

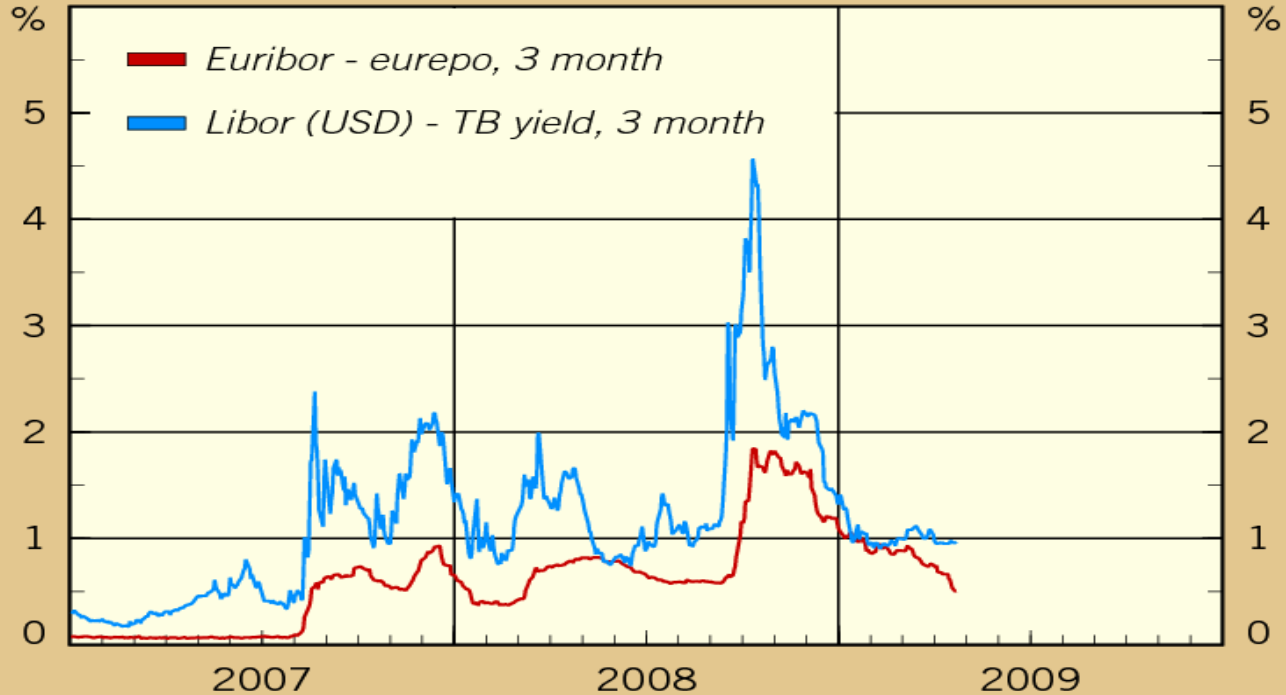
THE GLOBAL CRISIS – WHAT COMES NEXT?

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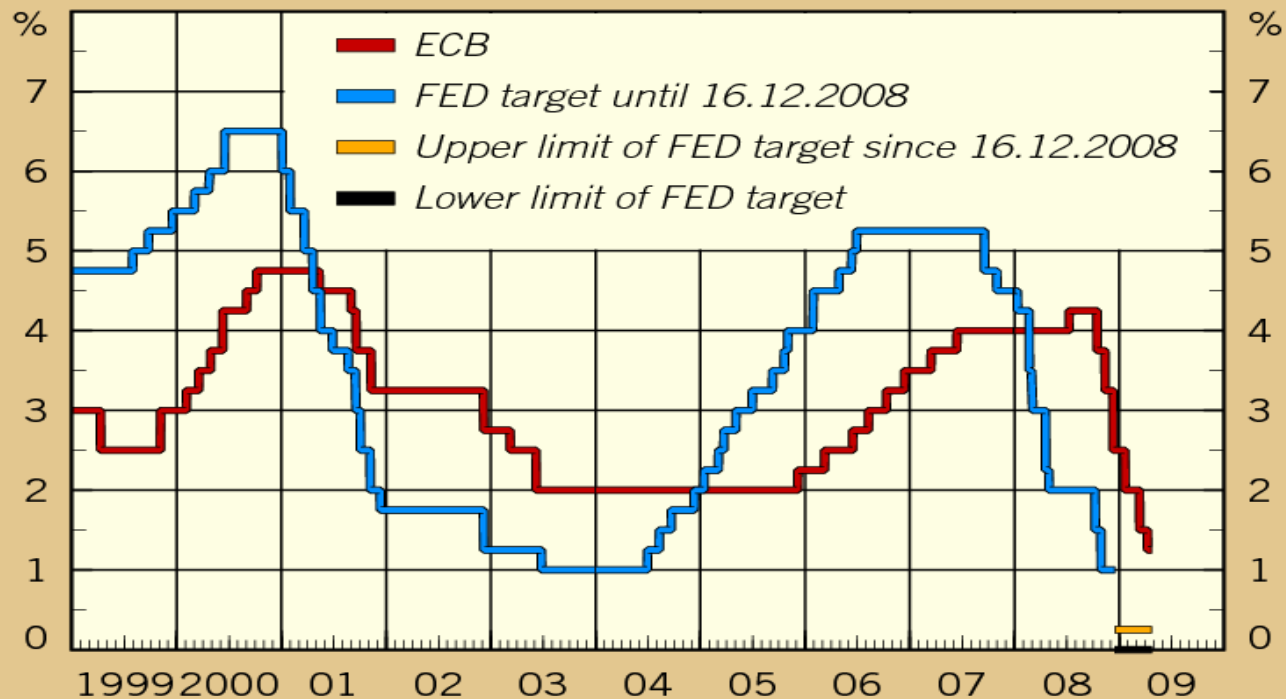


Money Market Risk in the U.S. and Euro Area, %-points





Central Bank Steering Rates

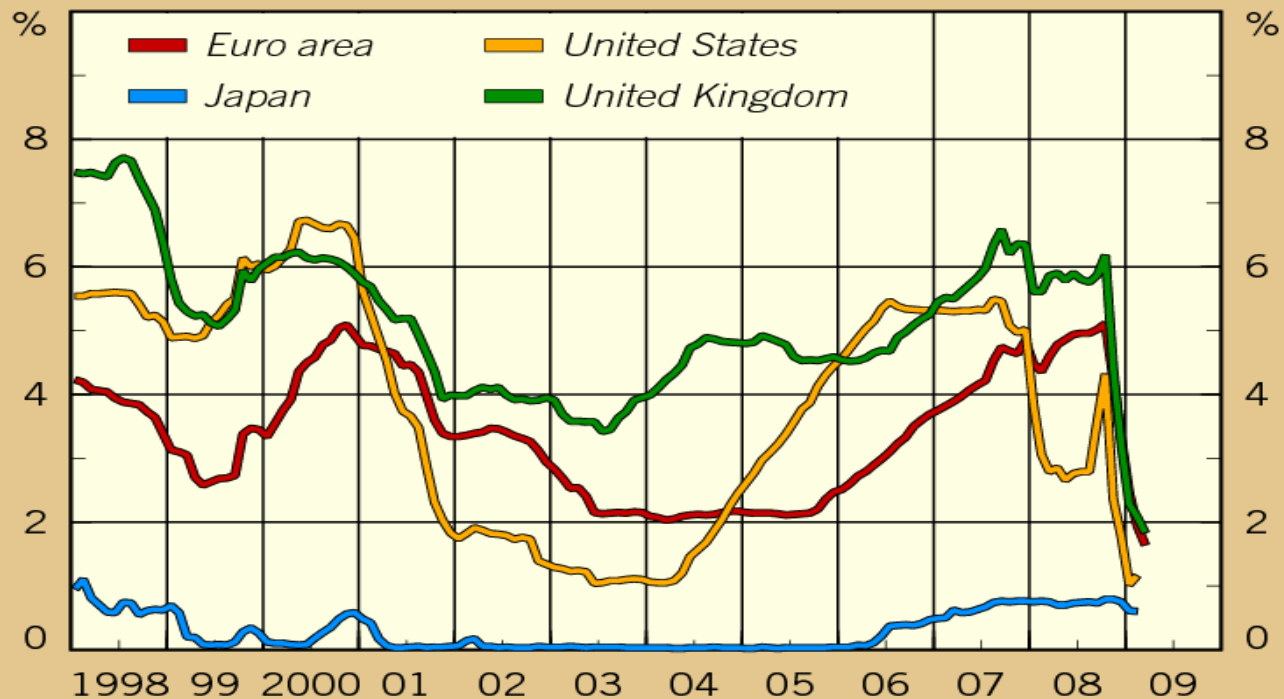


Sources: ECB, Federal Reserve, ETLA.

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Key 3-month Interest Rates



Sources: Bank of Finland, OECD.

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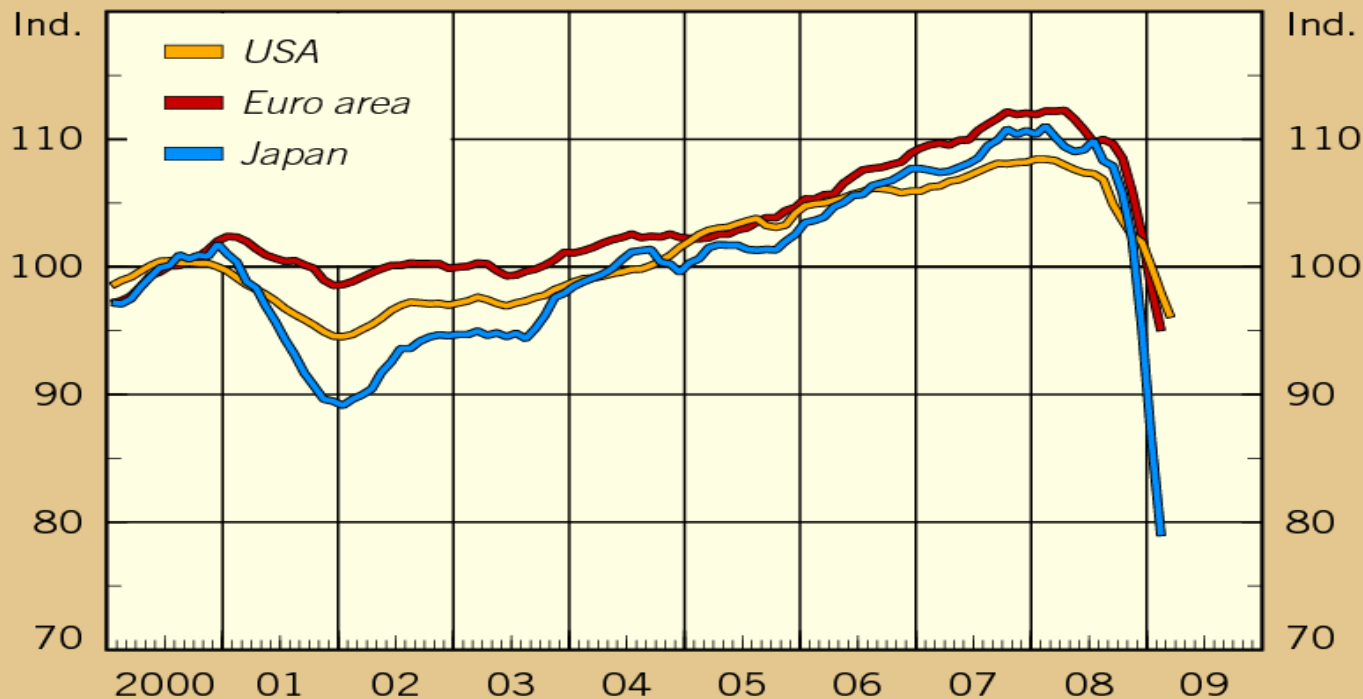


Stock Indices in Germany and in the US, 4.1.2000 = 100





Industrial Production in the Euro Area, the U.S. and Japan, 2000=100

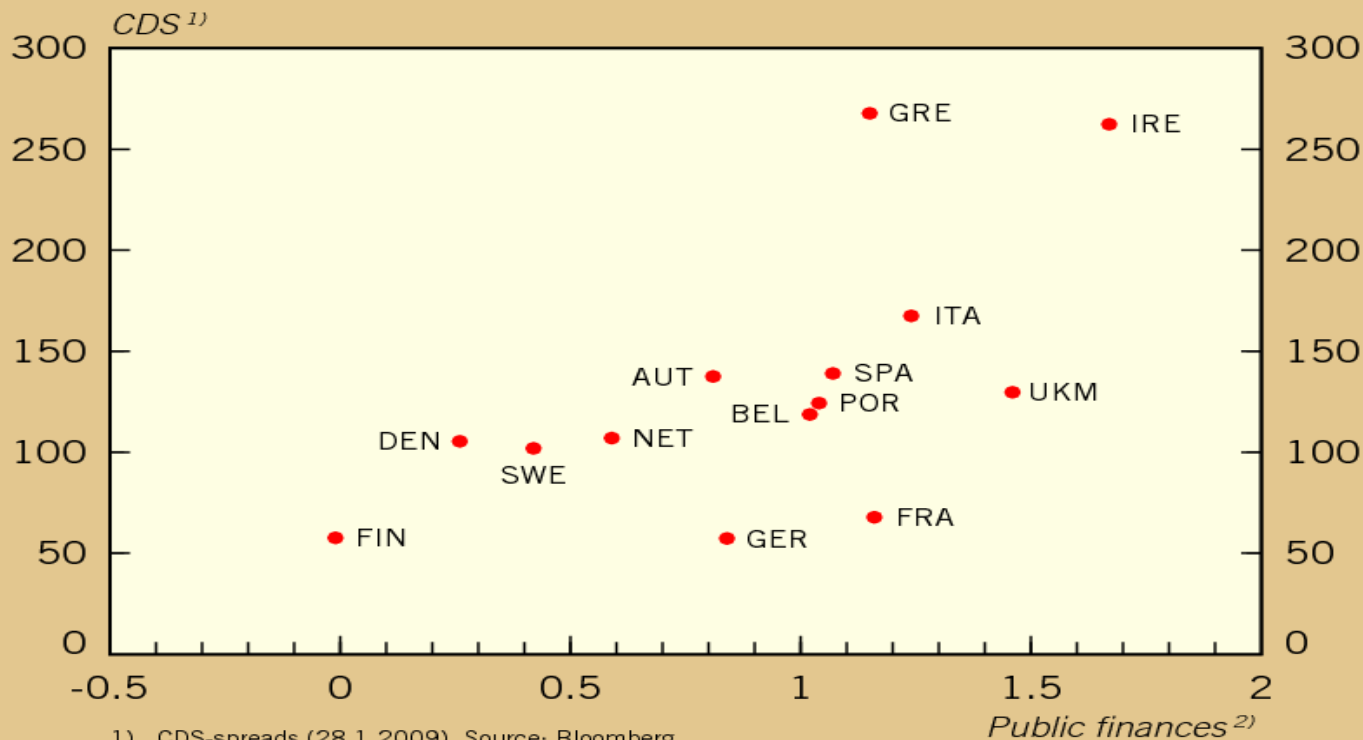


THE CURRENT CRISIS

- is still escalating: financial → economic → budgetary → social & political crisis →
- is a "transformational" shock (the economy, politics, institutions)
- is of a global character and requires global action: G20 in London?
- the optimistic view is that the US will start to recover in a year or so, thanks to monetary and fiscal expansion + low commodity prices, with Europe lagging behind
- however, the unresolved banking problem + continued deleveraging and falling house prices + credit losses may still stand in the way
- the euro, while it has contributed to stability, is facing a tough test: internal divergence is getting worse, and "outs" are arguably "begging thy neighbour"



CDS and Public Finances

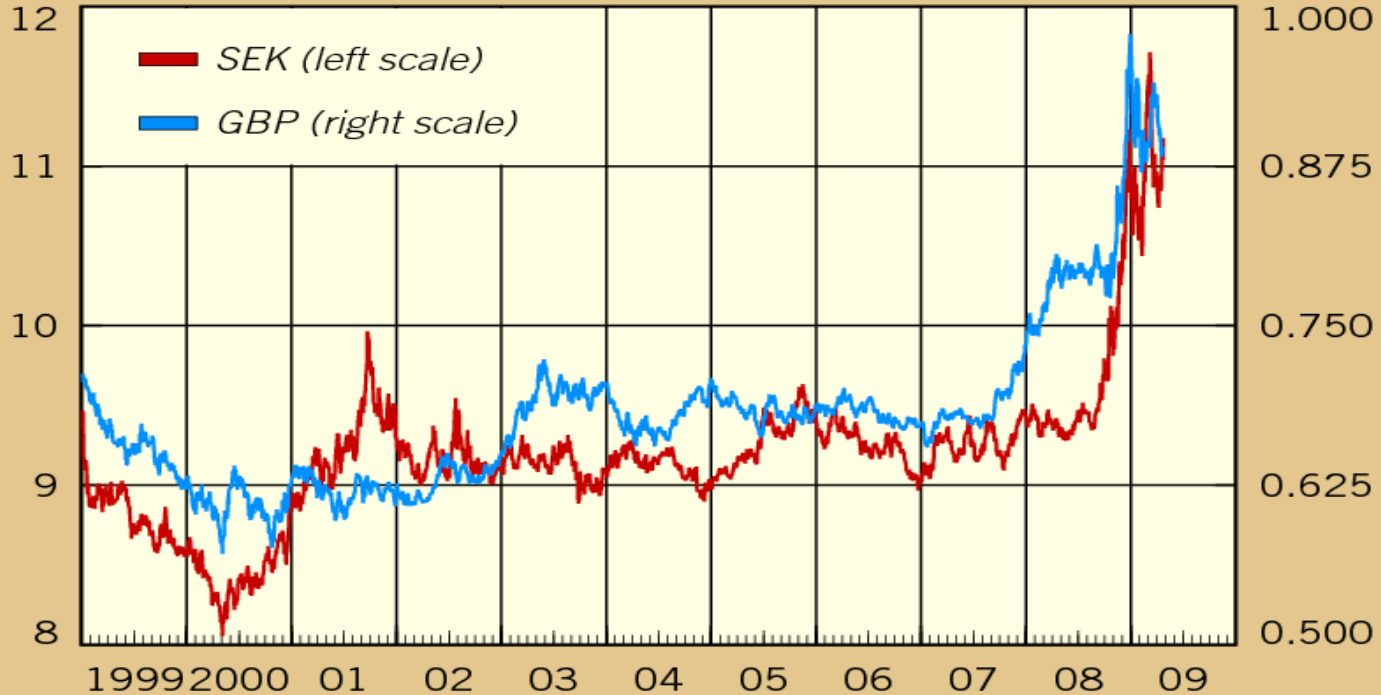


1) CDS-spreads (28.1.2009). Source: Bloomberg.

2) Indicator of public finances = $0.5 \cdot \text{gross public debt (2008)} + 0.5 \cdot \text{gen. gov. deficit (2009)}$.
Source: Commission.



Euro vis-a-vis British Pound and Swedish Krona



Sources: Bank of Finland, ETLA.

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THIS CRISIS IS TRANSFORMATIONAL AND RAISES MANY BIG QUESTIONS:

- Are *global imbalances* a serious threat to macroeconomic instability?
- Should monetary policy factor in the risk of *asset price bubbles*?
- Are financial markets rational & efficient or *inherently unstable*?
- What is the source of the problem in financial markets?
 - *financial innovations* and weak regulation (gaps in coverage)
 - faulty *incentives* (pay schemes) and *rating agencies* (conflicts of interest)
 - *capital requirements* and accounting rules (bias to procyclicality)
 - *greed* and herd instincts (resulting in excessive leverage)

(cont.)

- Has prudential supervision neglected *systemic risks*?
- What is the appropriate *trade off* between financial sector efficiency and stability (regulation)?
- What are the key ingredients of *better regulation*?
- Is *international cooperation* too weak in financial regulation & supervision?
- Is *globalization* under threat, protectionism and fragmentation on the rise?

(cont.)

- Will the *role of government*, policy activism and interventionism, increase more generally?
- Will *social safety nets* (pensions, unemployment benefits, health care) come increasingly under review?
- Are we heading for a *budget crisis*, how can public finances be returned to a sustainable path?
- Will monetary and fiscal expansion ultimately result in high *inflation*?
- What are the consequences of the crisis for the sectoral structure of the economy, where are the new *sources of growth*?
- Will the crisis have lasting effects on *values and political priorities*?

PERSPECTIVES

