



# The Global Financial Crisis and its Aftershocks. Does it Signal a New World Order?

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‘The only function of economic forecasting is to make astrology look respectable.’

Ezra Solomon, Member of Council of Economic Advisers, 1971-1973

The quotation was wrongly attributed to John Kenneth Galbraith, and more recently has been misattributed to Warren Buffett.

# For the record

‘...the combination of high debt and high asset prices that provides the backdrop to private sector decision-making presents some deflation risks to the US and world economy. Indeed, it was to insure against such deflation that the Fed cut interest rates aggressively in 2001-2003. Ironically, this action helped convert a spent equity boom into one involving house prices.

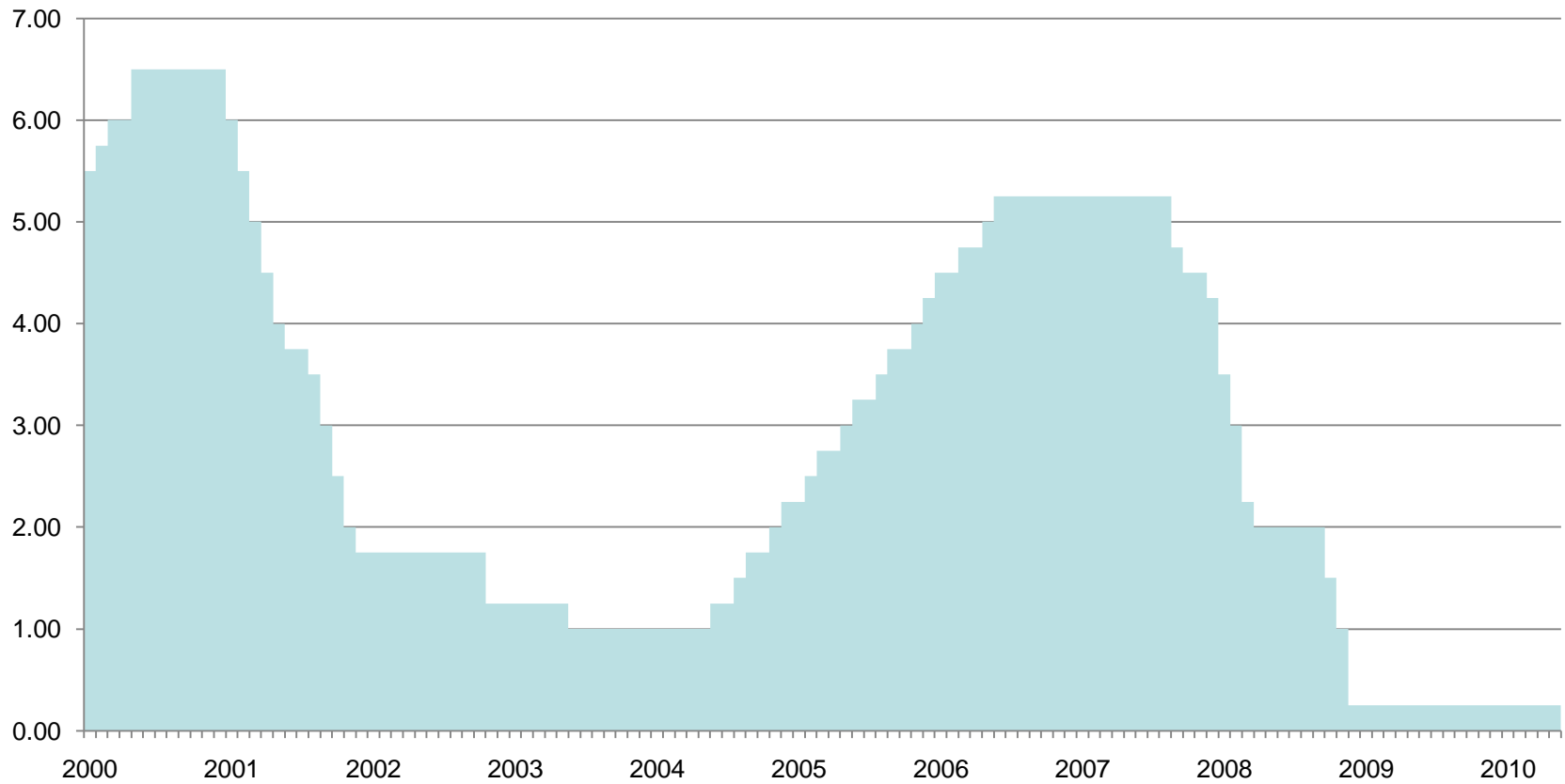
If US households were left to themselves, household borrowing could well ‘simmer down’, in Greenspan’s words, as the housing boom fades, and mortgage equity extraction subsides. The current account deficit might then begin to level out as household spending’s share of the economy returns to more normal levels and the household financial deficit recedes.

There is always a risk that the adjustment may not proceed in such an orderly way and lead to an asset price shake-out. In this case, it remains to be seen whether the ‘Bernanke Fed’ will respond to incipient signs of weakness in the housing market with the same alacrity that typically characterised the ‘Greenspan Fed.’

Iley, Richard A. and Lewis, M.K., *Untangling the U.S. Deficit. Evaluating Causes, Cures and Global Imbalances*, Edward Elgar, Cheltenham, UK and Northampton, Mass. 2007 (p243).



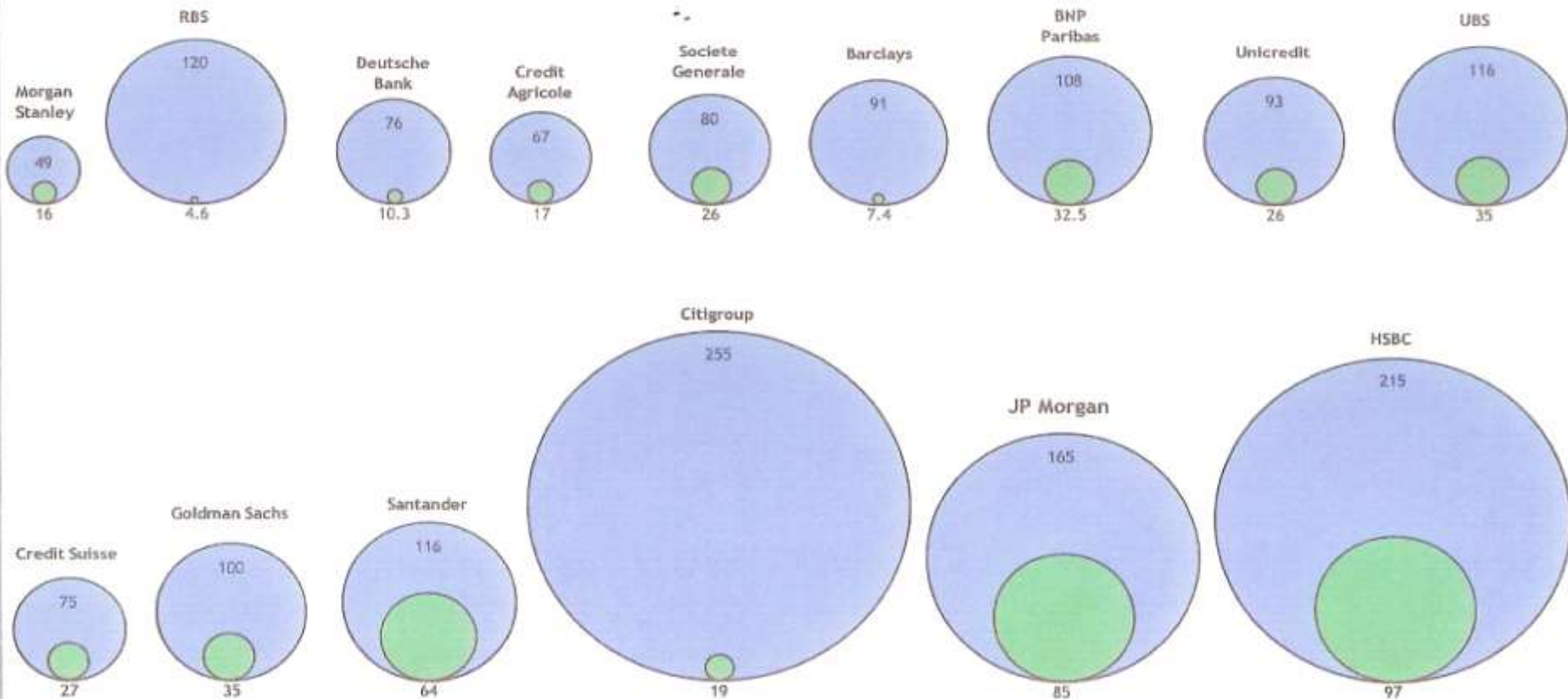
# Target Federal Funds Rate, 2000-2010



# The incredible shrinking banks

Figure 7 The incredible shrinking banks

- Market Value as of January 20<sup>th</sup> 2009, \$Bn
- Market Value as of Q2 2007, \$Bn



# The Immediate Consequences

- 29 advanced economies experienced recession during 2008-09
- GDP in advanced economies fell by 4.3 per cent over the year to June 2009
- 60 million people lost their job as a result of the global recession
- Financial markets were disrupted to such an extent that even the most credit-worthy borrowers had difficulty raising funds
- Governments were forced to provide capital injections to many of the world's largest banks on an unprecedented scale
- Wholesale funding guarantees for banks and other financial institutions were introduced in at least 19 countries

# The Great Recession?

- For the United States, the downturn from December 2007 to July 2009 was the most severe post-World War II recession
  - longer in duration
  - industrial production fell by 16 per cent
  - unemployment rose from 4.4 to 10.1 per cent
- Dwarfed by the 'Great Slump' of the 1930s in the US
  - industrial production fell by 45 per cent
  - unemployment rose from 3 to 25 per cent

# The view as of mid-2009

‘Unlike anything the world has experienced in the post-war period, the 2008 crisis struck at the core of the global system and not at the periphery... Our future will likely include a lowered standard of living, high unemployment, stagnant corporate profits, heavy government intervention in the economy and disappointing equity returns.’

PIMCO (‘The New Normal’)



# What has happened? - 1

	2003-2007 avg.	2008	2009	2010F	2011F	2012F
USA	2.8	0.4	-2.4	3.0	2.8	3.2
Eurozone	2.1	0.4	-4.1	1.2	0.6	1.0
UK	2.7	0.7	-4.9	1.4	0.9	1.3
Japan	2.1	-1.2	-5.2	3.6	2.3	1.4

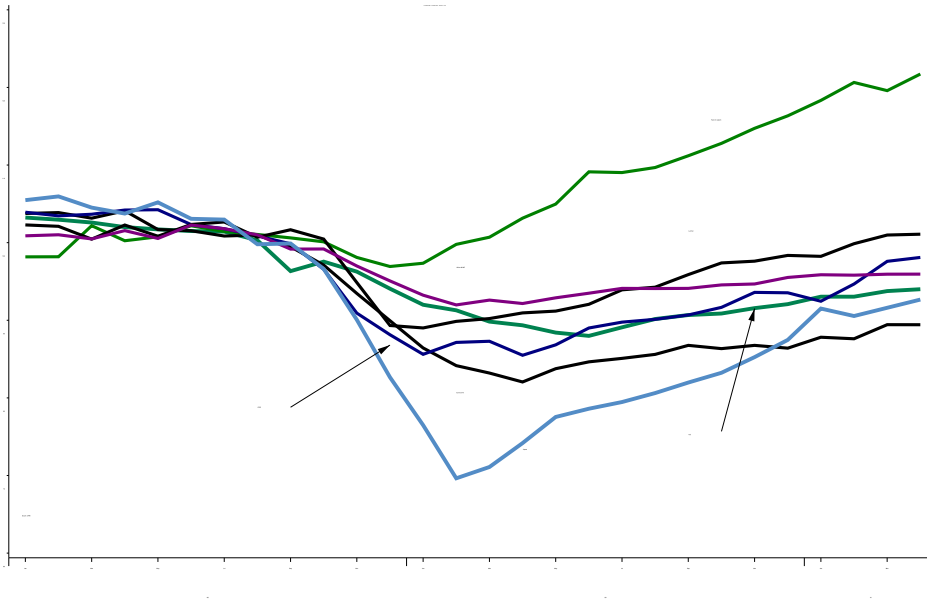
Source: BNP Paribas

# What has happened? - 2

	2003-2007	2008	2009	2010F	2011F	2012F
	avg.					
USA	2.8	0.4	-2.4	3.0	2.8	3.2
Eurozone	2.1	0.4	-4.1	1.2	0.6	1.0
UK	2.7	0.7	-4.9	1.4	0.9	1.3
Japan	2.1	-1.2	-5.2	3.6	2.3	1.4
Asia (ex Japan)	9.0	7.2	5.9	8.9	7.6	8.0
- China	11.7	9.6	8.7	9.8	8.4	9.0
- India	8.7	7.4	6.7	9.0	9.0	9.1
World	4.7	3.2	-0.6	4.5	3.8	4.2

Source: BNP Paribas

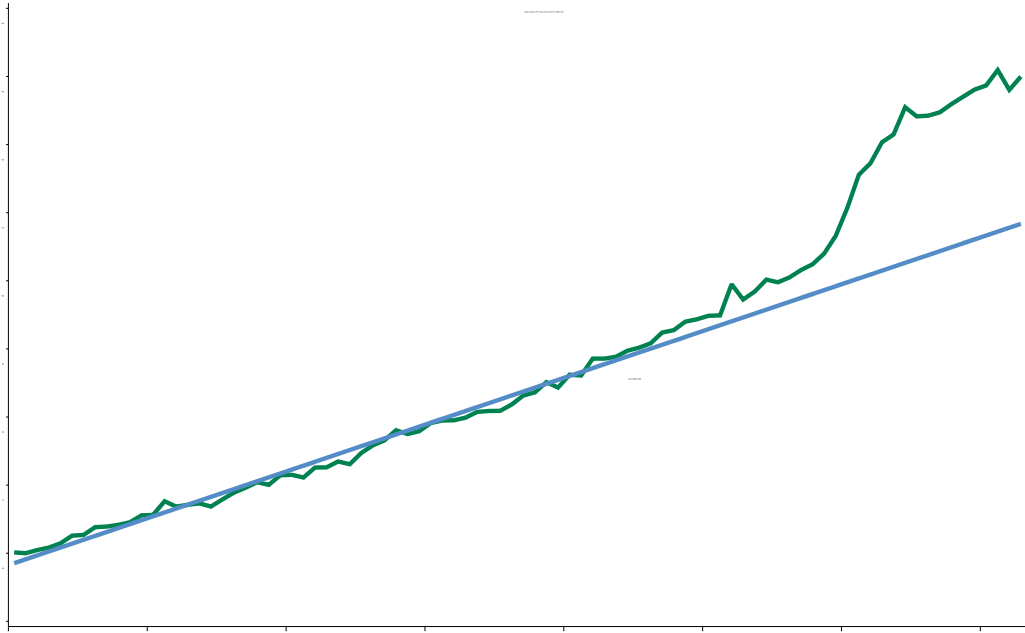
# Asia Decouples - 1



Source: CPD, BNP Paribas

- Key to the 'New World Order' was Asia's decoupling since the onset of the Global Financial Crisis
- Asian industrial production has soared to  $\approx 22\%$  above pre-crisis level

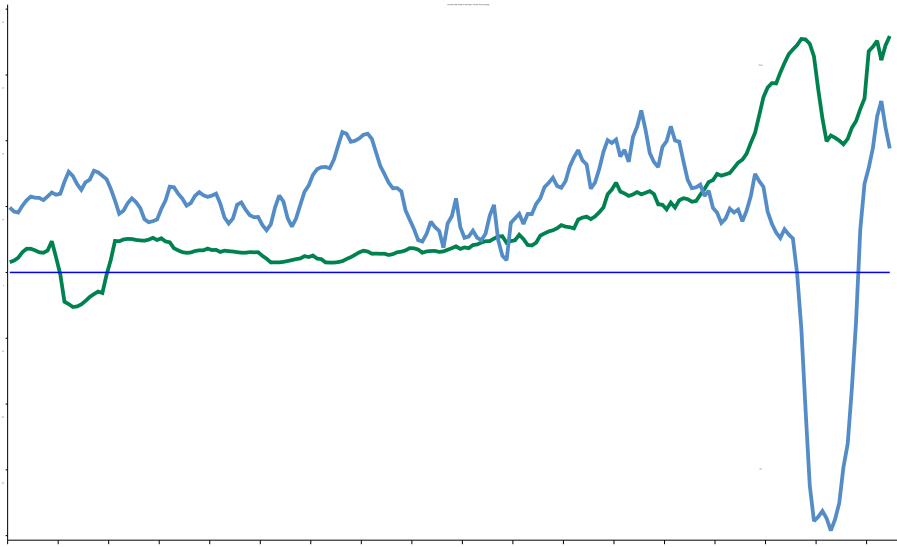
# Asia Decouples - 2



Source: CPD, BNP Paribas

- Asian industrial production has outstripped its pre-crisis trends versus the rest of the world...
- ....by 20% since 2008Q4

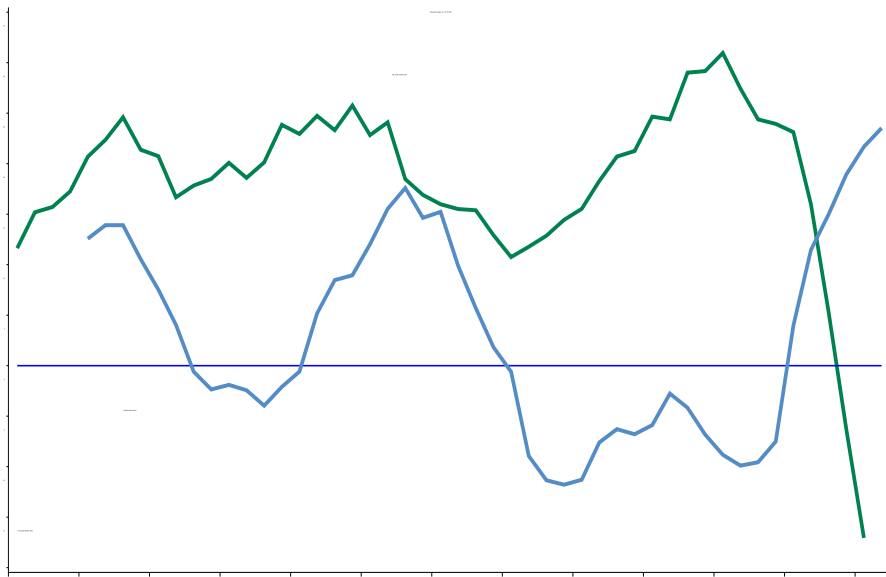
# China to the rescue



Source: Reuters Ecowin Pro, BNP Paribas

- Thanks to one of the biggest credit booms in history, China has boosted domestic spending by as much as realistically possible
- Increase in USD value of Chinese retail sales over the last two years more than offset the United States' fall

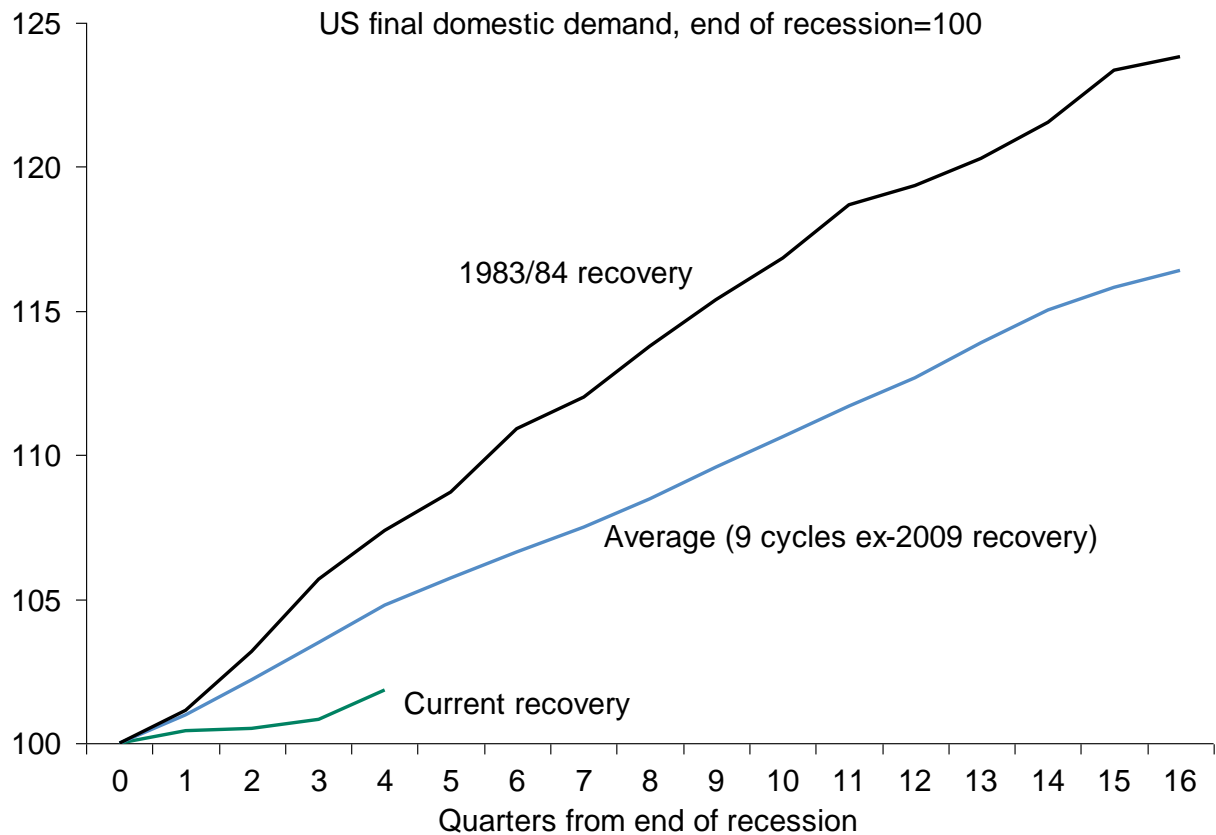
# A Chinese Credit Bubble?



Source: Reuters Ecowin Pro, BNP Paribas

- Despite large increase in bank lending in 2009
- ...China's credit 'bubble' remains in its infancy relative to the experience of the US

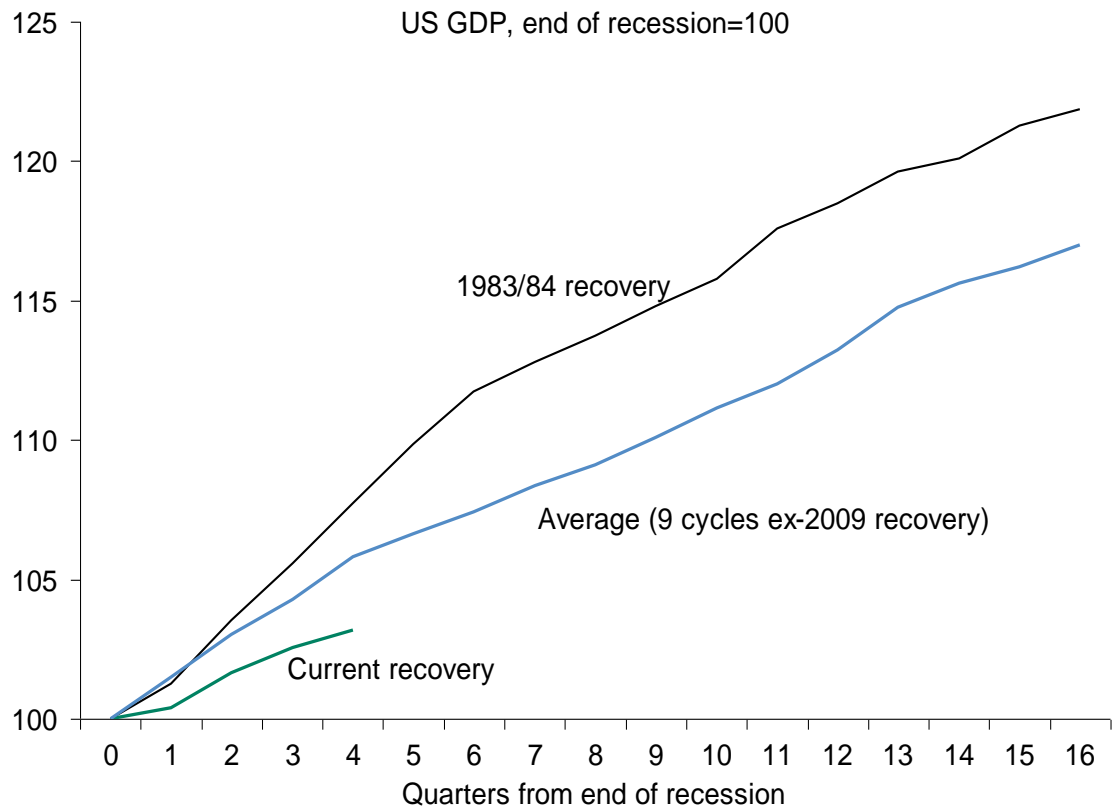
# US – Good, But Not Good Enough - 1



Source: Reuters Ecowin Pro, BNP Paribas

- mid-2009 final demand has crept up by 1.8%...
- ...3% points weaker than the 'average' recovery

# US – Good, But Not Good Enough - 2

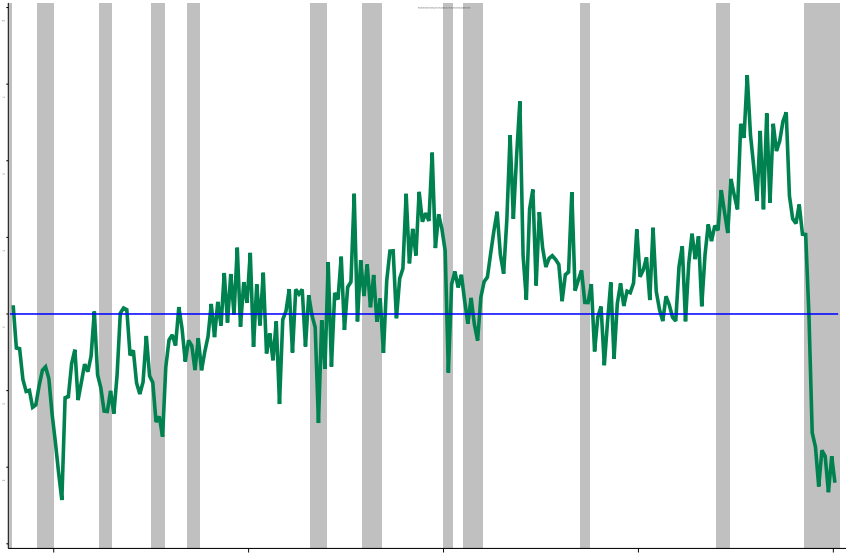


Source: Reuters Ecowin Pro, BNP Paribas

- GDP data tell a similar story
- GDP has recovered 3.2% over the last year
- 'Average' post-WWII performance is for 5.8% increase after four quarters



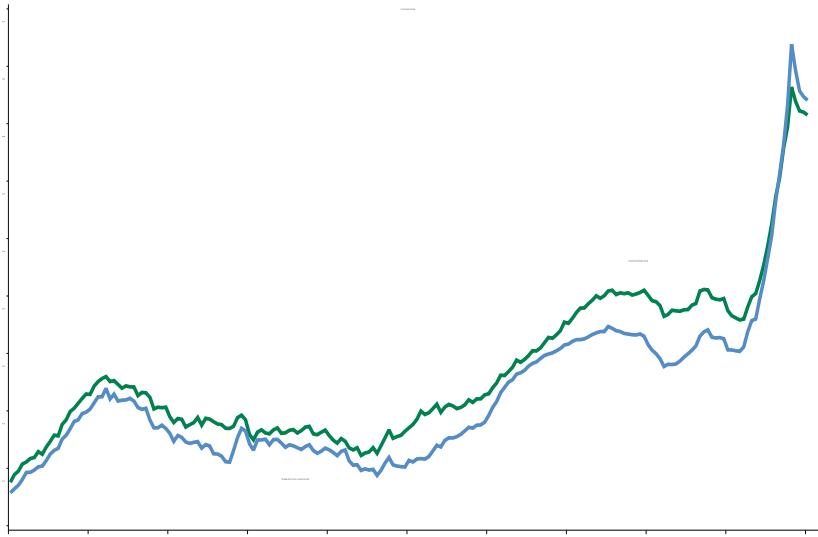
# The Core of the US problem - 1



Source: Reuters Ecowin Pro, BNP Paribas

- the key problem for US consumers this cycle is one of ridding themselves of excessive borrowing

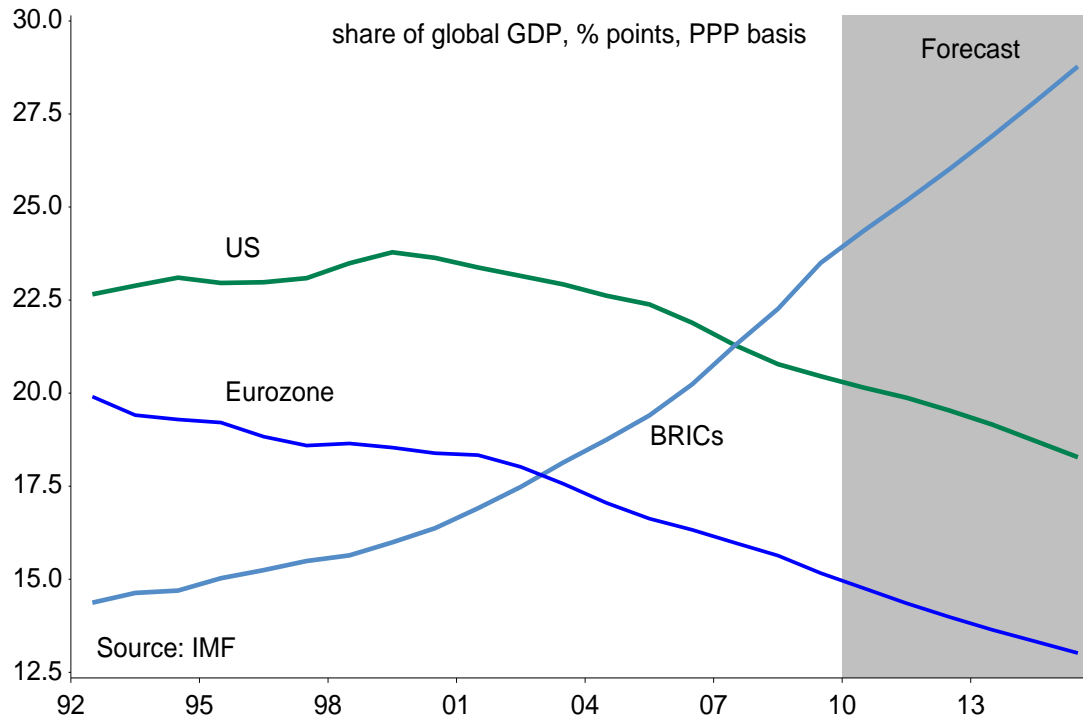
# The Core of the US problem - 2



Source: Reuters Ecowin Pro, BNP Paribas

- Mortgage debt to housing wealth and debt to tangible assets remain high

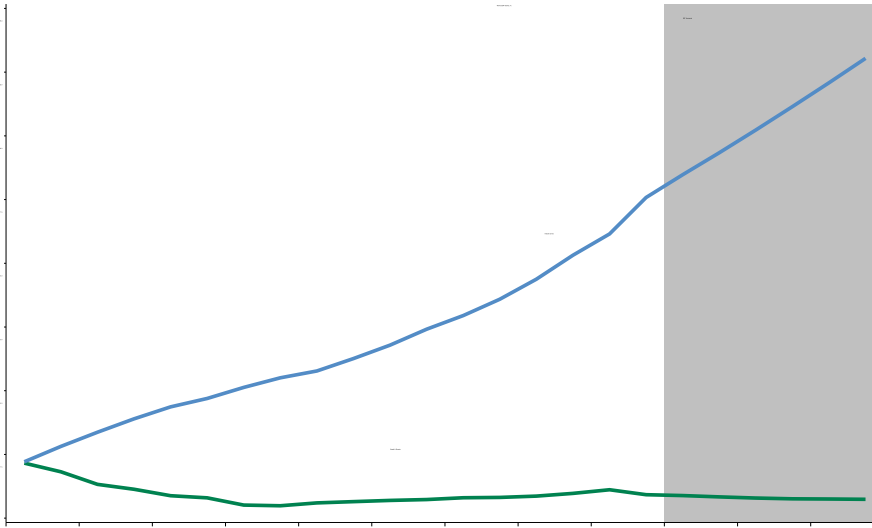
# UniSA New World Order – Rise of the BRICs – 1



Source: Reuters Ecowin Pro, BNP Paribas, IMF

- The emergence of the New World Order...
- ...marked by the rise of the BRICs in general and Asia in particular...
- ...can be seen more formally in the secular shift in world GDP shares as calculated by the IMF...
- ...using PPP GDP weights

# New World Order – More ‘ICS’ Than BRICS



Source: Reuters Ecowin Pro, BNP Paribas, IMF

- While the BRICs concept has gained momentum, it makes little sense
- Using a 2009 base, China accounts for  $\approx 50\%$ , India  $\approx 25\%$
- The rise of the BRICs is really the rise of China and increasingly India

Contribution to y/y World GDP growth, as a % of total

	2003-7 avg.	2008	2009	2010F	2011F	2012F	2009-12 avg.
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USA	12.3	2.8	-82.8	13.8	15.2	15.8	11.4
Eurozone	6.8	2.1	-102.8	3.9	2.6	3.8	-1.6
UK	1.8	0.7	-25.2	1.0	0.7	1.0	-0.4
Japan	2.7	-2.2	-51.7	4.8	3.6	2.1	1.1
Asia (ex Japan)	50.5	58.5	355.4	51.9	51.8	50.0	66.8
- China	31.3	37.2	280.0	27.4	27.6	26.7	37.7
- India	9.5	11.7	156.6	10.2	12.0	11.1	14.5
Memo:							
BRICs	46.7	58.4	295.6	45.6	46.8	44.9	58.0

Source: BNP Paribas

- Pre-crisis, Asia ex-Japan accounted for ≈50% of global growth on average between 2003-2007
- Between 2009-2012, BNPP forecasts see Asia ex-Japan producing ≈67% of global growth...
- ....with China and India together worth 50% on average

# China's 'insatiable' demand for raw materials

- China is the world's largest producer and consumer of coal
- China consumes 40 per cent of the world's aluminium, 37 per cent of cotton, 32 per cent of rice, 22 per cent of copper, and 16 per cent of wheat
- 66 per cent of all the iron ore that is loaded into a ship anywhere in the world ends up in a Chinese steel mill
- China has overtaken the United States to become the biggest total energy consumer in the world (about 4 per cent more than the US).
- China is the world's leading consumer of four of the five 'basic' commodities – grain, meat, oil, coal and steel. It lags the United States only in oil consumption
- In oil, China is second to the United States in world oil consumption, and is third in imports of oil, following the US and Japan

# Whose Era?

‘For most of its history, China was the dominant economic power in the world ... In 1820, China still accounted for 30 per cent of world GDP.’

Angus Maddison, Professor Emeritus, University of Groningen

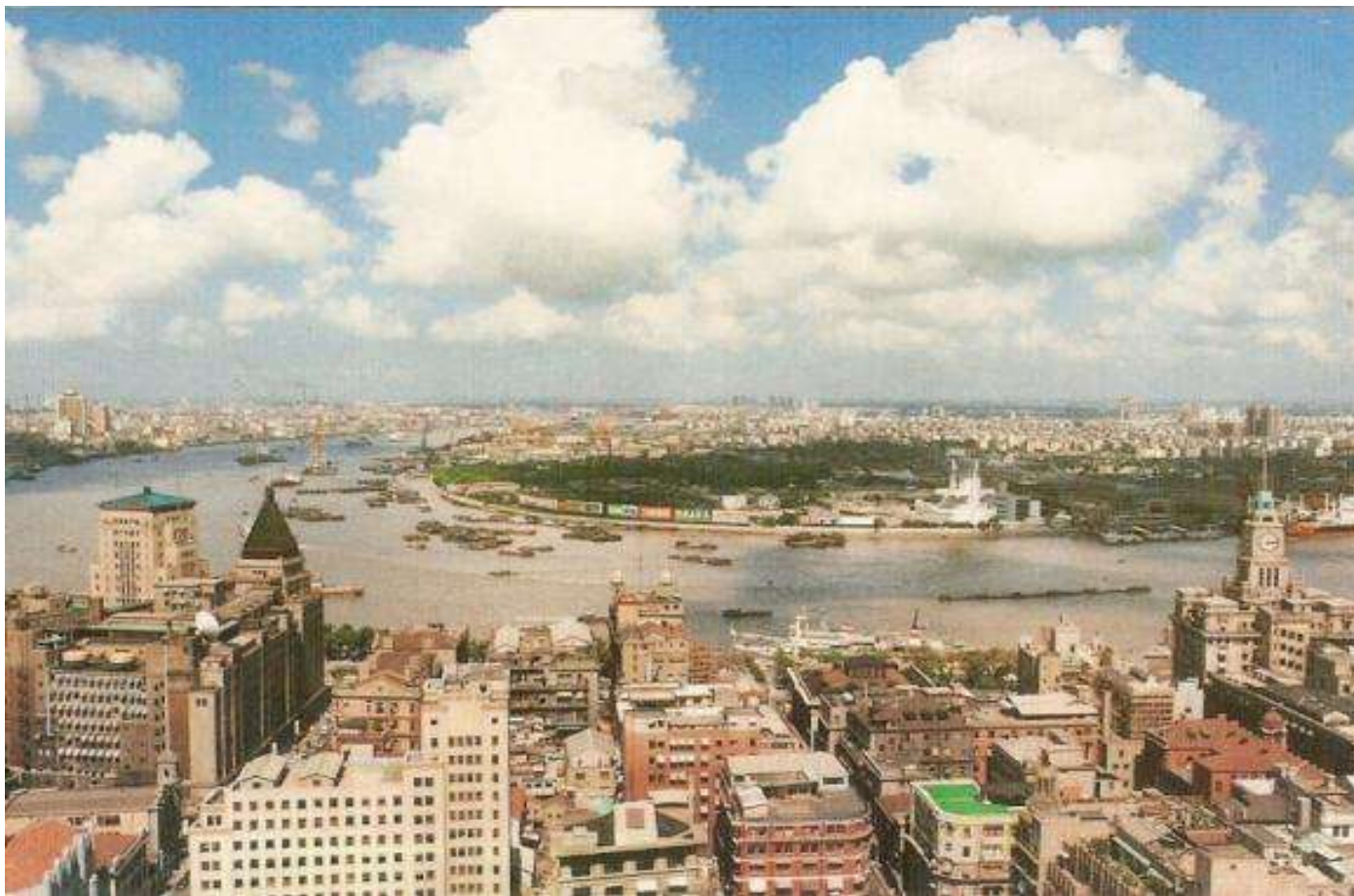
‘...while the 19<sup>th</sup> was the European century...

...and the 20<sup>th</sup> the American century...

...the world seems to have entered what may become known as the Chinese era.’

Jean-Pierre Lehmann, Professor of International Political Economy,  
IMD, Switzerland

# Shanghai - 1990

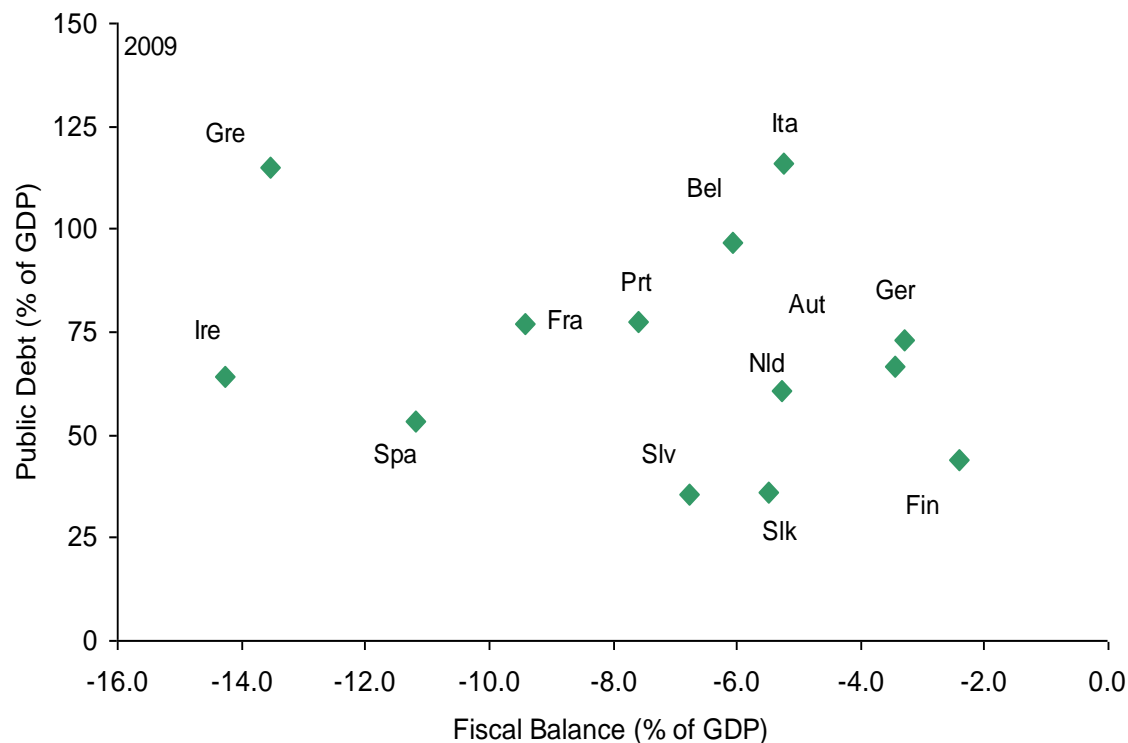




# Shanghai - 2010



# Eurozone – Fiscal Metrics



Source: Reuters Ecwin Pro, European Commission, BNP Paribas

- Greece is clearly the worst of a bad bunch
- Debt to GDP ratio of  $\approx 115\%$  in 2009 and a budget deficit of close to 14% of GDP
- Ireland actually has a larger budget deficit of 14.3% of GDP in 2009
- Irish debt levels still relatively low but rising rapidly thanks to unprecedented deflation

# How did Australia avoid the bullet?

## Niall Ferguson's 5 reasons

### 1. The 'Lucky Country'

- no sub-prime crisis
- good financial regulation
- domestically-oriented banking system

### 2. The Howard government

- healthier fiscal position of any developed economy outside Scandinavia

### 3. The Reserve Bank

- cut policy (cash) interest rates from 7.25 per cent to 3 per cent
- 'benign neglect' of exchange rate depreciation

### 4. China

- Chinese stimulus sucked in imports from Australia

### 5. The mining industry

- accounts for nearly 10 per cent of GDP
- contributes around 40 per cent of exports

# Forecasts for Australia

	2007	2008	2009	2010F	2011F	2012F
Real GDP Growth (% y/y)	4.8	2.3	1.3	3.4	3.3	3.3
CPI Inflation (% y/y)	2.3	4.4	1.8	3.2	3.3	3.2
Current Account Balance (as % of GDP)	-6.0	-4.4	-4.1	-3.6	-2.7	-4.1
Benchmark Policy Rate (a% Period End)	6.75	4.25	3.75	4.75	5.00	5.25
FX Rate (Period End)	0.88	0.71	0.90	0.90	0.95	0.90

Source: BNP Paribas

# Can Asian growth be sustained?

## BMI's Five Major Risks

1. Hard landing in China
  - slowing the surge in bank lending
  - bursting of the property bubble
2. Australian mortgage meltdown
  - over-indebted Australian consumers
3. Asian real estate bubble
  - property bubbles in China, Korea, Taiwan and Singapore
4. Another Thai political crisis
5. Japanese debt overload
  - public debt approaching 200% of GDP
  - debt servicing absorbs 44% of fiscal revenues

Source: Business Monitor International, July 2010