Ten Years After the Early Signs of the Financial Crisis: the State of the Economy and Economists

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November 21st, 2017
"Why did nobody notice it?" the Queen asked, surveying the size of the toxic debt that has led to the collapse of banks around the world. "If these things were so large, how come everyone missed them? It's awful." – from express.co.uk in November 2008
Letter from British Academy to Her Majesty The Queen – July 2009

“There were many warnings about imbalances in financial markets and in the global economy... but the difficulty was seeing the risk to the system as a whole rather than to any specific financial instrument or loan. Risk calculations were most often confined to slices of financial activity, using some of the best mathematical minds in our country and abroad. But they frequently lost sight of the bigger picture”
History of Financial Crises

1720: South Sea Bubble
1825: Latin American Crisis
1857: Railroad Crisis
1907: Knickerbocker Crisis
1973-4: Oil Crisis
1987: Black Monday
2001: Dotcom Crash

1792: Panic of 1792
1837: Cotton Crisis
1873: Long Depression
1929: Wall Street Crash
1982: Latin American debt crisis
1997: Asian Crisis
2008: Subprime Crisis
The origins of 2008 financial crisis: US financial assets as a proportion of GDP

Source: Carlos Braga, 2017

Minsky’s moment
Central Banks have a key role to play in mitigating crises

“During the Great Depression, the Federal Reserve not only failed to keep the money supply steady but also, by not acting as lender of last resort, allowed otherwise viable commercial banks to collapse, turning a financial storm into an economic catastrophe.”

-Anna Schwartz, co-author of A Monetary History of the United States (1963), together with Milton Friedman

“You’re right, we did it. We’re very sorry, but thanks to you, we won’t do it again.”

-Ben Bernanke, 2002.
U.S. policy response to the 2008 crisis
Fiscal stimulus; expansionary monetary policy; regulatory reform

Support Packages:
- Economic Stimulus Act of 2008
- Housing and Economic Recovery Act of 2008
- Emergency Economic Stabilization Act/Troubled Asset Relief Program (TARP)
- Dodd–Frank Wall Street Reform and Consumer Protection Act

The Federal Reserve Bank:
- Lowered the target for the Federal funds rate from 5.25% to 2%, and the discount rate from 5.75% to 2.25%. In Dec. 08, the Fed further lowered the fed funds rate target to a range of 0–0.25%.
- Undertook open market operations to ensure member banks remain liquid.
- Created a variety of lending facilities to enable the Fed to lend directly to banks and non-bank institutions, against specific types of collateral of varying credit quality.
- In Nov. 08, it announced a $600 billion program to purchase the MBS of the GSE to help lower mortgage rates.
- In Mar. 09, the Federal Open Market Committee (FOMC) increased the size of the Federal Reserve’s balance sheet by purchasing up to an additional $750 billion of government-sponsored enterprise MBS, and to increase its purchases of agency debt that year by up to $100 billion to a total of up to $200 billion. Moreover, to help improve conditions in private credit markets, the FOMC decided to purchase up to $300 billion of longer-term Treasury securities during 2009.
U.S Economic Indicators, 2007-present

U.S Inflation Rate

U.S Unemployment Rate

U.S Growth Rate
Shifts and changes in the global economy
Growth is picking up but is still lower than the pre-crisis average

Real GDP Growth, 2013-2018
(Percent, PPPGDP weighted averages)

Source: World Economic Outlook and Sean Nolan, 2017
Shifts and changes in the global economy
The rise of protectionist measures

Liberalizing and harmful measures as % of all trade measures, globally

Number of trade measures implemented each year
Liberalizing and harmful measures

Heat map of world protectionism

Source: Reuters, 2017
Shifts and changes in the global economy

The rise of protectionist measures

Source: Carlos Braga, 2017
Shifts and changes in the global economy

Growth of international trade is slowing

**Import Volume, Goods and Services, 2000-2016**

(Constant prices, Index 2000=100)
Shifts and changes in the global economy

Public debt burdens are rising

Public Debt burdens are rising, 2007-2017
(Percent of GDP, weighted averages)

Source: World Economic Outlook and Sean Nolan, 2017
Shifts and changes in the global economy

Inequality within countries is rising

Source: Sean Nolan, 2017 and World Bank, 2017
Shifts and changes in the global economy

Inequality within countries is rising

The share of US pre-tax income accruing to the bottom 50 percent and top one percent of income earners, 1962-2014

Source: Braga, 2017
Although inequality is rising within countries, it is declining across the global population.

Relative gain in real per capita income by global income level, 1988-2008

The largest negative effect is on the lower and middle classes in developed economies.
“Globalization and technology, both of which favor the most highly skilled individuals are not the only reasons for the top 1 percent’s increasing wealth; some people have pointed the figures at earning in the finance industry especially in the US and UK.”

Jean Tirole, 2017
Economics for Common Good
Is globalization retrenching?

Global Gross Financial Flows, 1990-2016 (percent of world GDP)

Depth of Globalization: Change vs 2005

Source: Braga, 2017

Trade and FDI depth through 2016

Source: Ghemawat, 2017
Shifts and changes in the global economy

Multipolarity

The world’s economic center of gravity, 1980-2016, in black, at three-year intervals

Evolution of the earth’s economic center of gravity: 1 CE to 2025

2,000 Years of Economic History in One Chart: All major powers compared by GDP from the year 1 AD

Source: Danny Quah, 2011

Source: Jeff Desjardins, 2017
Each industrial revolution shifts the manufacturing opportunities and patterns of specialization

Three “C”s determine the feasibility of success in export-led manufacturing:

- Competitiveness
- Capabilities
- Connectedness

“Digitization” is disrupting every part of financial services

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<th>Digitization Of:</th>
<th>Money</th>
<th>Cash Transfers</th>
<th>Identity</th>
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<th>Payments</th>
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<td>Convenience</td>
<td>Govt policy programs</td>
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<td>Need for transparency + efficiency</td>
<td>Ecommerce</td>
<td>Convenience of personal investments</td>
<td>Govt push for transparency + tax compliance</td>
<td>Falling interest rates &amp; invest income</td>
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<td>Govt action (e.g. India)</td>
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<td>Business &amp; leisure travel</td>
<td>Democratization of share ownership</td>
<td>Business need for efficiency &amp; risk assessment</td>
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<td>Transport</td>
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| Opportunities       | Account service providers; cash collection networks; regulatory advice to govt | Govt payment contractors (govts may unintentionally create largest payment banks) | Govt platforms for digital ID followed by innovative private-sector led applications | Digital lenders, marketplaces, originators, Scale SME Lending, Robo advice | Money transfer operators, cross border payment networks, FX operators | Back office operations, main exchanges (stock, currency, bonds, derivatives) | Back office operations, exchanges, value chain securitization | Direct insurance, online brokers & advisors, data and analytics, aggregators |

| Location | Global - populous countries first | Markets with cash transfer programs | Country specific and global (ID40 is global, regional, country specific) | Global - focus on large demographics | Global - main trade corridors | Financial market capitals (NY, London, Tokyo) | Regional & cross border | Global, regional and country specific |

| Impact | 1.5 Bn wallets in 6 years | Over 300m accounts | 1.5 Bn people without ID | $34 Bn in China alone | $3.6Trn value globally p.a. | $20Trn p.a. global flows | >$1Trn p.a. in LAC alone | >5 Trn GWP, >15 Trn AUM |

| Examples | Paytm, Fawry, m-Pesa, bKash, FINO | _NETI_ | AADHAAR | Kreditech, CompareAsia, Kabbage | bankFacil, comparoLH | Remitly | LMRKTS | _HellasDirect_, _eFactor_, _involNet_, _rolsin_, _lemonade_ |

Source: World Bank F&M Global practice, October 2017
Technology enabled innovation in financial services - FinTech

**FinTech:** Technology enabled innovation in financial services that could result in new business models, processes or products with an associated material effect on the provision of financial services.

*Source: FSB, Financial Stability Implications of FinTech, July 2017*
Meanwhile...
An Opportunity for Transformation
Addressing Global Megatrends and Challenges

- Economic diversification; 600 million new jobs (SDG#8)
- Sustainable Health & welfare system (SDG#3)
- Urban management (SDG#11)
- Private expertise/funding for infrastructure/urban services (SDG#11; SDG#9; SDG#17)
- Shift from fossil fuels to renewables/efficiency (SDG#7)
- Agriculture adaptation (SDG#2)
- Shocks and risks preparedness (SDG#13)
- Protecting vulnerable from fragility & violence (SDG#1; SDG#16)
- New sources of growth and trade, especially for commodity exporters (SDG#9)
Rodrik’s twenty commandments for economists and non-economists:

1. Economics is a collection of models; cherish their diversity.

2. It’s a model, not the model.

3. Make your model simple enough to isolate specific causes & how they work, but not simple that it leaves out key interactions among cause.

4. Unrealistic assumptions are OK; unrealistic critical assumptions are not OK.

5. The world is (almost) always second best.

6. To map a model to the real world you need explicit empirical diagnostics, which is more craft then science.

7. Do not confuse agreement among economists for certainty about how the world works.

8. It’s OK to say “I don’t know” when asked about the economy or policy.

9. Efficiency is not everything.

10. Substituting your values for the public’s is an abuse of your expertise.
Rodrik’s twenty commandments for economists & non-economists (cont’d)

1. Economics is a collection of models with no predetermined conclusions; reject any arguments otherwise.

2. Do not criticize an economist’s model because of its assumptions; ask how the results would change if certain problematic assumptions were more realistic.

3. Analysis requires simplicity; beware of incoherence that passes itself off as complexity.

4. Do not let math scare you; economists use math not because they are smart, but because they are not smart enough.

5. When an economist makes a recommendation, ask what makes him/her sure the underlying model applies to the case at hand.

6. When an economist uses the term ‘economic welfare’, ask what he/she means.

7. Beware that an economist may speak differently in public than in the seminar room.

8. Economists don’t (all) worship markets, but they know better how they work than you do.

9. If you think all economists think alike, attend one of their seminars.

10. If you think economists are especially rude to non-economists, attend one of their seminars.
1944
H.D. White and J.M. Keynes

Bretton Woods and establishment of the World Bank and IMF

1952
W. Vickry (Columbia University)

Congestion pricing for the new New York subway

1997
S. Levy

Conditional Cash Transfers (Progessa/Oppotunidades)

Source: Rodrik, 2016
The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist.

(John Maynard Keynes)
Thank You

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