Hi everybody,

Are you unsure what is developing on the economic front? You are not alone! The world’s “central bankers” themselves don’t know either. According to the article below from the Financial Times they are caught between “hope” (that things will improve next year) and “despair” (that we haven’t yet seen the worst of the current financial and economic crisis).

One particular comment in the article, from Stanley Fischer, the governor of the Bank of Israel, caught my attention: “We are in the midst of the worst financial crisis since world war two, but so far in the real economy we are not looking at anything exceptional.”

What that brought to mind was the early history of the Great Depression of the 1930s. The conventional start for the Great Depression was the stock market crash near the end of 1929, but actually there were some serious signs of problems before that (especially in agriculture), while most of the serious problems in banking and industry came well after the 1929 stock debacle. Things like the growing layoffs, bank failures, etc., actually developed over a 3 or 4 year period as the non-agricultural “real economy” spiraled down and down during 1930-1933. In other words, it takes some considerable time for the initial problems in the financial sphere to really work themselves out in the “real economy” and even in the rest of the financial sphere itself.

I’m not predicting that the next couple years will follow the pattern of the start of the Great Depression, and necessarily mark the start of a new depression. This might happen, but it also might not... quite yet. But something along these lines will be happening relatively soon. Either the current recession or else one of the next few will prove to be uncontrollable and will develop into something very much worse.

Scott

Financial Times  FT.com

Bankers caught between hope and despair

By Krishna Guha in Jackson Hole, Wyoming

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More than a year into the credit crunch, the world’s central bankers are still struggling to understand the impact of the squeeze on the global economy.

Stanley Fischer, governor of the Bank of Israel, summed up the mood at the annual retreat for leading banking policymakers in Jackson Hole, Wyoming, this weekend. “There is an enormous amount of uncertainty about where we stand at the moment,” he said at the close of the meeting.

“We are in the midst of the worst financial crisis since world war two,” Mr Fischer added. “But so far in the real economy we are not looking at anything exceptional.”

His comments came as US Treasury officials worked through the weekend on options for further intervention to support Fannie Mae and Freddie Mac, the troubled US mortgage giants, amid expectations of an announcement this week.

There was a strong view in Jackson Hole that the Treasury needed to stabilise the situation at Fannie and Freddie to bring down mortgage rates and avoid amplifying the housing bust.

Central bankers appeared torn between hope that the resilience of the world economy so far indicated that it would not be too greatly harmed by financial stress and fear that the worst could still lie ahead.

All agreed the impact of the credit crisis on the world economy was still unfolding. Ben Bernanke, Federal Reserve chairman, said its effects were “becoming apparent” in lower growth and higher US unemployment. Central bankers believe that the most likely scenario is that the world economy will muddle through and recover next year. There is concern over the potential for negative “feedback loops” between a damaged financial sector and weak economy this year.

“It is amazing a year later how much is still unresolved,” Alan Blinder, a former Fed vice-chairman, told the Financial Times.

Policymakers differed over how to interpret the slowdown in economies outside the US. US officials see this as a vindication of their view that the credit crisis is global and its economic impact will ultimately be felt in all big industrialised economies.

Eurozone officials disagree, attributing the slowdown to the rise in the oil price and spillovers from the US via exchange rate changes, believing it is not a domestic credit squeeze.

Central bankers now appear willing to put a little more weight on the stabilisation in oil prices but there is great reluctance to read too much into it. Fellow central bankers thought Mr Bernanke bold to highlight this in a speech on Friday – and even he hedged his statement.

There was appreciation at the meeting of the Fed’s unique situation at the epicentre of the credit and housing shock. But there remained a sense among many people that the Fed was an outlier in its response to the crisis – 325 basis points of rate cuts – even allowing for its cyclical and structural conditions.
Yukata Yamaguchi, former deputy governor of the Bank of Japan, warned that the example of 1990s Japan showed the risk of policy error was high in periods of extreme uncertainty.

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