Global Lessons and Implications of the Financial Crisis

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Credit induced cycles.

- Loose credit
- Asset price bubble
- Bubble pops, market crashes
- Bankruptcies
- Credit dries up
- Investment grinds to halt
- Recession
Credit induced cycles. Examples from around the world

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<tr>
<th>Country</th>
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<th>Trough</th>
<th>GDP Loss</th>
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<td>Japan</td>
<td>1993.1</td>
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<td>USA</td>
<td>1929</td>
<td>1933</td>
<td>-30%</td>
<td>3 years</td>
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Is $700 Billion a Big Number?
Federal Outlays 2007 (millions)

Entitlements, 1,593,967, 58%

National defense., 552,568, 20%

Other Discretionary, 356,848, 13%

Net interest., 237,109, 9%
To Whom Do We Owe Our $8.8 Trillion National Debt?

- **Federal Reserve and Government accounts**: 2,457, 52%
- **Total privately held**: 2,076, 23%
- **Foreign and international**: 2,197, 25%
TWWSC Bank Balance sheet
(Thought We Were So Clever)

- **Assets**
  - 700 (Bad Assets actually worth 500)
  - 500 (Good Assets)

- **Liabilities + NW**
  - 1000 (Borrow from investing public)

- **Net Worth**
  - 200
TWWSC Bank Balance sheet
(Thought We Were So Clever). RUN ON BANK
RUN ON BANK. Option 1—Original Paulson Plan

**Assets**
- 700 (Bad Assets actually worth 500)
- 500 (Good Assets)
- 700 (Cash from Hank)

**Liabilities + NW**
- 1000 (Borrow from investing public)
- -500 (withdraw)

Net Worth?
- 200
Meanwhile, over at the US Treasury Fund

Option 1—Original Paulson Plan

- **Assets**
  - 500 (Bad bank assets)

- **Liabilities + NW**
  - 700 (Borrow from China)

- **Net Worth**
  - -200
Meanwhile, over at the US Treasury Fund

**Option 1—Original Paulson Plan**

- **Assets**
  - 500 (Bad bank assets)

- **Liabilities + NW**
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- Worse than
  - Denver airport baggage system
  - New Coke
  - The Titanic
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- Plan Sunk Before It Was Launched
Meanwhile, over at the US Treasury Fund

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- Plan Sunk Before It Was Launched
- (Gazillions for Goldman)
TWWSC Bank Balance Sheet

(Thought We Were So Clever)

Run on Bank

Option 2—Fed as lender of last resort

- **Assets**
  - 700 (Bad Assets actually worth 500)
  - 500 (Good Assets)

- **Liabilities + NW**
  - 1000 (Borrow from investing public)
  - -500 (withdraw)
  - 500 (Borrow from Federal Reserve)

- **Net Worth**
  - 200
TWWSC Bank Balance Sheet (Thought We Were So Clever).

RUN ON BANK
Option 3—Treasury as White Knight recapitalizes the banks

- **Assets**
  - 700 (Bad Assets actually worth 500)
  - -200 (writedowns)
  - 500 (Good Assets)

- **Liabilities + NW**
  - 1000 (Borrow from investing public)
  - -500 (withdraw)

- **Net Worth?**
  - 0 (Equity holders)
  - 500 (Treasury warrants)
Some Good Ideas From the Last Couple of Days

- Interbank loan guarantees
- International Coordination
- Warrants (Option to own)

- These smart ideas came from the English and the Europeans
What’s coming? IMF Forecast

IMF: Global growth to slow to 3% in 2009. 2008 global economy expected to grow by 3.9%. U.S. to expand 0.1% next year, after growth of 1.6% this year; Growth to be "particularly weak" in the G-7 countries -- the U.S., Japan, Germany, France, the U.K., Canada and Italy. U.K. to contract by 0.1% next year; Italy's economy will contract 0.2%; Germany is expected to post zero growth next year; France's economy will register 0.2% growth; Canada to grow 1.2%
Last Words

- Since we’ve started down this path, some sort of bailout needs to be engineered.
- Force write-downs
- The Treasury (US taxpayers) should earn a profit or at least not lose on the deal
Swedish RGDP and Stock Market around 1992 Banking Crisis
Thailand Real GDP and Stock Market around 1997 Crisis
Argentina Real GDP and Stock Market around 2001 Crisis
Japanese Real GDP and Stock Market around 1990 Crisis
Depression Era US Real GDP and Stock Prices

Graph showing the fluctuations in GDP and stock prices from 1930 to 1944.