Financial Market Turmoil and Recession: What’s Next?

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Any opinions expressed here are my own and do not necessarily reflect those of the Federal Open Market Committee members.
Measuring Uncertainty: Real GDP Growth

Source: Bureau of Economic Analysis and Blue Chip Economic Indicators.
Growth Rate in Real GDP, SAAR, Percent
2008:Q4, 2009:Q1

Canada: -3.4, -6.0
U.S.: -6.3, -6.1
Latin America: -8.3, -5.9
U.K.: -6.1, -7.3
EU: -6.3, -7.9
India: 0.4, 6.0
South Africa: -1.8, -2.7
Russia: -1.5, -22.2
China: 1.3, 6.4
Japan: -12.1, -19.3
Australia: -2.1, 0.4

Source: Barclays Capital Global Economic Weekly.
Tracking the Global Recession: United States

Measures of Financial Market Stress
Debt Pricing: Bond Spreads to 10-Yr Treasury

(Monthly data. Last Observation: April 2009)

Source: Federal Reserve.
Cost of Credit Protection
(Weekly Data. Last Observation: May 5, 2009)

Source: Bloomberg.
Stock Market Indexes
(Weekly Data. Last Observation: May 8, 2009)

Index
Jan. 2007 = 100

- Dow Jones U.S. Total Stock Market Index
- S&P Financial Stock Market Index

Source: Standard and Poor’s and Wall Street Journal.
Housing Markets
Mortgage Market

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

MBA Mortgage Applications Index.
3/16/1990 = 100

Sources: Federal Reserve, Bloomberg.
New and Existing Home Sales
(Monthly Data. Last Observation: March, 2009)
Regulatory Reform
The Clamor For Regulatory Reform

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

- 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

- 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

- 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

Three important systemic calls by the Fed:

- William Poole on GSEs.*
- Gary Stern on “Too Big to Fail.”**
- Ned Gramlich on subprime.***


Inflation Risks
World Policy Rates
(Daily data as of May 8, 2009)
Implied 5-Year Spot Inflation Rates
(Weekly data. Last Observation: May 8, 2009)

Source: Federal Reserve.
Federal Reserve Credit
(Weekly Data. Last Observation: May 6, 2009, and Projected Values.)

Billions of Dollars

- Short-Term Lending to Financial Firms and Markets
- Rescue Operations
- Operations Focused on Longer-Term Credit Conditions
- Treasury Portfolio

Sources: Federal Reserve.