



CENTRAL  
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AMERICA'S  
ECONOMY™

# Financial Market Turmoil and Recession: What's Next?

**James Bullard**

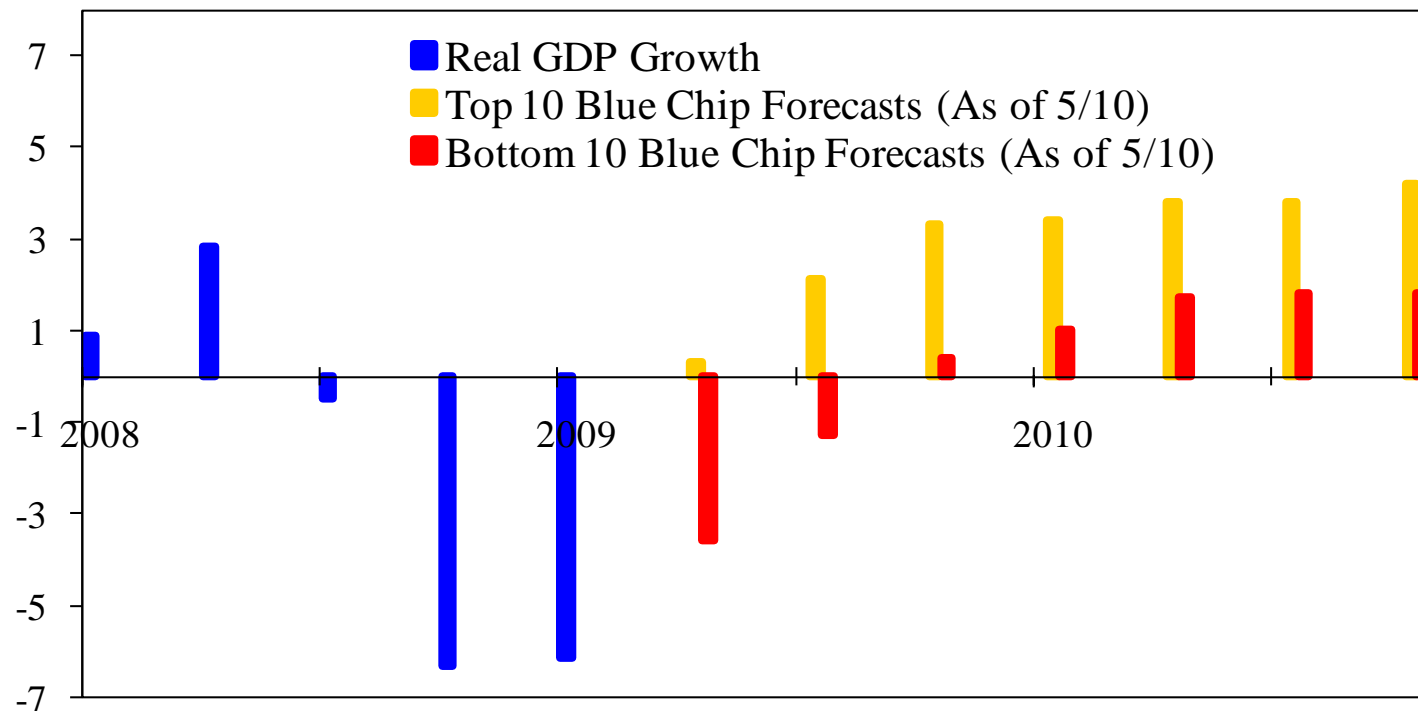
*President and CEO*

May 12, 2009

Indiana University

# Measuring Uncertainty: Real GDP Growth

Percent



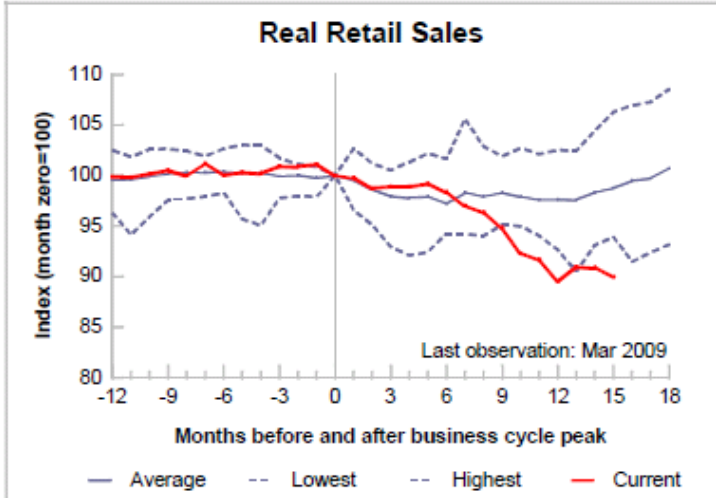
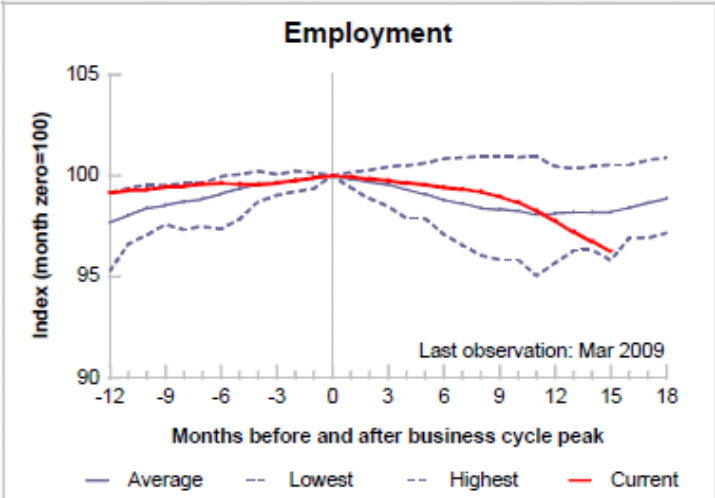
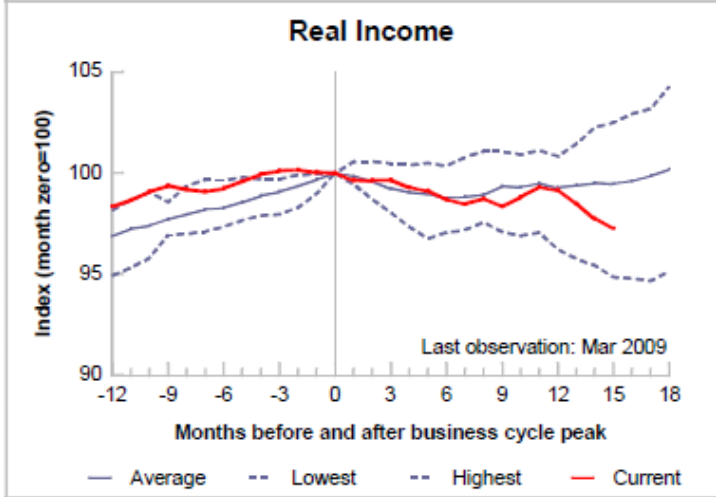
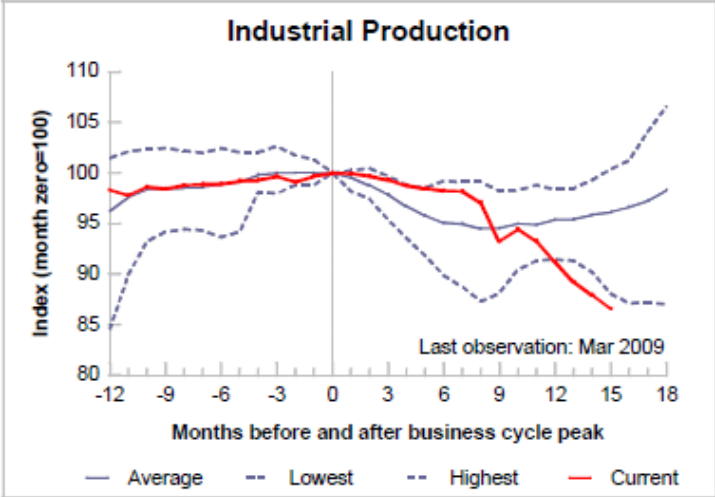
# Growth Rate in Real GDP, SAAR, Percent

2008:Q4, 2009:Q1



Source: Barclays Capital Global Economic Weekly.

# Tracking the Global Recession: United States



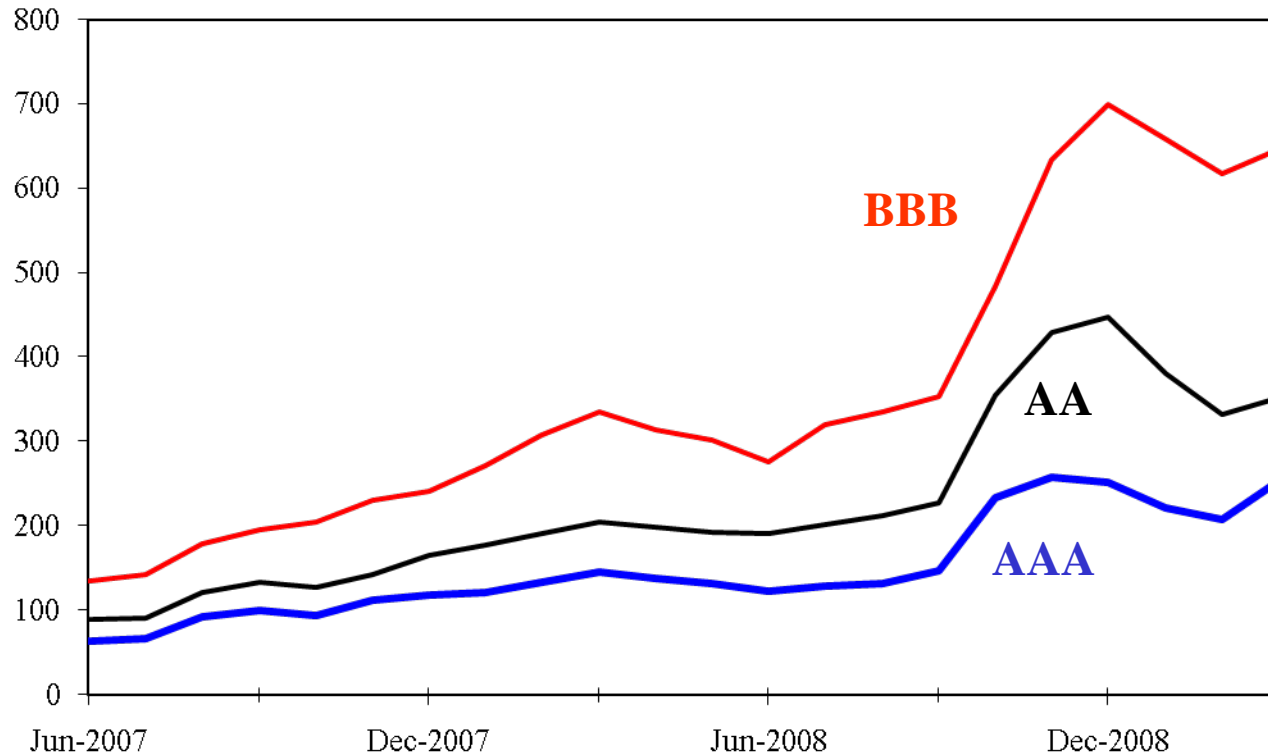
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# *Measures of Financial Market Stress*

# Debt Pricing: Bond Spreads to 10-Yr Treasury

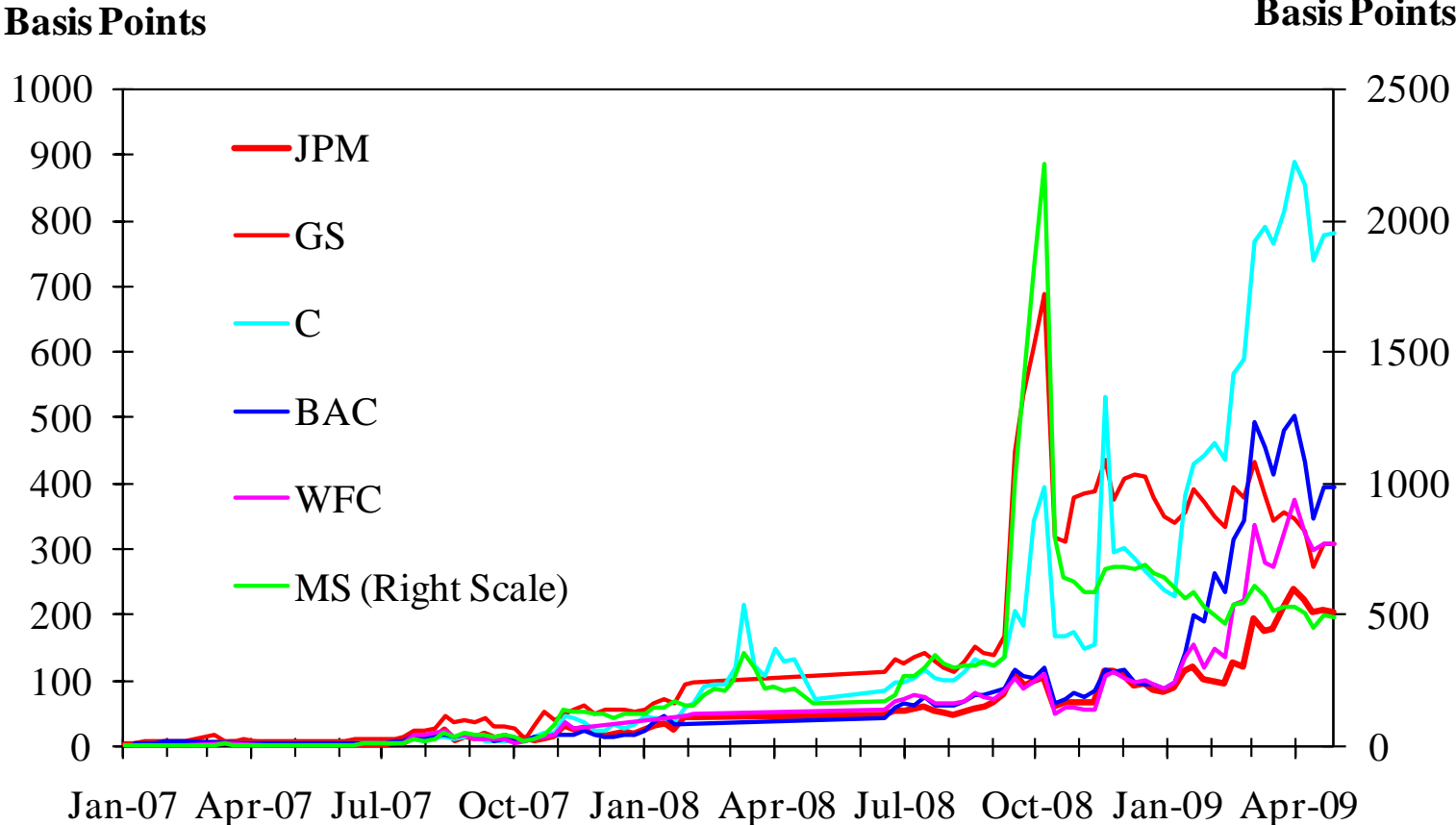
(Monthly data. Last Observation: April 2009)

Basis Points



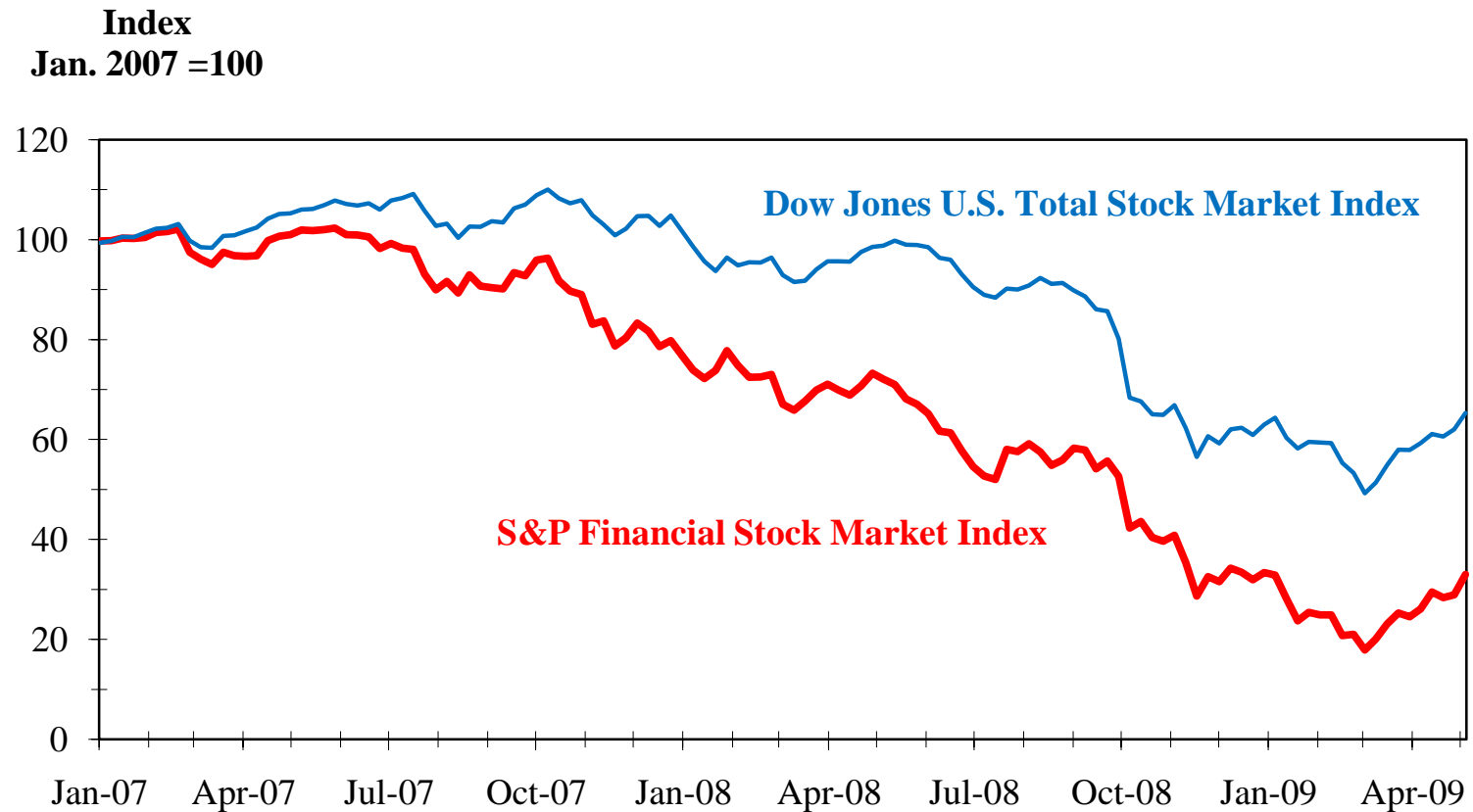
# Cost of Credit Protection

(Weekly Data. Last Observation: May 5, 2009)



# Stock Market Indexes

(Weekly Data. Last Observation: May 8, 2009)





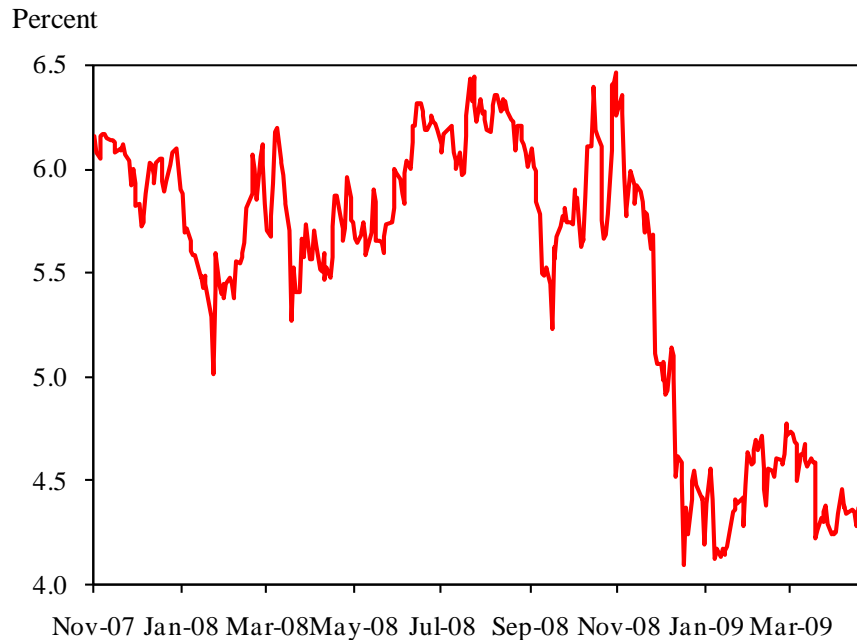
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# *Housing Markets*

# Mortgage Market

## Mortgage Rates: Fannie Mae Commitment Rates 30-Yr Fixed.

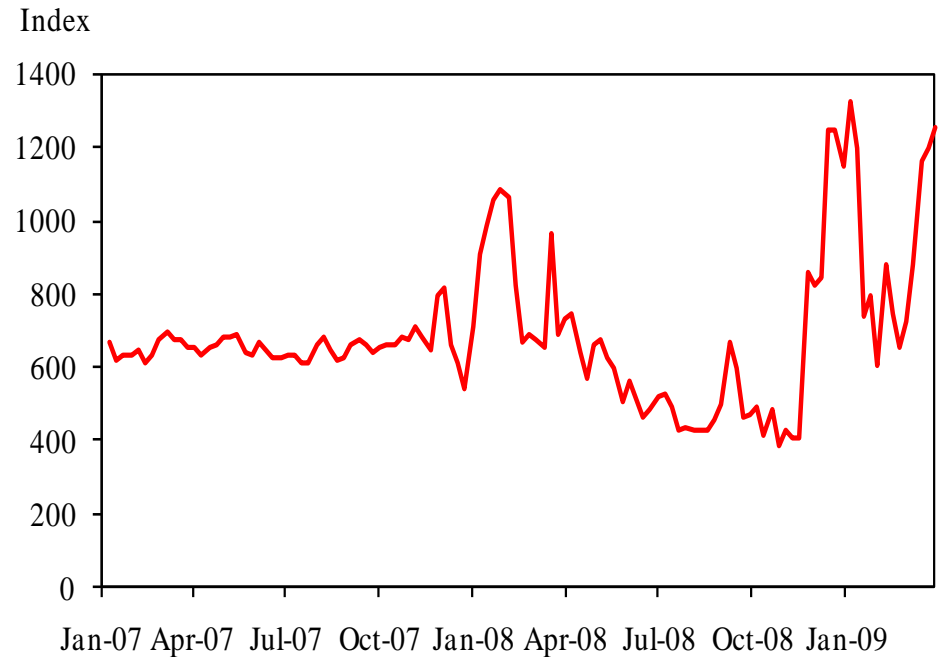
(11/2/2007 – 5/5/2009)



## MBA Mortgage Applications Index.

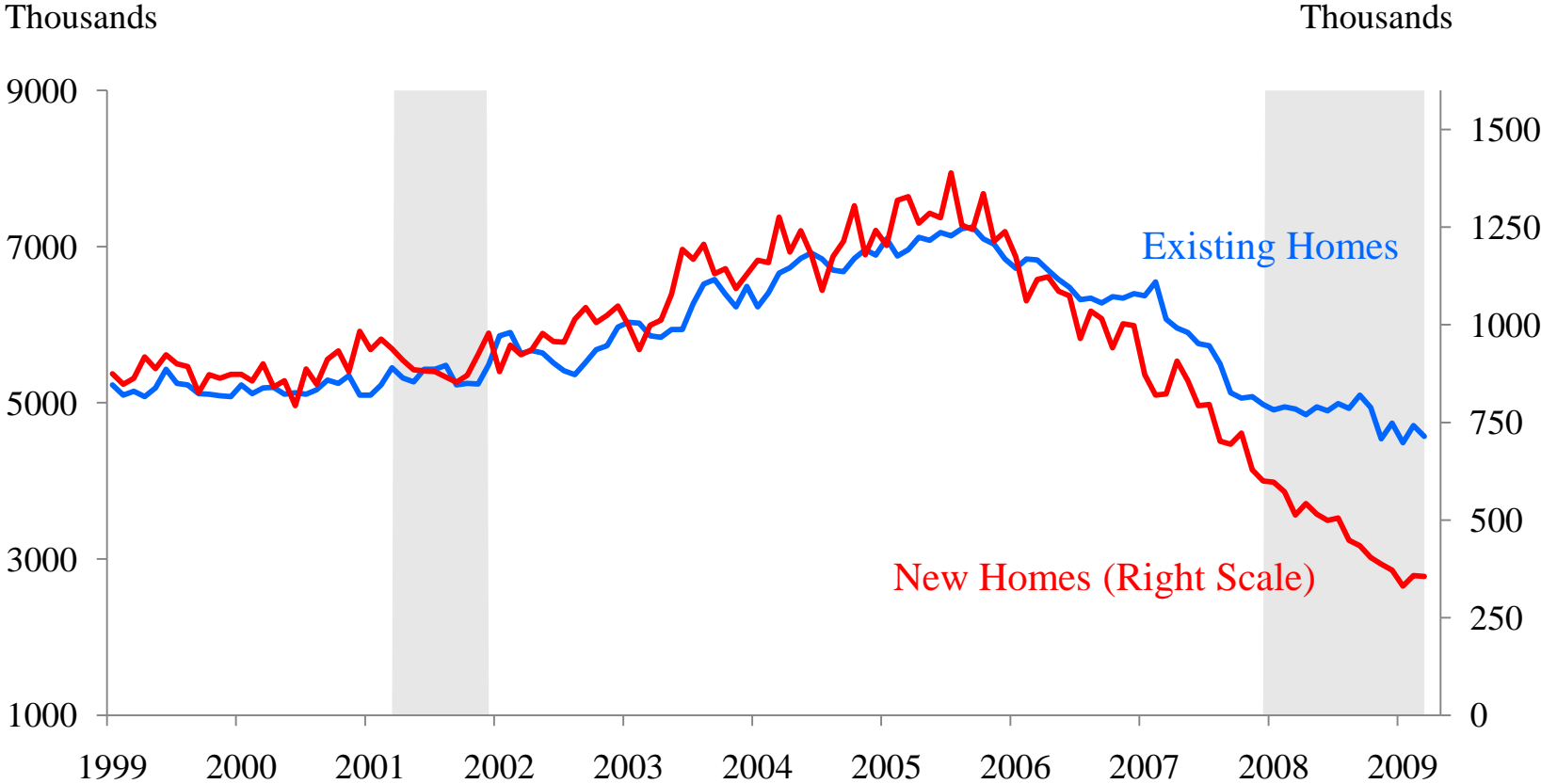
3/16/1990 = 100

(1/5/2007 – 5/5/2009)



# New and Existing Home Sales

(Monthly Data. Last Observation: March, 2009)



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# *Regulatory Reform*

# The Clamor For Regulatory Reform

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- Historically, important crises have resulted in regulatory reform.
  - The Panic of 1907 led to the founding of the Federal Reserve.
  - The Depression led to the enactment of Glass-Steagall in 1933, creating the FDIC, and separating commercial from investment banking.
  - The Thrift Crisis in the late 1980s led to the enactment of FDICIA and “prompt corrective action.”
  - The collapse of Enron and Worldcom led to the enactment of Sarbanes-Oxley.

# Portions of the Regulatory System Work Well

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- Bank regulation outside the largest financial institutions has worked well during the crisis.
- We do not see the small bank panic that characterized the Depression, even though this is a big crisis.
- The system of deposit insurance, prudential regulation, and a credible resolution regime solves that problem.

# Less Successful Regulation

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- The key problem areas in this crisis have been with large banks and large non-bank financial firms.
- These are often global enterprises.
- As a result, it has been difficult to discern how these firms were coping with the crisis.
- In addition, the resolution regime is unclear.
- These firms are often considered “too big to fail” because of the market disruption that might be caused.
- The correct phrase is “too big to fail ... quickly.”

# The Fed's Role in Regulation

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- The Fed is the nation's lender of last resort.
- If the Fed may be lending to institutions, it will need to have a role in regulating those institutions.
- The Fed also runs the monetary policy of the nation.
- To perform this function effectively, the Fed needs to know the condition of the financial system.



# The Fed and Systemic Risk

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- Three important systemic calls by the Fed:
  - William Poole on GSEs.\*
  - Gary Stern on “Too Big to Fail.”\*\*
  - Ned Gramlich on subprime.\*\*\*

\* William Poole, “Financial Stability,” 2002; “Housing in the Macroeconomy,” 2003; and “Reputation and the Non-Prime Mortgage Market,” 2007.

\*\* Gary H. Stern, Ron J. Feldman, Too Big To Fail: The Hazards of Bank Bailouts, Brookings Institution Press, 2004.

\*\*\* Edward M. Gramlich, Subprime Mortgages: America’s Latest Boom and Bust, Urban Institute Press, 2007.

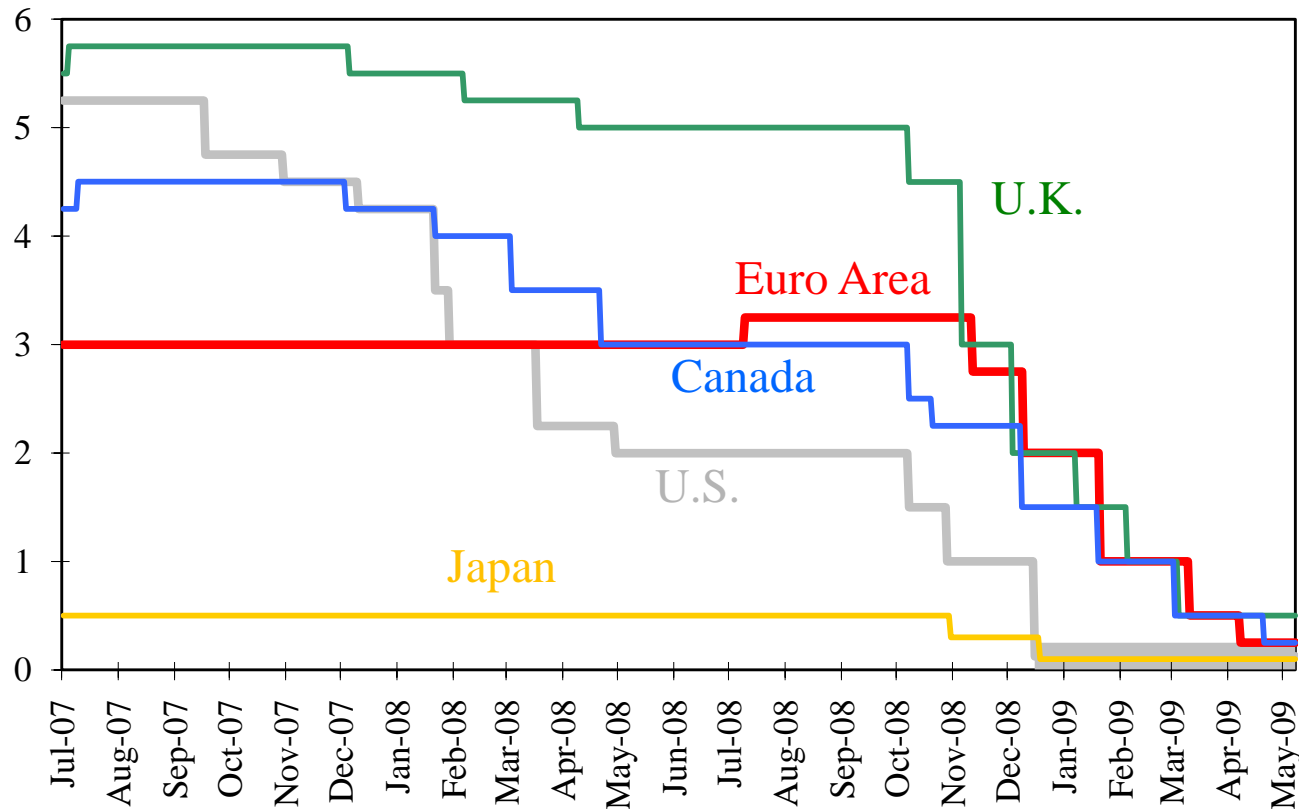
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# *Inflation Risks*

# World Policy Rates

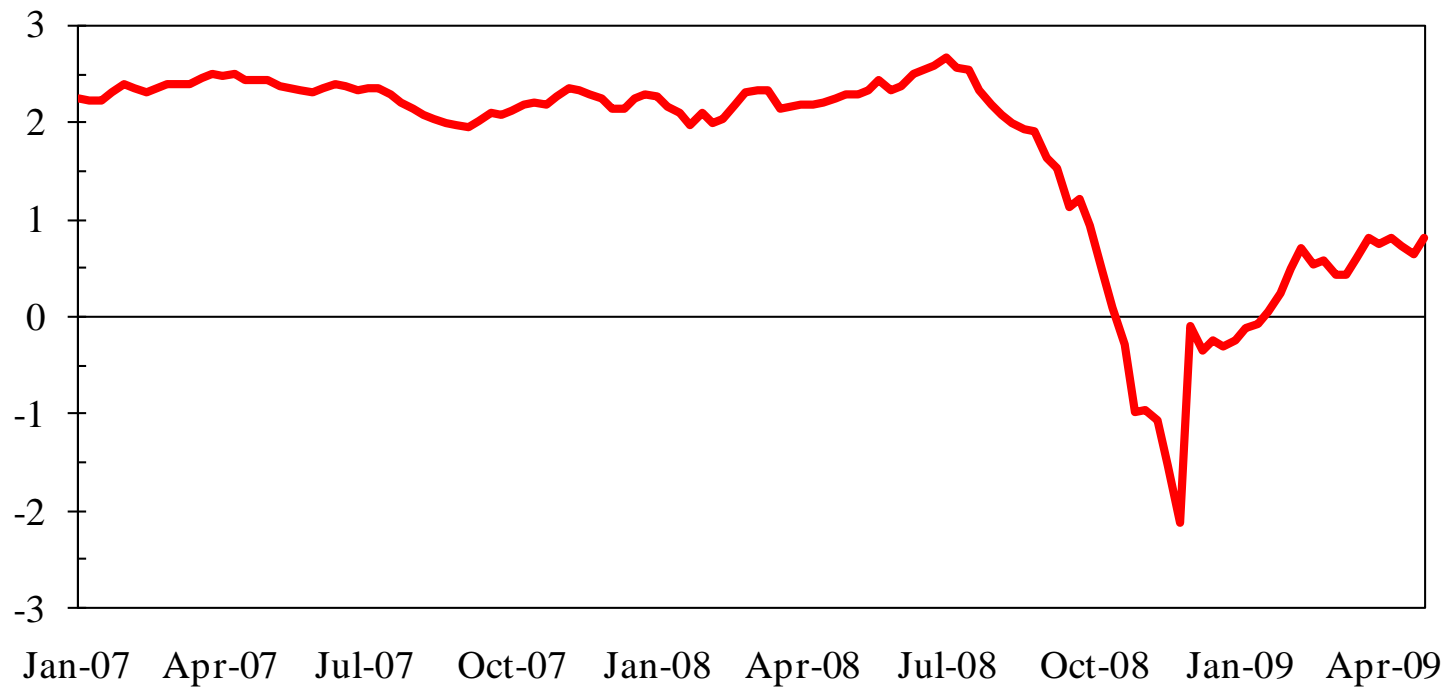
(Daily data as of May 8, 2009)

Rate (%)



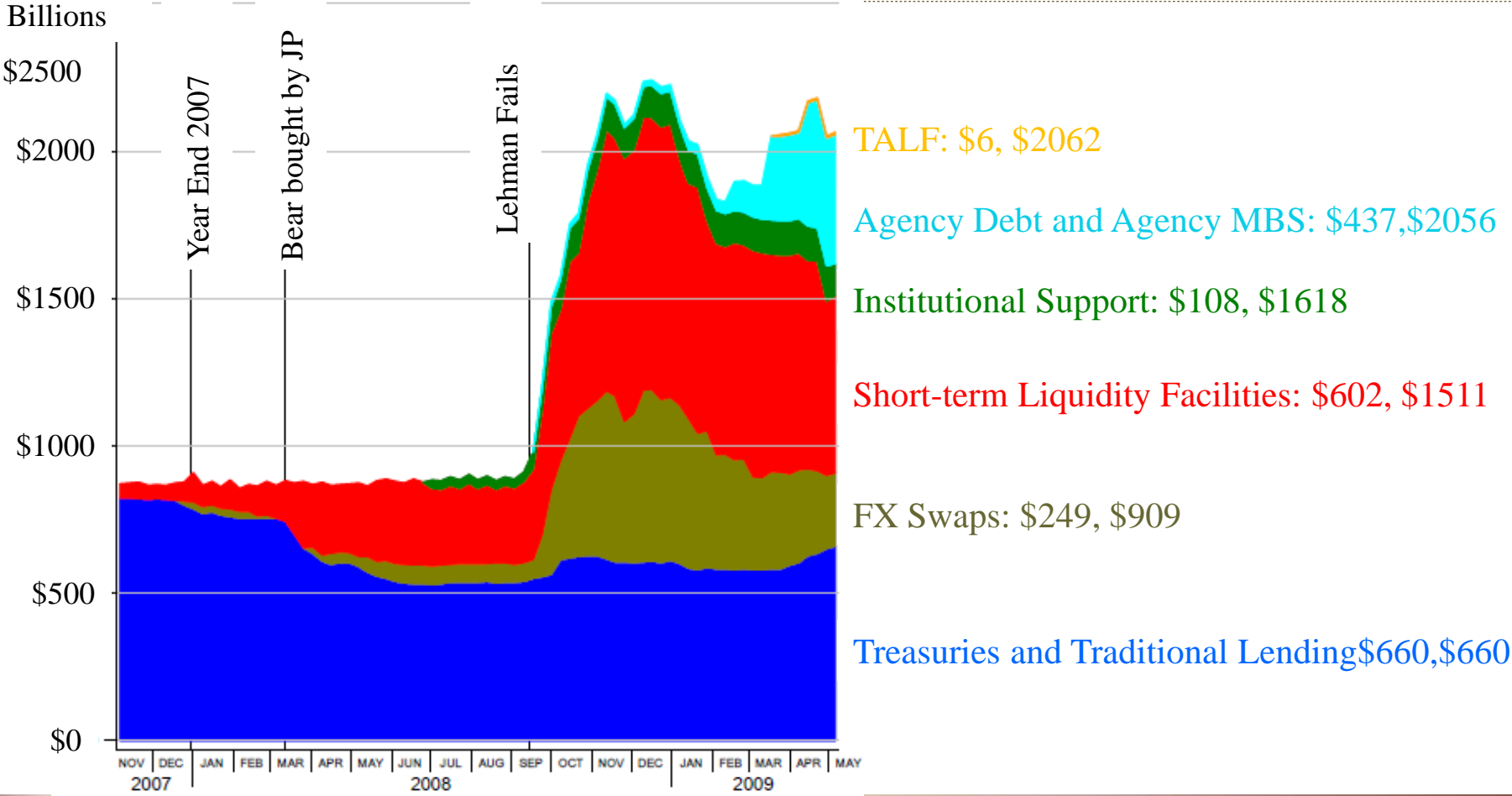
# Implied 5-Year Spot Inflation Rates

(Weekly data. Last Observation: May 8, 2009)



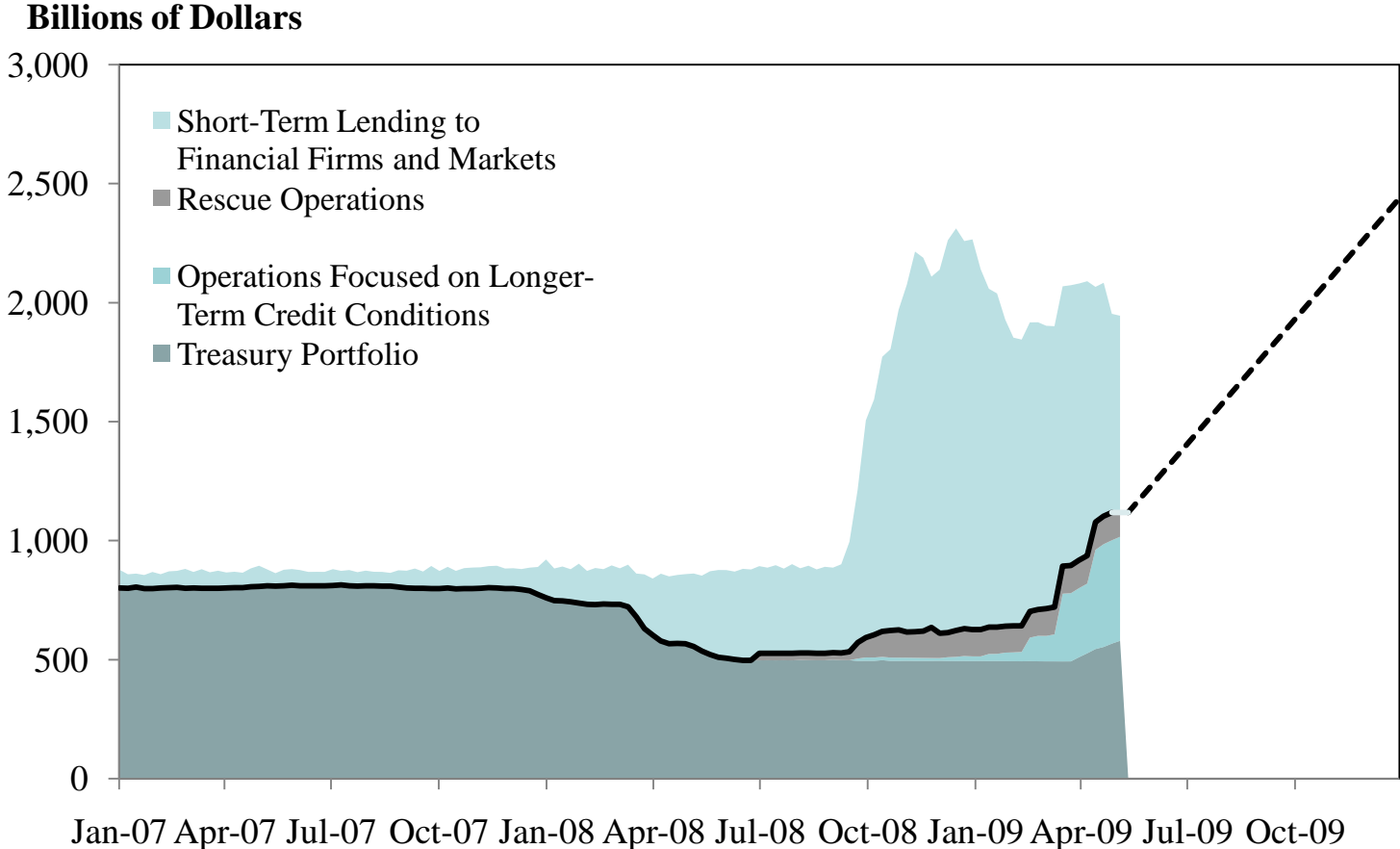
# Federal Reserve Credit: Component Size and Cumulative Total

(Weekly, 10/3/2007 to 5/6/2009)



# Federal Reserve Credit

(Weekly Data. Last Observation: May 6, 2009, and Projected Values.)





***Federal Reserve Bank of St. Louis***  
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