

A satellite image of the Earth showing the North Pacific Ocean and the northern part of North America. The ocean is a deep blue, and the land is a mix of green and brown. The title 'Aspects of the financial crisis' is overlaid in yellow text.

Aspects of the financial crisis

*Prepared for HIPA
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Data SIO, NOAA, U.S. Navy, NGA, GEBCO
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Image © 2009 TerraMetrics

44°40'46.39" N 136°52'57.55" W elev -13737 ft

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Eye



Key aspects of the current downturn

- Roots in housing / residential investment cycle (typical)
- Greater “synchronicity” between Hawaii, U.S. (atypical)
- Synchronized housing downturn undermines diversification
- Spatial performance variation swamped by correlated default
- Hawaii better off, but synchronous cycle is a problem

Policy implications:

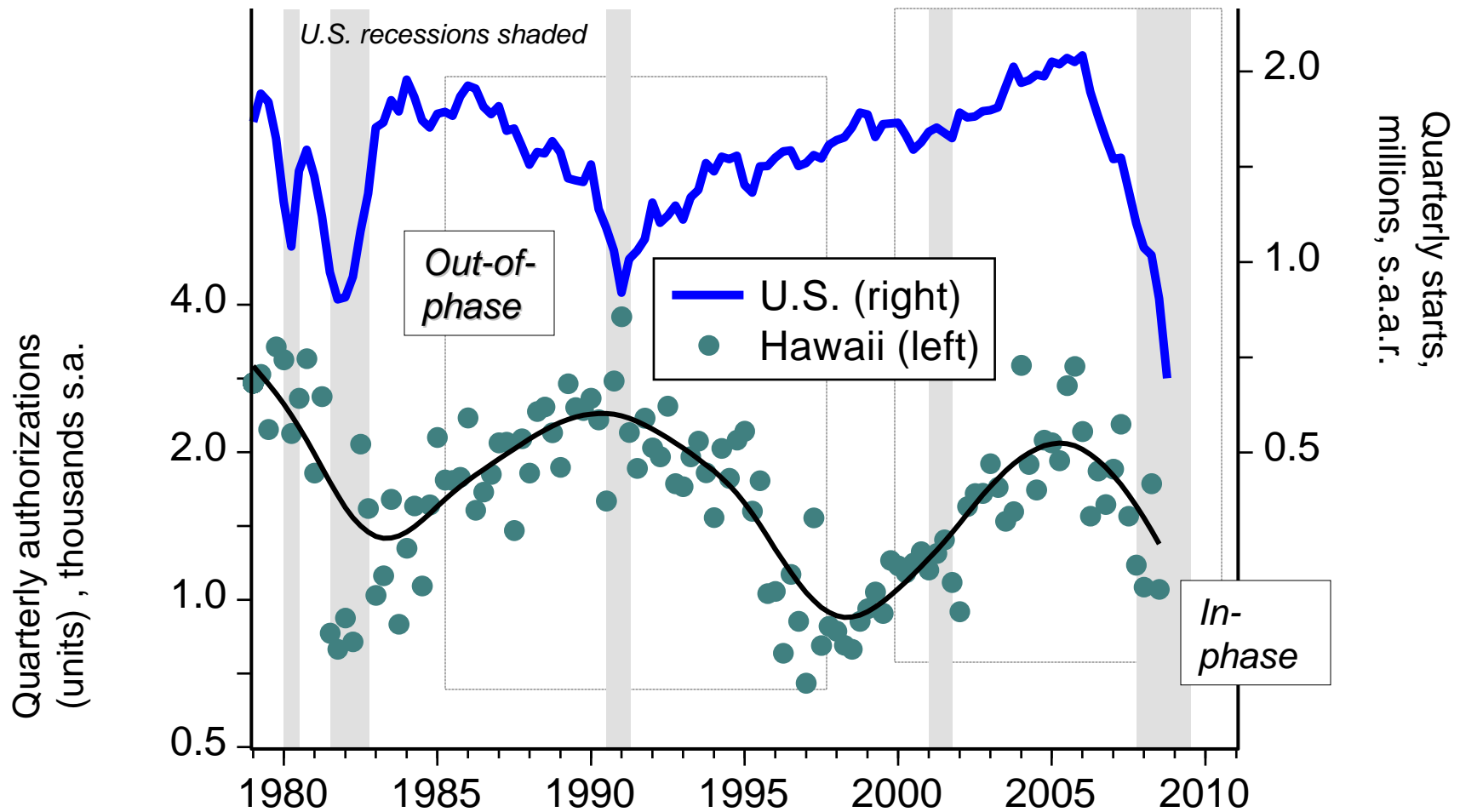
1. No time to wait before “lagged effects” arrive in islands
2. Speed of policy response takes precedence over polish
3. Regulation must be revised, revisited because of innovation

See Carmen Reinhart and Kenneth Rogoff (http://www.economics.harvard.edu/files/faculty/51_Aftermath.pdf and http://www.economics.harvard.edu/faculty/rogoff/files/ls_The_US_Subprime_Crisis_So_Different.pdf, as well as slideshow at <http://nabe.com/pc09/documents/Reinhart.pdf>).

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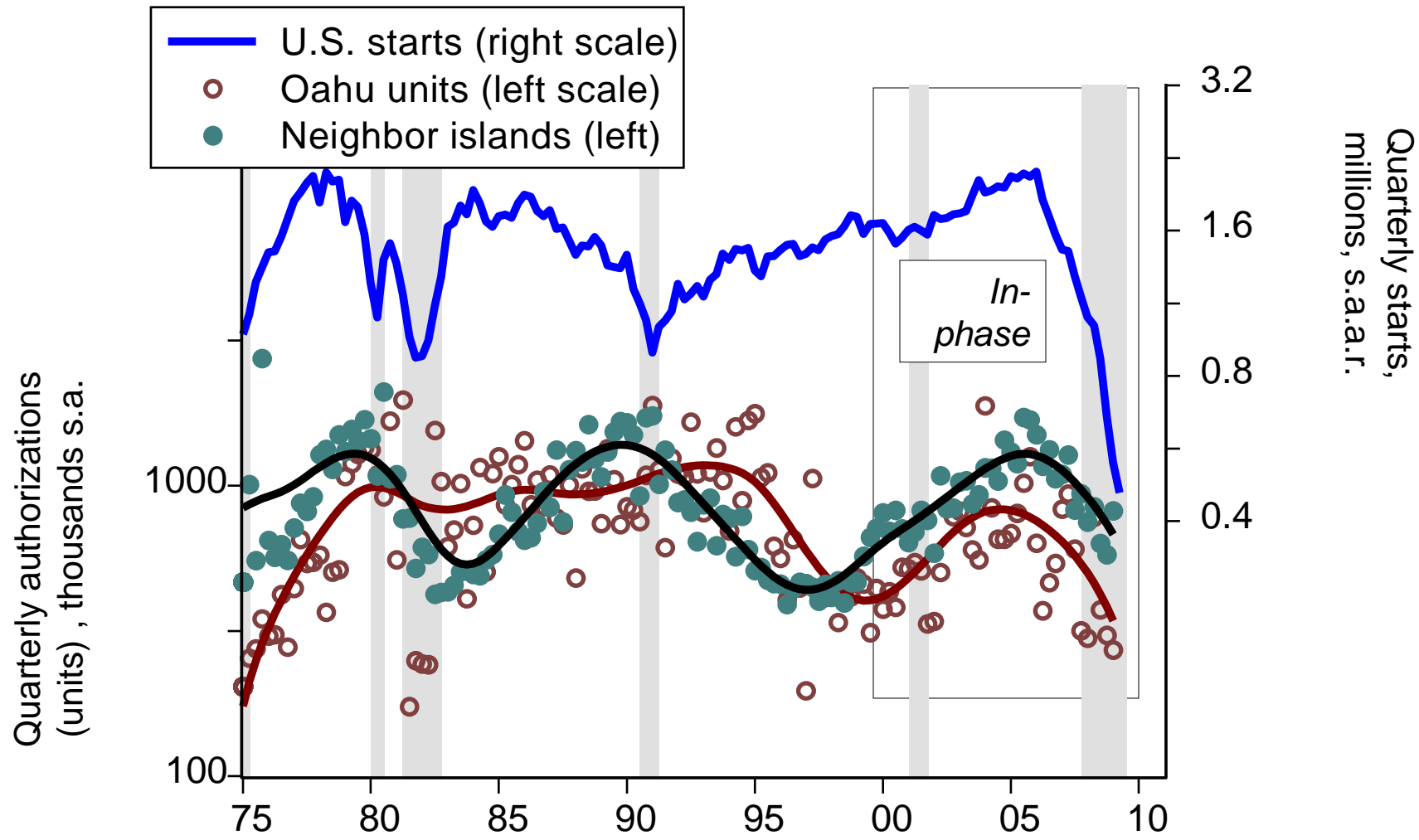
New home construction



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Sources: Federal Reserve Bank of St. Louis, Bank of Hawaii, Hawaii DBEDT; calculations by author

Even Neighbor Islands are in-synch

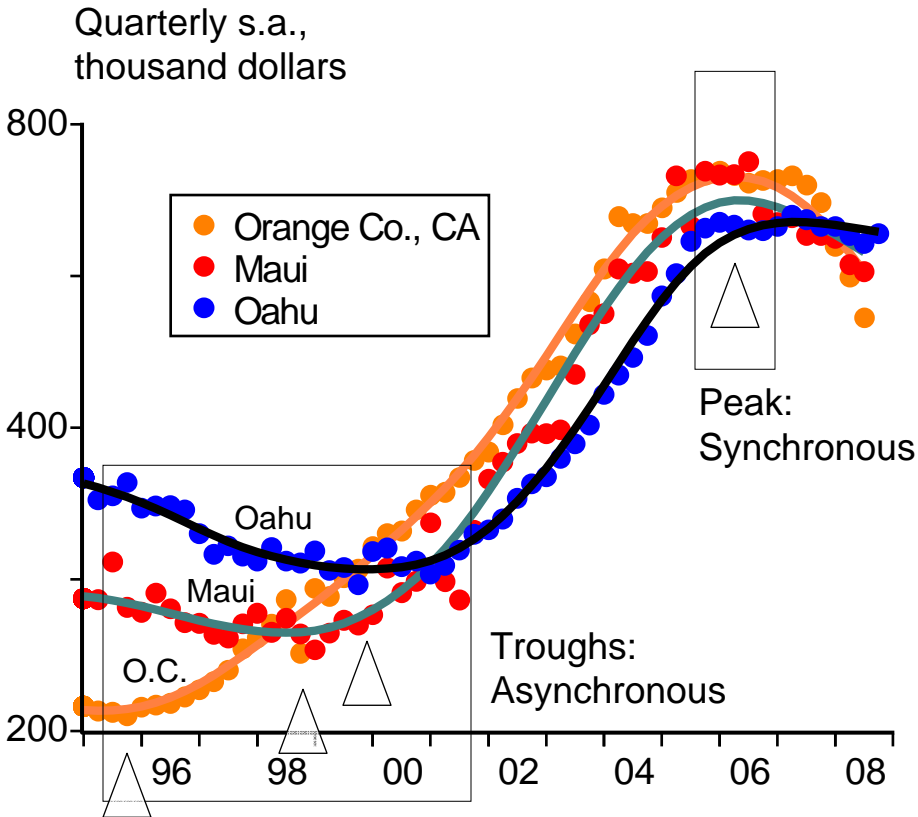


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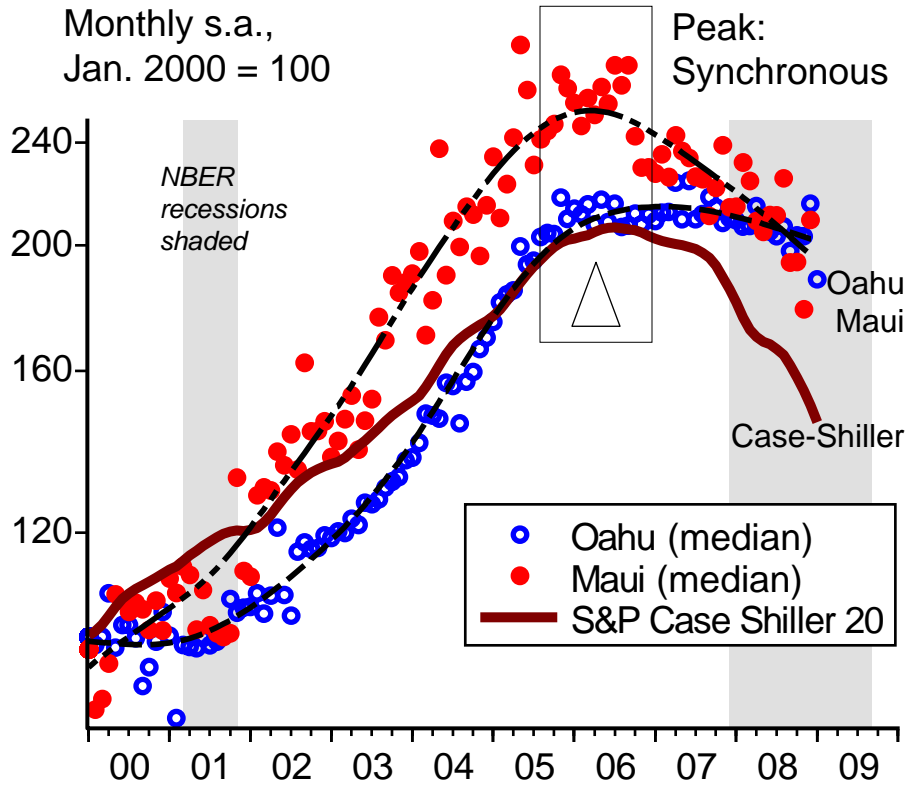
Sources: Federal Reserve Bank of St. Louis, Bank of Hawaii, Hawaii DBEDT; calculations by author



Asset-pricing synchronicity



Median existing SF home sales prices



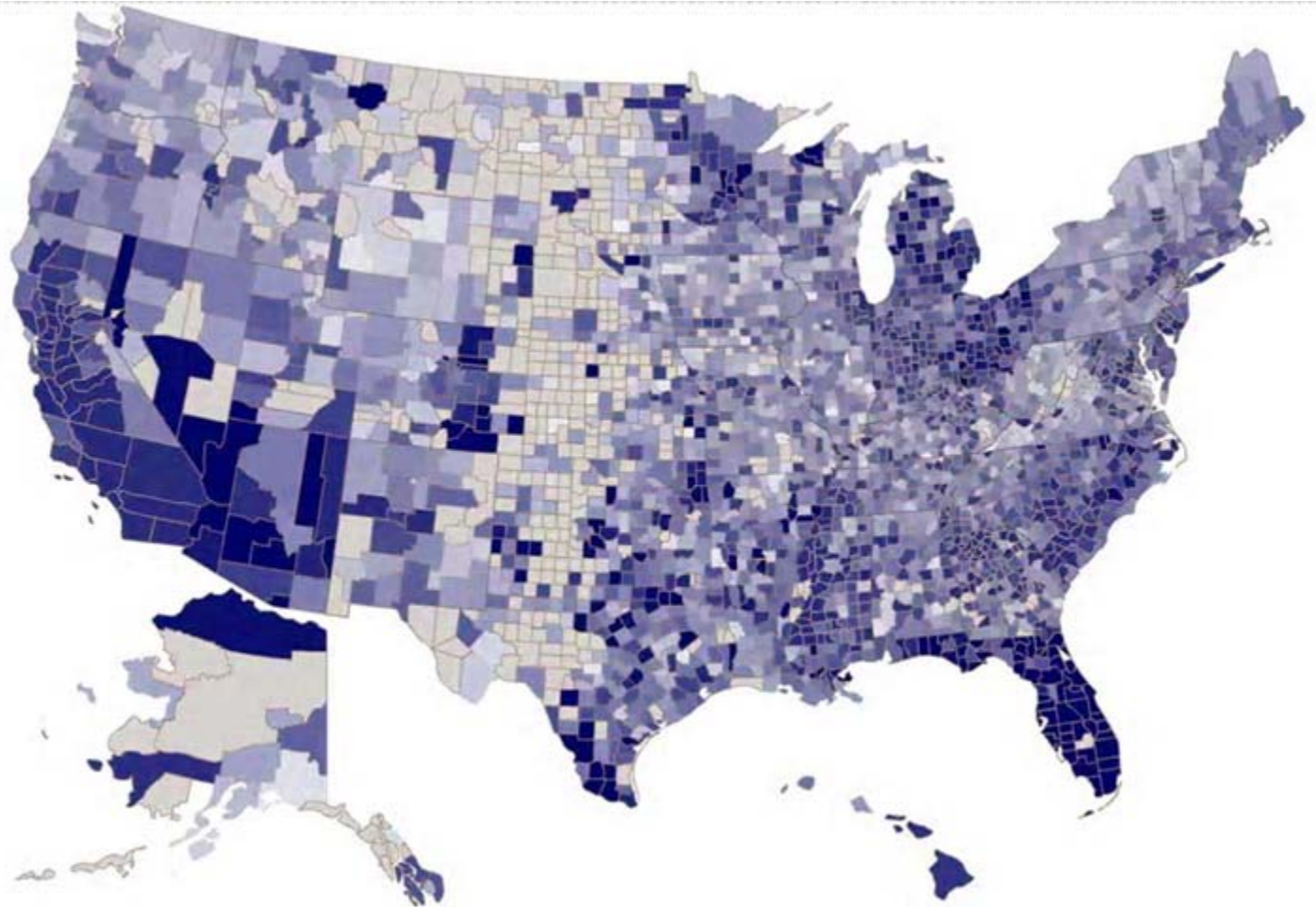
Index numbers (not strictly comparable)

Serious mortgage delinquency (90+ days past due)

Selected Counties:
(percent of loans)

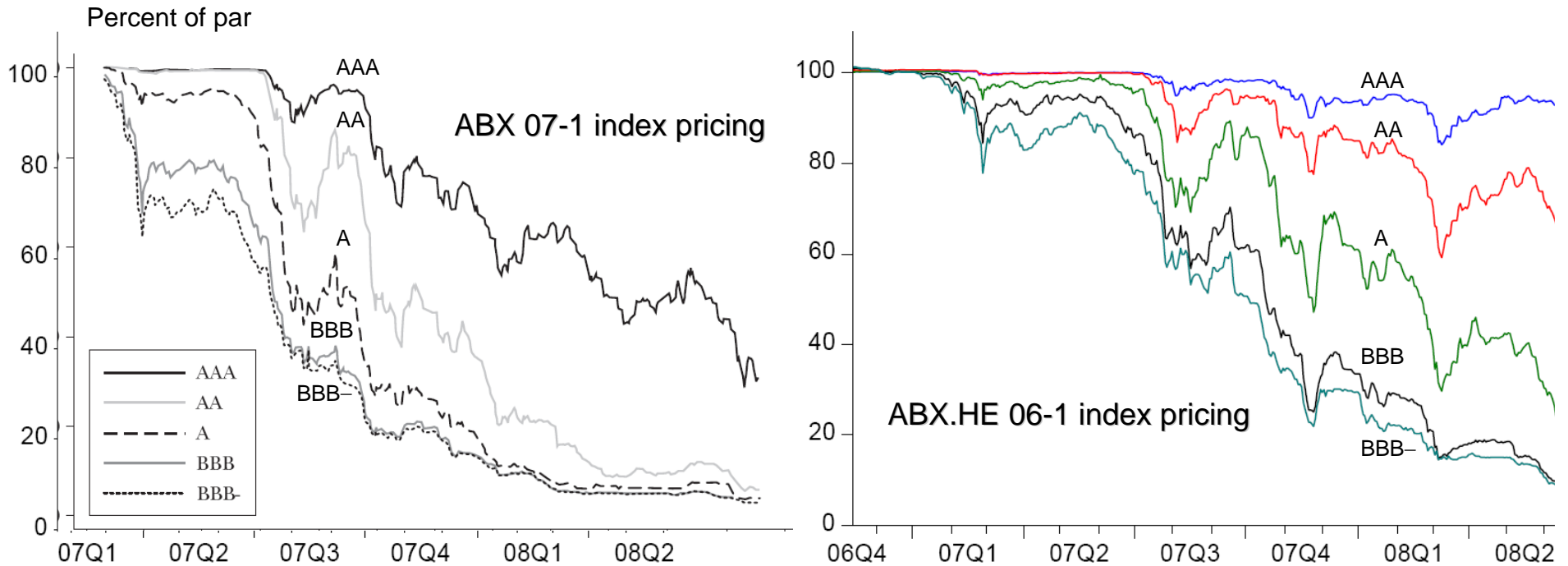
Dade, FL	12.26
Merced, CA	10.57
Clark, NV	8.24
Maui, HI	3.15
Hawaii, HI	3.08
Honolulu, HI	1.64

Resilient Oahu home prices reflect underlying economic fundamentals, not imminent collapse



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Sub-prime mortgage-related risk pricing



Based on baskets of 20 CDS-referencing asset-backed securities containing sub-prime mortgages and home equity loans of different ratings; after initiation, fee (spread) that buyer pays is $(100 - \text{ABX price})$, plus, the upfront fee that previous sellers pay rises if ABX falls

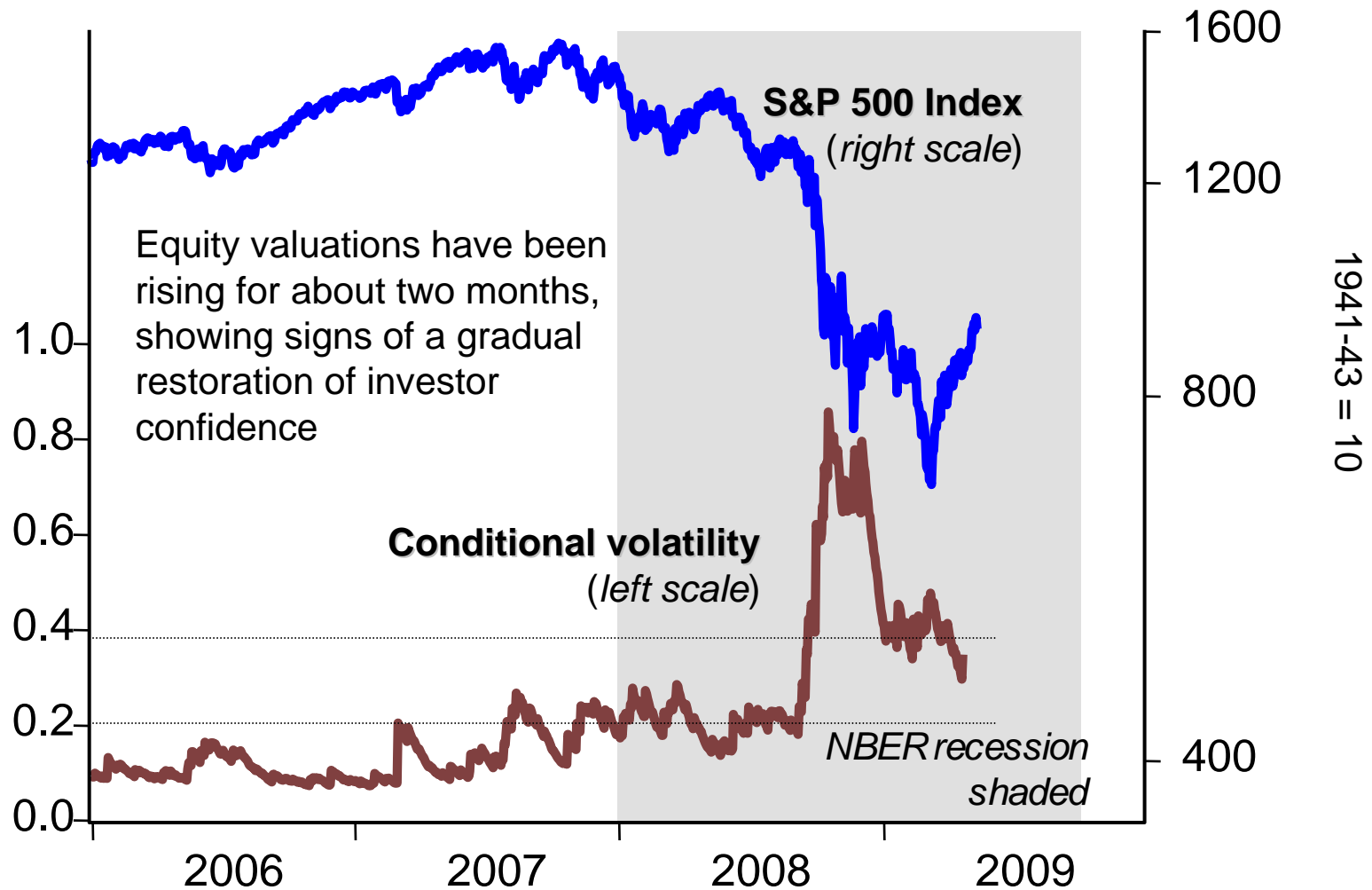
Sources: Graph on left based on data from Markit, via Lehman Live, as published in Markus Brunnermeier, "Deciphering the Liquidity and Credit Crunch 2007-2008," *Journal of Economic Perspectives*, Vol. 23 No. 1 (Winter 2009) pages 77-100; graph on right is Chart 3. in Ingo Fender and Martin Scheicher, "The pricing of subprime mortgage risk in good times and bad: evidence from the ABX.HE indices," *Bank for International Settlements Working Papers No. 279* (March 2009), page 38.

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Note: Time (horizontal) scales are slightly different, as in originals



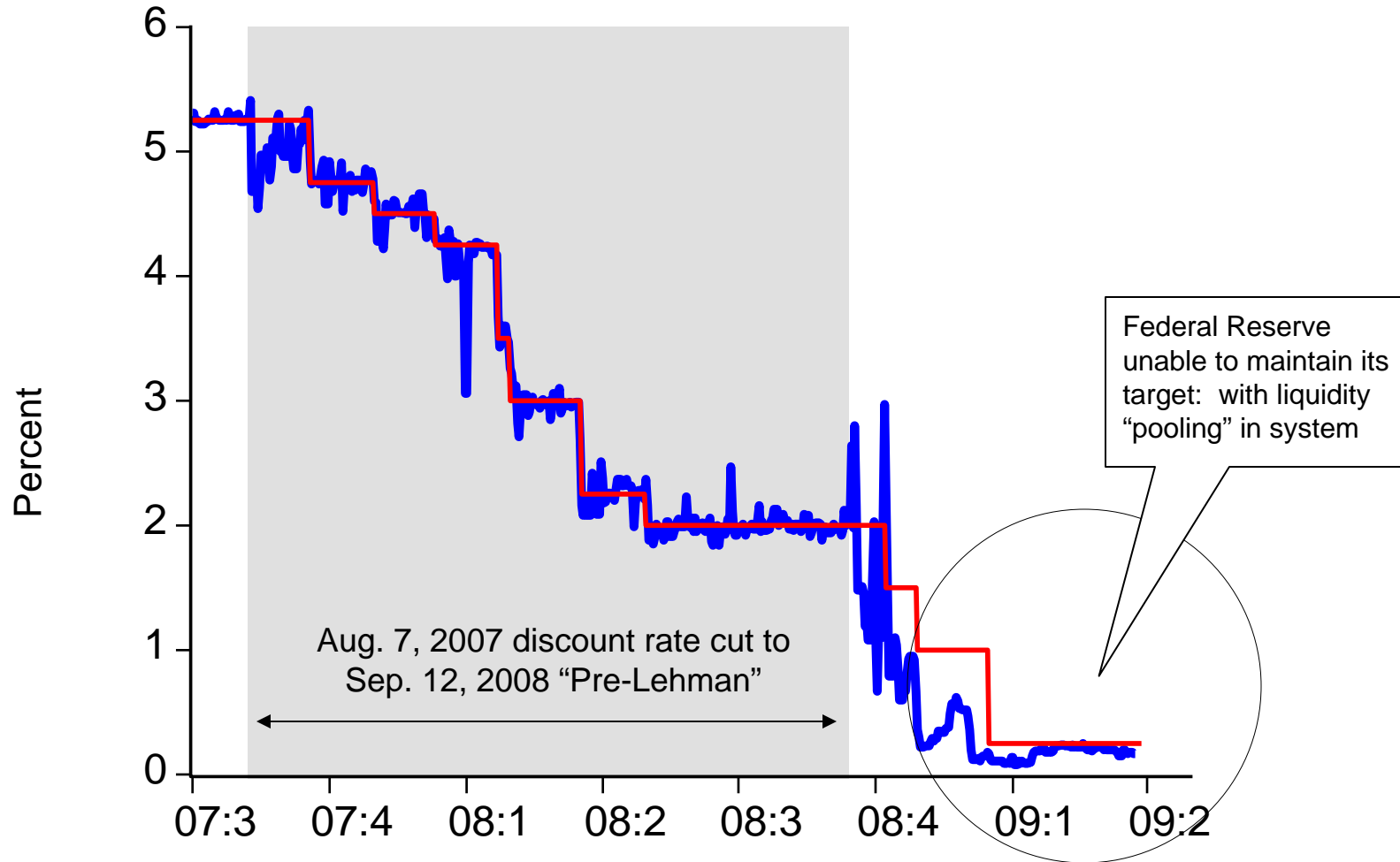
Equity valuations may have found a bottom



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Source: Standard & Poor's; Threshold ARCH standard deviations calculated by TZ Economics through May 11, 2009

Monetary policy out of ammo?



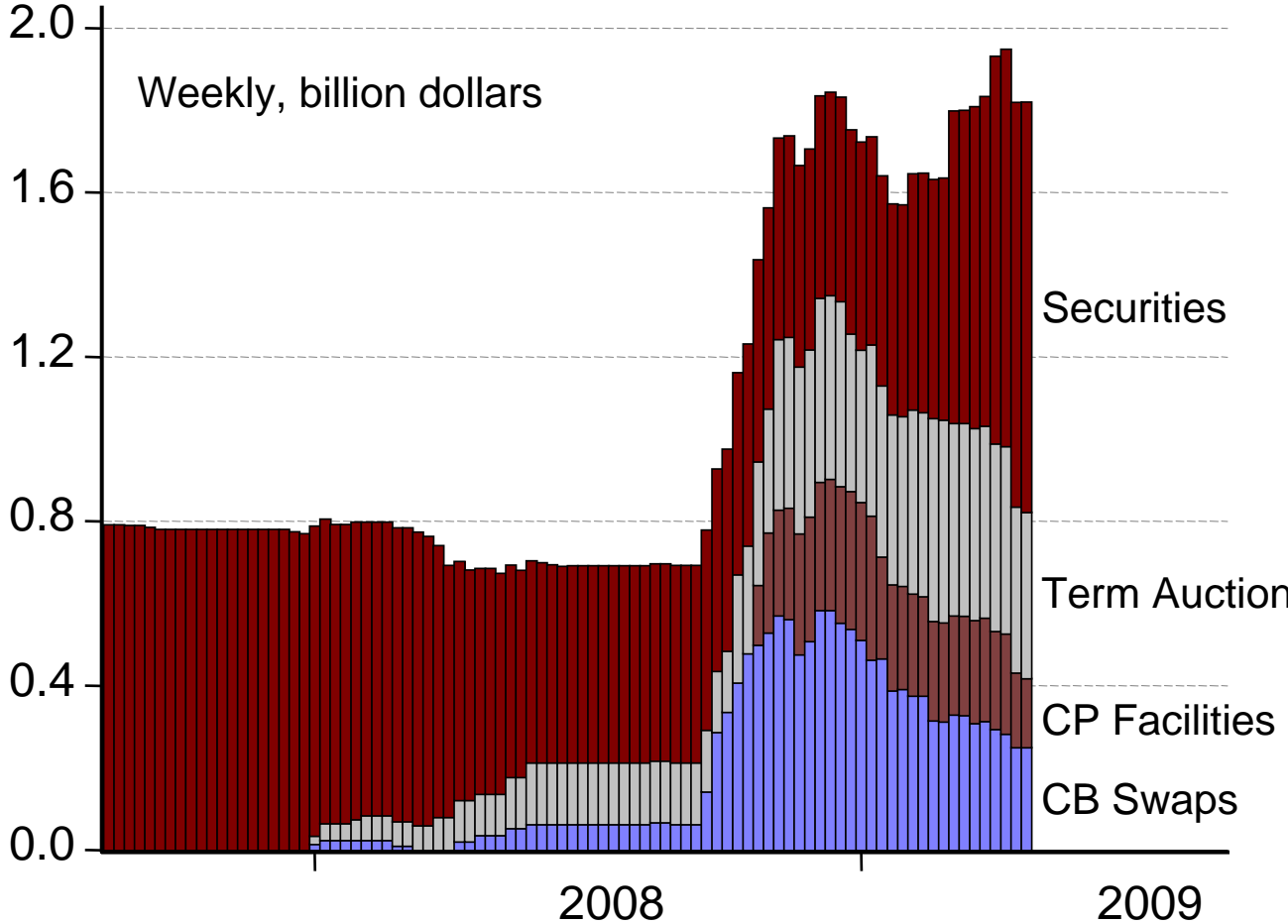
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Sources: Federal Reserve Board; calculations by author



Federal Reserve assets through April

The growth of Fed assets slowed somewhat during the last two weeks while the composition shifted towards securities as balances in other extraordinary facilities subsided



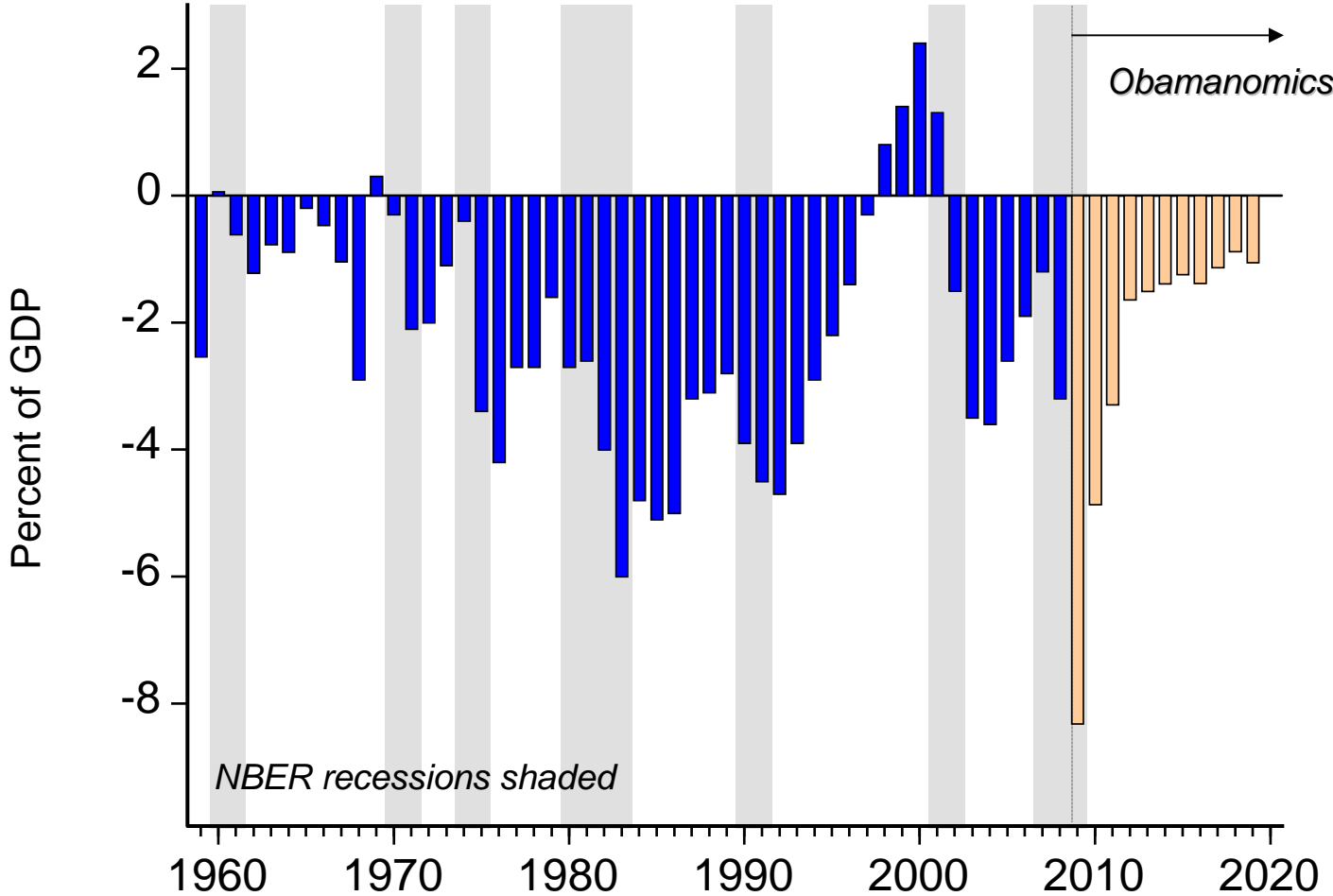


Financial services themes and reforms

- A way to think about the situation:
 - Multiple equilibria—good and bad
 - Change the “rules of the game” so good one is basis for pricing risk
 - Regulatory reform
- Six reform ideas (Calomiris)
 - Smarter “micro prudential” regulation of banks
 - “Macro prudential” regulation of bank capital and liquidity standards
 - Prepackaged “bridge bank” plans for large, complex financials
 - Eliminate distortions in housing finance encouraging leveraging
 - Improve stockholder discipline of banks
 - Greater transparency in derivatives transactions to promote improvements in counterparty risk management and OTC transparency



U.S. federal budget deficit / GDP





Christina Romer (CEA view)

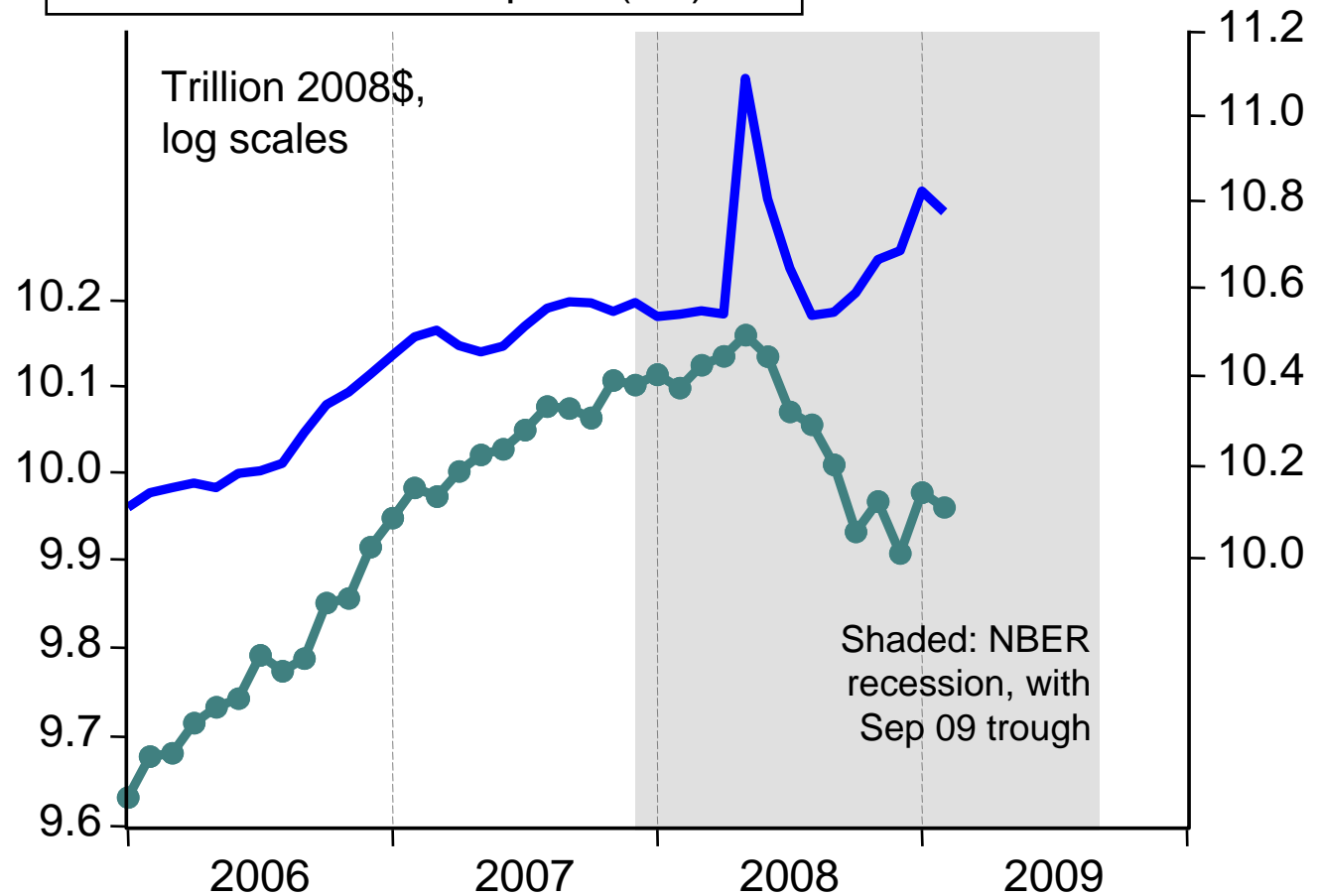
- American Recovery and Reinvestment Act
 - “Biggest, boldest countercyclical fiscal stimulus in American history”
 - Twice the size of the New Deal (1934); 3% vs. 1½% of GDP
 - ¾ of stimulus spend out in 18 months (CBO)
 - Textbook stimulus—tax cuts (95% of families), direct aid via standard channels, support to states, infrastructure, energy, education (+AMT)
- Fiscal policy multipliers—substantial uncertainty
 - Rampant omitted variable bias (Romer²); (use big macro models)
 - Tax cut multiplier ≈ 1.0 ; spending multiplier ≈ 1.6
 - “Estimates almost surely more likely to [be] biased downward”
- Differences “this time”
 - Liquidity constraints gives fiscal stimulus “more oomph”
 - Inherited deficit, unsustainable long-run fiscal trajectory place great burden on credibility of commitment to long-run fiscal solutions
 - Need to address loss of confidence

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Consumers retrenched

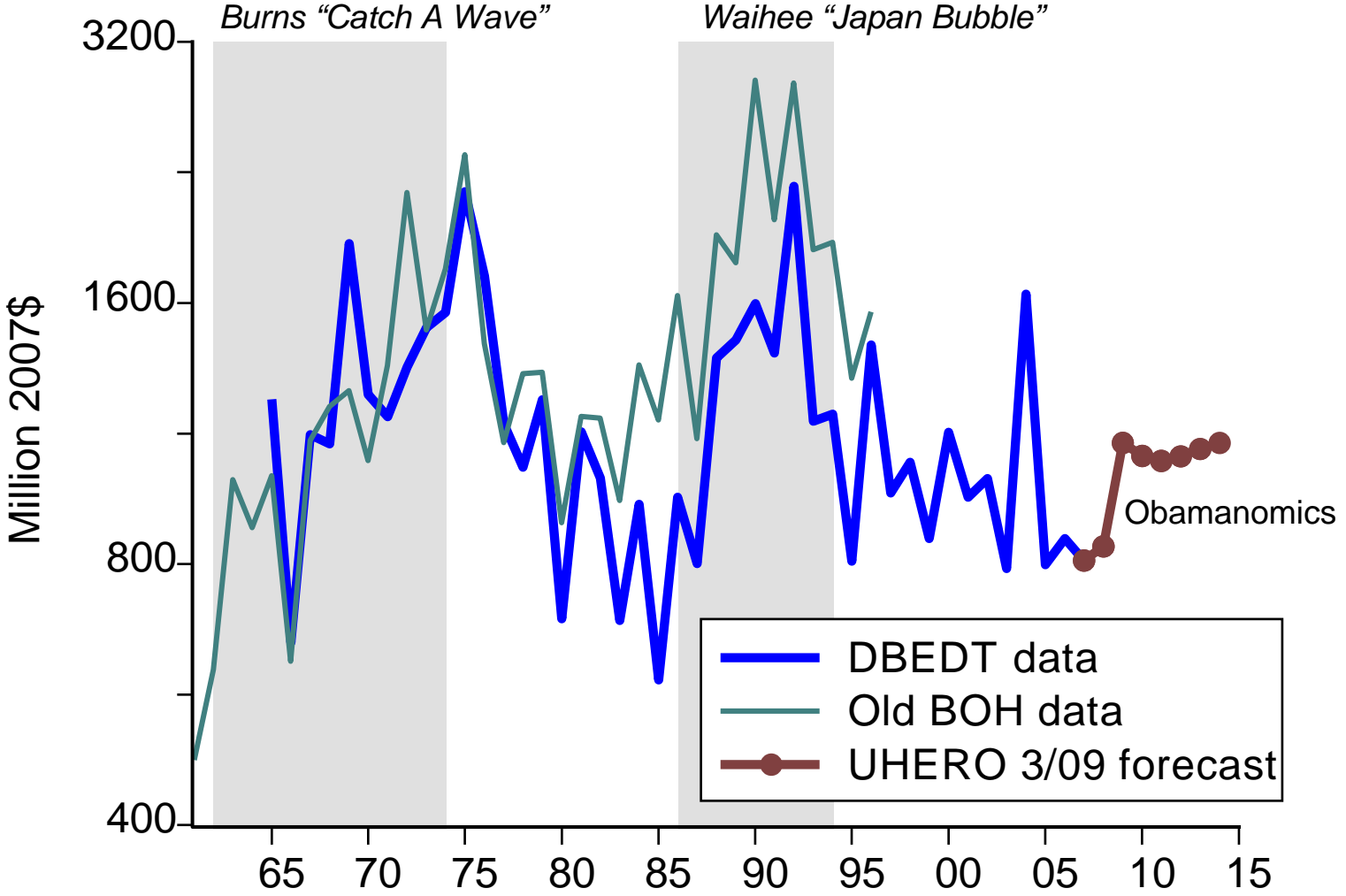
— Disposable income (right scale)
—● Personal consumption (left)

The NBER cyclical peak in December 2007 came two quarters before consumption and real GDP began declining, but the consumption recession dragged the broader economy downward with it, exacerbated later in the year by falling exports (global consumption).



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Public investment “stimulus”



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Sources: Hawaii DBEDT, UHERO; TZ Economics



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