Other Eroding Advantages On the To-Do List

- Uncertainty about the role and scope of government in several key industries: finance and insurance, real estate, autos, health, energy, …?
  - "How to Destroy American Jobs" *WSJ* 2/3/10
  - "The Global Jobs Competition Heats Up" *WSJ* 6/30/10
- The Crumbling Infrastructure: What grade did ASCE assign the United States in 2009?
  - "How to Jump-Start American Manufacturing" *WP* 8/13/10
- The Protectionist Drift away from Open Borders
  - "We Cannot Afford to Spurn the Emerging Investors" *FT* 1/4/10
  - "Comparative Advantage and American Jobs" *WSJ* 1/24/11
  - "China, Patents, and U.S. Jobs" *WSJ* 6/6/11

# Was This a Good Start on the To-Do List?

- "Do you approve or disapprove of the federal government providing loans and financial assistance to Chrysler and GM?" Approve: 39%. Disapprove: 53%. (NBC News-*Wall Street Journal* Survey, 8/26-30, 2010)

# Are We Crossing Items Off the To-Do List?



# Are We Crossing Items Off the To-Do List?

## Share of U.S. Demand Deposits

| Institution | 1995 | 2010 |
|---|---|---|
| Giant Banks | 7% | 44% |
| Large Banks | 32% | 19% |
| Medium Banks | 26% | 13% |
| Small Banks | 28% | 15% |
| Credit Unions | 8% | 10% |

- IMF, May 2011: “The largest U.S. banks have been able to borrow funds at lower rates than smaller banks, and this advantage widened after the crisis.”

# Are We Crossing Items Off the To-Do List?

- 70% of the finalists in the 2011 Intel Science Talent Search competition were children of immigrants. 60% of the finalists had parents who entered the United States via H-1B visas.
- So what was the last major U.S. policy change to the H-1B visa program?
  - "It's a Terrible Time to Reject Skilled Workers" *WSJ* 3/11/09
- A recent survey of Indian and Chinese immigrant returnees found that 72% and 81%, respectively, said that opportunities to start their own businesses were better or much better in their home countries.

# Meanwhile, One Thousand Words From 1990

# Another Thousand Words From 2010

# Takeaways for You and Your Companies

- Recessions triggered by financial crises tend to be much harder and longer than those triggered by central banks.
  - "Real per capita GDP growth rates are significantly lower during the decade following severe financial crises and the synchronous world-wide shocks. The median post-financial crisis GDP growth decline in advanced economies is about 1%."
  - "In the ten-year window following severe financial crises, unemployment rates are significantly higher than in the decade that preceded the crisis. In ten of the fifteen post-crisis episodes, unemployment has never fallen back to its pre-crisis level."

(Reinhart and Reinhart, 2010 NBER working paper)

- How exposed are your companies to the prospect of permanently slower growth in U.S. and many countries?

# Closing Thoughts

# Will This One Be in the History Books?

# Reading Something Like This?

# So, Was That Sunrise or Sunset?

- "Do you think America is in a state of decline, or do you feel that is not the case?" (*WSJ*-NBC 8/10)
  - Not in a state of decline: 31%
  - In a state of decline: 65%
- "Do you feel confident or not confident that life for our children's generation will be better than it has been for us?" (*WSJ*-NBC 8/10)
  - October 1990: 50% Confident vs. 45% Not Confident
  - December 2001: 49% Confident vs. 42% Not Confident
  - August 2010: 27% Confident vs. 66% Not Confident

# Closing Thoughts

- "In my more than 50 years in business, I cannot recall a time when there were so many daunting national challenges, with business engagement so lacking. This was not always so … It's time to get off our butts, cure ourselves of an aggravated case of short term-itis … It's time to do the right thing, not just to protect our kids and grandkids but to safeguard our remarkable country's future."
  - Peter G. Peterson, "Business Is Missing in Action," *BusinessWeek* 11/16/09

# Closing Thoughts

- It is not difficult to forecast renewed but modest short-term economic growth in the U.S. and many other countries. A central challenge is how to foster widespread private-sector job creation and investment.
- The United States and many others continue to face difficult and monumental policy choices today that will shape economic performance for years into decades—and that, poorly handled, could curtail growth even in the short term as well.
- From where will the necessary leadership come?