

The financial crisis

Discussions in Switzerland and a macroeconomic view

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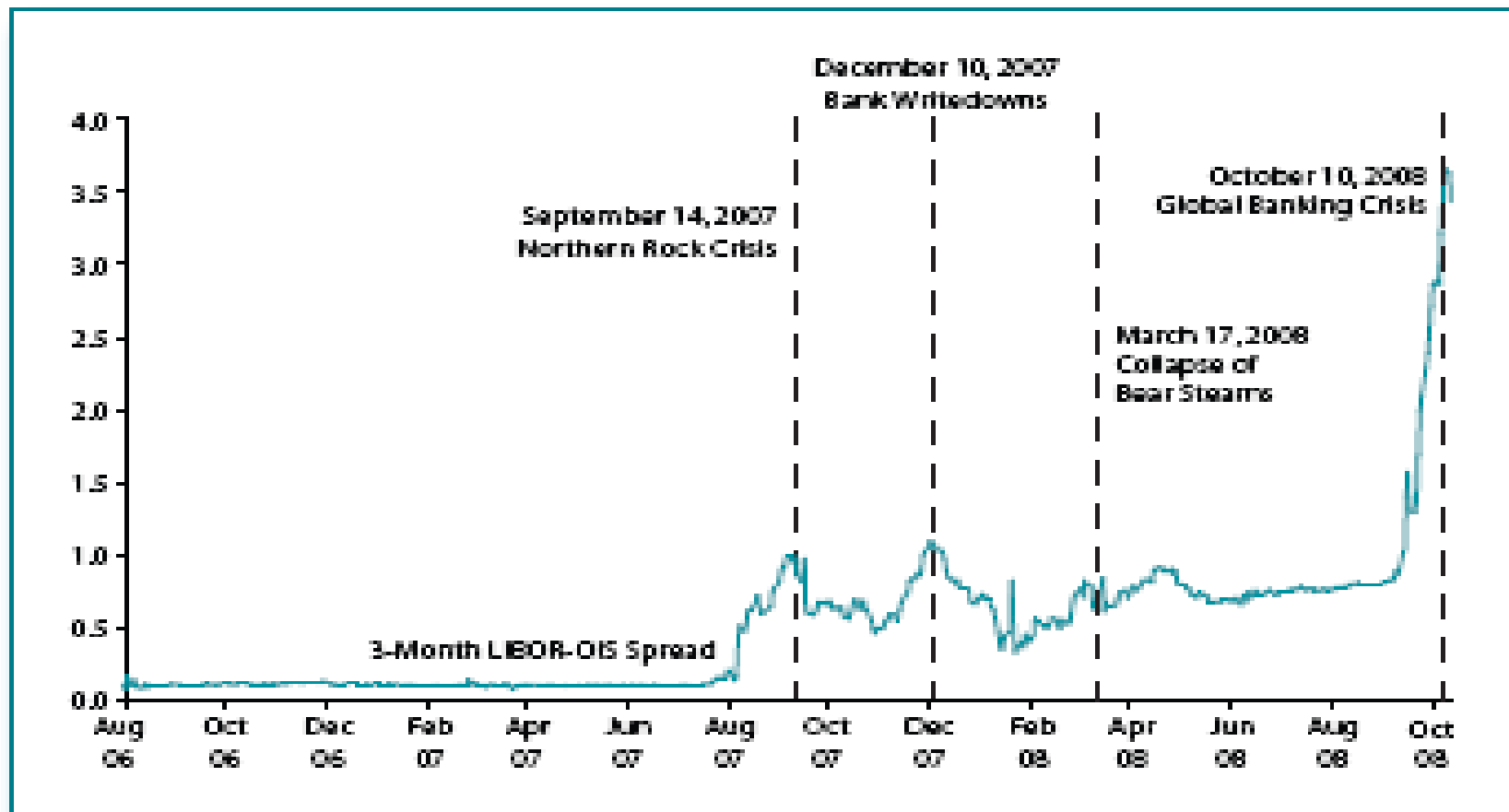
The crisis unfolds

1. The shock

- ◆ 2002-2007 strong recovery from “new economy” recession
- ◆ growth engine finance sector with record profits quarter after quarter
- ◆ Sep 14, 2008: Lehman Brothers bankrupt
- ◆ Oct 16, 2008: emergency rescue of UBS
- ◆ Q4 2008: world wide recession begins

The crisis unfolds

Lehman Brothers: from a banking problem...



The crisis unfolds

...to a world in recession

GDP		Switzerland		United States	
Year	q	y-o-y growth	q-o-q growth	y-o-y growth	q-o-q growth
2007	1	3.30	-1.82	1.42	0.30
2007	2	3.60	2.69	1.86	0.79
2007	3	3.61	-0.36	2.74	0.89
2007	4	3.90	3.43	2.53	0.53
2008	1	2.97	-2.70	2.04	-0.18
2008	2	2.94	2.65	1.60	0.36
2008	3	1.64	-1.61	0.03	-0.68
2008	4	-0.34	1.41	-1.86	-1.37
2009	1	-2.18	-4.50	-3.30	-1.65
2009	2	-2.04	2.79	-3.83	-0.18

Stage 2: Consternation

2. Silence

- ♦ crisis largely unexpected by
 - ♦ politicians
 - ♦ central banks
 - ♦ industry experts
 - ♦ academics

Analysis

3.A search for explanations

- Macroeconomic view: US current account deficit
- Microeconomic views:
 - ABS / CDO / CDS as crisis triggers?
 - Incentive problems
 - Traders
 - Managers (too-big-to-fail)
 - Rating agencies
 - academics
- Low quality products?
- Is the economic theory right?

Analysis

The US current account deficit

The US current account		
year	balance	% of GDP
2006	-788'115 Mio. US\$	-5.88
2007	-731'214 Mio. US\$	-5.19
2008	-664'125 Mio. US\$	-4.6
2009	-568'800 Mio. US\$	n.a.

Analysis

Too big to fail

Consolidated bank balance sheets and GDP	
Country	share of GDP
Iceland pre crisis	1000%
Switzerland 2008	963%
Germany 2007	315%
United Kingdom 2007	410%
USA 30 largest banks May 30, 2008	76%

Discussion

4. Discussions in Switzerland

- ◆ PLUS: Emergency rescue measures
 - ◆ Extra CB money restores trust
 - ◆ Free trade continues
 - ◆ Switzerland: "cheap" UBS rescue
- MINUS: Rescue creates new problems
 - Too much regulation?
 - Forced takeovers: even bigger to fail?
 - Out of recession in to inflation?

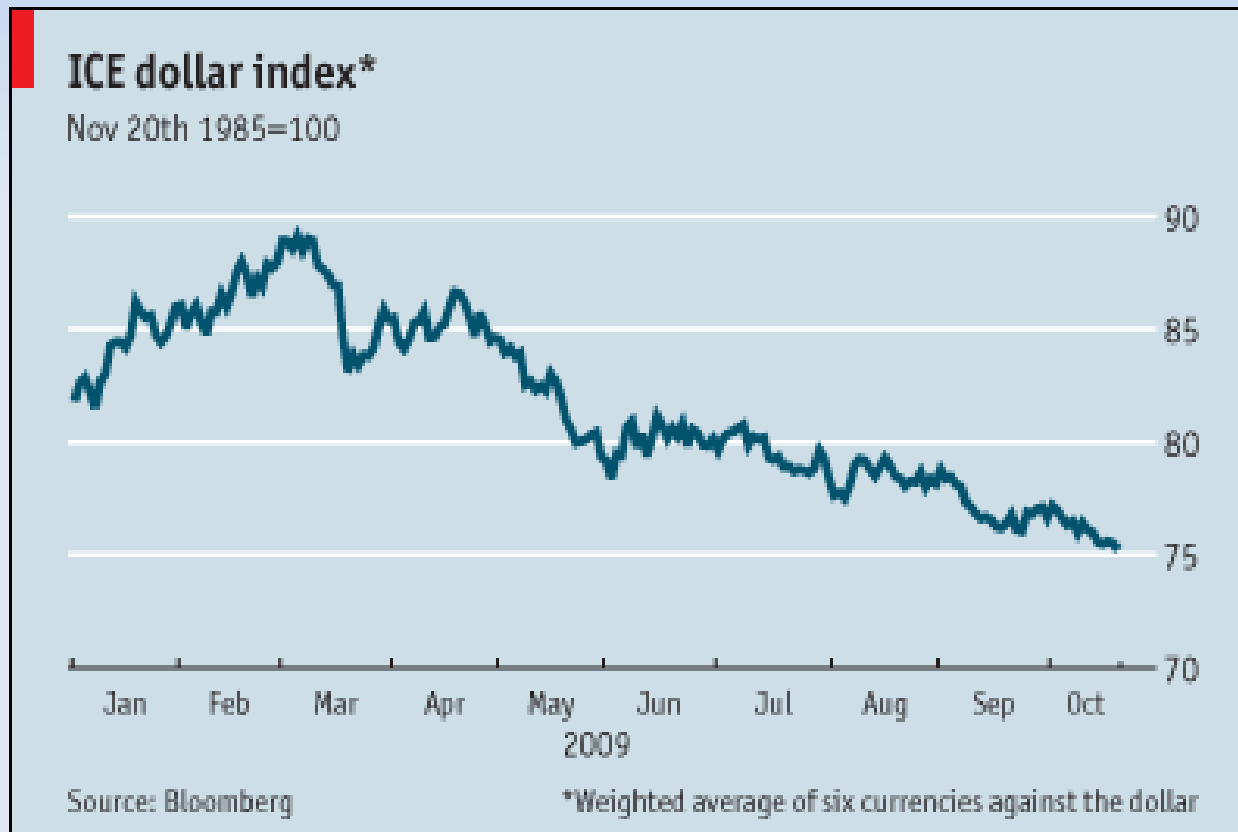
Solutions? Answers?

5. New front lines

- ◆ Consensus
 - ◆ Reduce US current account imbalances
 - ◆ Devaluation of US Dollar
 - ◆ New value chains: EU/J/China must consume
 - ◆ Get handle on tbtf
- Dissent
 - Industry and friends: hands off!
 - New paradigm needed in economics?

Solutions? Answers?

The decline of the US Dollar



Problems ahead

6. Problems (un)solved and problems created

- ◆ Window of opportunities closing soon
- ◆ "Quantitative easing"
 - More cheap money – more bubbles?
 - **Inflation** due to more money (**Simbabwe**), or
- Policy ineffective in medium run
 - Long lasting recession and **deflation (Japan)**